

# MANAGERIAL SATISFACTION WITH SUBSIDIARY PERFORMANCE

## The Influence of the Parent MNE's Capabilities and the Subsidiary's Environment

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SOM theme G: Cross-contextual comparison of institutions and organizations

### Abstract

Multinational enterprise performance is one of the most researched topics in the strategic management literature over the last thirty years. Despite the proliferation of studies, the dispute over the relation between firms' international investment activities and corporate performance has not yet reached a consensus. This paper's contribution is threefold. First, we focus on entry by West European multinational enterprises into Central and East European countries. Second, we develop a multi-theory argument, combining insights from transaction cost, new institutional, behavioral, resource-based and international strategy theories. Third, we estimate the determinants of managerial satisfaction with subsidiary performance with questionnaire data for a sample of 198 subsidiaries.

## **INTRODUCTION**

Multinational enterprise (MNE) performance is one of the most researched topics in the strategic management literature over the last thirty years (Miller, 2004). The relation between multinationality and performance has not only “generated a flurry of empirical studies” (Kotabe et al., 2002), but has also produced inconsistent findings. Over thirty studies have tackled a range of linear (positive or negative), curvilinear U-shaped, inverted U-shaped and S-shaped relations between the degree of firms’ multinationality and their performance (recent examples are Kotabe et al. 2002; Goerzen and Beamish, 2003; Capar and Kotabe, 2003; Lu and Beamish, 2004). Despite the proliferation of studies, the dispute over the relation between firms’ international investment activities and corporate performance has not yet reached a consensus. It could be that other factors, in addition to firms’ degree of multinationality, dominantly influence firms’ performance. Following standard strategic management logic, there are two prominent groups of such factors that received some, albeit insufficient, attention in the past: firms’ environmental contingencies and their organizational capabilities.

Moreover, with a few exceptions, most studies on MNEs’ performance addressed the concept of geographic scope as a unidimensional construct, and did not account for host-countries’ environmental diversity (Goerzen and Beamish, 2003). We argue that because local environmental specificities are not similar, various geographic locations may have divergent effects on MNEs’ performance. Hence, the consideration of host-country characteristics is of critical importance in studies on foreign direct investment and MNEs’ performance. In addition, we believe that performance is largely conditional upon the firms’ competitive capabilities. Past studies on multinationality-performance relations have at best controlled for firm-specific variables (Kotabe et al., 2002), thus leaving the importance of firms’ assets and capabilities, required to effectively maximize the advantages of internationalization, largely under-researched. In conclusion, despite the fact that there has been an abundance of studies on MNEs’ performance, more research is necessary to illuminate the extent to which firms endowed with specific capabilities to establish subsidiaries in diverse environments benefit from their international activities (Wan and Hoskisson, 2003).

This study makes the following threefold contribution to the extant literature. First, unlike the majority of studies on MNEs' performance, which mostly examined either international expansion into developed countries or into a single emerging economy (particularly China), we investigate the level of satisfaction of West European business-unit managers with the performance of their subsidiaries in eight Central and East European (CEE) transition countries.<sup>1</sup> Second, in a review of strategy research on emerging economies, Wright et al. (2005) identify four conceptual perspectives – transaction cost theory, principal-agency theory, resource-based theory and new institutional theory. In a similar vein, we argue that a single-theory approach in studies on transition will limit our comprehension of the magnitude with which diverse endogenous and exogenous factors influence MNEs' performance. In this study, therefore, we combine elements of new institutional theory, transaction cost theory, behavioral theory of the firm, resource-based view and international management theory to analyze how a set of exogenous host-country characteristics – i.e., transition economies' institutional structure and national culture<sup>2</sup> – and a set of endogenous firm-level heterogeneities, namely MNEs' capabilities (intangible assets and strategies) and ownership stake, may influence managerial satisfaction with subsidiary performance.

Third, to determine drivers of MNEs' performance, earlier work has typically used information from corporate-level financial reports, such as annual return on sales and return on assets. In this study, we focus on a different level of analysis: we examine the performance of MNEs' subsidiaries, which represent business-unit international expansion activities. Furthermore, due to the inaptness of officially published corporate performance estimates, unavailable business-unit-level information or incomparable annual reports for all subsidiaries, we conducted an international survey to capture the managers' level of satisfaction with the performance of their subsidiaries. In fact, as far as subsidiaries' survival is concerned, we believe that headquarters' subjective evaluation of subsidiary performance is of critical importance: Geringer and Herbert (1991) report that in the case of international joint ventures particularly those perceived by the parents as successfully performing were more likely to remain in operation.

## **THEORY AND HYPOTHESES**

### ***A multi-theory approach***

Entries of MNEs from developed economies into emerging countries<sup>3</sup> have created an ever-rising “appetite for knowledge” about these markets (Meyer, 2004; Ramamurti, 2004). Transaction cost theory (TCT) and its offspring, internalization theory, are considered to be the dominant theoretical perspectives in foreign direct investment studies (Dunning, 1993). Although emerging economies provide “a new ground to test and refine TCT”, its popularity measured by the number of articles applying the theory is rather limited in comparison to other perspectives such as the resource-based view of the firm (Wright et al., 2005: 4). TCT’s key constructs such as transaction costs, opportunism and uncertainty are, beyond doubt, highly relevant in transition economies, though: the arguments presented by Hoskisson et al. (2000) that transaction costs are higher in emerging economies than in developed countries are difficult to dispute.

The reason for TCT’s unpopularity among transition economies researchers is perhaps the fact that, given the hundreds of TCT studies already published in the literature, it is difficult to make a “solid contribution” based on an exclusive TCT perspective (Wright et al., 2005: 4). In a strive for theoretical contribution, yet retaining the benefits of TCT’s robust analytical tools, some authors have extended the theory with insights from new institutionalism to better fit with the specificities of transition economies. On such premises, it is argued that institutional differences between developed and transition economies exacerbate transaction costs (Meyer, 2001). Yet, there are avenues for cross-bridging TCT or resource-based logic with other theoretical domains that remain largely unexplored. We argue that that the entry mode choice and performance are conditional upon a parent’s strategic posture thus the key role of MNEs’ intangible resources can be further emphasized with insights from international management’s theory of international strategy.

This type of argument suggests a multi-theory approach. We will explore such an eclectic perspective in this paper, too, focusing on a specific issue: the explanation of differences in the managerial satisfaction with subsidiary performance. If for managers from developed economies the process of establishing a successfully operating outlet in a transition economy narrows down to one leading challenge, namely “How to make

their strategy work” (Wright et al., 2005: 7), then investigating the level of satisfaction with subsidiaries’ performance will give a clear indication of their success or failure in the implementation of “western” strategies. In this line of argument, we further demonstrate how the differences between the context of business activity (CEE transition economies) and the setting of subsidiary evaluation (west European MNEs) shape perceptions of subsidiaries’ success or failure. Given our focus on managerial satisfaction, a natural candidate to add to the multi-theory approach is the behavioral theory of the firm (BTF). After all, BTF’s very core deals with how managerial satisfaction is linked to adaptation and learning (Greve, 2003). Below, we will introduce the pieces of our multi-theory puzzle step by step, suggesting one specific hypothesis for each of our five theoretical lenses. Figure 1 summarizes our logic, linking the five theories to five key variables and the associated hypotheses.

[INSERT FIGURE 1 ABOUT HERE]

So, this paper’s approach is eclectic. Although all five theories share similar assumptions (e.g., about bounded rationality and environmental contingencies), we will not really integrate them into an overall logic other than that they together suggest a set of variables that may well influence managerial satisfaction with subsidiary performance. In future work, we hope to contribute to the development of integration by focusing, for instance, on possible interaction effects. In the context of the current paper, though, our first step of testing a series of main effects simultaneously will suffice. After all, as far as we know, this study is the first one doing that as comprehensive as we propose here.

***Transaction Cost Theory: Ownership Stake***

The first line of argument is based upon straightforward transaction cost theory (TCT) logic. In transition economies, the effective transfer and implementation of non-capital resources, be they technical or organizational, often requires the involvement of the parents’ expatriates because of shortages of local labor with the expertise and experience for managing these processes (Child, 2002). In CEE acquisitions, for

example, MNEs either inherit “mediocre assets and managers who lack the skill, resources, and expertise to manage firms in competitive market environments” (Uhlenbruck et al., 2003: 258) or the magnitude of the required change exceeds many of local managers’ and employees’ cognitive abilities (Newman, 2000). Uhlenbruck and De Castro (2000) provide evidence that MNEs in CEE tend to improve efficiency and performance because of the capital, new technologies and management skills provided to their local subsidiaries.

Indeed, the transaction cost model of foreign direct investment stresses the importance of a firm’s intangible assets. Hennart (1991) notes that because the transfer of knowledge and other intangible-intensive resources comes with high market transaction costs, parent firms typically prefer equity transactions. The argument is that the parent that supplies the most critical resources and has the greater expertise should obtain the ownership arrangement that would provide optimal incentives to invest the necessary assets that will contribute to subsidiary performance (Mjoen and Tallman, 1997). Therefore, the more critical the strategic resources transferred abroad are, the more likely it is that the parent will desire whole ownership – or, if that is not possible, the highest possible level of ownership. As a mirror image, we have

*HYPOTHESIS 1 (ownership stake): A greater ownership stake is positively associated with managerial satisfaction with the subsidiary’s performance.*

### ***New Institutional Theory: Institutional Inefficiency***

The rise of new institutional theory (NIT) in social sciences dates back to the 1970s, but the ascendance of NIT as a leading perspective, is a more recent phenomenon (Wan and Hoskisson, 2003). According to Peng (2000), research on emerging economies has helped propel the NIT perspective to the front line of the strategy research agenda. Hoskisson et al. (2000) content that although NIT presents the most applicable paradigm for explaining firm behavior in emerging economies, the number of studies using an institutional perspective is rather limited. In the most recent review of NIT research, Wright et al. (2005: 6) conclude that the studies on firms from developed economies entering into emerging economies and analyzing the impact of institutions on foreign entrants’ strategies have “barely scratched the surface”. Moreover, regarding

extant research on MNEs' performance in European transition economies, to the best of our knowledge, only Uhlenbruck and DeCastro (2000) and Uhlenbruck (2004) took an institutional approach.<sup>4</sup> Clearly, the richness of the transition setting to test the applicability of western strategies provided by emerging economies is not yet fully exploited.

In comparison to the traditional transaction cost theory approach that focuses on "the technical environments of individual transactions" (Lu, 2002: 22), new institutional theory emphasizes broader institutional contexts (DiMaggio and Powell, 1991). While both Williamson (1975) and North (1990) acknowledge the importance of transactions, North emphasizes the central role of the larger environment in constraining the optimality of a firm's actions. The role of institutions in an economy is to lessen "both transaction and information costs through reducing uncertainty and establishing a stable structure that facilitates interactions" (Hoskisson et al., 2000: 253). The relative economic and social stability in developed countries promotes the development and acceptance of certain rules of exchange (Hitt et al., 2000). In contrast, the rules of exchange in transition economies are largely emergent, because the institutional instability in such economies produces ambiguity and uncertainty (North, 1990). Furthermore, market economy rules and requirements were not in place when the communist system collapsed, because for decades markets were closed and industries were protected (Peng, 2003).

The replacement of the old central planning regimes with market economy mechanisms requires multifaceted government activities to secure a consistent transformation. Those activities range from restructuring and privatizing businesses to initiating legal and institutional reforms to establish the rule of law. Furthermore, government agencies face the challenge of liberalizing markets, introducing competition policies, keeping inflation under control, and sustaining a viable financial sector and a foreign exchange regime that permits profit repatriation (IMF, 2000). CEE transition economies are currently at different stages of transformation, still to a certain extent being regulated, thus presenting an institutional environment that is profoundly different from what a typical Western firm would encounter in the developed world (Peng, 1994). MNEs in CEE emerging markets have to adopt strategies that fit with an

institutional environment characterized by inefficiency, instability and unreliability (Meyer, 2001).

The pace of dismantling old institutions does not necessarily coincide with the speed of constructing new institutions: there is typically a period of incremental evolution full of uncertainties (Peng, 2003). In North's words (1990: 6), "although formal rules may change overnight as the result of political and judicial decisions, informal constraints embodied in customs, traditions, and codes of conduct are much more impervious to deliberate policies". Specifically, "informal constraints rise to play a larger role in regulating economic exchanges in these countries during the transition" (Peng and Heath, 1996: 504; emphasis added). Moreover, to combat uncertainty and to overcome initial inabilities to use market mechanisms, economic agents in CEE economies continued to rely on the inherited systems of personal networks that "earlier served to overcome shortages under the central plan" (Meyer, 2001: 358). Personal networks in both business and political circles have retained their importance as a coordination mechanism during transition to a market economy (Puffer, 1996). Upon entering CEE, western MNEs often lack sufficient information about local partners, do not have effective personal networks in place, and face unclear regulatory frameworks, inexperienced bureaucracies, underdeveloped court systems, weak protection of intellectual property and widespread corruption (Meyer, 2001).

Any multinational expansion is typically challenging with respect to overcoming the liability of foreignness (Andersen, 1993; Inkpen and Beamish, 1997) because regulatory restrictions on foreign firms, among other factors, contribute to the costs of doing business abroad (Zaheer, 1995a). Expansion into transition economies, characterized by institutional inefficiency and environmental turbulence, is perhaps more difficult, necessitating even greater efforts (Luo and Peng, 1999). Peng (2003: 279) contends that in a transition environment, the costs to engage in relational contracting are high because transaction parties "need to build strong social networks through a time- and resource-consuming process." Thus, in addition to the transaction costs associated with overcoming liabilities of foreignness and managing business operations in an institutionally volatile environment, western MNEs bear additional costs related to an integration into diverse personal and government networks. Because



of all the costs incurred, MNEs in the CEE region may experience dissatisfaction with their subsidiary's performance dependent on the level of host-country institutional inefficiency. Hence, we suggest

*HYPOTHESIS 2 (institutional inefficiency): The level of institutional inefficiency in terms of (a) instability and (b) corruption of a host country's institutional environment is negatively associated with managerial satisfaction with the subsidiary's performance.*

### ***Behavioral Theory of the Firm: Cultural Distance***

National culture relates to the unique 'soft' features of a host country's 'way of doing things' (Brouthers and Brouthers, 2001). National cultural distance between countries has been associated with significant differences in their legal systems, administrative practices and working styles (Hofstede, 1980; Shane, 1992). Extensive empirical research has shown that the greater the national cultural distance, the larger the difference in terms of routines and practices (Hofstede, 1980; Morosini et al., 1998). For instance, routines and practices related to innovation have been found to vary significantly across countries along Hofstede's (1980) "individualism-collectivism" dimension (Shane, 1993). As a result, the organizational routines and practices that create firms' competitive advantages are often constrained by national culture (Kogut and Singh, 1988; Hofstede et al., 1990), and therefore difficult to replicate in other national cultures (Barney, 1986).

International business literature suggests that cultural differences deteriorate the applicability of MNEs' capabilities in the local environment (Barney, 1991; Madhok, 1997), yet extant empirical support for this argument is scarce. Barkema et al. (1996) suggest that failure rates among foreign subsidiaries increase with cultural distance. Very et al. (1997) state that dissimilarity between merging firms' national cultures negatively affects post-merger performance. Li and Guisinger (1991) find that the failure of US affiliates is significantly higher if the parent company is based in a culturally distant country rather than a culturally similar country. In contrast, O'Grady and Lane (1996) argue that operating in a psychically<sup>5</sup> close country does not necessarily lead to superior performance, as the assumption of similarity prevents

executives from detecting subtle but important differences in the foreign market. Evans and Mavondo (2002) arrive at similar conclusions: psychic, cultural and business distance positively influence performance, because firms originating from similar markets may find it difficult to establish a clear basis for differentiation.

The behavioral theory of the firm posits an alternative explanation of a positive relationship between cultural distance and satisfaction with organizational performance. Cyert and March (1963) and March (1994) argue that managers evaluate organizational performance relative to their “aspiration level”. An aspiration level, in Schneider’s (1992: 1053) words, is “the smallest outcome that would be deemed satisfactory by the decision maker”, and is used by decision-makers to determine the boundary between success and failure when evaluating performance. It appears that managers assess performance as being either high or low by comparing it with an aspiration level (Greve, 2003). The process of decision-making in uncertain environments revolves around a cycle of environmental scanning, interpretation and learning (Daft and Weick, 1984). Managers interpret received information by using their “cognitive schemata, structures that encode past experiences and guide future actions” (Greve and Taylor, 2000: 55), and learn by either continued exploitation of their current activities or by introducing explorative change (March, 1991). Differences in patterns of beliefs and values manifested in practices, behaviors and artifacts of culturally distant countries are typically obstructing information analysis, subsequent interpretation of firms’ experience and consequent learning processes.

Due to such constraints, international managers may naturally develop low-level aspirations and expectations that eventually result in an easier satisfaction with subsidiary performance. Moreover, because subjective performance evaluation is highly dependent on the managers’ aspiration level, their perception of success depends on how the aspiration level is adjusted over time (Greve, 2003). Evidence suggests that aspiration levels are updated slowly, with recent performance given low weight relative to the prior aspiration level: Elsbach and Kramer (1996) report empirical evidence that managers are quick to explain performance downturns with reference to faults of the measurement criteria. Therefore, we may expect that with respect to culturally distant subsidiaries, the initial low aspiration/expectation level that results in an easy

satisfaction with performance, will most likely be sustained for some time, even if updated with less encouraging performance estimates. Hence, we have

*HYPOTHESIS 3 (cultural distance): National cultural distance between the MNE's country of origin and the host nation is positively associated with managerial satisfaction with the subsidiary's performance.*

***Resource-Based Theory: Intangibles Intensity***

The resource-based theory (RBT) postulates that because intangible assets such as technological know-how, patents, management skills, brand names and best practices are information intensive, transactions with such assets are subject to market failures. Hence, intangible assets' internalization becomes critical for their efficient exploitation (Lu and Beamish, 2004). Firms' intangible assets encompass an array of unique characteristics: their development is capital, human and time-resource intensive, they can be applied in new markets at a proportionally smaller cost due to economies of scope, and international exploitation does not diminish their home market value (Dierickx and Cool, 1989; Delios and Beamish, 2001). When deployed abroad, knowledge-based intangible assets provide rent-yielding advantages for MNEs (Caves, 1971), also because they give the foreign subsidiary a superior competitive position in the local marketplace (Isobe et al., 2000; Delios and Beamish, 2001). Morck and Yeung (1992) and Mishra and Gobeli (1998) empirically support this argument: they find a positive relationship between MNEs' possession of intangible assets and their subsidiaries' market value. Likewise, Delios and Beamish (2001) report a positive relationship between MNEs' intangible asset endowments and the likelihood of their subsidiaries' survival.

Extant research suggests that the competitive advantages of MNEs frequently stem from offering highly innovative and highly differentiated products (Oviatt and McDougall, 1994). Due to a technology gap between firms from more developed markets and firms from transition countries, MNEs' technological intensity offers an advantage in transition economies (Svetlicic and Rojec, 1994). Because this gap tends to be quite large, local firms in CEE transition countries cannot compete in product technologies with firms originating from developed market countries. They cannot

develop or offer new and sophisticated products in sufficient quantity and *ditto* quality to be competitive *vis-à-vis* firms from developed countries (Hitt et al., 2000). Thus, firms originating from developed economies are typically in possession of relatively complex technologies that, when transferred to transition economy subsidiaries, provide competitive advantages.

In addition, by transferring marketing skills abroad MNEs often seek to generate firm-specific assets in the form of brand recognition and product differentiation in foreign markets (Denekamp, 1995). Evidence shows that firms recognized as leaders in marketing activities often try to gain market power by defeating competitors in foreign markets, aggressively creating brand-name loyalty and establishing their products as industry standards (Oviatt and McDougall, 1994). In contrast, for many decades CEE enterprises have shared organizational cultures that promoted production under centralized instruction rather than market demand, being characterized by consumer neglect. In such organizational cultures, there was typically limited – if any – use of marketing techniques. Clearly, marketing-intensive MNEs can benefit from a reduced level of local competition because re-programming obsolete organizational practices is difficult, takes time and is not always successful (Barkema and Vermeulen, 1998). In this line of argument, we expect MNEs' competitive advantage, stemming from technological and/or marketing intensity, to be favorably exploited by their subsidiaries in CEE countries. Launching a technologically or marketing-intensive product will create a competitive advantage over local competition, thus positively influencing satisfaction with performance. Hence,

*HYPOTHESIS 4 (intangibles intensity): The MNE's intangibles intensity in terms of (a) technological and (b) advertising intensity is positively associated with managerial satisfaction with the subsidiary's performance.*

#### ***International Management Theory: International Strategy***

International strategy, a key issue in international management theory (IMT), is a means to exploit the firm's competitive advantages and establish complementary organizational capabilities (Chang and Rosenzweig, 2001). Considering the complexity of the MNE's organizational form, there is a clear necessity for reducing this

complexity into a manageable number of related characteristics to understand and explain MNEs' functions and behaviors (Harzing, 2000). To do so, we adopt the well-known typology approach of Bartlett and Ghoshal (1989), along the lines of their integration-responsiveness framework<sup>6</sup> and Dunning's (1980) eclectic theory of international production, to examine to what extent following a global or a multidomestic international strategy may affect managerial satisfaction with subsidiary performance.

Global companies promote a convergence of consumers' preferences and strive to maximize standardization of production (Rugman and Verbeke, 1992). They benefit from home-country specific advantages, which can be efficiently transferred to foreign locations by creating "replicas" of the parent company (Bartlett and Ghoshal, 1989). Harzing (2000 & 2002) reports that global companies tend to exercise tight control over subsidiaries to preserve parents' corporate culture, exploit their unique core competencies and funnel strategic decisions on production and marketing to the outlets. In contrast, multidomestic firms develop strategies for national responsiveness. Due to significant competitive differences between countries, a multidomestic strategy is determined by local cultural, political and social characteristics (Bartlett and Ghoshal, 1989). Products and policies conform to different local demands and the MNE's activities are usually "tied to the buyer's location" (Harzing, 1999: 39). In order to fulfill the requirements for market-specific product customization, multidomestic firms must be aware of the specificity of local markets, policies and production nuances (Harzing, 2000). Thus, the primary objective then is the adaptation of marketing and production strategies to specific local customer needs and government requirements.

Wright et al. (2005) raise a question that has, to date, not been fully addressed by research: can an MNE's global strategy be extended and adapted with minimal changes to emerging economies? Or does a focus on emerging economies call for more strategic attention and tailor-made business models? Maybe a simple adaptation and extension of the traditional global strategy will not be sufficient in transition economies: an investment without understanding how location specificity affects firms and customers might not produce the anticipated positive results. Overall, emerging economies present a challenge to the global strategy concept (Wright et al., 2005). The traditional global

strategy is built on business models profiting from “the top of the global pyramid” – i.e., about a billion customers, mostly in the developed world –, whereas business models in emerging economies have to be based on profiting from the bottom of the global pyramid – that is, four billion people each making less than 2000 US\$ a year (Prahalad and Hammond, 2002). Clearly, there are points of convergence between developed and emerging economies, but if Western MNEs only considered extant similarities, they may find themselves “trapped by their devices in gilded cages, serving the affluent few but ignoring the potential of the billions of new customers that attracted them in the first place” (Dawar and Chattopadhyay, 2002: 457). Perhaps a multidomestic approach, which incorporates market specificities and compromises between value and price, will prove to be the winning strategic solution for markets in transition.

Dunning’s (1980) eclectic theory of international production postulates that the most prominent motives for foreign direct investment are those related to market-seeking and/or factor-seeking strategies. MNEs that choose to pursue an export-oriented strategy are typically corporations that operate on a global basis, favoring a higher level of vertical integration to serve them as a tool to cut production costs by intra-firm exchange of production components. Global firms can leverage across various business opportunities because they are fit to move their production across countries in order to seek for the most competitive workers, suppliers and technologies (Bartlett and Ghoshal, 1989), or to respond to exchange rate movements, minimize taxes and avoid financial restrictions imposed by local governments (Kumar, 1994). Although global MNEs have an access to information on world markets, which makes them well equipped to counteract uncertainties and fluctuations, they are less fit to adapt to changes in the local market structure. Business operations in transition economies are subject to various risks and uncertainties (high inflation, unstable financial sector and foreign exchange regimes, *et cetera*). Therefore, an exclusively global focus and a neglect of local specificities could result in underperformance of the local subsidiaries due to underdeveloped capabilities to counteract environmental volatilities (Pan and Chi, 1999).

In contrast, firms that adopt a foreign market entry strategy that aims at establishing a sustainable local market presence tend to adapt strategies to better respond to local consumer preferences. These are typically MNEs following a multidomestic strategy, characterized by a primary concern with adaptation of operations and strategies. Unique market knowledge is accumulated during the process of customizing production, marketing and management activities. Consequently, multidomestic MNEs develop capabilities to react promptly to local environmental changes and market fluctuations. In several surveys among MNEs in CEE, seventy-five percent of the surveyed firms stated that the primary reason for investment was reflected in market-seeking motives, rather than manufacturing-for-export purposes (Heimpohl et al., 1993). It could be that expectations of reduced competition in the region, in addition to the associated better performance of Western firms, have further encouraged market-seeking entry (Uhlenbruck, 1997).

Based on the above arguments, we argue that there is a need for profound understanding of local market forces and specificities to build a successful operation in CEE countries. Therefore, MNEs following a multidomestic type of strategy have greater chances for success than MNEs following a predominantly global strategy. Hence, MNEs' investments to establish a market presence will result in greater satisfaction with the subsidiary's performance than MNEs' investments in export-oriented production. Thus, we propose

*HYPOTHESIS 5 (international strategy): (a) MNEs following a multidomestic strategy will be more satisfied with their subsidiary's performance than those following a global strategy; and (b) a market-focused investment will be positively associated with managerial satisfaction with the subsidiary's performance.*

## **METHODS**

### ***Data***

To test the above hypotheses, an international mail survey was conducted in May 2003 among companies from the European Union (EU) that either acquired an existing local enterprise or had invested in a greenfield subsidiary in CEE. We initially selected from the AMADEUS dataset all registered companies based in the then-fifteen member

states of the EU that had established subsidiaries in CEE between 1992 and 2002, and that had at least a 10 per cent<sup>7</sup> ownership stake in a subsidiary located in any of the following ten transition economies: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia. These countries were chosen for this study because of the multifaceted economic and political significance of their 2004 and 2007 accession to the European Union.

An English-language questionnaire was created and pilot tested with managers in four Dutch companies who were competent in both the English language and their firm's international expansions into CEE. The final English-language questionnaire was then back translated into German (for German and Austrian companies), French (for French and Belgian companies) and Italian. In total, 2,798 questionnaires were initially mailed to west European CEOs at the MNEs' headquarters with a request to have the questionnaires completed by a business unit top manager accountable for and knowledgeable of the latest CEE expansion. From this, 35 questionnaires were returned as non-deliverable. After compressing the targeted firms to 2,763, we received 209 usable questionnaires, representing an overall response rate of 7.5 per cent. We further excluded the observations from Latvia and Lithuania due to unavailable data on cultural distances for these two countries, thus reducing the sample to 198 subsidiaries. The response varies from 64 for Poland to 5 for Slovenia.

We tested the collected data for non-response bias. We conducted a *t*-test comparing the firm size variable (number of employees worldwide) of our sample to a random selection of the relevant MNE population, which revealed no statistically significant differences in the two means. Although we have a mix of predictors derived from primary and secondary-data sources, we also performed a common-method variance test. According to Podsakoff and Organ (1986), if all variables load on one factor or there is one factor that explains the majority of the variance, there is a common-method problem. We performed a factor analysis by entering all dependent and independent variables used in this study. Because the factor analysis resulted in a four-factor solution with the largest factor explaining 22 per cent of the variance only, we consider our data unconfined by common-method variance.



### ***Dependent variables***

The dependent variable of this study, managerial satisfaction with subsidiary's performance, was captured using subjective measures. Due to unavailable or inaccessible official financial reports for every subsidiary in all ten CEE countries for the time period from 1992 to 2002, we were unable to collect objective measures of performance at the subsidiary level. Furthermore, in studies involving firms from multiple home countries investing in multiple host countries, objective measures of performance may suffer from interpretation errors and measurement noise due to dissimilar accounting practices, differences in reporting company-level data and exchange rate fluctuations (Brouthers et al., 1999; Brouthers and Brouthers, 2000). Based on the experience with anonymous surveys by Woodcock et al. (1994) and Brouthers et al. (1999), who reported the unwillingness of firms to provide objective measures of performance for their foreign subsidiaries, we employed managerial evaluations to measure satisfaction with performance.

Subjective measures can be used to proxy performance against multiple financial and non-financial criteria (Dess and Robinson, 1984). Subjective financial measures of performance provide valuable insights into the estimated achievements of the firm's economic objectives (Brouthers, 2002). To limit the effect of recall and memory bias, we inquired about the MNEs' most recent investment in CEE. We received a substantial number of questionnaires referring to investments made after the year 2000, which made financial measures of performance of limited importance, further justifying the introduction of subjective non-financial measures. After all, in the early stages of high-risk investments in such inefficient CEE environments, objective financial performance indicators are not that important. However, non-financial measures of performance provide important information about the firm's competitive and strategic goals because managers tend to judge success or failure in terms of to-be-accomplished objectives (Anderson, 1990). Therefore, even in the early stages of a new enterprise's existence, managers can evaluate the progress of meeting such pre-set objectives (Brouthers, 2002).

We adopted the approach of previous studies and asked respondents to rate their satisfaction along eight performance dimensions: sales level, sales growth, profitability,

market share, marketing, distribution, reputation, and market access (Geringer and Hebert, 1991; Brouthers et al., 1999, 2000 & 2002). Respondents evaluated each performance measure on a scale ranging from 1, “very dissatisfied”, to 10, “very satisfied”. To assess the dimensionality of managers’ satisfaction with subsidiary’s performance and to reduce the number of variables, we performed a factor analysis. The results are reported in Table 1.

[INSERT TABLE 1 ABOUT HERE]

Using principle components analysis with the conventional eigenvalue cut-off level of one, we were able to extract two factors, which have a significant factor loading above 0.50 (Hair et al., 1995). The first factor, named “satisfaction with financial performance” or Financial Performance, has substantial loadings for sales level, sales growth and profitability. The second factor, labeled “satisfaction with marketing performance” or Marketing Performance, has substantial loadings for reputation, market access, distribution and marketing. The variable “market share” was excluded from the analysis because it loaded substantially on both factors (0.51 and 0.63, respectively). Note that we refrain from formulating separate sets of hypotheses for both types of performance satisfaction measures. Given lack of earlier work on this, we will simply run separate regressions for our financial and marketing performance satisfaction measures to explore whether or not any interpretable differences will occur.

### ***Independent variables***

Our hypotheses relate to the influence of eight independent variables, in total. The first hypothesis is a straightforward transaction cost theory one, focusing on the impact of ownership stake of the Western MNE in the local CEE subsidiary. Ownership Stake was determined through the survey by inquiring about the actual percentage of foreign ownership in the CEE subsidiary.

The second hypothesis deals with the effect of institutional inefficiency. Here, we used two measures. For one, we created a series of five-point Likert-type of questions (with answers ranging from very low to very high) inquiring about (a) the general

stability of host country's political and social institutions, (b) barriers to conversion and repatriation of income, (c) level of corruption of political leaders, (d) ability of host country's government to enforce existing laws, (e) efficiency of government agencies and institutions, and (f) legal restrictions to foreign ownership. High values demonstrate perceived Institutional Instability. The scale's high Cronbach's alpha coefficient indicates internal consistency ( $\alpha = .74$ , which is above the .7 cut-off level). Moreover, to guarantee the robustness of our analyses, we included an institutional variable derived from a secondary source, namely the 2004 Transparency International Corruption Perception Index (<http://www.transparency.org>), or CPI. We calculated an Institutional Corruption score by measuring the distance in corruption estimates between home and host countries. For every observation in our sample, that is, we subtracted the CPI score of the host nation from the CPI score of the relevant home country. We chose the CPI source to measure the inefficiency of the institutional environment for two reasons. For one, according to recent research by the World Bank and the EBRD, corruption is often portrayed as the major institutional constraint on business (Hellman et al., 2000). A secondary reason for choosing the CPI source is that there exist high correlations between CPI scores and other potential measures of a country's institutional inefficiency. For example, Brouthers and colleagues (2004) report that the Euromoney risk measure is highly correlated with the CPI ( $r = .70$ ), the EBRD measure of institutional factors ( $r = .88$ ), the World Bank's institutional measures ( $r = .79$ ) and Henisz's political constraints measure ( $r = .85$ ).

For our third hypothesis, Cultural Distance was measured following Kogut and Singh's (1988) formula, based on Hofstede's (2001) updated national culture scores. To date, Hofstede's study is the only one providing cultural distance indices for the CEE nations central in this study. Kogut and Singh (1988) defined national cultural distance as the degree to which cultural norms in one country differ from those in another country. A number of authors followed up on this definition by providing empirical evidence on the direct association of critical routines and repertoires within firms in different countries with the national cultural distance between them (Hofstede, 1980 & 2001; Shane, 1993; Morosini et al., 1998; Brouthers and Brouthers, 2000). Shane (1995) and Morosini and colleagues (1998) express concerns about the

occurrence of common-method variance when individuals answer questions about their cultural values and the effect of those values (in our case, on their satisfaction with performance). However, a correlation between Hofstede's cultural distance indices and the satisfaction with performance scores derived from our survey cannot be an artifact of a common-source bias, by definition. Furthermore, due to a natural tendency toward ethnocentricity and a preference for similarity, interviewed managers might recall the national culture of the target country as being more similar to their own than it really is. Using the national culture scores from a source external to our sample and not dependent on the memory of the respondents, we avoid this problem of retrospective rationalization (Morosini et al., 1998).

Relating to our fourth hypothesis, Caves (1996) noted that R&D and advertising intensities have emerged as the most robust measures of intangible assets in the literature on MNEs. Therefore, we adopted the two measures of this pair of intangible assets most commonly used in the literature (Morck and Yeung, 1991; Delios and Beamish, 1999; Lu and Beamish, 2004). Technological Intensity is obtained by asking the respondents a five-point Likert-type of question as to the percentage of sales spent on R&D (ranging from very low to very high), because it was believed that the surveyed sample of managers would be unlikely to answer adequately or at all questions regarding a monetary estimation of the annual R&D budget. Following the same logic, we obtained Advertising Intensity by asking the respondents a five-point Likert-type of question as to the percentage of sales spent on marketing and advertising activities. The decision to use primary data to proxy both intensity variables was based mostly on pragmatic reasons: official secondary data on R&D and advertising expenditures for all surveyed firms were simply unavailable.

With respect to our fifth hypothesis, an International Strategy measure was obtained by asking two sets of multi-scale questions describing multidomestic and global strategies. The questions were adapted from Harzing (2000 & 2002), who constructed four statements that measure whether international competition in the industry of investment is predominantly global and focused on achieving economies of scale or multidomestic and aiming at local differentiation. We performed a cluster analysis, which resulted in a two-cluster grouping of the four constructs as multidomestic and

global, and performed an independent-samples *t*-test to check for significant difference in the mean scores of the two groups. Clearly, the profiles of the multidomestic and global strategies are significantly different, along the lines expected by the theory, as is clear from Table 2.

[INSERT TABLE 2 ABOUT HERE]

The type of international strategy is captured by a dummy variable taking the value of 1 if the strategy is predominantly multidomestic, and 0 if it is predominantly global. Furthermore, to obtain our Market Focus variable, we asked respondents two questions referring to their strategic intentions to enter into the respective market: is their investment aimed at either establishing a local presence to supply the host market, or at setting up a low-cost production site for export purposes (Meyer, 1998). We defined a dummy variable with a value of 1 if the investment had a market focus, and 0 if it had an export-oriented focus.

#### *Control variables*

Eight control variables were included. For one, we asked for the Establishment Mode – i.e., the choice between a greenfield establishment or an acquisition mode. According to several studies, performance of greenfields should be systematically better than that of acquisitions (Woodcock et al., 1994; Li, 1995), while others suggest differently based on the assumption that because acquisitions are less risky than greenfields, the former should outperform the latter (Pennings et al., 1994; Caves, 1996). Regardless of the divergent findings in earlier work, it is clear that the two establishment modes might well have different performance implications.

We follow the reasoning of Padmanabhan and Cho (1999), who argue that once the decision to invest in a foreign country has been made, as opposed to a non-equity entry, international experience (or level of multinationality) becomes less important than other types of experience. Unlike previous studies that tested for the effect of multinationality on performance, we introduce three alternative measures of international experience. First, we included Acquisition Experience, comprised of a composite measure of the number of acquisitions and the number of countries that hosted them. Second, a similar

composite measure – Greenfield Experience – controls for the number of foreign greenfield establishments. Third, a Regional Experience control variable, measured as the number of years experience doing business in any CEE country, was taken on board. All information is from the questionnaire.

Christensen and Montgomery (1981) associated performance effects specifically with relative industry growth. Hence, we included a host country's Industry Growth rate variable. Due to the heterogeneity of our observations and the significant range of industries of investment, secondary data on industry growth in all host countries were either unavailable or incomparable. Therefore, we obtained our industry growth control variable by asking the respondents to estimate, with a five-point Likert-type answer scale, the host country's growth rate of the industry of their investment.

Finally, we include three standard control variables. Previous research has found that firm size influences performance: an individual subsidiary is less important to a large firm than to a relatively small one, and therefore may receive less attention and support (Slangen, 2005). We control for Firm Size through the approximate number of their MNE's employees worldwide. Furthermore, years of experience in a particular industry sector in a given host country are expected to exert a substantial influence on performance (Oliver, 1997). To control for such experience, we created a variable Subsidiary Age by calculating the years of existence since the establishment of the subsidiary. To control for the Industry Type, we used the OECD classification of manufacturing industries based on technology, and created three dummy variables: a first dummy for high and medium-high technology industries, a second dummy for medium-low and low-technology industries, and a the third dummy for all industries that fall outside the OECD categorization (for example, service firms, building contractors, agricultural producers and wholesalers). The primary information about the industry of investment is obtained through the survey.

### ***Statistical methods***

To test our hypotheses, we performed two ordinary least-squares multiple regression analyses with SPSS 11.0, one for the financial and one for the marketing performance satisfaction measure. To reveal the explanatory power of our independent variables as a

set, we ran two models – Models 1 and 3 – with the control variables only, before adding our independent variables in Models 2 and 4. Table 3 reports the usual descriptives.

[INSERT TABLE 3 ABOUT HERE]

Two correlation coefficients stand out: .664 between two industry classification dummies, and .557 between the two dependent variables. For each of the regression runs, variance-inflation factors (VIF) were examined to determine any potential multicollinearity bottleneck. All of the VIF scores were below 2, thus confirming that multicollinearity is not an issue here (Hair et al., 1995). Tests for heteroskedasticity and correlation of error terms showed that neither of these problems were present in the data.

## **RESULTS**

The results of the regression analyses are shown in Table 4.

[INSERT TABLE 4 ABOUT HERE]

Clearly, the full models perform much better than the models with control variables only. As far as the control variables is concerned, half of them are not associated with significant estimates at all: Establishment mode, Firm size, Subsidiary age and Industry type are apparently unrelated to managerial satisfaction with subsidiary performance. In both Marketing Performance regressions, only Acquisition experience and Industry growth reach significance: with more acquisition experience and higher industry growth, managers are more satisfied with the marketing performance of their subsidiaries. In the full Financial Performance Model 4, the estimates for Greenfield experience (negative), Industry growth (positive) and Regional experience (positive) are significant. The results for our three experience measures point to a particularly interesting avenue for future research.

We observe significant differences between the results for both performance measures, comparing Models 2 and 4: the variance explained in the Marketing Performance satisfaction regression is much higher than the one in the Financial Performance counterpart. In addition, the contribution of the independent variables in our fourth model, demonstrated by the values of the beta coefficients, is much lower than in the second model. It could be that the results of the Marketing Performance analysis carry more explanatory power because of the methodology applied: managers' opinion of a subsidiary's financial performance (sales growth, sales level and profitability) measured with a Likert-type of question is perhaps less accurate and representative than the "real" picture presented by officially published or internally available financial reports.

More importantly, the stronger explanatory power of our predictors in the Marketing Performance analysis possibly suggests that subjective measures of non-financial performance, as opposed to subjective financial estimates, may be of greater strategic importance for the subsidiaries' managers. From a long-term strategy perspective, subsidiary's performance in the sense of distribution, marketing, market access and reputation may be more valuable for the parent MNE than the short-term growth or profitability of the outlet. Several authors have argued that foreign investments may not be undertaken solely to increase short-run financial performance (Anderson, 1990; Geringer and Hebert, 1991). They suggest that increased financial performance may not occur for a number of years after initial foreign market entry, but that other measures of performance may help to determine the effectiveness of the investment. This argument may hold true particularly in high-risk and "young" markets such as those in CEE.

Model 2 tests the hypothesized effects of our predictors on managerial satisfaction with the subsidiary's Marketing Performance. The Ownership stake coefficient is positive and significant, offering support for Hypothesis 1. Both the Institutional instability and Cultural distance predictors are significant and have the expected sign, thus providing support for Hypothesis 2a and 3. Hypothesis 2b is rejected, given the non-significant estimate of the Institutional corruption coefficient. Hypothesis 4 is partially supported – i.e., Hypothesis 4b is confirmed, but Hypothesis 4a is not:



Advertising intensity is significantly and positively related to satisfaction with Marketing Performance, whilst Technological intensity is significantly but negatively related to satisfaction with Marketing Performance (which is opposite to what was expected). Hypothesis 5a is supported: the coefficient of the International strategy variable is positive and significant, as hypothesized. The significance of our Market focus predictor and its positive sign offer support for Hypothesis 5b.

In Model 4, we analyze managers' satisfaction with Financial Performance. Hypothesis 1 is not supported, as the coefficient estimate for the Ownership stake variable fails to reach significance. Hypothesis 2 is partially confirmed, due to the significance and expected sign of the Institutional corruption estimate (Hypothesis 2b) but the insignificant coefficient for the Institutional instability variable. Hypothesis 3 is supported: the Cultural distance coefficient is significantly positive. Hypothesis 4 receives partial support, due to the unexpected negative sign of the Technological intensity coefficient (Hypothesis 4a) and the expected positive and significant estimate for the Advertising intensity variable (Hypothesis 4b). The coefficient of the International strategy variable has the expected sign, but is insignificant. Hence, Hypothesis 5a cannot be supported. Our Market focus predictor is not significant in the fourth model either: therefore, Hypothesis 5b is rejected, too.

## **DISCUSSION**

Tan and Litschert (1994) suggest that the environment in transition economies, characterized by a weak regulatory regime, underdeveloped factor markets and poorly protected property rights, is typically hostile to business. In such contexts, transactions costs are likely to be high, which is why a large ownership stake is needed to reach a satisfactory level of performance. Indeed, we find support for this argument for the case of satisfaction with marketing performance, but not for the financial performance case. Our interpretation is that this asymmetric result can be explained by the relative unimportance of short-run financial performance objectives for many FDI entries into a high-risk region such as CEE, particularly in the early stages after entry.

Studies have concluded that legal efficiency is positively correlated with the role of the court system, and that malfunctions regarding corporate governance have high

explanatory power for the mediocre performance of the private sector in transition economies (Johnson et al., 1999). In the case of CEE, EUMAP (Open Society Institute's EU Monitoring and Advocacy Program) acknowledges the impressive progress towards establishing democracy, the rule of law and a market economy in the region. However, it points out that the inherited tradition of entrenched mistrust of the state is conducive to the persistence of corruption. According to the 2002 EBRD report on transition, the level of government corruption in CEE is still very high: for example, the percentage of firms frequently bribing public officials is as high as 22.6 in Hungary and 36.7 in Romania. A possible explanation for the high levels of corruption in the region is the nature of the transition process: all CEE countries have undertaken transitional tasks that are inherently vulnerable to corruption, including the privatization of their entire economies (EUMAP, 2005).

In the 2002 and 2003 reports on progress with EU accession, the European Commission makes frequent references to problems with corruption, because they impede the smooth functioning of the single market, the quality of democratic institutions and the core democratic values the EU seeks to represent. Furthermore, with the accession of the first eight CEE countries, the EU has admitted a number of countries with persistent and serious problems of corruption (EUMAP, 2005). The magnitude of the problem is further emphasized by EU's annual declaration on candidate states, which recommends a "safeguard clause", possibly delaying accession of either Bulgaria or Romania if their judicial reforms stall. The document concludes that while both candidates continue to fulfill the political criteria for EU membership, there is a dire need for improvements in the reforms of their public administration, the functioning of their judicial system and the fight against corruption (Sofia News Agency, 2004). Clearly, the empirical evidence provided in this study further supports these arguments, revealing that institutional deficiencies in the CEE region have a preponderating negative effect on local economies and foreign investments: because institutional inefficiency has a negative effect on the western managers' satisfaction with their subsidiary's performance, we conclude that institutional inefficiency indeed presents a considerable impediment to business.

We provide further support for Uhlenbruck's (2003) suggestion that culture remains a prominent issue even during the turbulent economic transition process: our empirical analyses reveal that cultural distance strongly influences managers' satisfaction with their subsidiary's performance. Previously, studies on the effects on performance of cultural differences between two countries reveal that the more dissimilar the norms, values, customs and business practices are (Kogut and Singh, 1988; Hofstede, 2001), the lower the performance of culturally distant subsidiaries will be (Barkema et al., 1996). Perhaps surprisingly, our findings highlight the fact that west European managers evaluate the performance of subsidiaries in countries with more dissimilar routines, repertoires and working styles more favorable than the performance in countries that are culturally closer to their home nations. Our interpretation is that managers of west European MNEs are initially uncertain of their success in a culturally different environment or skeptical of the performance of their culturally distant CEE subsidiaries, and therefore adjust their aspirations to a lower level. As a consequence, a low aspiration level could eventually result in a satisfactory evaluation of the subsidiary's performance. Furthermore, valuable knowledge about culturally imbedded practices is acquired through an investment in a culturally distant CEE country. If that knowledge is of critical importance for the MNE's development of organizational practices, the strategic importance of the subsidiary will favorably influence a positive evaluation of its performance.

The present study identifies to what extent vital capabilities of MNEs determine their managers' satisfaction with subsidiaries' performance in CEE transition economies. Advertising intensity positively affects satisfaction with distribution, marketing, firm reputation and market access at the subsidiary level, whilst technological intensity has the opposite effect. Meyer (2001) points out that in Eastern Europe technology transfer is of secondary importance to the transfer of modern managerial skills. Marketing expertise is an asset of great importance in CEE, however, because in the central planning system enterprises produced under instruction and not for the market, thus implying that modern marketing knowledge was once rendered redundant. Importing marketing skills from developed-economy firms, on the one hand, creates a competitive advantage over local products and brands and, on the other hand,

marketing and advertisement leaders can gain market power by defeating global competitors in foreign markets by aggressively creating brand-name loyalty.

Reversely, technology transfer in CEE is difficult and conditional on the establishment mode (a greenfield or an acquisition). In the case of a greenfield, technologically intensive MNEs not only need to transfer modern technology and equipment, but also must engage in extensive re-training of local labor to overcome the deficiencies of divergent educational systems. The process of re-training is very time consuming, and may involve unforeseen expenditures and delays. Therefore, the positive outcome of MNEs' technological "superiority" will most likely be obstructed. In the case of an acquisition, western MNEs acquire local enterprises with weak and outdated technological capabilities. To make production facilities competitive, the MNE generally needs to make significant post-acquisition investments to restructure the local enterprise, change its corporate strategy and structure, and engage in technological modernization (Newman, 2000; Meyer, 2001). However, strong inertial forces within an organization might prevent even technologically rational adaptations, which put further burden on the post-acquisition integration process (Barkema and Vermeulen, 1998). In conclusion, regardless of the establishment mode, technology transfer is difficult and time consuming in CEE countries. Therefore, the positive effect predicted by theory in transition economies is unlikely to be reflected in short-term evaluations of subsidiary performance.<sup>8</sup>

In the early 1990s, the CEE countries not only experienced major political and economic changes, but also an annual decline in GDP by approximately 20 per cent. During these first years of expansion into CEE, the GDP decline may have curtailed initially foreseen benefits from entering into these new markets. Consequently, market-seeking FDI has produced rather disappointing results (Uhlenbruck, 1997). Our survey conducted in 2003 reveals opposite results: investments aiming at establishing a market presence resulted in high satisfaction with the subsidiaries' performance. At least two incremental changes in the region may have triggered a more optimistic perspective on performance. First, after 1995, there was generally a more positive outlook on CEE economies (Transition Report, 1996). Second, in the period 1995-2003, most of the countries in the region initiated negotiations for EU membership, demonstrated

considerable progress in their transition, and reached a consensus on a future date for accession (i.e., May 2004). The prospects of an enlarged EU common market presented a lucrative opportunity of serving an additional 150 million consumers, yet imposed a threat of labor cost equalization in a foreseeable future. Clearly, in a greater EU of 25 member states, a long-term factor-seeking strategy cannot be ultimately viable, while an establishment of a stable market presence in CEE is mostly promising. Furthermore, a stable market presence goes hand in hand with a multidomestic strategic approach, rather than adopting a global strategy in a new environment. A recent survey of the Hungarian retail market points to the key success factor for one of the best-performing western retailers (UK-based Tesco): a meticulous attention to local market characteristics, namely ultra-high price sensitivity, local sourcing of most retailed products, and a wide selection of local favorites (Budapest Week Online, 2005).

This study has several limitations, all pointing to interesting avenues for future research. First, the insufficient number of respondents by industry prevents us from investigating in-depth the industry-level factors that might influence managers' satisfaction with their subsidiary's performance. Future studies may overcome this drawback by focusing on a limited number of industries, investigating detailed industry-specific factors that may determine a particular foreign investment mode preference. Second, the time window of the collected data implies a methodological weakness. The survey inquired about the latest CEE entry, yet in many cases the time gap was over five years, which increases the chances of recall and memory biases typical of retrospective surveys. A better response accuracy will be achieved if future studies avoid surveying firms that have not made relevant investments within a shorter time period. Third, our study is limited to foreign entry decisions by west European MNEs into a pre-selected set of CEE countries. Further work is needed to find out to which extent our findings are generalizable to other transition or non-transition countries, and to MNEs from other parts of the world.

Clearly, a multi-theory perspective that takes into consideration both the MNEs' asset specificities and the host-countries' environmental idiosyncrasies offers a better platform for determining the drivers of performance than single-theory lenses. Indeed, our set of five theories produced hypotheses that proved to make sense in the context of

explaining managerial satisfaction with the performance of subsidiaries of west European MNEs in CEE countries. Nevertheless, one critical question remains unanswered: What is the relative importance of all tested predictors on managerial satisfaction with performance, and in what situation will institutional inefficiency be a more important determinant of subsidiaries' performance than the MNEs' capabilities? Furthermore, which of the institutional forces have a greater impact on MNEs' activities in transition economies: differences in legal systems, government corruption or political instability? Can we assume that, because of the decade-long EU integration programs in CEE, there are hardly any institutional differences between the old and new EU members, and that such differences are in fact only a false managerial perception? Future research could achieve in-depth understanding of firms' performance by initiating detailed surveys on a larger number of MNEs.

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**Table 1. Factor analysis of performance measures**

Rotated factor matrix		
Factors and items	1	2
Satisfaction with Financial Performance measures ( $\alpha = .87$ )		
Satisfaction with sales level	<b>0.88</b>	-
Satisfaction with sales growth	<b>0.87</b>	-
Satisfaction with profitability	<b>0.82</b>	-
Satisfaction with Marketing Performance measures ( $\alpha = .89$ )		
Satisfaction with reputation	0.34	<b>0.82</b>
Satisfaction with market access	-	<b>0.77</b>
Satisfaction with distribution	-	<b>0.87</b>
Satisfaction with marketing	-	<b>0.86</b>
Eigenvalues	1.19	4.87
Cumulative per centage variance explained	77.90	42.14

**Table 2: Cluster analysis of strategy variables**

Cluster names	Economies of scale	Global competition	Domestic competition	Differentiation (product adaptation)
Global	3.08	3.78	2.01	2.67
Multidomestic	2.63	2.05	4.12	3.92
<i>t</i> -value	2.497 (0.013)	10.525 (0.000)	-16.231 (0.000)	-7.809 (0.000)

Items (Scale: Strongly disagree 1 2 3 4 5 Strongly agree)

- (a) Our company's worldwide strategy was focused on achieving economies of scale by concentrating its important activities at a limited number of locations.
- (b) Our company's competitive position was defined in worldwide terms. Different national product markets were closely linked and interconnected. Competition took place on a global basis.
- (c) Our company's worldwide competitive strategy was to let each subsidiary compete on a domestic level as national product markets were judged too different to make competition on a global level possible.
- (d) Our company not only recognized national differences in taste and values, but also actually tried to respond to these national differences by consciously adapting products and policies to the local market.

**Table 3: Means, standard deviations and correlations among all variables**

VARIABLES <sup>n</sup>	MEAN	S.D.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
1. Marketing Performance	22.46	9.56																			
2. Financial Performance	16.23	7.19	.557**																		
3. Institutional Instability	22.30	4.56	-.073	-.061																	
4. Institutional Corruptness	4.07	1.25	.101	.065	.126																
5. Cultural Distance	1.85	1.70	.181*	.155*	.246**	.449**															
6. Technological Intensity	2.07	1.07	-.180**	-.039	-.036	-.061	-.009														
7. Advertising Intensity	2.06	1.13	.157*	.057	.019	.063	-.053	.146*													
8. Market Focus	.83	.38	.279**	-.067	-.001	.093	.073	-.137*	.142*												
9. International Strategy	.58	.49	.249**	.040	-.024	.025	.019	-.110	.094	.227**											
10. Ownership Stake	.87	.22	.065	.102	.126	-.071	-.058	.095	-.058	-.073	-.087										
11. Establishment Mode	.36	.48	.002	-.020	-.217**	-.027	-.037	-.032	-.068	-.052	-.114	-.226**									
12. Acquisition Experience	10.90	35.11	.126	.092	.109	.063	.162*	-.039	-.047	-.073	-.117	.016	.214*								
13. Greenfield Experience	15.59	34.90	.043	.012	.072	-.029	.027	.003	.016	-.012	-.064	.108	-.079	.396**							
14. Industry Growth	3.20	1.06	.150*	.196**	-.013	-.040	-.033	.102	.082	.142*	.007	-.046	-.074	-.034	.017						
15. Regional Experience	11.66	14.80	.066	.140*	-.094	.072	.067	.065	-.038	.060	-.002	.046	-.009	.016	.335**	.105					
16. Firm Size	86.56	24.72	.069	-.043	.022	.106	.097	.012	.103	.040	-.020	.034	.213**	.367**	.188**	-.043	-.034				
17. Subsidiary Age	4.93	3.37	-.076	-.009	.144*	.005	-.142*	-.062	-.024	-.075	-.041	.038	.019	.069	.039	-.226**	-.017	-.070			
18. High-Tech Industry	.20	.40	-.112	.029	-.050	-.015	-.155*	.290**	.015	-.092	-.108	.120	.068	.132	.214**	-.059	.141*	.091	.149*		
19. Low-Tech Industry	.36	.48	.021	.038	.003	-.084	.121	-.042	.046	.006	-.045	-.015	.021	-.013	-.208**	.046	-.120	-.103	-.120	-.383**	
20. Non-OECD Industry	.43	.49	.070	-.060	.039	.094	.010	-.194**	-.057	.068	.131	-.082	-.075	-.094	.029	.003	.003	.027	.003	-.436**	-.664**



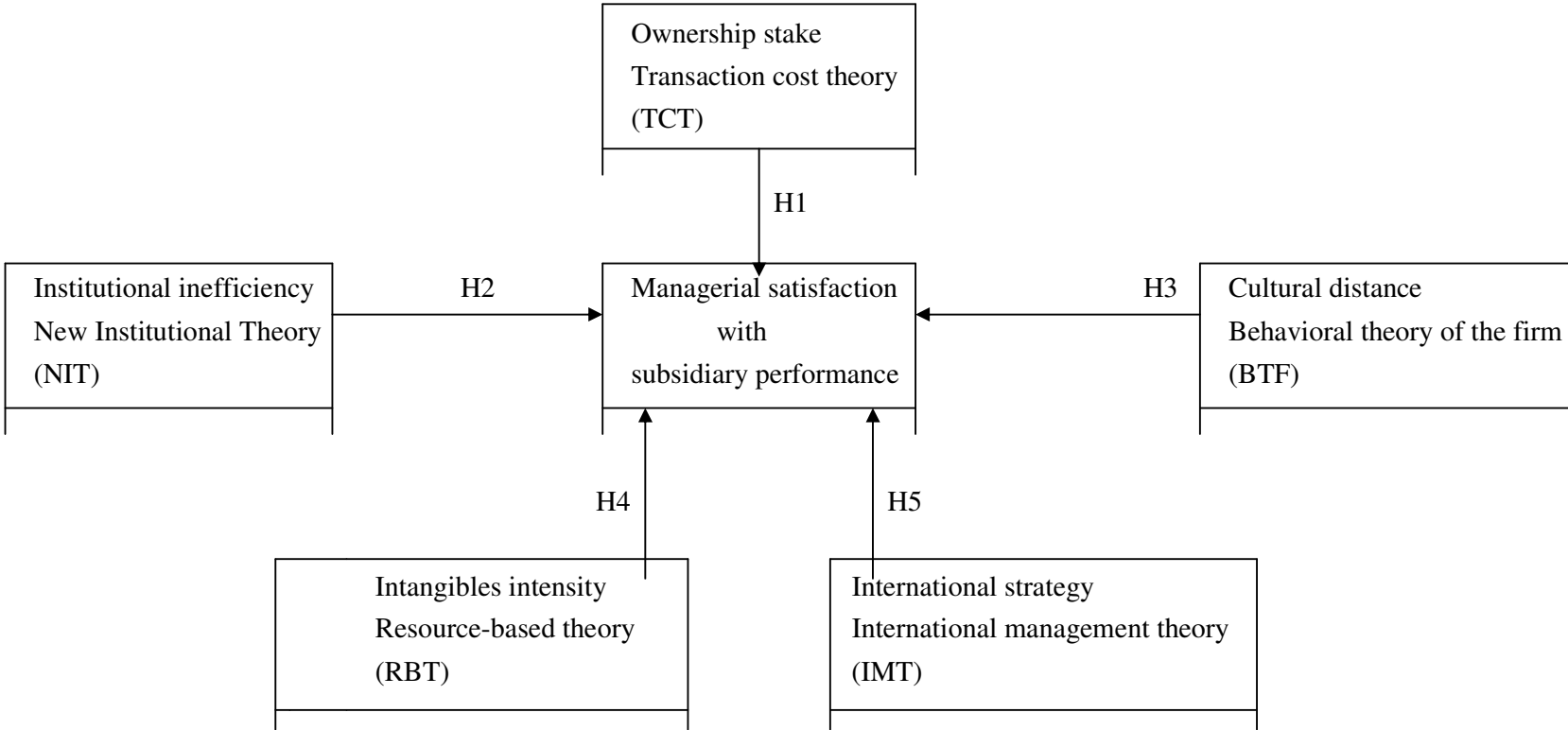
**Table 4: Multiple regression analysis**

Independent variables	Marketing Performance				Financial Performance			
	Model 1		Model2		Model 3		Model 4	
	Betas	t-stat	Betas	t-stat	Betas	t-stat	Betas	t-stat
Constant	19.601	(6.66)***	15.530**	(2.82)	16.043***	(6.66)	17.069**	(3.02)
Establishment Mode	-0.252	(-0.15)	1.188	(0.71)	-0.252	(-0.15)	0.165	(0.10)
Acquisition Experience	4.425 <sup>†</sup>	(1.97)	4.298*	(2.04)	4.425 <sup>†</sup>	(1.97)	2.780	(1.27)
Greenfield Experience	-1.345	(-0.58)	-1.447	(-0.68)	-1.345	(-0.58)	-3.667 <sup>†</sup>	(-1.68)
Industry Growth	1.181 <sup>†</sup>	(1.67)	1.669*	(2.48)	1.181 <sup>†</sup>	(1.67)	2.126**	(3.17)
Regional Experience	5.163	(1.12)	3.044	(0.70)	5.163	(1.12)	9.987*	(2.36)
Firm Size	1.220	(0.16)	8.630	(0.12)	1.220	(0.16)	5.832	(0.80)
Subsidiary Age	-0.131	(-0.59)	3.161	(0.02)	-0.131	(-0.59)	0.107	(0.51)
High-Technology Industries	-3.163	(-1.57)	-0.314	(-0.15)	-3.163	(-1.57)	1.947	(0.95)
Low-Technology Industries	-1.385	(0.85)	-1.513	(-0.92)	-1.385	(-0.85)	-0.165	(0.10)
Ownership Stake (H1)			9.609**	(2.99)			5.191	(1.56)
Institutional Instability (H2a)			-0.321*	(-2.02)			-0.140	(-0.87)
Institutional Corruption (H2b)			-0.646	(-1.00)			-1.426*	(-2.12)
Cultural Distance (H3)			1.217*	(2.60)			1.431**	(2.96)
Technological Intensity (H4a)			-2.072**	(-2.99)			-1.311 <sup>†</sup>	(-1.87)
Advertising Intensity (H4b)			1.515*	(2.39)			1.066 <sup>†</sup>	(1.68)
International Strategy (H5a)			3.971**	(3.04)			2.035	(1.37)
Market Focus (H5b)			4.873*	(2.45)			-1.505	(-0.73)
N	171		162		171		163	
F	1.471		4.079***		1.649		2.234**	
Adjusted R <sup>2</sup>	0.08		0.34		0.09		0.21	

Two-tailed tests: <sup>†</sup> p < .10; \* p < .05; \*\* p < .01; \*\*\* p < .001 (standardized beta coefficients and t-statistics presented).



Figure 1: A multi-theory perspective



## NOTES

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<sup>1</sup> We refrain from reviewing the literature on the evolutionary role of subsidiaries in MNEs (see Birkinshaw and Hood, 1998) and draw upon traditional academic models that view subsidiaries as either market access providers or recipients of the parents' technology transfer (Vernon, 1986). 71 per cent of our observations refer to investments made after 1995, thus considering the model of subsidiary evolution by Birkinshaw and Hood (1998), we believe the CEE subsidiaries in this study are in a rather early stage of evolution and therefore dependent on parents' decisions regarding allocation of activities. Hence, our focus is on parents' subjective evaluation exclusively.

<sup>2</sup> Scott (1995) conceptualizes institutional forces into three groups: regulative, normative and cognitive. We concentrate primarily on the effect of regulative institutions because regulative forces are the most commonly studied in international business (Delios and Beamish, 1999; Brouthers, 2002). In addition, we study cultural distance to capture the second institutional pillar, namely countries' normative forces (values and norms).

<sup>3</sup> Hoskisson et al. (2000) identified 64 emerging economies, among which 51 are rapidly growing developing countries and 13 are in transition from centrally planned economies (they are mostly referred to as transition economies).

<sup>4</sup> Brouthers (2002) studies the performance of subsidiaries of EU firms in an unspecified range of transition economies.

<sup>5</sup> Psychic distance can be defined as the distance between the home market and a foreign market, resulting from the perception of both cultural and business differences (Evans and Mavondo, 2002).

<sup>6</sup> Bartlett and Ghoshal's (1989) typology describes four strategic types of multinational companies: global, multidomestic, international and transnational. We only examine the influence of global strategy and multidomestic strategy due to a lack of empirical support for the existence of international strategy (Harzing, 2000) and the ambiguity about the empirical support for the transnational solution.

<sup>7</sup> We comply with the majority of empirical studies that use a stake of 10 per cent and above in a foreign enterprise as a minimum to qualify as a foreign direct investment (Benito and Gripsurd, 1992; Padmanabhan and Cho, 1999; Larimo, 2002).

<sup>8</sup> Note that only 67 (32%) of the investments in our sample were made before 1998. Therefore, we regard the majority of the evaluations as short-term ones.