



Does country context distance determine subsidiary decision-making autonomy? Theory and evidence from European transition economies

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ABSTRACT

We studied an underrepresented area in the international business (IB) literature: the effect of country context distance on the distribution of decision-making autonomy across headquarters and foreign affiliates. Foreign affiliates directly contribute to the competitive advantages of multinational enterprises, highlighting the importance of such intra-firm collaboration. The division of decision-making autonomy is a core issue in the management of headquarters–subsidiary relationships. The main contribution of our paper is that we confront two valid theoretical frameworks – business network theory and agency theory – that offer contradictory hypotheses with respect to the division of decision-making autonomy. Our study is among the first to examine this dilemma with a unique dataset from five Central and Eastern European transition countries. The empirical results provide convincing support for our approach to the study of subsidiary decision-making autonomy.

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1. Introduction

Multinational¹ enterprises (MNEs) typically operate subsidiaries in different geographical locations to exploit location-specific advantages abroad. Today, it is acknowledged that foreign subsidiaries contribute to the competitive advantages of multinational enterprises (Andersson, Björkman, & Forsgren, 2005; Birkinshaw, Hood, & Jonsson, 1998; Cantwell & Mudambi, 2005), highlighting the importance of intra-firm collaboration. Operating in different geographical locations implies that MNEs face contextual differences between the home country in which the headquarters is located and the host country in which the foreign affiliate is located. These contextual differences between country contexts are associated with the liability of foreignness (Hymer, 1976; Zaheer, 1995), which suggests that MNEs face organizational challenges that domestic firms do not. Recent studies report great differences in the

geographical portfolios of MNEs (De Jong, Phan, & van Ees, 2011; Rugman & Oh, 2010). Consequently, IB scholars have addressed the impact of distance in country contexts on MNE strategy and performance (Dikova, 2009; O'Grady & Lane, 1996; Shenkar, 2001, 2012a, 2012b; Tung & Verbeke, 2010).

With few exceptions, however, the authors of most prior studies ignore the role of country context distance in the distribution of decision-making autonomy between headquarters and foreign subsidiaries. The division of decision-making autonomy is a core issue in the management of headquarters–foreign affiliate relationships (Paterson & Brock, 2002; Verbeke, Chrisman, & Yuan, 2007). We argue that the division of decision-making autonomy is complicated by the distance in country contexts of headquarters and subsidiaries that inherently characterizes the MNE's organization. The main contribution of our paper is that we confront two valid theoretical frameworks – business network theory and agency theory – that offer contradictory hypotheses with respect to the division of decision-making autonomy. On the one hand, for example, business network theory argues that headquarters may need to grant decision-making autonomy to subsidiaries in order to enable local managers to respond to changes in local circumstances. On the other hand, agency theory suggests that MNEs might seek to control subsidiaries in unknown

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contexts to reduce the risks of opportunism and uncertainty. However, the question of whether the division of decision-making authority responds to the distance between the home and the host country contexts remains unexplored to date. The study of country context distance in relation to subsidiary decision-making autonomy is our first contribution to recent contextual IB research. Through this contribution, we are responding to the calls for more interdisciplinary research to better account for the multifaceted nature of home–host country context distances and variations in subsidiary decision-making autonomy (Dörrenbacher & Geppert, 2006; Geppert & Williams, 2006; Verbeke et al., 2007).

This paper's second contribution is that it provides a stepping-stone towards investigating in detail core aspects of country context differences for decision-making autonomy in general, as well as for decision-making autonomy for certain business functions in particular, such as strategic management and marketing. In our particular research setting of Central and Eastern European countries, the empirical results help solving the dilemma between the opposite theoretical hypotheses concerning country context distance and the division of decision-making autonomy. We follow recent IB research that has advocated the use of a multidimensional perspective for country context distance in studies of MNE operations, building upon growing concerns of unidimensional approaches such as Hofstede's cultural distance measures or variations thereof (Kirkman, Lowe, & Gibson, 2006; Shenkar, 2012a, 2012b; Tung & Verbeke, 2010). We therefore test our research hypotheses in this study by regressing various country context distance dimensions – in terms of economic, religious, language, cultural, and geographic differences – on survey-based indicators of subsidiary decision-making autonomy from a sample of foreign affiliates based in five Central and Eastern European (CEE) transition countries: the Czech Republic, Hungary, Poland, Romania and the Slovak Republic. CEE countries offer a relevant research context for our study because they have experienced a strong inflow of foreign direct investment due to the liberalization of trade policies, the mass privatization of state-owned companies and the increasing opening up of markets resulting from EU integration (Jindra, Giroud, & Scott-Kennel, 2009; Meyer & Peng, 2005). The majority of CEE countries achieved privatization through divestment of state assets to strategic investors, in which MNEs played an important role (Nakos & Brouthers, 2002) and which raise questions of country heterogeneity and MNE organization. Their communist heritage has had a substantial impact on the formal and informal institutions in these countries. This appears in distinct cultural traits such as a lack of initiative and risk aversion among CEE managers. Western companies investing in CEE countries need to deal with differences in language and social and cultural change processes, which carry with them differences in the 'liabilities of foreignness' and the solutions for handling them. Our unique multi-level database not only permits us to study to what extent the MNEs which have entered CEE markets used different patterns of ownership and control – reflected in differences in subsidiary mandates – but also whether, and if so, how, heterogeneity in country context distances plays a role in the stratification of decision-making autonomy across parents and foreign affiliates.

The outline of this paper is as follows. We begin by reviewing the subsidiary autonomy and the country context distance literature which serve as the foundation for our research. Next, building on this research background, we formulate our hypotheses about the effect of country context distance on subsidiary decision-making autonomy. That is, using business network theory and agency theory we develop new theory for decision-making autonomy. Then, we introduce this paper's research methodology, addressing issues related to the collection of our data and our measures of the variables. Following that, we present our empirical

evidence. Finally, we conclude with an appraisal, discussing the study limitations and offering reflections on opportunities for future research.

2. Theory and hypotheses

2.1. Subsidiary decision-making autonomy

There are various reasons why subsidiary decision-making autonomy matters and is worthy of further study (Gammelgaard, McDonald, Stephan, Tüselmann, & Dörrenbacher, 2012a, 2012b; Johnston & Menguc, 2007; O'Donnell, 2000; Rabbiosi, 2011). First of all, it is a key reflection of the overall organizational structure of subsidiaries and the current power-dependence structures between headquarters and subsidiaries as well as the intra-organizational management of an MNE network. Second, it is among the most important variables determining the behaviour, strategy and performance of subsidiaries and therefore also of the overall MNE organization, given that MNEs are networks of interrelated affiliates.

Any study of this phenomenon requires a precise definition. Decision-making autonomy has attracted the attention of scholars in various fields and is usually studied at either the individual or the firm level. Depending on the context, the term 'decision-making autonomy' can have different meanings. According to Brooke (1984:9) for example, decision-making autonomy refers to an organization 'in which units and subunits possess the ability to take decisions for themselves on issues which are reserved to a higher level in comparable organizations'. This is similar to Roth and Morrison (1992) who define decision-making autonomy as the extent to which the subsidiary managers are able to make decisions without headquarters' involvement. This definition aligns with other leading studies in the field, such as Young and Tavares (2004), who relate it to the constrained freedom or independence available to or acquired by a subsidiary, which enables it to take certain decisions on its own behalf. Accordingly, irrespective of the study foci, subsidiary decision-making autonomy generally refers to the degree to which an MNE subunit can make significant decisions.

A stream of relatively recent studies – following earlier work from the 1980s (Garnier, 1982; White & Pointer, 1984) and 1990s (Birkinshaw & Hood, 1998; Blaine, 1994; Taggart & Hood, 1999) – focus on an analysis of the role of the subsidiary to explain inter-organizational differences in MNE behaviour and performance (Birkinshaw et al., 1998; Paterson & Brock, 2002). Several studies have pointed out that some MNEs allow their subsidiaries a great deal of decision-making independence, while others assume tight control of their subsidiary activities (Ambos, Asakawa, & Ambos, 2011; O'Donnell, 2000). Furthermore, there is some evidence to suggest that this strategy can change over time (Dörrenbacher & Gammelgaard, 2006). This line of research argues that autonomy is a necessary (though not the only) requirement for the optimal performance of subsidiaries and their contribution to an MNE's value chain. Autonomy is a key motivator for subsidiary management: decision-making power enables network links, innovation and resource accumulation. Like other relational features of intra-firm alliances, autonomy creates autonomy and will foster performance through co-evolutionary processes.

Although the subsidiary literature offers a somewhat scattered picture of the subsidiary's decision-making position, we can classify autonomy antecedents into three clusters. A first set of antecedents accounts for the strategic role of the subsidiary. This is reflected in a subsidiary's level of integration within a MNE network, the subsidiary's knowledge competences, and its size and performance. It has been argued that some subsidiaries are more important to their headquarters and the overall subsidiary

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