

## Strategická volba v České republice: Jsou manažeři poboček chytřejší?

### A Strategic Choice in the Czech Republic: Fiendishly Clever Subsidiaries?

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#### Abstract:

**Purpose of the article:** This contribution focuses on the parent-subsidiary relationship from the perspective of centralisation in the strategy-making process.

**Methodology/methods:** First, the development and contemporary state of theory relating to parent-subsidiary relationship are analyzed and research questions are formulated. Second, the empirical data from 155 MNE subsidiaries are used to reveal which strategies are pursued by these subsidiaries, taking into consideration the level of centralisation of the strategy-making process. Finally, the performance implications of strategies deployed by the companies are examined.

**Scientific aim:** The role of the MNE subsidiary may vary between creation of the strategy and adoption of a strategy created by the parent company. The main objective of this study is to reveal differences among strategies chosen by subsidiaries with different levels of centralisation of the strategy-making process, and to evaluate performance implications.

**Findings:** Findings show that subsidiaries that are allowed to determine their strategy choose innovative and prospective strategies. Such strategies proved to be related to higher subsidiary performance, followed by the defender strategy.

**Conclusions:** The results imply that the MNE subsidiary could be more efficient than headquarters in adjusting to the local environment and might benefit from familiarity with the local environment. Therefore, this study confirms that a subsidiary can be a powerful determinant in the strategy-making process. This study has important implications for managers at MNC headquarters and at their subsidiaries. Since the emerging market of the Czech Republic is considered attractive for foreign direct investment, the findings of this study may have implications for executives already active in this market, but they are primarily for those intending to enter this market.

**Keywords:** MNE, strategy, centralisation, Miles and Snow, performance

**JEL Classification:** M160

## Introduction

Coordination of the activities of a complex network of subsidiaries operating in diverse environments to create competitive advantage is a challenge for the contemporary MNC (Andersson *et al.*, 2007). Although the benefits of interaction between subsidiaries and their particular local environments in creating knowledge and initiatives for dissemination across the MNC are increasingly recognised (Almeida and Phene, 2004; Birkinshaw *et al.*, 1998; Hansen and Lovas, 2004; Gnyawali *et al.*, 2009), the potential for a subsidiary to exploit its local environment through developing downstream entrepreneurship and strategy has been underexplored (Young and Tavares, 2004).

The ability of subsidiaries to access knowledge and opportunities within their specific environments (Andersson *et al.*, 2002) has led to an ever-increasing acknowledgement of their role (Mudambi and Navarra, 2004; Mudambi, 2008). In response, a considerable body of literature (for example Andersson *et al.*, 2007) has examined the role of subsidiary context in terms of its ability to generate initiatives (Scott, Gibbons, Coughlan, 2010).

This study contributes to the process by revealing the extent to which centralisation/ decentralisation of the strategy-making process affects subsidiary strategic choice and, eventually, performance. The survey is conducted in the Czech Republic, so it adds to a few existing empirical findings focused on the MNCs subsidiaries in one of the countries of Central and Eastern Europe (e.g. Klupalová, A., Králová, M., Blažek, L. a Pirožek, P., 2012). The author investigates the relationship between the strategy chosen by the subsidiary and the power of the subsidiary to create a strategy. After this, the performance of the subsidiaries pursuing particular strategies is evaluated. Hence the study contributes to existing knowledge of how a parent-subsidiary relationship helps subsidiaries to implement effective strategies that might strengthen performance.

## 1. Theoretical Background

Business strategy defines the manner in which companies compete in a specific industry or market (Walker, Ruekert, 1987). The strategy of an organisation is an outline of the way it intends to pursue its goals given the threats and opportunities in the environment and its resources and capabilities (Rue, Holland, 1989). A strategy is considered effective if it leads to sustainable competitive advantage for

an organisation, resulting in superior performance (Oosthuizen, 1997). However this can be achieved only if the strategy matches properly with the organisation's external environment and internal conditions (Thompson, Strickland, 1996).

Organisations face important constraints and contingencies arising out of their external environments and their competitiveness depends on the ability to monitor the environment and adapt strategies to environmental trends (Boyd, Fulk, 1996). Carpano, Chrisman and Roth (1994) have shown the linkage between the strategic profile of a company and its external context, and this linkage has important implications for performance. The adjustment of an organisation's strategic orientation to its environment is crucial to business success (Morrison, Roth, 1992).

In an environment moving constantly towards increasing complexity, the importance of the strategy-environment fit becomes even more pronounced. The question arises as to whether the headquarters of the MNC or the subsidiary is better able to assess the environment properly and therefore choose the right strategy.

The concept of a subsidiary strategy as such emerged through global strategy literature (Bartlett, Ghoshal, 1987) that focused on the demands for global integration and local responsiveness (Birkinshaw, Morrison, 1995). Subsidiary strategy is defined in relation to the environment, specifically to the nature of the threats and opportunities within (Birkinshaw, Morrison, 1995). Although subsidiaries might have resource-based power, they usually lack authority-based power in terms of key strategic decisions (Yamin, Sinkovics, 2010).

Earlier literature uses the terms "subsidiary strategy" and "subsidiary role" interchangeably (Birkinshaw, Morrison, 1995). However, "role" might largely suggest a deterministic process, while on the other hand "subsidiary strategy" indicates a higher degree of freedom for subsidiary managers in their strategy formulation process (Prahalad, Doz, 1981). Both subsidiary strategy and role are of relevance to the centrepiece of this study, primarily role/strategy-environment configuration.

In the literature on MNCs, increasing prominence has been given to the roles and contributions of their subsidiary units (Scott, Gibbons, Coughlan, 2010). The increasing number of MNC subsidiaries was initially considered an agency dilemma, with the focus on how corporation headquarters could minimise opportunistic behaviour in their subsidiaries (Watson O'Donnell, 2000). Later studies have shown the potential of subsidiary units to contribute

to the MNC by generating initiatives or expanding their activities (Holm and Sharma, 2006; Kotabe and Mudambi, 2004). Subsidiaries are now recognised as sources of knowledge that can be utilised throughout the MNC network (Mudambi, 2008). According to Birkinshaw, Hood, Jonsson (1998) three contrasting perspectives emerged from the MNC subsidiary literature with regard to the factors associated with differences in subsidiary roles. The first perspective, of environmental determinism, emphasizes the role of each subsidiary as a function of its local environment; the second, of head office assignment, works on the basis that headquarter management is responsible for defining the strategic imperatives of the subsidiary. The third perspective is of subsidiary choice, which suggests that the role of a subsidiary can be to a large extent defined by the subsidiary's management.

The actual role of a given subsidiary may be an important factor influencing subsidiary strategy. The MNC subsidiary role is initially defined by corporate headquarters. However, over time the subsidiary itself may evolve initiatives (Birkinshaw J., 1996). In this process, the local host environment shapes the activities of the subsidiary. Recent authors addressing subsidiary role typologies and subsidiary initiatives emphasize the importance of local market responsiveness in shaping developments of subsidiary role (Yamin, Sinkovics, 2010). Therefore the question arises as to whether the centralisation of the strategy development process results in different strategies being selected in comparison with those chosen by subsidiaries which can make more individual decisions. Previous studies have been inconclusive about the nature of the impact of centralisation on the choice of business-level strategy and hence there is a gap in the literature. I formulated research question 1 in order to clarify this relationship.

**Research Question 1: Are there differences between the strategic choices among subsidiaries with different levels of centralisation of the strategy-making process?**

Finally, the strategy should be viewed in relation to organisational output performance. A substantial number of empirical studies have examined the relationship between business-level strategy and performance. However, studies focusing on the strategy-performance relationship through the lens of centralisation of the strategy-making process are rare. I formulated research question 2 to clarify this issue.

**Research Question 2: Which strategy is related to higher performance of the subsidiary?**

## 2. Methodology

The focus of the study is on foreign subsidiaries in the Czech Republic, which are legal entities registered in the Czech Republic, have 50 or more employees, and belong to the "Industry C" – manufacturing industry as defined by CZ-NACE classification – and their owner is a foreign legal entity. The entire population of over 700 MNC subsidiaries located in the Czech Republic was targeted for this study.

### 2.1 Data Collection and Instrument

Primary data were collected through an electronic questionnaire, through the Research Centre for the Competitiveness of the Czech Economy, as part of research on multinational companies (Blažek *et al.*, 2011). Following on from previous research (Desarbo, Benedetto, Song, Sinha, 2005; Hambrick, 1983; Nandakumar, Ghobadian, O'Regan, 2010; Snow, Hrebiniak, 1980), questionnaires were directed at the CEO level of MNEs, or a competent member of management. CEOs are considered to have the best overview of a given company's strategy (Pertusa-Ortega, José F., Claver-Cortés, 2008); Zajac, Shortell, 1989).

Secondary data were collected from annual company reports, available via web pages, the commercial register or the Credit Info database. The draft questionnaire was pre-tested by a mix of experienced commercial managers and academics. Respondents were kept unaware of the relationships under investigation to avoid over-justification issues.

During the period of data collection, CEOs were telephoned randomly to assure that they were the real respondents to the survey. Personally administered questionnaires were also used to gather further pertinent information.

The response rate reached 21%, which compares favourably with the average top management survey response rate (Hult and Ketchen, 2001). This response reduces the probability of non-response bias (Weiss and Heide, 1993), while standard tests confirmed an absence of significant differences between early and late respondents on a range of characteristics.

### 2.2 Measures

#### 2.2.1 Centralisation of strategy-making process measure

Respondents were asked how the strategy of the company is determined in order to assess the level of centralisation of the strategy-making process. The questionnaire provided five options: (a) The subsidiary determines its own strategy and does not re-

quire further approval. (b) The company determines its own strategy, and this is subject to the approval of the directly superior management headquarters. (c) The company determines its own strategy, and this must be approved by group headquarters. (d) The company strategy is determined by the directly superior management headquarters. (e) The company strategy is determined by the group headquarters.

### 2.2.2. Strategy measures

For the purposes of this study, the Miles and Snow typology (Miles, Snow, 2003 orig. 1978) was chosen as a business framework to explore the environment-strategy configuration of MNCs. Various typologies have been proposed in the strategic management literature, *e.g.* (Miller D., 1990; Treacy, Wiersema, 1997). However, the Miles, Snow typology is unique because “it views the organisation as a complete and integrated system and presents a particularly useful theoretical framework for analysing the ways in which organisations dynamically interact with their environments” (McDaniel, Kolar, 1987). The Miles and Snow typology has consequently generated a large amount of interest, investigation, controversy and support (Conant, Mokwa, Varadarajan, 1990). It has been widely acknowledged to be the most influential of its kind for the past quarter of a century (Desarbo, Benedetto, Song, Sinha, 2005) and its staying power has been ascribed to its independence of industry and correspondence to situations in the real world (Hambrick, 2003).

Strategic choices were assessed via a self-typing paragraph and therefore binomial variables for each strategy type were used. There is a wide range of ways in which a company’s strategy may be viewed, from prescribed description or self-description of the strategy, through personal interviews, to the employment of objective indicators (Conant, Mokwa, Varadarajan, 1990). There is much to be said both for and against these approaches. For this study, strategy selection on the basis of a description has been chosen, since this method of self-typing of strategic orientations on the part of CEOs has received considerable empirical support for its validity (Conant, Mokwa, Varadarajan, 1990; James, Hatten, 1995; Shortell, Zajac, 1990). This is a relatively low-cost method compared to personal, in-company interviews but still allows all of the strategies noted to be explored. A further advantage lies in the facility with which the data obtained may be processed and interpreted (Conant, Mokwa, Varadarajan, 1990). This method is recommended for larger samples and it appears in many similar studies, *e.g.* (Jennings, Lumpkin, 1992).

### 2.2.3 Performance measures

As in a number of previous studies, ROA has been chosen as the objective measure for this study (Banalieva, Santoro, 2009; Wu, Pangarkar, 2006). Although studies in international business have sometimes used other measures, such as return on sales, in order to maintain maximum consistency with prior studies, ROA turned out to be a more appropriate measure for the purposes of this study as it is the most widely-used measure of a firm’s financial performance (Banalieva, Santoro, 2009). As an indicator, it facilitates clear, rapid comparisons among firms of various sizes and business areas. Moreover, it is highly correlated with ROS (54%) (Banalieva, Santoro, 2009). Although there exist fundamentally more complex, sophisticated models to evaluate economic success, all the models share an identical basis. Contemporary researchers also incline to simpler methods for determining company success. ROA was computed by means of operating profit.

The draft questionnaire was pre-tested by a mix of seven experienced commercial managers and eight academics. Respondents were kept unaware of the relationships under investigation to avoid over-justification issues.

### 2.3 Control variables

Size and legal form were used as control variables. Size was based on the number of employees in the subsidiary in three categories, reflecting small (<50), medium (<250) and large (>250) organisations. Legal form was either joint/stock company or limited company.

### 2.4 Analysis

Results show that in general, in most of the subsidiaries, the strategy is either approved by the headquarters/immediately superior management headquarters or directly set by those headquarters. However, there is a significant difference between the strategy choice of subsidiaries that choose their own strategies and with those that have to involve superior management/headquarters in the strategy-making process. The most important differences are illustrated below in Figures 1, 2 and 3.

Focusing on the first research question, in the subsidiaries that determine their own strategies without the approval of MNC headquarters, more than half of companies choose a prospector strategy. Thus, a clear tendency towards innovative and proactive strategies in these subsidiaries is disclosed.

In contrast, in subsidiaries where strategy is either determined by the subsidiary and has to be approved by superior management/headquarters (Figure 2

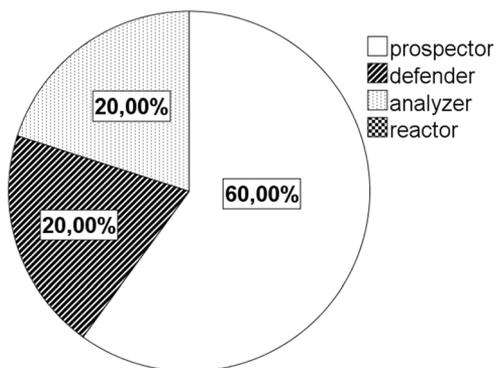


Figure 1 Distribution of strategies in subsidiaries that determine their own strategies and do not require further approval. Source: Author on the basis of research data (Blažek et al., 2011).

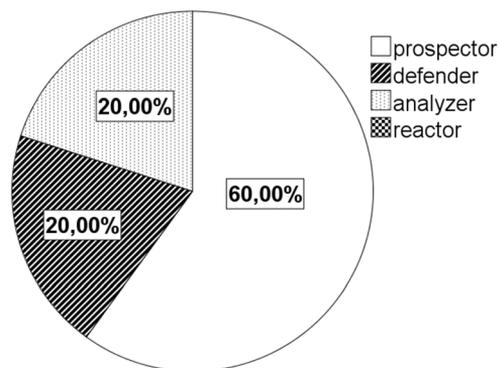


Figure 2 Distribution of strategies in subsidiaries that determine their own strategies but these must be approved by directly superior management headquarters. Source: Author on the basis of research data (Blažek et al., 2011).

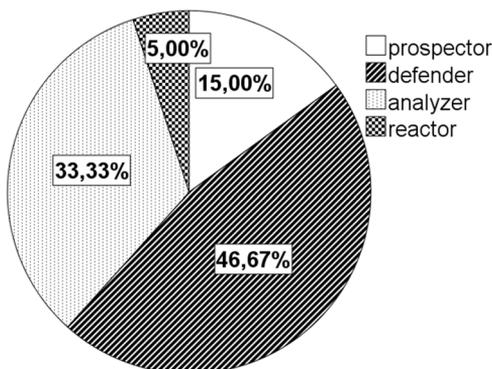


Figure 3 Distribution of strategies in subsidiaries that determine their own strategies but these must be approved by group headquarters. Source: Author on the basis of research data (Blažek et al., 2011).

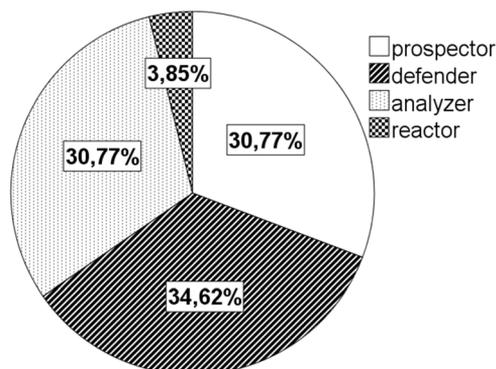


Figure 4 Distribution of strategies in subsidiaries where strategy is determined by directly superior management headquarters. Source: Author on the basis of research data (Blažek et al., 2011).

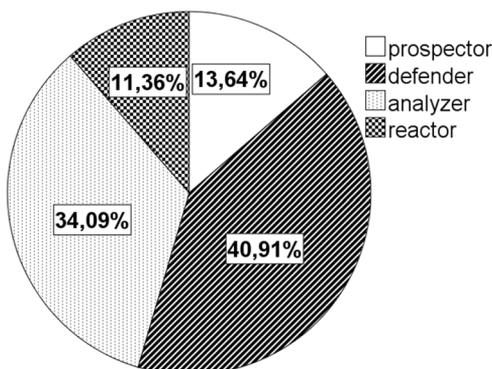


Figure 5 Distribution of strategies in subsidiaries where strategy is determined by group headquarters. Source: Author on the basis of research data (Blažek et al., 2011).

and 3), or strategy is directly determined by superior management/headquarters (Figure 4 and 5), there is an important shift to defender strategy. The share of analyzer strategy increases slightly, but the employment of prospector strategy decreased significantly in comparison to subsidiaries that determine their own strategies and do not require further approval.

Also, in the subsidiaries that determine their own strategies without the approval of MNC headquarters, reactor strategy is not used at all. Reactor strategy is not considered viable, which points out to a very interesting fact. Subsidiaries that are enabled to decide about their strategies avoid situations when there is no strategy at all.

The results show that in subsidiaries where strategy is approved by superior management

headquarters the share of prospector strategy is higher (25%) in comparison to those subsidiaries where approval by group headquarters is needed (15%). This might be caused by the larger distance from subsidiary to group headquarters. Between a particular subsidiary and group headquarters, there are often even more management levels than one, and headquarters therefore have to overcome a larger distance to get information about the subsidiary.

Again, it is proved that in those subsidiaries where the strategy is determined by directly superior management, the share of prospector strategy is twice as large as in subsidiaries where strategy is determined by group headquarters. This might again point out to a larger distance and more obstacles between the headquarters and subsidiary.

Next, performance related to usage of a particular strategy was examined for answers to the second research question. Linear regression was applied to this relationship. The results appear in Table 1.

Table 1 Relationship between strategy and performance:  
Dependent Variable: performance.

Dependent variable	ROA	ROA
<i>Control variables</i>		
Firm size	0.098	0.074
Legal form	-0.013	0.012
<i>Strategy variables</i>		
Prospector		0.162*
Analyzer		-0.097

\* $p < 0.1$ ; \* $p < 0.05$ ; \*\* $p < 0.01$ ; \*\*\* $p < 0.001$

Source: Author on the basis of research data  
(Blažek et al., 2011).

Regression analysis showed that the coefficient of the prospector strategy was positive and significant for performance variable. The assumptions of linear regression were tested properly. Throughout the analysis, the variance inflation factor (VIF) indicated a multicollinearity when all three strategies were included, which is understandable because the choice of one strategy means not choosing the others, and since strategy variables are dichotomous variables, the collinearity could be the issue. Therefore the variable defender was omitted, which had the highest VIF and was not significant. In new models, the collinearity was not indicated and none of the VIF for the model was greater than 1.3, which is generally considered not to be a cause for concern (Field, 2005).

The control variables were entered first, followed by the strategy variables in the second step. The results of the full model will be discussed. Based

on the significance of F value ( $+p < 0.1$ ), it can be concluded that the model results in significantly good degree of the outcome variable.

The results imply that in emerging economy of the Czech Republic, a prospector strategy for MNEs fits with the dynamic environment, when the aim of the company is higher performance. With respect to the results of the previous research question, those subsidiaries that can determine their own strategies pursue that which has a positive impact on performance.

### 3. Discussion, limitations

Studies to date have focused on the direct influence of contextual elements on subsidiary contribution (Rugman and Verbeke, 2003) and have failed to provide empirical evidence of the effects of centralisation and its relation to the strategy-making process.

This study adopts a different approach, suggesting that subsidiary strategy and subsequently performance are to some extent dependant on the centralisation of the strategy-making process.

This implies that, while headquarters may set the strategy for the subsidiary, the subsidiary itself could be more efficient in adjusting to the local environment and might benefit from familiarity with the local environment.

The results may indicate that subsidiaries that can determine their own strategies differ in their strategic choice from those where superior management headquarters/group headquarters is in charge of determining or approving strategy. Subsidiaries might be more familiar with the environment, the local market conditions and market possibilities and can therefore suggest more innovative, proactive strategies. They try to react quickly to signals indicating new opportunities on the market and they are often the initiators of change on the market, or they try to force the competition to react. However, they may not happen to achieve a strong position on every market they enter.

On the other hand, superior management headquarters/group headquarters appear to tend towards making more defensive strategic choices, less risky, more focused on efficiency of processes, through choosing a defender or an analyzer strategy.

Subsidiaries adopting defender strategies try to maintain a stable position on the market, perhaps with high-quality products, low prices or above-standard services. They offer a stable, relatively narrow portfolio of products. Such subsidiaries are not initiators of change in their field. They do not

follow current developments in the areas that do not directly concern their products. Instead they try to concentrate as much as possible on their products within the framework of the existing portfolio, for example by raising productivity, effectiveness, use of capacity, economies of scale, and so on. Subsidiaries adopting analyzer strategy try to maintain a relatively stable product portfolio, but in selected areas where they follow developments they are able to react quickly to change on the market and take advantage of promising opportunities. They are not usually the first on the market with a new product, but thanks to thorough tracking of the market they may be the second or third.

The findings also demonstrate that a prospector strategy is related to higher performance. Therefore, subsidiaries with a lesser extent of centralisation in the strategy-making process choose more proactive strategies, leading to higher performance. Of course, there are various factors influencing the strategic choice of MNC subsidiaries and performance on a particular local market does not have to be the priority. Still, this research has contributed to the issue of (de)centralisation of the strategy-making process and this should be explored in more detail.

This work has several limitations that may be addressed by further studies. These include the effect of specific host-country characteristics, perhaps true of the Czech Republic. As a research instrument, a questionnaire also falls short of a sophisticated temporal study. The use of existing measures for strategies has advantages in terms of validity, but does not necessarily reflect the real strategy of the subsidiary in precise fashion. There may also be other factors not captured by the study that influence the relationships under examination, e.g. MNC country of origin and subsidiary general manager nationality.

Despite these limitations, this study has important implications for managers at MNC headquarters and

at their subsidiaries. This study confirms that a subsidiary can be a powerful determinant in the strategy-making process. Subsidiaries that determine their strategies choose innovative and prospective strategies. Such strategies proved to be related to higher performance of subsidiaries, followed by the defender strategy.

Since the emerging market of the Czech Republic is considered attractive for foreign direct investment, the findings of this study may have implications for executives already active in this market, but primarily for those intending to enter this market. This study suggests that management of MNC headquarters should consider involvement of subsidiary management in the strategy-making process, because subsidiary management can more properly assess the local environment.

## Conclusion

In conclusion, it is disclosed that a prospector strategy is related to higher performance for subsidiaries in the Czech Republic, and this strategy is preferred by those subsidiaries in which the strategy-making process is decentralized. This might imply that the MNE subsidiary can be more efficient than headquarters in adjusting to the local environment and might benefit from familiarity with the local environment. Therefore, this study confirms that a subsidiary can be a powerful determinant in the strategy-making process.

Future studies in this area may wish empirically to investigate the strategy-making process in the MNC and the extent to which parent-subsidiary relationships help MNEs to formulate and implement effective strategies that would strengthen their performance.

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