Michailova and Jormanainen "Knowledge transfer between Russian and Western firms: Whose absorptive capacity is in question?": A reply

Michailova and Jormanainen (forthcoming) are trying to challenge the mainstream (or, rather, expressed in rare papers on Russian management in A and B-level journals) conviction that the "deep and wide stream of Western business knowledge is flowing to Russia, but due to the limited absorptive capacity of Russian firms that flow does not allow to irrigate properly the somehow virgin land of the 6th largest world economy, but creates instead swamps and "quagmires" that engulf even the most ambitious initiatives to enhance value creation". They put forward three major arguments:

- Soviet experience and knowledge is still valid and forms a background for actions of Russian firms;
- Soviet experience serves as a "sieve" for cautious imitation and selective acquisition of Western business models and management techniques;
- Some aspects of genuine Russian business techniques should be properly used by foreign companies operating in Russia, and also may have wider impact on international practices of leading MNCs.

Michailova and Jormanainen have strong personal interests in defending such arguments. As by their own words "Half and a third of [their] lives respectively so far has been split between living in [their] native countries and the West", they are proud to demonstrate that the Western education they received is properly used to create knowledge valuable to the global academic audience. We do not intend to attack their arguments as we consider them correct in many aspects. However, we must admit that Michailova and Jormanainen presented a complex phenomenon of knowledge transfer in a rather simplistic way. By proper presenting the major constructs of that phenomenon, we may derive a much more interesting picture.

Let us clarify the major elements of cross-border knowledge transfer between the firms:

- The object (substance) to be transferred between the firms.
- "Domestic" and "foreign" firms.

- The effects of transfer (changes in competences of the firm, its competitive actions and corporate performance).

First, let try to understand what is really transferred between the firms. In the practical world of business abstract and even applied knowledge is worthless unless it may be used for creating value to firm's stakeholders (shareholders as well as customers, employees, government authorities, creditors and other suppliers of resources necessary for running the firm's operations) (see Gurkov et al., 2011). In this respect, we may talk not on knowledge, but on competences assembled by the firm from various sources and by various methods. As usual, philosophers put deeper insight that organizational and strategy theorists. Michailova and Jormanainen cite Lave and Wenger (1991) who pointed out that knowledge transfer leads to developing the competence to perform new ways of working by engaging in new practices.

As competences form the basis for competitive advantage of the firm, the firm tries to defend its competence base. Thus, the firm is not inclined to share its knowledge with other firms unless this transfer will have a positive impact on the firm's competitive position (decrease of costs and increase of value of the products). The problem here is that competences are divided into open (generally available systems used by the firm) and proprietary (unique know-how and know-why, proprietary systems, irreproducible relationships), and through direct industrial espionage, personnel rotation between competitors and persistent work of business case writers proprietary competences are routinely becoming open for a wider audience.

Therefore, we may distinguish between voluntary transfer of competences between the firms and involuntary loss of proprietary competences occurred through direct espionage, imitation of firm's actions by its competitors and "enlightenment" activities of business writers. The voluntary transfer of competences is more likely to occur in vertical relationship (dealing with suppliers and distributors), where potential gains in costs and quality are more probable. Horizontal transfer (strategic alliances among the firms in the same level of value chain) occurs when subtle synergetic effects may be clearly identified (like in airline alliances).

Similarly, "absorptive capacity" of the firm is simply the capacity to steal, to distract from business partners or to distill from open sources and subsequently to master particular competences in a manner in which the costs of transfer and application of new (enhanced) competences is lower than the resulting gains in the value added. In this respect, a firm that opts for a "cost-leadership position" will be viewed, at the first glance, as a firm with low absorptive capacity, as it must carefully select among all possible competences the competences that do not deteriorate its cost position. In reality, as Japanese firms of 1950s, Korean firms of 1970s and Chinese firms in 2000s have demonstrated such a cautious and selective approach for acquisition of knowledge and skills may result in enormous gains in competitiveness and transformations of the global markets.

Second, we should point out the various agents of competences transfer, that may occur either directly (through firm-to-firm iteractions) or with the use of "intermediaries'. Michailova and Jormanainen present in their paper the most visible but least effective "intermediaries" – business schools. Of course, they play their role in exposing advanced (academic) knowledge and mostly yesterday's management techniques[1], but other "competence intermediaries" are less visible but usually much more effective. We mean here two types of "agents". First, there are professional service firms (global accounting firms imposing uniform standards of managerial accounting and financial reporting, law firms imposing standards of legally correct company behavior, strategy consultants). In addition, numerous specialized firms provide advice or directly subcontract particular activities (from deep drilling in oil fields to design of at attractive furnishing of a shop)[2]. The second kind of "competence brokers" is expatriates at managerial positions at Russian firms. Prior to the financial crisis of 2008, they were around 80,000 persons. Their post experience and ranks differed from the former German chancellor heading the subsidiary of Gazprom (the largest hydrocarbon company of the world in terms of output) to modest shop managers and production superintendents serving as interim directors for sales and operations of medium-size Russian companies.

Taking into account all these corrections, we may see the competence transfer as a rather chaotic process where deliberate transfer of knowledge to business partners coexists with involuntary loss of competences by intentional or occasional actions of competitors. Moreover, competence transfer may have both positive and negative effects on the sides in the transfer (for example, the transmitter is deteriorating its competitive position as his proprietary knowledge became exposed to a wider audience, the receiver is deteriorating its competitive position as the costs of absorption exceed the gains or new less effective competences replace old effectively used competences).

---

[1] Most often advanced management techniques developed in business school is retained for consulting assignments of the faculty.

[2] In our survey of Russian executives in 2010, consultants and subcontractors with industry expertise assisted 60% of industrial innovations. They developed new business ideas, assisted in design of new products, provided advice on purchase, delivery and installation of necessary equipment etc. (see Gurkov, forthcoming)

Now we may proceed to the second element of cross-border knowledge (competence) transfer – definition of “local” and “foreign” companies. The distinction here is not that clear as Michailova and Jormanainen present it. “Russian companies circa 2011” include:

- Truly global firms (Dutch “stichtings”, British Virgin Islands investment banks, Cyprus holding companies and other firms of the kind) representing individual and collective resources of leading Russian investors[3]. They are smart, aggressive and looking for unusual direction for investments. For example, Yuri Milner’s deal in 2009 when his fund DST acquired a minority stake in Facebook put him immediately among the 50 “smartest persons in tech” by Fortune; “DST way” became a new standard for tech deals[4].

- Export-oriented large Russian corporations. Export-oriented companies must deal with foreign companies directly. They also routinely using services of the “Big Three” accounting firms and as well of the best strategy consultants, hiring to the top managerial positions expatriates with decades-long executive experience in Fortune 500 companies, recruiting best MBA graduates. Large export-oriented Russian corporations already know almost everything they need to know and develop their competences by acquisitions in downstream businesses. However, they still unable to combine their appetites for prominent Western assets with the wishes to keep their ownership structures as obscure as possible[5].

- Locally oriented large conglomerates like X5 Retail Group (that is currently headed by a Wharton MBA and use 4 expatriates for its 7-member Supervisory board). Recently, the former CEOs of AFK “Sistema” (another Russian locally oriented conglomerate with US$20 billion of sales) pointed out: “We do not need any consultants [anymore] to

---

[3] In 2010, around 70% of US$116 billion of the accumulated direct foreign investment in Russia originated from Cyprus (40%), the Netherlands (20%), British Virgin Islands (4%) and Luxemburg (GKS, 2011). In the same year, capital flight from Russian was estimated at

[4] At the end of 2010, DST group was renamed as Mail.ru Group, but the cry of tech creeks: “We wish to sell the stakes in our start-ups by DST way” remained unchanged.

[5] A long list of unsuccessful attempts to acquire prominent Western companies (Accelor, Opel, Saab, Hungarian MOL) supports this point. Even if the former CEOs of Accelor once politically incorrectly referred to the acquisition proposal of Indian Tata Group: “We do not need monkey’s money”, he later preferred that sort of money to Kremlin-backed funds of a Russian contender in that corporate bid.

redesign our corporate structure."[6] We may include into that group independent dealers and distributors of foreign goods (cars and trucks, machinery and equipment, pharmaceuticals) as well as specialized Russian exporters. Such companies also routinely interact with foreign companies.

- Finally, there are all other Russian companies, limited in their exporting activities. They have a few chances of direct interactions with foreign companies, unless they are supplying Russian subsidiaries of foreign MNCs. Thus they absorb competences mostly from "competence brokers" and from open sources.

If we look into "foreign companies," involved in competence transfer, we again should distinguish three kinds of "species". The first group is the largely neglected (in academic research) purchasers of Russian exports as well as foreign targets of Russian acquisitions. Here we cannot limit the analysis only to Western firms. For example, in 2009-2010, Russian firms learned a lot about the Chinese bargaining tactics, Hungarian and Vietnamese ways to keep acquirers away from strategic control over their acquisitions, West African logistics etc.

The second group is Russian subsidiaries of the leading and second-class MNCs (banks, insurance companies, dealers of leading world carmakers, foreign retail chains, and production and marketing facilities of companies in FMCG)[7]. Although most of them are still headed by expatriates[8], most of managerial, clerical and shop-floor positions are staffed locally. The initial competitive superiority of MNCs, based on offering of ageing trademarks to inexperienced Russian customers, lower costs of capital and implementing advanced systems in merchandising and logistics was later reinforced by aggressive purchase of local competitors[9]. In operating in

---

[6] This statement was made in an interview a week before his sudden resignation from the corporation.

[7] It is almost impossible nowadays to find in Russia goods of major world trademarks in soft drinks, tobaccos, household expendables that are not produced locally. For example, 85% of the volume of beer produced in Russia is made just by four MNCs etc.

[8] By our own calculations, 36 out of 50 local subsidiaries of the largest MNCs are headed by expatriates.

[9] One good example is Unilever that struggled for a decade to establish a considerable market share in the Russian market for ketchup until it purchased the major Russian competitor and carefully preserved all its trademarks after the acquisition. Another example is Danone that is completing now the acquisition of the major Russian milk and soft-drink producer (Wimm-Bill-Dan).

Russia, the subsidiaries of many leading MNCs also amended standard business models[10], adapting to specific market conditions and local standards of corporate citizenship. As in all subsidiaries of MNCs around the world, Russian subsidiaries are asking simultaneously the headquarters for resources and for autonomy (see Pisoni et al., 2010). To justify such claims Russian subsidiaries are stressing the uniqueness of their business environment. To offend such claims, headquarters are trying to hide the mechanics of corporate decision-making, including the logic behind marketing plans and competitive actions, methods of calculations for necessary investments and other "know-why" from managers of local subsidiaries.

Again, we may see that the competence transfer is a "two-blade sword" even in in-company relations. It follows the general logic of the quest for strategic resources of the firm, achieved by "squeezing" competences from business partners and competitors. Thus we may present an unusual perspective on knowledge transfer between Western and Russian companies:

1) Western companies ardently preserve their competences offering them in a piecemeal mode to Russian their subsidiaries, direct suppliers and distributors.

2) Competence brokers, however, are revealing a pat of proprietary expertise of Western companies and bring them to the "market of expertise".

3) Russian companies routinely visiting that "marketplace", carefully selecting and picking up items that will not endanger their fragile competitive advantages and will not destruct existing power structures.

Now we may approach to the main arguments of Michailova and Jormanainen – "Soviet heritage of company competences is valuable and should be amended and replaced with caution". Soviet competences were exposed in details in managerial literature, for example, in Jancovizc (2002) (not cited by Michailova and Jormanainen) and include "highly focusing copying skills", "technical rationality in decision-making", "well-developed networking skills", "the handling and mishandling of stress", "sophistry and sophistication". Unfortunately, we should point out that this list is both archaic and incomplete. It is archaic as it pertains to persons who grew up and were promoted and, most importantly, succeeded in top managerial positions in a highly specific system of central planning and strong ideological control. Such system does not exist

[10] For example, Swedish IKEA gave up the model of its retail super centers as staying-along blue hangars and agreed to share market malls with other retailers.

now for 20 years, the people who developed such skills are now over their 60s[11] and there are no reasons to reproduce most of these skills in a new system. Therefore, such skills are highly generation-specific and projecting such skills for a new generation of Russian business leaders will be a mistake (see Gurkov and Maital, 2001; Gurkov, 2005). At the same time, the usually presented list of Soviet competences is incomplete as it ignores one unique Soviet competence. We mean here to create systems of management where the liability for failure was passing down to lower levels of the managerial hierarchy, while the authority to make the decisions and to accumulate the necessary resources to implement the decisions was concentrated at the top (see Gurkov et al., forthcoming). This competence is largely reproduced today and clearly visible in any kind of large Russian organization – from the federal government where ministers lack the authority and resources to make decisions listed in ministerial charters to medium-size private companies where owners may hire CEOs but turn them into Chief operating officers (COO), while retaining all strategic decisions for themselves. Western managers, involved into horizontal relationships with Russian counterparts may testify that in most cases such relationships are in fact "diagonal" – to achieve real coordination a Western manager must interact with a Russian colleague who is one or two ranks higher in the managerial hierarchy.

This competence to create organizations with "invisible" and totally "irresponsible" strategic apexes corresponds extremely well to the first two arguments of Michailova and Jormanainen (this knowledge is still valid and forms a background for actions of Russian firms; it serves as a "sieve" for cautious imitation and selective acquisition of Western business models and management techniques). However, we hardly see that foreign companies operating in Russia should properly use this fundamental feature of genuine Russian management techniques. If such a competence will have wider impact on international practices of leading MNCs, the consequences will be disastrous.

Michailova and Jormanainen wrote a very interesting and provocative paper. If they were put less efforts on citing theoretical articles and more attention to cases, documentary evidence of firms' actions and articles in less popular journals focused on East European management, they would derive even more powerful and far-looking conclusions.

[11] The life expectance of a Russian male was 59 during 1990s and 2000s.

References:

Gurkov, I. (2005), "Anarchist around. Considerations of the book", Journal *for East European Management Studies*, Vol. 10, Iss. 4, pp. 347-349.

Gurkov, I. (forthcoming), "Innovative actions and innovation (in)capabilities of Russian industrial companies – A further extension of observations", *Post-Communist Economies.*

Gurkov, I., Saidov, Z., Settles, A. (2011), "Sailing the dangerous waters of contradicting stakeholders' claims: A simplified chart". *Paper presented at 1st Interdisciplinary Conference on Stakeholders, Resources and Value Creation, Barcelona: IESE/SMS.*

Gurkov, I. and Maital, S. (2001), "How will future Russian CEOs manage? A survey of attitudes towards loyalty, leadership and teamwork", *Journal for East European Management Studies*, Vol. 6, No. 1, pp. 28-42.

Gurkov I., Morgunov, E., Settles, A. and Zelenova, O. (forthcoming), "HRM in Russian over a century of storm and turmoil - a tale of unrealized dreams", in B.Kaufman (Ed.) *HRM management in international perspective*. Cheltenham: Edward Elgar.

Jancovicz, A.Devi (2002), "Limits to knowledge transfer", *Journal of East-West Business,* Vol. 7, No. 2, pp. 39-61.

Lave, J. and Wenger, E. (1991), *Situated learning: Legitimate peripheral participation.* Cambridge: Cambridge University Press.

Pisioni, A., Onetti, A., Fratocci, L. (2010), "Internationalization of Italian firms in Central and Eastern European countries: Headquarters-subsidiary relationship", *Journal of East-West Business*, Vol. 16 No. 2, pp. 89-117.