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Sanctions As a Tool of Foreign Policy and Statecraft - Case Valio Russia

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1  INTRODUCTION

This bachelor study is aiming at giving the reader an understanding of sanctions and embargos; how they are being used, what effects they have and how well they succeed in serving their purposes in a broad way. The outcome of sanctions will also be analysed on company level in the case study Valio Russia.

1.1  Topic and research questions

This topic is current in the global setting when the current Foreign relationships between East and West is examined, especially as the confrontation between these two is certainly high. As possible interference of Russia into Ukraine internal conflict has launched an interesting international political crisis in the EU area which has led into a situation where both sides have assigned trade sanctions (Lönnström 2015). Though sanctions are used often as non-violent options to force other countries into concessions and this topic has still being considered as just a minor part of international relations studies (Hufbauer, Clyde. 2000). It is important to understand how long reaching and lasting the effects of these sanctions can be to both targeted and sanction sender countries, different interest groups and business sectors (Andreas,Peter 2005). The following research questions try to explain what kind of methods can be used to create pressure for the target countries and what kind of outcome sanctions might cause.

What kind of different tools can sanctions programs utilize?

What side effects might sanctions programs cause?

The empirical purpose of the case study is to focus on the different effects of sanctions on individual companies. In the case of Valio and dairy business it is important to understand that the usage of sanctions has tremendous effects to the whole market. Raw materials and finished products usually will not last more than few months. When the distribution of the raw materials and the market balance
change suddenly, quick actions are needed. Valio's situation was even more extreme as most of their products were imported to Russia. Valio is also smaller than its global competitors, such as Pepsi Co. and Danone. Prior to the sanctions Valio only had minimal local production in Russia and was forced to develop quickly to survive from this crisis. Case will be analyzed by following research question:

*How have sanctions affected Valio and dairy sector in EU and Russia and have the different parties reached their sanction policy goals?*

### 1.2 Research methods

Literature review is used to create theoretical framework for understanding sanctions thoroughly. The case study is used to reflect theory findings. Empirical qualitative research was conducted in the autumn of 2015. Different manager level personnel from the company were interviewed to get insights to gain understanding of the situation on different levels of analysis. The methodology of the case is presented in chapter four.

### 1.3 Structure of the paper

Chapter one is the introduction chapter which presents the research questions, structure and the purpose of this bachelor study. The second chapter is the theory chapter where different sanction methods are analyzed. The theory of sanctions will be analysed through examples from around the world to understand these phenomena better. It includes short analysis of embargo of Cuba which has lasted now over fifty years and which is now ending after US President Obama has started to lift the sanctions. The European Union and Russia in the case study represent the recently started sanctions program which is still unlifted. These examples show what can be find what can be gained by using sanctions but also what unwanted side effects they might have.
OOO Valio Russia is chosen as case company as Russia was the largest export market for Valio before the trade sanctions were announced. Valio is well known Finnish company with history of dairy business, innovation and successful international business. Valio is owned by milk producers and thus it has amples to ply raw material and an obligation to find markets for their processed products. The sanctions program of Russia forced the whole organization of Valio to evolve in many sectors. The sanctions program has also changed the whole global dairy business which is worth over 5 billion euros in the European Union alone which has required quick and agile actions from Valio in order to survive and maintain its high position at Russian dairy markets. (Koskinen 2015.)

1.4 Main concepts

The Term “sender” is used to describe a country or international organization like the United States or the United Nations as the party who announces the sanctions programs.

The Term “target” is used to describe country who is the object of the program.

Concept OOO, Limited liability company, (объектство с ограниченной ответственностью)

Comprehensive embargo: Complete blockade of a nation.

Trade sanctions: Interference into trade systems, for example denying access to markets and blocking trade routes

Financial sanctions: Interference into financial systems, for example asset freezes, investment restrictions and credit manipulation.

Smart sanctions: similar methods which are targeted on individuals and / or sectors. These can also include for example trade and financial sanctions.
Travel bans: denying travelling by using visa restrictions and travel bans.

Patriot act: Legislation from the USA which gives financial tools to fight against terrorism globally.
2 SANCTIONS AS A TOOL OF STATECRAFT

Following chapter analyzes comprehensive sanctions. First part explains the short history and academic study of sanctions. The second part will analyze the different tools of sanctions and what different methods can be used. The third part examines the side effects of sanctions.

2.1 Short history of sanctions

For ages different kinds of sanctions, from trade and financial sanctions, asset freezes and travel restrictions to broad embargos have been used as a tool for persuading other nations. Basically, sanctions are unilateral actions of countries or alliances meant to create pressure on the target country, or regime to persuade or force them in certain foreign policy actions. They can also be used to provide a frisson of moral satisfaction of doing something (Hufbauer, Clyde 2000; Gottemoeller, Rose 2007).

Economic statecraft, sanctions based, their mechanisms and side effects has not been studied a lot before cold war period. Sanctions can have many different forms which vary depending on the situation. Literature about sanctions was seen as a more irrelevant part of international relations relying mostly in case studies of high profile embargos (Zarate, Juan 2013; Drezner 2015.) The sanctions can be examined from multiple perspectives such as sender and target countries. Recently the academic studies have also started to examine effects of sanctions to second and third parties, for example worsening of human rights and the emergence of corruption in the target countries. (Andreas, Peter 2005). Consequently nations tend to create more effective and more easily supervised sanctions by sender countries with higher effects to targeted individuals and various companies. As the usage of sanctions as an economic statecraft tool gains popularity amongst the global superpowers like China, Russia and the United States, it is important to better understand these tools and how they can influence different parties in diverse ways.
For example United States announced 85 new sanctions on foreign states between 1996 and 2001 (Gottemoeller, Rose 2007).

2.2. Comprehensive sanctions

Money makes the world go round. For ages it has lifted nations, companies and individuals into high power. It also keeps the criminal syndicates, authoritarian regimes and terrorist organisations like Isis alive and operational. By blocking vital assets from targeted receivers, their political, personal and ideological ambitions can be heavily influenced. This strategic vulnerability can be used effectively to persuade how targets operate like the sender wants. (Zarate, Juan 2013, 10-11.) Basically comprehensive sanctions are broad complete blockades of a country or a sector. Different kind of sanctions can have better effects on the targets if they are properly imposed on the sensitive sector of the economy of the target. Hufbauer and Clyde (2007) have found that when trade sanctions are being used the sender can disturb export or import businesses from the target country in various ways. Prices, for example, can be manipulated, critical imports and exports can be denied and higher tariffs can be used to cause pressure. (Hufbauer, Clyde 2007, 91-92.)

One of the most famous embargos has been placed on Cuba. It has lasted for over fifty years after Cuban Soviet Union missile crisis, the fiasco of Bay of Pigs and rise the of Fidel Castro (Renwick, Danielle 2015; Zarate, Juan 2013) The embargo started in 1960 by cause Cubas mass expropriation of United States properties and Cuba’s close relations to Soviet Union (Hufbauer, Clyde 2007). The goal of the US comprehensive embargo was to destabilize Fidel Castro’s communist regime near American soil and to bring Cuba into capitalistic and democratic system (Katz, David 2005). During the years of embargo Cuba’s trade in export and import, travel, culture and investments was prohibited. (Hufbauer, Clyde 2007).

Katz and David (2015) has studied the effects of sanctions on Cuba. During these years Cuba has weakened dramatically as a nation and its economic growth has stagnated. Cuba suffers from inadequate agricultural production to non operational
plumbing. The embargo itself gave Castro the most powerful weapon to drive his regime’s political means and to criminalize the actions of United States in the eyes of his own nation and also given to possibility to hide the failures of his own actions. (Katz, David 2005.) Cuba is not the only party who has suffered because of the sanctions. Every year that the United states have maintained their embargo, they have spent hundreds of millions of dollars just on administration. Also the losts in revenue for US companies are remarkable. Estimates vary from 1.2 to 3.6 billion Dollars annually. (Hanson, Batten, Ealey 2013.) In the end all the results of the embargo are quite elusive (Hufbauer, Clyde 2007).

According to Hufbauer and Clyde financial sanctions can exist in many forms like delaying or denying credit or grants, interruption of official development assistance and interruption of global export import bank financing. Financial sanctions often provide better potential for concessions as a tool of foreign policy as they are easier to monitor, enforce, bolster and harder to evade. One pretty unusual sanction used alongside other financial sanctions, is asset freezing, when the target country’s financial assets are freezed in the sender country. A broad freeze of assets is often imposed together with broader trade sanctions. This has influence to multiple sectors in target country when the financial flows stops. Basically everything that is owned by the target country from qualified assets, merchandise, accounts receivable and bank accounts are in danger. These extreme broad freezes are rarely used: mostly during wartimes or extreme hostility. However, asset freezes are used more often against terrorist and criminal organisations (Hufbauer, Clyde 2000).

Comprehensive economic sanctions and embargos considered as very important tool of UN to put pressure on rogue regimes without recourse to force (Hufbauer,Gary C. 2000). Gottemoeller and Rose (2007) says that not have they only caused negative outcomes but comprehensive sanctions have also brought about positive results during the history of their existence. They ended bio, nuclear and chemical weapons programs in Iraq. The comprehensive sanctions on South Africa were effective to bring the end to apartheid regime and Libya did everything from ending weapons programs to handling persons to international court to get rid
of the sanctions. There are also numerous variables which might also influence the
outcome of the embargo (Gottemoeller, Rose 2007.)

Comprehensive sanction programs often fail to fulfill their mission in modifying
the target country’s behaviour. Sometimes sanctions are just too plain. To reach
these sometimes, the methods can be can be too gentle or the international co
operation between other nations can be too tepid to, to enable reaching the set,
often elusive, political goals. (Hufbauer, Clyde 2007). Target countries can start to
look for evasive actions on governmental and commercial level in response to the
sanctions. These actions can even bring up new strong and wealthy allies to the
target country that allow them to offset the losses from the sanctions program. The
goals of sanction programs might also be so elusive that it might be impossible to
reach the set goals. (Hufbauer, Clyde 2007, 46-47.)

2.4 Side effects of comprehensive sanctions

Sanctions can have crucial effects on the target country which might have
surprisingly long lasting asymmetric effects (Andreas, Peter 2005). Hufbauer and
Clyde (2007) has also found that sanctions programs can alienate the allies abroad
and also harm domestic business interests. This can lead into infected relationships
between allied countries which will affect global businesses in large scale. Sanctions
have direct influence on the companies with export and import
businesses through imminent losses of sales. Also credibility, brand and reliability
can suffer because of the uncertainty (Koskinen 2015; Hufbauer, Clyde 2007, 108).
Usually humanitarian support is let through to avoid collateral damage on conflict
zones. Sanctions are known to be a so powerful tool of foreign policy that
sometimes even just the threat of the imposition of sanctions will lead to actions in
the target’s behaviour. (Drezner 2011) The effects of sanctions to international
companies will be examined more on company level during the case OOO Valio
Russia.
Gottemoeller and Rose (2007) have found that comprehensive sanctions can also create unwanted long lasting side effects which can have effects to the target nation. Comprehensive sanctions and embargos are extremely hard to implement and monitor due to the need for high covering of many sectors. Because of Weak enforcement, dire conditions in neighbouring countries and missing global cooperation. On the other hand, target country try to evade sanctions in different ways. (Hufbauer, Clyde. 2000.) The studies of the consequences of the sanctions and the creation of criminal activity are quite new fields of study. The black markets can have effects on many different sectors in a country and might affect the way how people react and accept the increase of criminal activity (Andreas, Peter 2005). Andreas and Peter (2011) has studied that Government support of criminal activity to avoid sanctions can have long lasting effects in the target country. Also during post sanction period. During the sanctions period power elite can use underground networks for sanctions busting tasks and privileged access in exchange for loyalty and support allowing to the creation vast black market often connected and protected by government . This creates difficult environment for the normalization of the target country during post sanctions period when the leaders of the regime have given a mandate of power to the criminal organization. This oftentimes leads into harder shift to legal trade during post crisis phase. (Andreas, Peter 2005.)

The powers gained during embargo do not disappear from the economy even when the crisis is over. While normal legal markets suffer under the sanctions, by lost of regular trade partners the black markets start to expand more also to the neighbouring countries gaining illegally more wealth and power for example from smuggling and looting during disordered times. The creation of new elite can be hard to be opposed by normal free and legal markets. Even though sanctions would be lifted and legal markets would be reached, the black markets still exist with wider networks than before and with a new powerful elite. Because of the difficulties which sanctions often cause normal people citizens might start to keep the illegal actions normal and maybe even patriotic. This often brings even more
“entrepreneurs” into illegal environment this affects the public tolerance for law breaking and the attitude against the rule of law. (Andreas, Peter 2005.)
3 SMART SANCTIONS

This chapter is about smart sanctions and different tools and purposes for which they are being used. The first part is about how and why smart sanctions have been created. The second part describes different smart sanction methods. The final part is about using smart sanctions against terrorism.

3.1 The evolution towards smart sanctions

Gottemoeller and Rose (2007) call smart sanctions as the precision guided munitions of economic statecraft. Compared to comprehensive sanctions smart sanctions often have better impact when they are pointed straight towards the regime elite, individuals and other leader organs. The results are often more quickly achieved than with comprehensive sanctions when the pressure is focused in the right position. Smart sanctions are designed to cause pressure on certain powerful individuals, organs and companies without the unwanted side effects on the normal population. (Gottemoeller, Rose 2007.) By altering the access to the goods, travelling and assets of the right individuals, the regime is eventually forced to accept the concessions (Drezner 2011).

After multiple more or less comprehensive sanction programs imposed in various places like Cuba the sanction outcomes were compromised by multiple organizations (Hufbauer, Clyde 2000). Comprehensive sanctions were kept as “blunt” tool which has multilateral and long lasting effects on target country also after the crisis. (Hufbauer, Clyde 2000; Andreas, Peter 2005) With high collateral damage to the local people and companies and the possibility of the regime to circumvent the pressure and enrich the elite of the regime through black markets during the embargo. These unsuccessful sanction programs have encouraged international organisations to develop the sanctions policies in a more effective direction. They were heavily analyzed in late 1990 when Swiss government sponsored an event “The Interlaken Process” in two large conferences held in 1998 and 1999. It gathered experts all around the world to analyze and to correct the
experiences from former sanction programs. Back then, focus was heavily concentrated on improvement of arms embargo, travel restrictions and financial sanctions. (Gottemoeller, Rose 2007.)

3.2 Tools of smart sanctions

There are multiple different possibilities for smart sanction programs. They often have similar abilities with regular sanctions from trade sanctions to arms embargos. Smart sanctions can also be categorised in “selective” and “targeted” sanctions. Selective sanctions are not as broad as comprehensive sanctions but their purpose is to disrupt specific sectors, products and or financial flows (Hufbauer, Clyde 2000.)

Arms embargos are often used to restrain conflicts in hostile regimes with ongoing wars. In 1990 there were 10 imposed arms embargoes to contain local conflicts. The use of arms embargoes can turn down the access to military equipment and still spare the local civilization from economic downfall. They are also used to slow down the stream of weapons into conflict zone. Arms embargoes are often hard to maintain in an effective manner. Because of the harsh conditions of other border countries arms embargoes are hard to monitor and enforce. Trafficking of small arms often offers lucrative possibility to earn more during the chaotic times of conflict. Also if target owns some valuable natural resources the profits gained can also help to evade the arms embargo, for example, via illicit trade networks (Hufbauer, Clyde 2007.)

Travel bans can be used to limit the movement from the target country. They can be categorized in two ways. By banning all travelling target in and out from the target country. This can certainly be quite difficult because all the borders of the countries can not be monitored constantly. For example Visa restrictions, individual access, air traffic monitoring and more tightening of border control can be used as methods to ban travelling (Hufbauer, Clyde 2007.) Because global flight routes and global aviation businesses even the smaller changes can have an impact on multiple sectors. If an airport will stand silent for a day hundreds or thousands of people
cannot work creating losses for many sub contractors on airfields. (Hufbauer, Clyde 2000) Another kind of travel ban is to target certain individuals. This way they cannot move out from the country to avoid other sanctions. This can also affect the businesses of certain elite members if they are not allowed to make any business trips. (Hufbauer, Clyde 2007). Targeted air bans do not cause so much collateral damage to business sector of the whole target country (Hufbauer, Clyde 2000). Basically travel bans are usually considered more as a symbolic actions to renounce regime or dissident forces. They are hard to monitor and relatively easy to evade by false passports and visas. Also right targets are hard to find (Hufbauer, Clyde 2007).

Targeted financial sanctions like asset freezes can be used to gain concessions by freezing monetary assets similarly like normal sanctions from certain individuals, governments and state owned companies (Hufbauer, Clyde 2000). They can be used together with targeted and selective trade sanctions too. Sanctions can try to weaken the position of the ruling elite or regime by denying them the access of luxury goods. This again requires large amounts of intelligence and understanding of the target before the sanctions start to hurt the targets (Hufbauer, Clyde 2007.)

3.3 Smart sanctions against terrorism

Financial sanctions are also used against global terrorist organizations. Terrorist organizations are often wealthy criminal organizations and they use multiple ways to laundry and transfer money all around the world. (Zarate, Juan 2013). Smart sanctions and financial power of the United States has given new weapons into fight against terror. After 9/11 the United States started to search new ways of tracking down Bin Laden’s sources of wealth. The new legislation “patriot act Title III” was developed (Gottemoeller, Rose 2007). Patriot act contains a certain part which is specific for criminalizing the financing terrorism “Title III, the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001”. Title III of the patriot act was notable because it enforced the penalties that financial institutions would face if they were involved in financing of terrorism.
Consequently these institutions had to pay more attention to their due diligence in all their transaction activities. More importantly Title III prohibited them from handling transactions of shell banks-foreign institutions. It was later bolstered in section 311 of Patriot Act. It gave the legal means for United States to freeze financial assets if threatening the national security interest of The United States. These asset freezes could be imposed anywhere in the world. Financial sanctions under Patriot Act are coordinated and supervised by US Departm of the Treasury through its Office of foreign Assets Control (Gottemoeller, Rose 2007.)

Some have argued that targeted sanctions like trade bans and travel restrictions do not generate good enough results to the sender countries because their economic impact to the target country is so small (Drezner 2015). Huge amount of intelligence is also required to understand the country, groups, individuals and targets to successfully implement and enforce targeted sanctions. Even though funds can be traced it requires large amount of resources to operate fast enough and secretly to stop targets from transferring their assets into new locations (Hufbauer, Clyde 2007.)

As with traditional sanctions smart sanctions usually give the sender country the feeling of doing at least something. Even if smart sanctions programs have created results. They are not the ultimate way to solve foreign policy problems Hufbauer and Clyde says in quite similar manner to regular sanctions that smart sanctions often work better on signalling level than as a coercive measure because of the difficulties of the creation of well functioning smart sanction. (Hufbauer, Clyde 2007.)

3.4 Sanction summary

As literature review has shown, there is various methods and tools of imposing sanctions. They vary from extremely targeted sanctions on individuals to broad embargos of whole nations. Sanctions are not perfect a tool of political coercion
and in the worst case multiple interest groups can suffer as sanctions are imposed. Found methods can be seen in figure one.

![Sanctions Diagram](image)

**Comprehensive sanctions**
Comprehensive sanctions and embargos are sanctions placed on sectors and whole nations. Various methods can be used to coerce nations. Requires large scale cooperation between nations.
- Comprehensive embargo
- Price manipulation
- Tariff manipulation
- Trade sanctions
- Denying of imports and exports
- Travel restrictions
- Cultural restrictions
- Investment restrictions
- Interruption of global import/export bank financing
- Denying of development aid
- Asset freezes
- Credit manipulation

**Smart sanctions**
Similar to comprehensive sanctions, but targets are individual persons, groups or sectors. They tend to cause less collateral damage than comprehensive sanctions but often smart sanctions require more intelligence to have an effect.
- Selected and targeted sanctions
- Altered access to goods
- Travel bans and restrictions
- Arms embargo
- Targeted financial sanctions
- Targeted asset freezes
- Patriot act legislation

**Side effects of sanctions**
Sanctions are not perfect tools of foreign policy. They tend to cause various issues for different interest groups on different levels from nation to individual level.
- Growth of illegal black markets
- Post sanction period issues, return to balanced situation
- Company and business level issues, these will be analysed in the case study
- Human trafficking
- Arms smuggling
- Nations attitude for criminal organisations
- Creation of new power elite
- Alienation of allies
- Alienation of domestic interests

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Figure 1. Sanctions conclusion - tools and side effects
4 CASE STUDY METHODOLOGY

4.1 Qualitative research

Qualitative study was chosen as research method to this case to understand the outcomes of the sanction program on individual companies and business sectors. Case study try to emphasise and reflect the theory, how long reaching the effects of sanctions can be and can nations reach their political goals by using sanctions. The case try to answer into following empirical research question:

_How sanctions have affected Valio and dairy sector in EU and Russia and has the different parties reach their sanction policy goals?_

Following case study: “Case Valio Russia” analyses how sanction outcomes on company and business sector level. It is important to understand how sanctions can have huge impact through different networks and interest groups into parties that were not targeted originally.

4.2 Interviews

Three people from different positions were interviewed to get different perspectives on the issue. The interviews were conducted in the autumn 2015 with specific question pattern which allowed broader discussion lasting from one to two hours. Interviews were recorded and questions can be found from appendix.

The following persons were interviewed in Saint Petersburg and Helsinki:

Annikka Hurme, CEO, Valio Ltd
Mika Koskinen, SVP, Former CEO and chairman of the board of OOO Valio Russia
Raul Lönström, CEO, OOO Valio Russia
5 CASE VALIO RUSSIA

This chapter analyzes how sanctions has affected Finnish dairy company Valio during the sanction crisis begun in 2014. First part is about Valio as a company. The second part is about Valio’s history on Russian markets and how sanctions affected Valio overall and how Valio sees its position in the future.

5.1 Valio

Valio is a 110-years-old Finnish dairy company with a long history in international business. It is also known for its fresh innovations in dairy products in industrial as well as consumer sectors. Valio is a co-operative owned by Finnish milk producers who will gain the profits according to Milk return. In 2014 Valios turnover was €1,950 million and 0.454€ was paid per litre to the producers. Valio had 4,375 employees and in Russia 475 persons on average. In 2014 Valio made €152 million worth production investments. (www.valio.fi)

As a company Valio operates in a way that all the milk producers have equal possibilities to practice their profession all around Finland. For raw milk the same price per litre is paid to every producer, regardless the amount of produced raw milk or the location. All the raw milk is received from the owners. Raw milk is not obtained from any other sources than the owners. Valio’s product portfolio consists of a variety of different fresh dairy products, cheeses, fats, juices, milk powders, whey powder and other industrial products. Annually Valio launches approximately 100 new products. (www.valio.fi)

Valio has five foreign subsidiaries mainly for marketing purposes. These are located in Sweden, Russia, Estonia, China and the United States. All production capacity is mainly located in Finland. In Russia there is one production facility near Moscow and 2 strategic contractor facilities which produces Valio’s products. Approximately 35% of Valio’s turnover comes from export and international
production. Valio’s export covers 30% of the whole Finnish food export income.
(www.valio.fi)

5.2 Case study Valio Russia

5.2.1 Russia and Valio

Lönnström and Koskinen (2015) told that Valio has a long history in Russia. Exports of Finnish butter started in 1908 and deliveries of Viola processed cheese begun in 1956. Throughout this long trade history Valio has supplied its products to the tables of millions of Russians. The current Valio Russia was established in 1994 to manage mainly marketing in Russia. Until 2002 all Valio products were mainly sold via distributors.

OOO Valio Russia took advantage of this situation and started expanding their operations in Russia. During 2004 - 2009 Valio built a sales organization, a distribution terminal with local warehouse and a logistics centre in Moscow. Moreover, direct delivery contracts were signed with local retail operators. In 2009 a new factory started producing processed cheese near Moscow. During these few years Valio also started collaboration with Russian dairy company Galactika. Valio consulted Galactika in building a high quality dairy factory near Saint Petersburg. Valio also provided second hand dairy equipment and made signed co-production and consulting agreements with Galactika. (Lönnström, Koskinen 2015)

Valio’s revenue grew steadily until the crisis in 2014. Valio was the market leader in various product categories like cheese, processed cheese and butter brands. Valio produced a large amount of products in Finland and Estonia and imported them into Russia. Russian business brought notably large revenues to Valio raising to 258 million euros before the sanctions. This created a picture of well functioning operations. When orders kept on coming in, more production capacity was built in Finland. At that time no risk were foreseen in Russia. Later on, it has been stated that it was too risky to create Russian markets so dependent on exports. On the
other hand business was very profitable for Valio in allowing further investments feasibly in Finland. (Lönnström, 2015) The structure of imports, production and consumption of cheese and butter can be seen in figures two and three.

The global price of crude oil is crucial to Russia and the well being of the society. It also influences the companies as a macroeconomic phenomenon. Companies are more willing to invest when the purchasing power is high. During the 21st century Russia has been in a positive growth period. The government took a favourable attitude to foreign enquiries and consequently convenience goods business was growing in Russia. (Koskinen 2015)

Figure 2. Russia - imports, production and consumption of cheese (1,000 tons) 
(http://apps.fas.asda.gov/psdonline/psdHome.aspx)
5.2.2 Sanction program - Crisis 7.8.2014

The tensions between Western Countries and Russia tightened after the speculated Russian military support to Eastern Ukraine, the civilian-plane shot down by a BUK missile and annexation of Crimea (BBC, News 2016). Consequently, both sides started to implement sanction programs to put political pressure on each other. One of these sanctions was crucial to Valio. On the 7th of August 2014 Russia banned the imports of certain food products from the United States, the European Union, Canada, Australia and the United Kingdom. Only few product categories were allowed: baby foods, water, berry soups, jams and lactose free products. Later also part of lactose free products were banned (Valio material 2.)

Lönnström (2015) says that the international dairy business was overall shocked by the sanctions. The market prices decreased dramatically and companies started to search for other markets to circumvent the production pressure. Russia has always been an eccentric market which requires special attention. There have been different crises earlier too, but the current situation is ranked as one of the most
According to Koskinen (2015) Russian dairy markets are largely dominated by major international companies like Pepsi, Danone, Lactalis and Valio. Regional markets (major city areas excluding St Peterburg and Moscow) have mainly been dominated by minor local Russian companies. The Russian government has been aware of the problem and tried to support domestic milk production and dairy segment but results can only be reached over time. Prior to the latest sanction program there have not been significant governmental efforts to decrease the amount of import. (Koskinen 2015, Valio Material 2, 2015)

Hurme says that this sanction program serves the political goals to fortify the position of domestic milk production and dairy business. (Hurme 2015). On the other hand, as multiple studies like Hufbauer and Clyde has shown, the goals of sanction programs can be really elusive and difficult to reach and side effects are hard to foretell (Hufbauer, Clyde 2007). According to Lönnström (2015) there has not yet been any significant proliferation of local raw milk production and dairy business, though local Russian dairy companies have started to gain more shelf space in the retail stores. (Lönnström, 2015.)

Import sanctions can be used in order to reach protectionist economic interests. (Hufbauer, Gary Clyde 2007, 46) If this fact is considered, Russia has made quite a controversial move. According to Hurme (2015) the sanction program can decrease the interest of foreign companies to invest in Russia. (Hurme 2015) By reason of Russia’s need of foreign dairy imports they might be facing problems when the borders are reopened. When the international producers have found new markets the threshold to expand and maintain operations in Russia might be higher. (Koskinen, Lönnström, 2015)
Koskinen (2015) assumes that if the sanctions program is lifted as suddenly as it was started it will be a death strike to local Russian raw milk production. This could cause a wave of cheap milk production inside the European Union as large dairy companies try to get their own share of the dairy products in Russian markets. This would be a huge disappointment for both the local companies and those foreign companies who had faith and invested in Russian markets and local production during the sanction program. This could lead into serious consideration about future Russian operations within foreign companies. Koskinen thinks that Russia will open the borders step by step to avoid this “milk wave”. This can be done, for example, by using different governmental steps. They may even permit single factories abroad at the time to start import to Russia again (Koskinen 2015.)

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<tr>
<th>Russia</th>
<th>EU and Valio</th>
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<tbody>
<tr>
<td>- Before sanctions, dairy markets mainly dominated by major international companies.</td>
<td>- Large amounts of raw milk</td>
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<td>- Proliferation of dairy and raw milk production</td>
<td>- Decrease of market prices</td>
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<tr>
<td>- Local investments</td>
<td>- Search for new markets for excess products; circumvent production pressure</td>
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<tr>
<td>- Lowered purchase power</td>
<td>- Conversation about the high geopolitical risk of the Russian markets.</td>
</tr>
<tr>
<td>- Limited access to higher quality products</td>
<td>- Major organizational adjustment</td>
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<td>- Protectionist interests</td>
<td>- Major losses in volume and revenues</td>
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<td>- Quick actions to overcome the situation</td>
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<td>- Responsibility towards owners</td>
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<td>- Recovery plan, survival of the brand</td>
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<td>- Visibility on Russian markets</td>
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<th>Russia</th>
<th>Post sanction period</th>
<th>EU and Valio</th>
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<td>- No significant development in domestic raw milk production, dairy problem still exists</td>
<td>- Years before program ends</td>
<td>- Increased milk production in EU</td>
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<td>- Increased geopolitical risk</td>
<td>- Increased geopolitical risk</td>
<td>- New substitute markets</td>
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<td>- Difficulties in lifting the sanctions with minimal damage to local entities</td>
<td>- Difficulties in lifting the sanctions with minimal damage to local entities</td>
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<td>- “European milk wave”</td>
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<td>- Possible investment disappointments for local and foreign companies.</td>
<td>- Possible investment disappointments for local and foreign companies.</td>
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<td>- Opening of the border in small sections</td>
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<td>- Need for high quality food exists</td>
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Figure 5. Effects of import sanctions during and after restrictions
5.2.3 Actions and countermeasures

According to all interviewees the sanctions came as quite a surprise for Valio (Hurme, Koskinen, Lönnström, 2015). There were speculations of the possible impacts of sanctions but mainly the attitude was that Valio would not be affected in anyway. When the sanction program was announced in August 2014 it came as a total surprise to Valio. The wideness of the crisis was immediately realized. The scale of the problem was enormous. In one night Valio lost over 15% of its total revenue and 90% of its volume in Russia. Prior to the embargo most of the products sold in Russia were imported from Finland and Estonia. When Valio grasped the situation the only way to remain a profitable company was to set up a major organizational adjustment.

![Weekly sales in 2014](image)

Figure 6. Weekly sales in 2014 (Valio material 2)

In the Russian organization only, over 200 hundred people were laid off. During the sanctions program it has been a huge benefit for Valio to have at least some local production in Russia says Lönnström (2015). This has enabled to keep the products visible in the shops and even to launch new products to the consumers. From the very beginning of the crisis OOO Valio Russia started negotiations with
its partner Galactika and later on with Ehrmann about the local production of Valio products. Contract production now was a natural decision for Valio (Lönnström, 2015.)

Besides making a recovery plan for restructuring production and operations, Valio had to decide how to communicate with media. From the very beginning Valio decided to start open messaging to the owners and to the consumers to avoid any risk of asymmetric information (and spreading of rumours). Decisions and actions had to be taken and it was extremely important to maintain visibility on the Russian market. (Koskinen, 2015)

According to Hurme and Koskinen (2015) - considering Valios responsibility towards its owners in Finland - it was imperative to change the flow of raw milk to suitable factories i.e. to produce industry products like butter and milk powder while searching for new markets. It was clear that all the collected milk had to be processed and sold. From the very start Valio estimated that these sanctions might last for a long period of time. OOO Valio Russia luckily had a large supply of products left for their regular customers, sufficing until the end of 2014. Assuming that no changes had been done, by January 2015, the only products left to sell from Finland would be water, jam and berry soups (Hurme, Koskinen 2015.)

Previous investments into brand building has kept Valio alive during the crisis, even though new competitors have started to gain shelf space from Valio. In the early 2000 Valio’s Viola was more famous as brand in Russia than Nokia says Lönnström (2015). As the market position has decreased with smaller production capacity it has been important to analyze which brands should be produced in the first place. The survival of the brand is one of the most important tasks during the crisis.

“In consumer tests competitors must always be won. If consumers are disappointed with the quality, the activities of OOO Valio Russia will start to collapse” Koskinen (2015)
When sanctions will be lifted it will be much harder to return to the market if the consumers do not remember the brands of Valio anymore. Valio’s high brand status has been proven as local competitors have started to imitate Valios packages and using of appearance “Finnish” origin as a part of their marketing strategy (Koskinen, Lönnström, 2015.)

5.2.4 Post crisis assumptions of OOO Valio Russia

Interviewees believe that the sanctions may last for a long time. (Hurme & all. 2015). Lönnström (2015) assumes that it will take years until the pre-crisis level of operations is reached. The longer the sanctions program will last, the harder it will be to return to the market. It will require a great deal of effort in various sectors to retrieve the former market positions. Even though Valio has an excellent reputation at Russian market, the competition is tough. Low purchasing power of the average consumer does not support Valio’s situation as market leader of higher quality products (Lönnström 2015).

Even though Russia is occasionally an unstable market, Koskinen (2015) still sees great opportunities there. By stable and reasonable growth of the local production combined with balanced exports there are great possibilities to compete with large international competitors such as Pepsi and Danone. He also emphasizes the importance of the learning process which this crisis has offered. Valio as a company has been forced to undergo a large change. Large reforms do not necessarily happen on well performing markets (Koskinen 2015.)

Hurme stresses the fact about the future that most likely there will be a need of high quality food rather than overproduction. She also assumes that Valio’s strong brand and innovativeness will help Valio when the Eastern border opens. This will ensure large possibilities in Russia in the future (Hurme 2015)
5.3 DISCUSSION

In conclusion: as a company Valio has survived extremely successfully in the challenge caused by the sanctions to the global dairy industry. Not only was it able to process all the milk it was obligated to take in from the producers in Finland, but also OOO Valio Russia managed to stay in the Russian markets. Valio was also able to evolve its business through the local production capacity, which was quite limited before the sanctions program.

In order to reach same high quality dairy products as Valio’s brand requires, an enormous amount of work will still be needed and investments in reaching these long term quality goals. When the border opens, for sure there will be aggressive competition for market shares. Valio’s brand and quality standards might give them a head start when the borders are opened again.

Like already mentioned this crisis was also huge possibility for Valio and OOO Valio Russia to evolve as an organization. After two years of sanctions Valio has launched 60 new products and it has invested over 64 million euros to the factory near Moscow. In the long run there might be undiscovered possibilities for Valio.

It is a fact that geopolitical crises will make producers aware of the risks when investing and maintaining operations in Russia. Obviously the crisis has led to increase of the local production like Russia’s President Vladimir Putin has stated as a reason for sanctions. Still, as discussed in the previous chapters, sanctions cause various impacts and crisis for many interest groups. Not only do they cause damage to the nations but also for the companies and whole business sectors. Issues will not end when sanctions are lifted and Russia and it’s dairy sector will face various risks when the current sanction program ends.
6 CONCLUSION AND SUMMARY

This chapter presents the essential findings of the study and the answers to the research questions. Limitations are also examined and how this study can be used in future research.

6.1 Theoretical conclusions and research question answers

This study was about different tools of sanctions and what kind of side effects they might cause, if used. The topic was analysed by looking at the methods without context and also through examples from history. Answers were looked at with following research questions:

What kind of different tools can sanctions programs utilize?

What side effects might sanctions programs cause?

How have sanctions affected Valio and dairy sector in the EU and Russia and have the different parties reached their sanction policy goals?

There are multiple different ways to coerce target objects into wanted actions and many of these includes the interference of target’s assets. Different methods and side effects are listed in figure 1 on page 17. Sanctions programs are often divided into comprehensive and targeted sanctions which are used on different occasions. These findings came from certain academic studies and current literal world events.

Sanctions do have many unwanted side effects. They have halted countries economical growth and created stagnated countries with many diverse issues without any true accomplishments of the set goals. As studies have concluded the goals and outcomes of sanction programs are quite elusive and success is hard to measure. Quite often the original goal is not even near as the expectations might be too high and unreachable.
As found in Case Valio Russia, sanctions have huge impacts on whole business sectors and individual companies. In 2014 Russia’s goal was to proliferate domestic milk production and dairy business by blocking dairy imports. According to Valio the quality of the local dairy products have not increased. Because of the sanction program Valio and also other dairy companies have lost huge revenues, gained new competitors and the Finnish brand has been exploited which will make the comeback harder during post sanctions period. Valio’s efforts to develop the organization structure, brand and maintaining high quality will most likely assist their recovery process after the lifting of the sanctions.

EU started their sanction program after Russia’s increased military actions near Ukraine and occupation of Crimea. After two years there is still conflicts in Eastern Ukraine and Crimea still belongs to Russia. Overall military activities and tensions seem to be increasing in Eastern Europe. Also European companies have suffered a lot as they have not been able to trade with Russia. Individual companies and whole business sectors were forced to adapt to the situation caused by sanctions.

When the time comes and sanctions are lifted new challenges will arise. Companies have to adapt again during post sanction period and governments need to find ways to get rid of sanctions with minimal damage to domestic interest groups. In the end it is hard to measure what was gained with the sanctions and what the final outcome is.

6.2 Limitations

This research does not include deeper analysis of the events included in the study. Also inner analysis of the latest events which has led to Russian sanctions is excluded.
Macroeconomic phenomena of Russia are not explained nor the geopolitical risk factors which might affect the tolerance of risk taking in different locations or events.

### 6.3 Future research possibilities

This topic is important as the usage of sanctions is increasing globally as a tool of coercion. Future research about long term effects of sanctions is an interesting topic. The case study also gives great possibility for future research about the outcomes of Russian sanctions program, its overall success and how the dairy markets have evolved during different time periods. It would also be interesting to study in what way Russian opens the border and if there will be wave of cheap milk from the EU and how that affects the Russian dairy market.

It would also be interesting to analyze the behaviour of Western companies and their enthusiasm of future Russian market expansions. How the hard sanctions program influences the willingness of taking risks at Russian markets in general.
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Materials and interviews provided by Valio
APPENDIX

Interview structure

Interviewee perspective: Tasks before and during the crisis and brief work experience at Valio.

- Situation: Russia ordered sanctions for food supply exports 2014
  - How Valio defined the situation according to your position - own view- Do you remember the day?
  - How broad effects the sanctions were assumed to have?
  - What was the position of OOO Valio Russia and export during that moment?
  - How sanctions influenced the subsidiary in the beginning?
  - How local production risks are being measured?
  - What immediate actions were performed on local level?
  - For what assumptions the decision were based on?
  - What kind of information you would have needed in the very beginning to make better decisions?
  - What kind of indicators you could name about the deepening of the crisis?
  - What kind of impacts there has been on Valios market position?
  - What other phenomena you have noticed on the markets?
  - Can you estimate qualitative or monetary losses?

- Operations after the stabilization of the markets
  - Have you seen signs of stabilization of markets? - How possible you think that sanctions will be lifted in XX months?
  - How markets / operations has stabilized after XX months of sanctions?
  - What would you have done otherwise when you have seen the outcomes of Valios actions?
○ How Valios market position have changed?
○ Have the crisis impacted Valios brand in Russian markets?
○ What possibilities do you see in developing local operations after crisis?
○ What goes well, what should be improved?
○ How the plans and decisions worked during crisis?
○ Can Russia reach its political goals effectively by using sanctions?

● Future expectations
○ How Valio Russia’s operations could look like in five years?
○ What the situation of Russia has taught or affected to thinking of international business?