

# INTERNATIONALIZATION OF THE CONSTRUCTION INDUSTRY: ENTRY STRATEGY PERSPECTIVE

**Andrei PANIBRATOV**  
St.-Petersburg State University, Russia

## ABSTRACT

*The entry strategy is still considered a frontier issue within the field of internationalization - as judged from the academic interest as well as from the numerous articles published in scientific journals. Despite considerable progress in later years in formulation of theories many weaknesses still exist within this field. A further development of theory is therefore needed.*

*As nowadays emerging markets show the greatest activity in the field of internationalization, as a through example the Russian market which is being considered by most of potential entrants as a huge and perspective chosen. Methods of entry and models of operations of the international contractors at the Russian market are investigated in this paper, as well as oversea strategies and foreign experience of Russian construction companies.*

**Key Words:** *internationalization, entry mode, international strategy, foreign direct investment, construction industry, emerging markets, Russia.*

## INTRODUCTION

Not so many studies regarding construction companies' process of internationalization exist. Most of them are related to the experience of the narrow set of construction firms of national origin, e.g. British (Crosthwaite, 2001) or Chinese (Pheng and Hongbin, 2006). In the recent years many construction companies from Finland, Germany, Russia, Turkey as well as other firms from developed and emerging economies countries have started to enter foreign markets. Therefore, the analysis of their activity, motives for internationalization and success factors in the foreign markets are of interest for this research.

The aim of the present article is to determine the factors influencing the operations of construction companies in foreign markets on the basis of comparison of entry modes of Russian and foreign construction companies. In turn, that requires critical evaluation of the basic conditions and methods of application of key theories of internationalization in the construction markets of developing countries. Research objectives are: to survey the contemporary theory of internationalization and its application to construction industry; to compare experience of internationalization process by Russian and European construction companies and their entry modes; to reveal the factors of success in the internationalization process of large construction enterprises entering emerging markets of Eastern Europe and Russia, and of newly internationalizing firms from developing countries.

This research was conducted through in-depth personal interviews with top managers and middle-management

of MNC's subsidiaries in Russia and of Russian construction enterprises. The research was based on a case study approach. The works by Bartlett and Ghoshal (2008), Bitzenis and Marangos (2007), Crosthwaite (1998, 2001), Gunhan and Arditi (2005), Helfat and Lieberman (2002), Hitt (2006), Phatak (1997), Whitelock (2002), Yu (2007) and many others were used in this study.

## **CONTEMPORARY APPROACHES TO INTERNATIONALIZATION**

### **Previous Research of Entry Strategy**

The phenomenon of internationalization is widely studied and many researchers contributed to this field. There are fundamental and contemporary studies on the foreign market entry. The fundamental research on internationalization was mainly focused on the foreign market entry decision process, entry mode choice, analysis of the large multinational enterprise (MNE) as an economical organization, as well as headquarter-subsidiary ownership and control issues. The investigations of Bartlett, Caves, Dunning, Ghoshal, Hymer, Kogut, Perlmutter, Singh and many others could be referred to as the classical works on internationalization. The entry mode choice is explained in most cases by the following theories: monopolistic advantages theory, internalization, transaction cost approach, eclectic paradigm. Agarwal, Cumberland, Dunning, Malhotra, Ramaswami, Tsang, Ulgado, Yip studied the problems related to the market entry process and to the activity of MNC subsidiary.

A review of the literature reveals that research within the field of entry strategy is still fragmentary regarding terminology, problem identification, methodology, and coherent theory. As a result literature concerning entry mode represents a rich variety of perspectives and paradigms today. The research has primarily focused on the examination of coherence between the foreign market and specific factors relating to the given enterprise - and finally the most efficient entry mode for an enterprise in relation to these parameters. The manufacturing sector has been in focus at the expense of the service sector (Erramilli & Rao 1993; Ekeledo & Sivakumar 2004; Domke-Damonte 2000) and emphasis has primarily been given to making predictions regarding accumulated levels of entry modes (Aulakh & Kotabe 1997). Taking into account considerable changes in the global environment over the past few years it is of vital importance to reassess

the frames of terms and references which have dominated research in the field of entry mode so far (Axinn, Matthysens 2002).

Despite limitation of this approach, the foreign market entry strategy decision making is considered as an important stage of the internationalization process in the construction industry in the given article. According to Root (1994), three various decision rules for foreign market entry mode choice are defined by the degree of sophistication: the naïve rule, the pragmatic rule and the strategy rule. According to the naïve rule the company uses the same entry mode for all foreign operations. The pragmatic rule stipulates to apply "a workable entry mode for each target market". The "right" entry mode should be used for each target market as the strategic rule suggests. Taking into consideration the severe competition in the world of construction, the formation of the "right" strategy is the serious challenge for newly internationalizing construction firms from Russia as well as from other countries in economic transition.

### **Alternatives in the Study of International Decision Making Process**

The dichotomy of the entry strategy study was analyzed by Benito and Welch (1997) from two main approaches - "economic perspective" and "process perspective". According to Whitelock (2002) the model incorporating the key elements of each approach may present a more realistic and comprehensive picture of the market entry decision. The dramatic problem of the state of contemporary research in the field is that none of the traditional theories take the changes of internationalization terms and conditions into account. Axinn & Matthussens (2002) call for new/revised theories which not only comply with the demand above, but also are capable of explaining and predicting enterprise evolutions through model adaptation or model innovation.

Gunhan and Arditi (2005) developed an international expansion decision model particularly for the construction companies but it could be used for other industries as well. The model consists of two steps. On the first step the firm makes a decision if it is necessary for the company to internationalize and determines if it possesses the resources. When the outcome of this step is positive then the company implements the second one. During the second step the firm could compare the benefits with losses in a foreign market. And when the outcome is positive, the company can choose the entry mode.

The evolutionary view on the company's internationalization pays attention to the experience of the MNE. The greater the international experience, the greater the degree of control in the chosen modes. Phatak (1997) has offered a comprehensive framework for the entry mode choice; such factors as firm capability, industry factors, location-specific factors, venture-specific factors, strategic factors are mentioned in his book. Cullen (2002) suggested a matrix for making a decision concerning the choice of the foreign market entry strategy. This matrix combines the factors and entry strategies and evaluates conditions for the foreign market entry.

MNE considering entry into an overseas location by means of foreign direct investment (FDI) faces two strategic decisions regarding the organizational form of its international operation. First, the level of control over its foreign entities (full ownership vs joint venture) and, secondly, the mode of entry (setting up a new venture via greenfield investment vs acquisition of an existing enterprise) has to be determined.

The theoretical literature on the choice of entry mode already provided important insights into the determinants of this decision (e.g. Bjorvatn, 2004; Norbäck and Persson, 2002). Buckley and Casson (1998) concluded that market structure as well as competition intensity in the market has crucial impact on the entry decision. Görg (2000) analyzes the effect of market structure on the choice between greenfield investment and acquisition. He shows that generally acquisition may be the preferred mode of entry, while only with a high cost of adaptation greenfield investment may be an optimal choice. Mattoo et al. (2004) examined how the choice of entry mode affects the transfer of technology and the degree of competition in the host country.

## **Internationalization Preconditions in Construction**

David Crosthwaite wrote several works concerning construction companies' process of internationalization with the special attention on British firms. In one of his works Crosthwaite (1998) studied the period of 1990-1996 and made a conclusion that mostly the firms dealt in the well developed markets in spite of the developing markets' entry. The reasons were the financial stability and low level of corruption in the developed countries. International construction develops in various markets with different intensity.

The study of Ranko and Crosthwaite (2001) showed that at the beginning of the XXI century the most attractive markets for construction were China, USA,

Singapore, Yugoslavia, Germany, Poland and Russia. According to the cities ranking Moscow was ranked in fifth place by the attractiveness for construction industry in the world.

Usually the contractors and developers create a joint venture or establish wholly owned subsidiary to internationalize their operations. Such companies as Skanska, Amec, Balfour Beatty, YIT, Vinci Group and many others have a presence in a global scale. They are going to continue the internationalization process.

## **RESEARCH METHODOLOGY**

### **The Research Approach**

This research has been based on the study of the adjustment to the internationalization process and of the impact of the external environment to this process. As this process is strategic in nature, the approach adopted here can be based on strategic management research traditions. The research applied a variety of approaches. Conceptual analysis approach was used to develop conceptual systems to study the transition process. A decision-making methodology approach was used to study internal processes. An operational analysis approach was the base for the empirical part of the study.

The basic concepts of the transition process were based on literature surveys. Literature surveys included a review of previous research on the transition processes in enterprises and in the business environment. The empirical part of the study combined both qualitative and quantitative research methods. In the first phase of the study a basic understanding of the transition process in enterprises was acquired through interviews of companies and experts in St.-Petersburg. Because of the nature of the research questions and complexities in studying the transition process in the companies, the research has employed the case study methodology. Benchmarking methodology has been applied for evaluation of the operations performance of the enterprises.

In the second phase of the empirical part of the study, case study methodology was used to develop hypotheses about the adjustment process. In the third phase, comparative case methodology was applied to test the hypotheses. Research has been carried out in five regions of Russia. The regions chosen represented well the whole economic structure of Russia and also demonstrated the different development phases. The study analyzed the process both in the region and in

the enterprises to find out the effects of the development in the business environment on the behavior of an enterprise. In each region seven to nine case companies were selected for analysis.

## The Basic Concepts of Strategic Management Research

The basic concepts of strategic management research identified by Summer et al. (1990) are: environment, strategy, leadership and organization, and performance. Each of these four constructs is multidimensional in case of construction industry.

*Environment* can be divided into macroenvironment and microenvironment (Kotler, 1991). Macroenvironment includes political and legal, economic, sociocultural, technological, and other general forces. Microenvironment includes those elements or groups that directly affect and are affected by an organization's operations. Some of these elements are the structure and practices of the industry, shareholders, customers, suppliers, competitors, creditors, local governments and communities, trade associations, and special interest groups. Microenvironment is also called business environment.

A firm's *strategy* can be defined as "the direction and scope of an organization over the long term: ideally, which matches its resources to its changing environment, and in particular its markets, customers or clients so as to meet stakeholder expectations" (Johnson, Scholes, 1993). Chandler (1962) defined strategy as "the determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals". A strategy can be a plan: a consciously intended course of action, or it may be a pattern, consistency in behavior, whether or not intended. Mintzberg (1991) proposed to distinguish deliberate strategies, where intentions that existed previously were realized, from emergent strategies, where patterns developed in the absence of intentions, or despite them.

Strategy can also be viewed as composed of process and content issues. Strategy process research is concerned with how a firm's administrative systems and decision processes influence its strategic positions. Hunger and Wheelen (1996) focused on what strategic positions of the firm lead to optimal performance under varying environmental contexts. They also proposed to make distinction between corporate, business, and functional strategies. Corporate strategy is concerned with activities such as diversification, mergers and acquisitions, resource synergies across

businesses, vertical integration, and internal venturing. Business strategy, also called competitive strategy, usually is developed at the divisional level. It deals with issues such as choice of product and market segments within the industry, selection of competitive weapons, and choices about timing. Functional strategy is concerned primarily with maximizing resource productivity. Examples are manufacturing, finance, marketing, research and development, and human resources strategies. *This research adopts Chandler's definition of strategy.*

*Leadership* refers to a firm's basic design or anatomy as well as the processes used to motivate, coordinate, and control activities. It is argued that organizations and their environments are so complex, and decision-makers so bound by human limitations, that techno-economic optimization of the firm cannot occur. Rather, managerial aptitudes, values, and experiences determine how problems are defined and which options are identified and selected. According Summer et al. (1990) there are three main perspectives concerning leadership and organization. The first is a focus on the problems and roles of top managers. The second perspective focuses on the processes by which strategic decisions are made and implemented. The third perspective deals more broadly with the overall design and culture of the firm.

The present research employs the three perspectives. To study the adjustment of enterprises to the environment, top management perspective is adopted. Operational performance evaluation is based on the second perspective. The third perspective is used to study the structural changes and organizational culture in the enterprises.

The basic classification of *performance* by Venkatraman and Ramanujam (1986) consists of three categories: *financial*, *operational*, and overall *organizational* effectiveness. Financial performance has been the dominant model in empirical strategy research. Typical indicators are sales growth, return on capital, profitability, cash flow, and earnings per share. Under the framework of operational performance are such measures as market-share, new product introduction, product quality, marketing effectiveness, manufacturing value-added, and other measures of technological efficiency. Organizational efficiency reflects the influence of different stakeholders and overall organizational goals.

The rise of the Total Quality Management (TQM) concept has turned the attention to the importance of focusing on the customer and to providing quality products and services as a means of gaining competitive

advantage. TQM has both an internal, or process focus, and also an external focus, or service focus. One attempt to integrate the performance measures is the so-called balanced scoreboard. The balanced scoreboard by Kaplan and Norton (1996) supplements traditional financial measures with criteria that measure performance from three additional perspectives: those of customers, internal business processes, and learning and growth. Generic measures for customer perspective are customer satisfaction, customer retention, market and account share, and new market introductions. For internal perspective measures there are, among others, quality, cost, response time, and new product introductions

## The Research of Russian Construction Firms Internationalization

According Hitt et al. (2006), there is a positive relationship between internationalization and firm performance. When analyzing the Russian construction industry internationalization process, Michael Porter's five forces model can appear especially useful. According Porter's approach, the company should pay attention to such forces driving industry competition as a threat of potential entrants, a bargaining power of buyers, a threat of substitute products or services, a bargaining power of suppliers, a rivalry among

existing firms. Wheelen (1995) proposed to add to these 5 forces the sixth one - the relative power of other stakeholders.

From this point of view the most significant driver of competition in the Russian construction industry is a rivalry among existing firms. The buyers cannot force down prices since the great unsatisfied demand for housing exists. The threat of potential entrants is not essential because of high entry barriers into this industry. There are no substitutes for housing, so their threat does not exist. Bargaining power of suppliers is not sufficient for a huge construction corporation, usually a system of bribes works in supplying a construction company.

We have stated the following *hypothesis*: the overcapacity of large contractors leading to the rise of competition significantly causes the internationalization of the construction industry in Russia. The data on competitive actions in the Russian construction market were gathered from the observation of the empirical evidence concerning the development of Russian construction in the last decade. According to interviews with experts and CEOs of large construction firms, the most efficient strategies are related with one of four action types: product action, pricing action, marketing action, capacity action. Exhibit 1 gives details on these four action categories we identified.

### EXHIBIT 1

#### Competitive Action Types as Motives of Internationalization in Construction

Action Type	Description	Implementation by Russian Contractors	Relation to the Internationalization
Product action	Product actions involving substantial investment in the new product development and key technology breakthroughs	LEK launched the studio flats. After couple years this type of habitation became a popular brand in the real estate market in Russia	No product action lead to the internationalization of the Russian construction market
Pricing action	Price-related actions such as price cuts, rebates, and discounts	LenSpecSMU who avoided to invest considerable sums at once proposed significant discounts to those buyers who were ready to pay for the housing in the initial stages of the construction process	No pricing action lead to the internationalization of the Russian construction market
Marketing action	Marketing-related actions such as marketing campaigns, advertisement investments, brand management	Stroimontazh, being very active in the field of marketing, has created new brand – Mirax – when establishing the Moscow partnering company, investing into this brand when moving in the markets of former CIS countries	Marketing action may prevent the internationalization process of the Russian construction firms
Capacity action	Changes in company's capacity or output	M-Industria established its subsidiary in Bavaria (Germany), its activity focused on training and educating of the company's employees and also on attracting foreign specialists to work on the company's objects in Russia; Etalon-LenSpecSMU when planning entry to Portuguese and Spanish markets had seek for plots in these countries	Capacity / output action in most cases led to the internationalization of the Russian contractors

These models, being introduced by large Russian construction companies in the recent past, and predominantly in Russia, reveal the motives of their internationalization.

Russian construction companies which have started their internationalization process have various goals: the strategy of development, compensation of the lack of plots in big cities, searching for new profits or just attempt to improve the image of a company. All these goals are related to the competitive actions in the table above.

In Moscow there are dozen of companies which entered foreign markets and have business there for several years or have the intention to enter in the nearest future (Inteko, Dekra, Konti, Mirax Group, Zarubezhstroj, Dohodnii dom "Bazis", etc.). At the moment most of them entered the markets of former Soviet Union, for example, Latvia or Ukraine. Some companies explore Western markets in such countries as Spain, France, Germany, etc.

According to Hovratovich (2005), the reasons of Russian construction companies to internationalize are the lack of plots for construction in Moscow and the market is going to be saturated. At the same time the markets of former Soviet Union and regions of Russia are at the primary stages of their development.

## FDI-based Entry in the Russian Construction Market

FDI is expected to bring a wealth of benefits to the local economy including fresh inputs of capital and, most importantly, the impetus that knowledge from outside may bring to local processes of technological change (Barrell & Holland 2000).

FDI flows towards less developed countries have not always resulted in the long-term growth outcomes one would expect (Lipsev 2002). Russia similar to many other transition countries faces the fundamental problem that it has few alternatives to the outside injections of capital, knowledge and network resources that FDI provides. Countries in transition in many respects appear to be closer to developing than developed countries when it comes to their particular experiences with hosting FDI (Konings 2001; Jensen 2004).

At the same time, it is questionable whether local firms in transition countries benefit much from the technological change introduced by foreign investors as is usually true for developed host countries (Lipsev 2002; Blomström et al. 2001).

Development of the relations between European Union

and Russia has affected a construction industry as well. The investment climate is getting better, competition is becoming more fair and entrepreneurial culture is improving in Russia. The management has become more professional. According to the research "New Tendencies in the European Real Estate Market in 2007" by PricewaterhouseCoopers (Restate 2007), Russian market is one of the major destinations for investment. There is a lack of commercial, residential real estate and huge growth potential.

European companies in the Russian construction industry deal mostly in markets of construction materials and construction instruments. Some companies export their production, another establish their own production facilities. German firms are among the most active foreign investors in the Russian economy. For example, Knauf, which started its operations from the acquirement of a factory producing construction materials in Moscow region 15 years ago, is the major investor in the Russian construction industry. When the company entered the market it was a risky decision but now it bears fruit. Producers of windows (Rehau, Veka), finishing materials (Caparol, Bau-Color), glues (Henkel Bautechnik), sanitary engineering (Grohe, Villeroy&Boch), construction instrument (Bosch, Hilti, Kress) have been successfully operating in the Russian market for several years. The exporting of these numerous companies was so massive that they decided to develop their own production through "brownfield" or "greenfield" strategies.

According interviews with top managers of European MNEs, operating in different construction-related industries (elevators, earth-moving equipment, tires, cranes, construction materials, etc.), FDI in Russia are mainly based on the following models:

- Foreign company invests money and seeks for the transparency of the projects;
- Foreign investor enters Russian market with its own project and management and organizes network with local contractors;
- International construction group searches for optimal entry mode to enter Russian market.

Western companies prefer to use the service of the familiar partners while deciding to establish manufacturing facility in Russia. For example, the plants for Philip Morris, Rothmans and Gillette were built by Skanska.

Western companies pay a lot of attention to the standardization of construction and management processes. Dom Lemkon (subsidiary of Finnish

construction company Lemminkainen) uses "the model of project management LEMCON". The whole construction process is divided into separate packages and subcontracts while tenders are organized. A contractor has the functions of general contractor and is the coordinator of subcontracts. The advantages of such an approach are an economy of the time spent to start the construction and for the whole project, a competition of subcontractors and suppliers, which minimizes costs, and absence of conflict between interests of customer and contractor because customer always knows about real costs.

Construction concern YIT started its expansion in Russian market through establishment of the subsidiary. In 2006 the company started the construction of 3,699 residential units in Russia (in Finland - 2,818 - for comparison). In total YIT currently has 13,600 units under construction (YIT 2007). According YIT, in Russia it takes two years to build a housing project because of the large size of the residential complexes and in Finland - only one year. Also the apartments are not equipped and are unfinished in Russia what is unacceptable for Finnish customers. In such a way YIT tries to use the standards which are applied for developed countries.

## **The Study of MNCs' Success Factors on the Russian Market**

The research had allowed to issue that major factors of MNEs' success in Russia are:

- 1) the right choice of mode and time of entry to the Russian market,
- 2) quality of production (including perceived quality defined by the brand of the country of MNE origin),
- 3) marketing activity with the strong focus on the communication to customers.

MNEs that entered the Russian market in the times of the beginning of transition processes in the national economy are now the leaders in their industries. All risks and difficulties which these firms have faced during the initial stages have approved themselves, and nowadays these companies are profitable.

Those MNEs reach considerable competitiveness working in the Russian market, which conduct purposeful and consecutive marketing activity (Exhibit 2). At the heart of the chosen strategy of an entry on the Russian market are: orientation to high quality of production and services; the effective marketing policy adapted for Russia; local partnerships.

Empirical approaches to the development of marketing

strategy by construction-related MNEs with well-known brand for the Russian market were studied: Otis, Knauf, Nokian Tyres. The chosen companies represent the economic developed countries - one from USA, two - European (Germany and Finland). They have been selected by a principle of the greatest competence and a maturity of their international activity; investigated MNEs are leaders in their industries (elevators, construction materials, rubber and tyres).

The carried out research has allowed to reveal key factors of success of these companies. Base factors in elevator and in tyre industries are: the strategy of building of own production facilities without use of resources of the local enterprises; FDI oriented to the placing of manufacture in the local market; early entry to the Russian market (first-movers have received the strategic advantage). We also noticed the switch of interest of the companies-followers to the strategy based on creation of own subsidiaries. According interviews such an approach was connected with absence of appropriate targets for acquisition, increase of the investment attractiveness of the Russian market and rise of competition among MNEs in this market.

From 100 largest European industrial companies operating on 196 enterprises in Russia, 39 have acquired local enterprises and modernized them, 61 has built new enterprises. In 44% of cases (82 enterprises) the purchase of the controlling interest took place, 114 enterprises (56% of cases) have been established as totally new facility. Each of the companies considered in the paper not only concentrates on quality in the process of formation of product strategy, but also places special emphasis on quality when performing pricing policy, distribution and promotion. This approach makes the marketing mix of these firms even more effective.

## **CONCLUSION AND DISCUSSION**

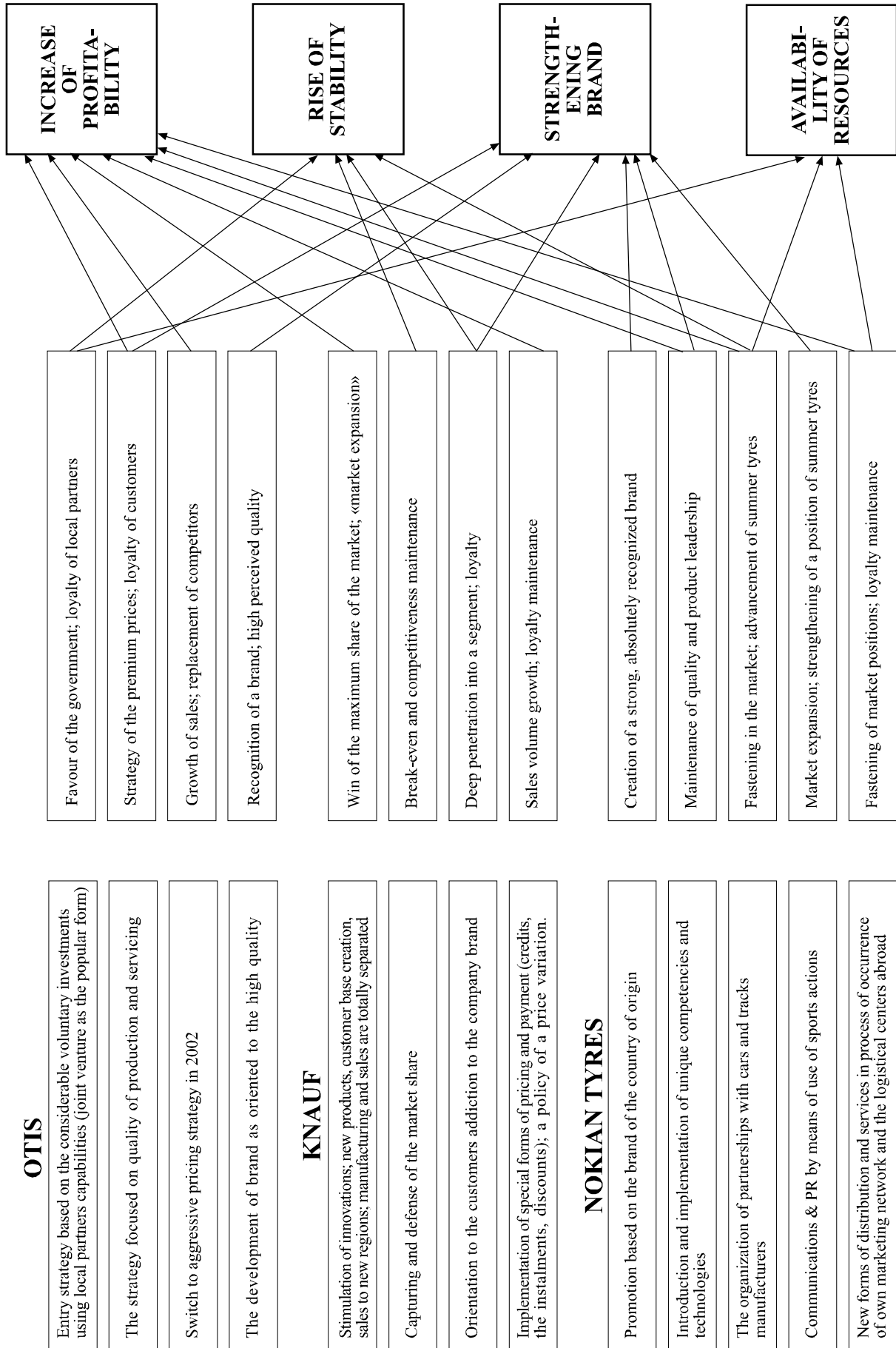
The tendency of rising demand for housing is stipulated by several factors: the ageing of the population, especially, in the Northern region; increasing incomes of the population due to the oil sales in Norway and Russia; membership of Baltic countries in EU; establishment of the new Housing Codes (particularly, in Russia), all this has made the population more confident; the trend of the population's migration to big cities in Russia. The construction companies should not loose such opportunities to satisfy this demand. Additional investments should be made in the acquisition of plots for construction because of their

# C O M P E T I T I V E N E S S

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lack. Financial resources could be received from other businesses or with the help of banks' credits.

It is usually easier for big and well known construction companies to develop internationally. At the same time, their complicated organizational structure leads to slower decision-making process. The most recent example of the death of one of such "dinosaurs" - the bankruptcy of the Spanish construction company Martinsa-Fadesa in July, 15, 2008 with assets of \$17,2 billion and debts of €5,2 billion. This bankruptcy will definitely influence few banks, involved in the credit operations on the construction market of Spain (Gorboljskaya, 2008). Hence, restructuring and foreign (emerging) markets entry is recommended for such companies.

The construction companies of emerging economies countries should explore new foreign markets to insure themselves from political and economic risks in the countries of origin and to increase profitability. These companies could have an advantage over Western competitors applying new approaches in marketing, HRM, construction technologies and developing unique projects.

For Russian companies which enter foreign markets the form of the wholly owned subsidiary as an entry mode is preferable due to the investment of capital into other businesses to avoid risks in the local market. Diversification of business is also one of the ways for construction companies to reduce the potential risks. Russian companies should first of all internationalize their operations to minimize risks, increase profitability and develop the image.

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