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## **Management in CEE Countries between 1996 and 2016 — Enduring and Emerging Issues**

This special issue of JEEMS is indeed special. It is not just longer than special issues of the past but also deals with a special topic as it sheds light on the past two decades of JEEMS with a collection of articles, each representing one year of this period.

This special issue pursues three main objectives. First, it should give an overview of research on post-socialist organizations and management in Central and Eastern Europe (CEE) throughout the transformation process. Secondly, it aims to elaborate on the extent and variety of contributions to CEE management research published in JEEMS during the past two decades. Finally, it will present dominant as well as underrepresented topics, theoretical and methodological approaches, and countries addressed, explored, and used as examples in this time span.

Throughout the years since the fall of the Berlin Wall, numerous projects and publications have focused on research on CEE Management. A considerable number of researchers from both Western and Eastern countries, thus insiders as well as outsiders, have been involved in studying changes in organisations and management in CEE countries with the intention of understanding the specific developments of management practice and structures under the conditions of fundamental societal and organisational change.

This said, it must be stated that with respect to both authors as well as institutions, a clear dominance of Western perspectives is visible in the literature on CEE management. In many situations, this has also led to some highly questionable lines of argument, particularly related to modernization theory-based assumptions of simplified East-West oppositions. Since its foundation in the mid 1990s, a central aim of JEEMS has been to provide a platform and opportunity for indigenous Eastern authors to publish and disseminate their findings and knowledge while, at the same time, not discriminating against Western authors and, thus, setting fertile ground for intensified scholarly discussions. Unique contributions to the field were made by scholars who were born and socialized in CEE countries and later migrated to Western countries bearing and transferring intimate knowledge of the field via improved access to publication opportunities in Western institutions. In our special issue, these colleagues are represented by Marin Marinov and Svetla Marinova (1996), Snejina Michailova (2004), Dorota Dobosz-Bourne (2005) and Yuliya Ponomareva (2015).

The selection of articles in this special issue is not representative of the geographical or institutional heritage of our authors, nor do we just look at most cited papers. Instead we pursued the idea of mirroring the broad scope of topics,

countries, authors, and approaches published in JEEMS in the past and also include papers that dealt with particular trends in CEE management research in this time frame and had a considerable impact on the field. Moreover, our selection of articles remains somewhat biased as, firstly, JEEMS has always been clearly dedicated to behavioural-oriented management research and has neglected submissions from various other fields, e.g., econometric or macro studies. Secondly, the decision to publish papers in JEEMS is not based solely on academic excellence alone but is also triggered by the wish to promote studies that can be characterised as novel and unorthodox in terms of country or methods (e.g., Llaci & Kume 1997, Geppert 2002, Grancelli 2011, Vissak & Zhang 2016).

When looking at the topics of the articles in this special issue, we see that they are mostly related to some typical post-socialist legacies. Worth mentioning here are (a) the important role of the state, namely through state ownership in the early years of transformation, (b) the importance of social security issues and motives of workers as well as their respective expectations of company management, (c) the importance of hierarchy and informality within enterprises, both also characteristics of East European national cultures, and (d) the importance of networks and network ties within and between companies. These legacies, the challenges of societal transformation towards capitalism, and the subsequent integration in a globalised world economy have formed some typical patterns of an emerging East European capitalism, with consequences for management agenda and management practices. The obviously persisting differences between CEE countries are related to the different states of transformation and the respective development of institutions of the new capitalism.

Accordingly, several illustrative lines of development may be found in the articles in this special issue. It started, for instance, with privatisation (Marinov & Marinova 1996), system change and new institutions (Catana et al. 1999) as typical topics in early years, followed by rather classic topics ranging from institutionalisation processes (Geppert 2002, Karhunen 2008), and the development of governance structures and networks (Buzady 2005, Prašnikar et al. 2014), to special management problems in often neglected branches (Karhunen 2008, Grancelli 2011). Another line links several culture studies dealing with national cultural differences and cultural change (Robinson & Tomczak-Stepien 2000), and intercultural conflicts (e.g., Suutari 1998) in early years, followed later by some more specified studies on the interplay of national culture and organisational learning (Škerlavaj et al. 2013), culture and trust (Kovac & Jesenko 2010), meaning creation (Serdukov 2012) and symbolism and sensemaking (Clark & Soulsby 2009) in later years. A third line can be traced from studies on management transfer from Western countries and the respective resistance in CEE (Catana et al. 1999), followed by studies about management learning (Michailova & Husted 2004) and foreign direct investment activities from CEE

to other countries (e.g., Kalotay 2003), to particular studies about the re-transfer of successful practices from CEE (Dobosz-Bourne 2006) and cases of internationalisation in less developed countries (Vissak & Zhang 2016).

While the above-mentioned issues represent a shift within some broader topics such as ownership and restructuring, culture, or management transfer and learning, some other issues like changing and emerging management practices mirror an enduring interest in (general) management practices and instruments (e.g., Stanojevic 2001, Dörrenbacher 2007) or management behaviours (e.g., Ponomareva & Umans 2015). Despite the influence of new or transferred management practices, these studies also point to the stability of practices and behaviours often in line with the cultural and institutional legacies of CEE countries.

Regarding the theories and conceptual approaches, the selected articles also demonstrate a clear development from more traditional approaches like Hofstede's national culture concept, Mintzberg's concept of decision making, theories of structural inertia, or more implicit perceptions of ownership, privatisation or governance based on property-rights or principal-agent assumptions towards alternative approaches that combine theoretical concepts to better address the special situation of organisations and management in transformational settings. The latter can be found, for example, in contributions from Geppert (2002), who combines theories of organisational learning and institutionalism with the enactment approach of Weick, or from Serdukov (2012), who analyses some sense-making processes in an emerging group of entrepreneurs and managers based on the theory of social representation. Another typical trend found in the material is an increasing interest in studies based on a process view using process theories (e.g., Robinson & Tomczak-Stepien 2000, Dobosz-Bourne 2006, Karhunen 2008, Clark & Soulsby 2009, Serdukov 2012, Vissak & Zhang 2016).

The importance and fruitfulness of a process approach in studying stability, change, and the emergence of new patterns of management in transformational societies is also highlighted by a clear (methodological) focus on qualitative case study approaches that are used in more than half of our selected articles, though surveys or quantitative analyses based on secondary data played an important role. Both also allow some cross-country comparisons to be found in contributions by Kaloty (2003) or Škerlavaj et al. (2013).

Looking back on two decades of JEEMS, a certain enduring interest and, thus, dominance of studies about Russia (e.g., Suutari 1998, Michailova & Husted 2004) as well as about the countries more advanced in the transformation process such as Poland (e.g., Robinson & Tomczak-Stepien 2000), Hungary (e.g., Buzady 2005), and Slovenia (e.g., Kovac & Jesenko 2010) is evident. Other countries have attracted increased interest in more recent years (particularly Serbia) while others have declined in quantitative terms (particularly East Ger-

many). With the selection of articles for this special issue, we tried to somewhat counterbalance this picture by giving room to a large range of countries.

Nevertheless, some issues remain underrepresented, both in JEEMS as well as elsewhere in CEE management publications. These include studies dealing with critical issues (e.g., social inequality, processes of inclusion and exclusion), gender studies (an exception is Llaci & Kume 1997), or research from generally underrepresented countries and regions (an exception is Vissak & Zhang 2016). Against this background this special issue should also remind us to make enduring efforts to ensure that JEEMS continues to enhance and promote activities in and papers from these areas, in accordance with our editorial mission.

Many more words could be written about management research in and about CEE countries since the early 1990s, but we will leave the stage free for eminent scholar James March from Stanford University to do so. In 2002, he was interviewed by Miklos Dobak and Karoly Balaton. His words from then will open this special issue.

We hope you enjoy reading this look back at two decades of JEEMS!

*Thomas Steger, Rainhart Lang, Irma Rybnikova*

### **Dedication**

**More than two decades of JEEMS would not have been possible without the continuous and tremendous efforts and support of Rainer Hampp, who was the publisher for this whole period until the end of last year.**

**We owe him so much and, consequently, dedicate this special issue to him!**

## Interview with James G. March\*

*Miklós Dobák, Károly Balaton*

### Stanford, January 16<sup>th</sup> 2001

Q: Last year you were awarded the title of Honorary member of the European Group for Organizational Studies (EGOS). How could you characterize your connections to European organizational scholars?

J.M.: As you know, my closest relations over the years have been with Scandinavian students of organizations. In the rest of Europe, I also have, I think, good relations, including close connections to a number of colleagues and friends, particularly in the western parts of Europe. My relations with colleagues in Central- and Eastern-Europe are less dense, but I have relations I value with you and your colleagues in Hungary, as well as less elaborated contacts in the Czech Republic, Poland, Bulgaria, Romania, Croatia, and Russia. These contacts are important to me. They provide the multi-national perspective that is essential. On a more concrete level, I think the post-Soviet history of the eastern parts of Europe have created natural experiments in organization studies. It is in most respects a hard time to live, but a great time for learning about organizations.

Q: How useful are Western management and organizational approaches in studying Central- and East- European organizations?

J.M.: Any decent organizational theory or management theory has to attend to historical, cultural and institutional differences in the institutions we study. Moreover, research traditions differ. There's a difference in the kind of research or the research orientation between the average European scholar of organizations and the average American scholar. These are also very substantial differences within Europe, English writers are really quite different from the French, for example. And a real community has to attend to all of these somehow. As far as applying things, it's sometimes true that research that is developed from your own culture turns out to be less useful than research that is developed from another culture about you. One classic case is De Tocqueville's analysis of American institutions in the nineteenth century. This advantage of outsiders stems partly from the fact that their observations are less redundant with what is already known and partly from the fact that they often proceed from a different basic framework, one that illuminates different aspects of the phenomena of interest. So I would expect western approaches to be valuable for example in Hungary, and Hungarian approaches to be valuable in the US. I am an enthusiast for diversity. But perhaps you had something else in mind.

\* Reprint from JEEMS, Vol. 7, Issue 1, 2002.

Q: The role of historical contingencies versus adaptation to emerging conditions?

J.M.: I think adaptation to emerging conditions occurs in the context of history and cannot be separated from it. Adaptation builds on history. So you cannot really have a theory of adaptation without embedding it in what's gone before. That's how it works.

Q: We talk about Western approaches very often in our conversations and of course in business as well. Sometimes it's also a question of globalization in organization theory, isn't it?

J.M.: I think we should always strive to have a global theory, but we'll never succeed. The tension between idiosyncratic institutional, historical and cultural factors and our desire to have an overall, overarching theory is a good tension. I have been reading a book on Hungarian history. It's a fine book, and it's an extraordinary history. Modern Hungary is embedded in that history. That's very important. At the same time, our job is to struggle to find some things that extend across different histories. So whenever people start having global theories we need to say 'well, you have to worry about institutions, history. And whenever people emphasize historical and institutional idiosyncracies, we need to say 'Let's make it more general.'

Q: How does knowledge creation and distribution work in modern organizations?

J.M.: I'm a little nervous about the word 'knowledge' because it's a popular word that has become fashionable without any precise understanding of what it is or how we can talk about it. If you speak about 'knowledge' softly, I suppose knowledge creation and knowledge distribution is pretty much my focus these days. But I don't often use the 'knowledge' term because I think it's been corrupted by the way people use it. It has become too popular.

Q: And how do you see the future of this 'knowledge theory'? Is it much more a fashion or does it have any lasting relevance?

J.M.: Well, a large part of it is fashion. Certainly. And there are all manner of books about 'knowledge' that don't say anything. But I think the pursuit of knowledge, and through knowledge of intelligence, represent enduring problems. The word itself is unimportant. When I talk about the problem of exploitation and exploration, I'm really talking about knowledge creation. And when I talk about diffusion of learning, then I'm talking about knowledge distribution. And I think that we will come to learn a little bit about those things. I would be hesitant to give any very precise consulting advice but I wouldn't at all be hesitant to talk to people who work in the field and say 'Here is something we know'. Consider a very specific example, what I consider the most important theorem from so-called 'bandit' problems. 'Bandit' problems involve a version

of exploitation and exploration. Probably the most important theorem from that research is one that shows that the optimal rate of exploration depends on the time prospective, that is how far ahead you look. The further ahead you look, the more exploration you should do. Now sometimes that's obvious but it's extremely important. And the problem for most organizations is that they don't look very far ahead. As a result, they often underexplore. Because they have a short time frame. They also have short, well, I call it 'space horizon'. Part of the organization is learning. It learns on the basis of feedback about how that part is doing. Of course, what it's doing has consequences for other parts of the organization, but those consequences are less salient. These 'spatial' perspectives tend to be local, rather than global. As a result, tend to invest too little in exploration from the point of view of the whole system. I think I can explain that to a business person. They'll understand it. And they can then apply that to their specific situation. I could not apply it to their specific situation. I can say that here is a phenomenon and these are the implications.

Q: You mentioned consultancy. Knowledge management in practice is a high issue. Every consultant would like to introduce a new term. We are talking about consultants who "Talk funny and make money". But on the other hand they have real influence on business. How do you see the role of these consultants, and consulting firms in the knowledge world, and in general?

J.M.: The "Talk funny and make money" description is one that I wrote, but the main point of that article was that consultants have a very important role. It's not quite the role that we sometimes assign to them. Their role in solving the specific problems of businesses is relatively modest. Without knowing the context they can't do much. They spread ideas around as "disease carriers". But when they spread ideas, of course, the ideas change. For example, ideas like 'Total Quality Management' have been spread by consultants. But when we study TQM, it seems to be rather different in different organizations. Consultants spread the rhetoric and some procedures, but then the organization takes over. That's useful. But it's important to recognize that what is happening is the stimulation of some kind of change, not any specific, well-defined change. 'Total Quality Management' is quite different in different organizations and in different countries I'm sure. I assume it exists in Hungary, but if I went into a Hungarian firm, it would look different from what I might find in an American firm. If I go to different American firms, TQM looks different. The other useful thing that consultants do is to say things that are not really quite true, but look at the world in a way different from the way a manager looks at it. The perspective may not be precisely applicable, but it stimulates the manager to think differently. In this way, the consultant acts in much the way a theorist does to provoke a manager to think in a different way and to organize his own rich contextual knowledge (which the consultant does not have) in a new way.

Q: There is a way of argumentation that business consultants contribute to the standardization of procedures and the standardization of solutions by taking solutions from one company to another. Is that true?

J.M.: I think that's a reasonable statement if you qualify it somewhat. Remember, I said consultants are aids to diffusion. And diffusion is a homogenization process. But what we observed in organizations is that when you transfer something, it changes. It is transformed at the same time. So generally you don't get homogenization. You homogenize some of the terminology. You homogenize the symbols. But you usually don't get very great homogenization on other things. The words 'Total Quality Management' spread and everyone has 'Total Quality Management' by now.

But what different organizations have are quite different things. So the rhetoric spreads more easily than the content typically, although I can think of situations where it's the other way around. A situation where it's the other way around is, you can remember, from twenty years ago in Hungary. A lot of management techniques spread in Hungary but they had to be distinguished from capitalist techniques. They had to have Marxist-Leninist type of labels on them. So you got Gvishiani's book, a thoroughly informed western book on management, couched in Marxist-Leninist terminology. In that case, the labels didn't diffuse but the ideas did.

Q: Maybe you know that Lenin was the first to support the translation of Taylor's books.

J.M.: Marxism was quite consistent with those parts of management theory that emphasized rational planning. Operations researchers in the Soviet Union had no difficulty at all talking to operations researchers in the U.S.

Q: It may be interesting for you why the activity of the consultants is important for us. In Hungary, as well as in other Central-European countries, there was a real lack of market oriented knowledge. And the consultants from McKenzie to KPMG played a very important role in bringing in these ideas. That is the reason why everywhere in Eastern European countries it was a really important question.

J.M.: It has to be true. You don't have to go that far from here. If you look at start-up companies here, they were typically started by people who haven't the remotest idea what a market is. They know nothing about how to run a company. They go to consultants who tell them 'You have to have this, you have to have this, you have to have this.' They go to one consultant to get their human resource department set up, and they go to another consultant for their accounting system, and so on. Of course, what happens is that the consultants give them some packages and gradually they learn how to work around those or through those. But without that help they'd be lost. They couldn't communicate to any-

one. When I'm a board member of a company, I have to have someone give me a list of things I'm allowed to do, that I'm not allowed to do, and that I have to do. There are manuals where I can find these. That kind of knowledge is extremely important. Take a Hungarian, or American or French firm trying to operate in China. The first thing they do is to try to find somebody who can tell them the 'rules' of operating in China.

Q: You mentioned that understanding how to achieve organizational effectiveness is a tough question. I ask it because every manager would like to have a successful organization, business excellence etc. And sometimes the consultants manage to create a much more effective organization. So my question is why do you think that organizational effectiveness is a tough topic. I have seen about five hundred items in the Socrates library program related to it.

J.M.: I don't object to the word 'effectiveness' or to the idea that there are some things that make organizations more effective. My objection is much more narrow and addressed primarily to scholars. I think it usually is a mistake for scholars to try to study performance as a dependent variable. Determining the factors that produce differences in organizational performance requires data we usually do not have and experimental controls that we almost never have. There are too many variables and too few data points. The variables are not under experimental control but are themselves endogenous. Since apparently successful practices are imitated, their visible effects are eliminated. If you look at the history of research trying to say something about ultimate organizational performance (profit in the case of business firms), that research has been almost entirely disappointing. Partly this is because there is a good deal of knowledge that has already been put into the system. If we could persuade someone to organize in a clearly stupid way, it would show up in the data. But nobody organizes in a clearly stupid way so it doesn't show up. Suppose for example that you wanted to understand the effect of participation and decision making by teachers on the retention of teachers and on turnover. That is essentially impossible to study in the field. There may be an effect but you never see it, and whatever you see is produced by so many factors that you cannot untangle them. Despite this, there is a lot of pressure on consultants and professors to answer questions like that. Consultants want to be able to say: If you organize in this way, you will have higher profits. In standard scholarly terms, they cannot have a valid basis for making such statements, but the market compels them to try.

Q: But the company manager pays for the consequences. They pay a lot of money. And they ask 'What have you done for me?'

J.M.: I think you should not work for those managers. But consultants, like so many of us, have to make a living.

Q: What is your present research interest and what is your opinion about the current management and organization theory?

J.M.: My present research interests are not much different from the research interests of my whole life. I've been mostly interested in how organizations adapt to their changing environments, either by calculated rationality or by learning or by selection, whatever. So that's where I am now. I think if I had to say what things at the moment most interest me, they are, first of all, the various aspects of the balance between exploitation and exploration – the way in which organizations develop what they already know and discover what they might come to know. How they balance those two activities against all kinds of pressures. And secondly, I am interested in trying to develop a somewhat richer theory of the diffusion of knowledge.

Q: How do you see the future trends of organizations?

J.M.: The one thing that you can forecast about the future is that your forecast will be wrong. Most people in forecasting are doing either one of two things. Either they are taking things that have already happened and say they will happen some more, or they are take their wish list, what they hope will happen, and announce that it will happen. I don't think either of those are very good prediction devices. Most of the interesting things that have happened in the past in organizations, the big things that have happened, none of us predicted. So why would it be different in the future?

Q: How do you see the role of information technology? Sometimes there are people who talk about chaos that will happen and other people believe in order. Order versus chaos. It's a really interesting question. It is a very interesting question for us in Central and Eastern Europe because here the gap is smaller compared to West-European countries and to America. Maybe it is not the latest technology but three to five years old technology. So in Hungary it's an interesting question for us what is our expectation: chaos or rather order? We know that Orwell wrote about that very well and sometimes people are afraid of the future – the socialist order comes back or something else?

J.M.: I think we can have vague kind of speculations about that. I would think that one of the first steps one ought to take, but we don't take, in understanding what the impact of information technology will be is to try to understand what it has been and why it has been what it is. Everyone agrees that it has an enormous impact. But I don't think we have a very clear notion of how that impact has happened or what exactly that impact is. One of the arguments for example is whether on balance all the money spent on information technology has produced a return equivalent to what it has cost. There are serious people trying to study it who say that the gains from information technology are very substantially less than the total costs of it. They are not referring to social cost, they are talking

about money, about financial cost. And this enormous amount of investment has really not had anything like a return equal to the cost. Now suppose that's true. Then our job is to explain why it spreads, why is it that so many people use it. And will that help us understand what will happen in the future? I think the kind of question you were asking, the Orwellian question, is a very important one though I don't have any idea about how to go about talking about it. When I was younger and more daring I said. Modern electronics and information technology in general will force us to have less privacy and as a result of less privacy, we would have to change our moral code. Because our moral code is built fundamentally on the ability to conceal many of the things we do. A whole set of rules, the rules that could not be satisfied, so we satisfy them publicly but not privately. I argued that if you increase the domain of what is public, then the rules would have to change. I suppose there are a few signs that that speculation has proven to be true, but I don't think the confirmation is very conspicuous. What I think is impressive in many ways about the whole debate over privacy is the extent to which people are clever in sustaining privacy. So, although it looks like you get much less privacy, I'm not sure it's quite like that.

Q: It is a bad feeling that we can not make a forecast for two or three years, when we are talking about information technology. But for other parts of business or another part of management we can create a much better forecast. However it is much less possible to create a forecast for tree to five years.

J.M.: We are getting to be a little bit more sophisticated about what the market is, the people, about little gadgets, but it's hard for me to comment because I live in this very funny culture around here where newspapers have headlines on the front page about some new product that might seemingly revolutionize something although probably you'll never hear about it again. The visions about the future become news and they never become reality. We can't even decide whether information technology will lead to more centralization or more decentralization. Part of the problem stems from the inadequacy of concepts like centralization and decentralization, but part of the problem is that we simply don't understand the processes of social change.

Q: What about the changing role of management education?

J.M.: I think that any time you're in the world in which things are changing management education has to go to the fundamentals. You cannot train a manager now for the details of management. He will learn that when he gets there, and it will change several times during his career. So my management education looks like a highly intellectual training in fundamentals.

Q: You said basic fundamentals. What fundamentals do you mean?

J.M.: The basics of economics, social life, psychology, the basics of computers, mathematics, and languages. And what drops out of that? Probably the more applied domains that are linked to specific practices.

Q: But it does not always depend on us, teachers, because sometimes students would like to learn about the American practices.

J.M.: Yes. But they adapt and you just have to resist them. They don't know. They are right in the sense that somehow they have to sell their services to somebody and that somebody will say 'Well, you don't know anything about accounting' So they should know something about accounting. So give them a textbook to read before they go to talk to somebody. But I wouldn't waste much educational time. But it is easy for me to pontificate. No one has asked me to design business education.

Q: It is not so easy to define what is basic either because it will also change. I remember that twenty years ago we taught the classics of organization from Taylor to James March for a semester. And now it's a question for us, for example, to teach the post-modern or not. Is it basic or not.

J.M.: I think that's an interesting intellectual formulation of the problem, so I would teach some of that. Not because it's current, but because ideas of social construction and technology are important. If you want you can teach it using Plato. I don't think you have to use so called 'modern terminology' which tends to be a little tortured. The essence of my strategy is that what you would teach people is reading, writing and arithmetic.

Q: That doesn't change.

J.M.: That doesn't change. And you teach some attitudes. I would say now the biggest problem with contemporary business education is that we don't teach an attitude that says you have to learn continuously. Education does not stop when you walk out the door. Education is a permanent thing. So what we should be doing is preparing people for permanent life of education. The notion that you continue to read, you continue to try to solve problems.

Q: To what extent are you involved in teaching? Do you teach PhDs or graduate students, do you lecture?

J.M.: My life is mostly teaching. I no longer give large lecture courses, but I spend most of my time trying to communicate a few ideas. The particular format or content may be important but they are really ideas about life. I had lunch today with a film maker. And we have been talking about the possibility of producing a film that would essentially focus on what I talk about on my leadership course. What I told this film maker was I was not interested in a film that was oriented particularly to business. I wanted to talk about the ideas and I hope the ideas underlying leadership, the ideas underlying life.

Q: Is it a kind of challenge for your ideas, or is it fun?

J.M.: If you are thinking about using a new medium, you should stand back and ask 'What can this new medium do that I couldn't do before'. And my answer may be 'nothing' and then I will say 'No, sorry, I won't do it.'

Q: We hope we shall see that film. Thank you very much for the interview.

## Characteristics and Conditions of Entrepreneurship in Eastern Europe\*

Marin Marinov, Svetla Marinova\*\*

*Establishing of new small businesses is an intensive process in the whole of Eastern Europe. As they are new, most of them are in the introductory phases of their existence (survival, consolidation and control). Contemporary industrial and market structure in the countries of Eastern Europe provides entrepreneurs with many opportunities for niche company creation. However, many problems exist related to the lack of resources (mostly financial), inadequate knowledge and skills in management and marketing needed in market economies, insufficient availability of business support organisations combined with inappropriate understanding and attitude among managers in the newly created businesses towards the existing business support organisations.*

### Introduction

Economists consider four major strategies for entrepreneurial development: "capital", "nuclear", "evolutionary" and privatisation of state enterprises (Brunner, 1993). The application of a certain strategic approach depends on the current conditions of the economy and the governmental attitude and goals for development of entrepreneurship. Analysis of entrepreneurship using this approach focuses on the macroeconomic and political conditions for creating and developing new ventures. It considers the state as entrepreneur without considering the entrepreneurial characteristics and requirements of the individual entrepreneur and the entrepreneurial support system.

Entrepreneurial success depends on the pursuit of opportunities, and the organisation and implementation of resources. If resources are understood not only as those currently controlled by an entrepreneur, but also as the ones owned by other people, the chances for a new venture success increase. However, the key factor here is how to convince the possessors of resources not only that it is an opportunity for the entrepreneur, but for them as well.

A key change in Eastern Europe is the replacement of the previously imposed dominant value system by multiple value options. This availability of overwhelming variety of options in Eastern Europe at present creates some problems for entrepreneurs. They are mainly related to identifying the appropriate opportunities. Establishing conditions for individual entrepreneurial activities through

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realising market opportunities based on motivation, drive and ability mobilises resources for such a purpose. This could be the basis for the effective and efficient implementation of a certain macroeconomic entrepreneurial strategy encompassing focuses on the development of businesses with present comparative advantages creating islands of excellence and reducing the state ownership and control on the productive assets of the economy.

The transfer of ownership from state to private is the key issue of the transition from centrally planned to a market led economy. The practical achievements in this aspect, however, are unsatisfactory and disappointing in the global context of Eastern Europe. Some of the main reasons for these can be found in the change of ownership and the respective development of entrepreneurial system.

This paper reviews the entrepreneurship development in the context of Eastern Europe from a theoretical perspective. It explores the dimensions of some key factors in shaping small and medium enterprises (SMEs), the characteristics and requirements for the different types of entrepreneurship, the tasks and role of entrepreneurship for closing the structural gap in the economy that could speed up the East European transitional processes, and the conditions for entrepreneurial revival in Eastern Europe. Using a dynamic vs. a traditional entrepreneur comparison, the article relates its theoretical analysis to the experience of an SME new venture in Bulgaria.

### **Key Factor Characteristics of Entrepreneurship in Eastern Europe**

The tradition of support for small business creation and development was severely suppressed with the establishment of communist regimes in all Eastern European countries and consequently it could not promote and push forward the development of private SMEs (See Table 1). The past experience and traditions in entrepreneurship are nowadays difficult and painful to resurrect and start functioning effectively and efficiently. The distribution of political power is a gradual process, as the gap between central planning and market driven decentralisation is still very significant. Governments favouring centralisation resist radical change and delegation of authority to regional and local governments, as the old societal structures continue to be decisively powerful.

The monopolistic positions of industrial "giants" in Eastern Europe have been shaken in the recent years through the processes of restructuring and privatisation, but they still dominate the national output and highest contribution to GDP in almost all of the Eastern European countries. Consequently, small businesses and entrepreneurship are presently with low economic power and too vulnerable in the turbulent economic conditions.

Establishing institutions to support the development of small businesses is a serious task and a big challenge that will take a long time. The existing network of private and restructured former public institutions forming the small business

**Table 1: Key Factors for Entrepreneurial Development**

Key Factors in Shaping SME's Policy	Dimensions of the Factor in Eastern Europe
The length of tradition of support for SMEs	None in the period of at least 45 years
The relative distribution of political power between central, regional and local governments	Presently unclear, historically exclusively concentrated in the central governments
The strength of the existing SME sector	Mostly weak, financially unstable and insignificantly developed
The balance of industrial and political power between large industry and SMEs reflected in their company orientation	The cases are different in various countries, but as a whole power still stays in large industries
The overall economic and social rationale for business policy development	Development of small private businesses is considered to be of significant importance in the economic restructuring of Eastern European countries, still the restructuring processes are not well supported with national programmes
The basic ideology of governments	The processes of restructuring have been slowed down with the forming of socialist governments in many Eastern European countries following the election victory of socialist (former communist) parties in the last elections.

Source: Based on the idea for the content of the key factors for entrepreneurial development by Haskins, G. *et al* (1986)

support network in Eastern Europe is far from being sufficient and adequate. The indispensable for the creation and development of market economy financial sector is still emerging. There is little evidence for coherent local and regional strategies for small private business creation and development. Very little has been done in these aspects on central government level.

As stated by Dubravcic (1995) the change of ownership of economic assets is a part of a global entrepreneurial system that includes risk taking and profit seeking agents as well as help in their entrepreneurial efforts by an adequate and well developed business support structure, basically a financial market structure.

The types of entrepreneurship related to the needs of small private business creation and development in the conditions of mature transitional economies, having the characteristics described in Table 2, were non-existent in the centrally planned economies of Eastern Europe during the communist rule.

The types of entrepreneurship presented in Table 2 can be domestic or foreign. As a result of the systematic destruction during the communist regime of the entrepreneurial system domestic entrepreneurship (productive and financial) is cur-

rently in poor condition in Eastern European countries and is unable to fully benefit from the availability of existing opportunities.

The rudimentary financial markets, the main private business support institutions, cannot provide the necessary assistance for entrepreneurial development in Eastern Europe. Foreign entrepreneurship, to date mostly financial, does not fully exploit the emerging opportunities in the region due to political and economic instability, lack of legal guarantees for investment, high inflation that in some countries is beyond control. The strong positions of the former nomenclatura, socialist (former communist) governments in many Eastern European countries, the existence of powerful Mafia and lobbying groups that influence the revival of entrepreneurship raise additional problems and barriers for entry of foreign entrepreneurs both productive and financial. The financial business support structures mainly consist of state owned institutions that do not favour the development of private small businesses. As the economic conditions are bad countries' internal investment funds are scarce and this limits the performance of domestic financial managerial entrepreneurship. Therefore, for the whole region it is mainly foreign through investment funds and international financial institutions.

### **Goals of Entrepreneurship in Eastern European Transition**

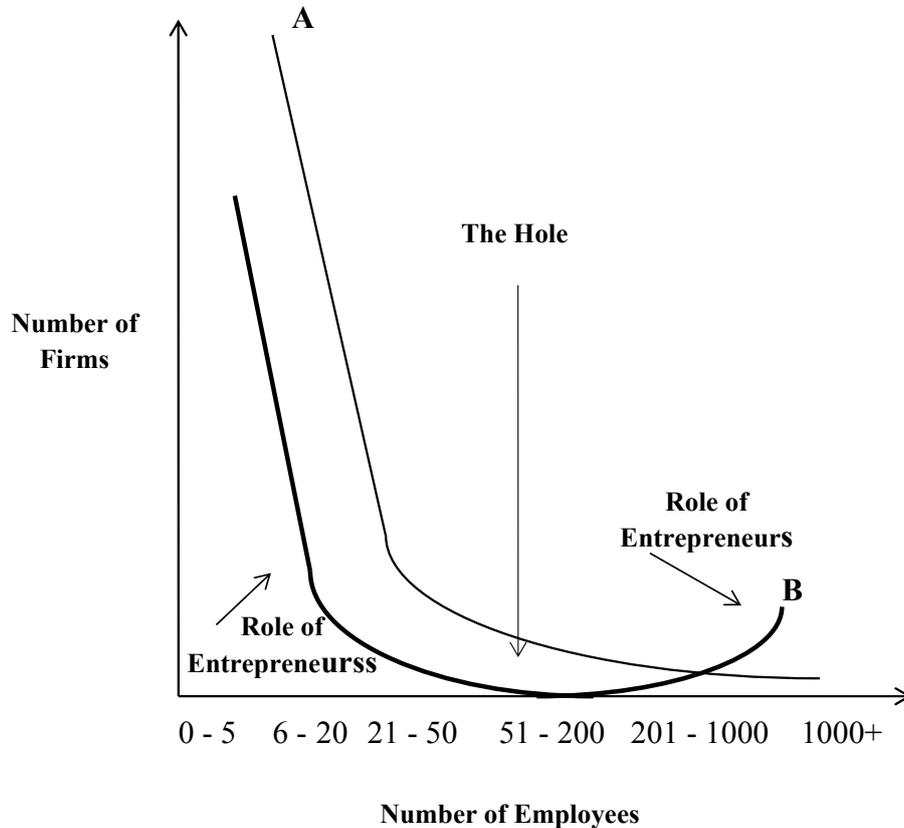
The experience to date in transitional reforms of post-communist economies in Eastern Europe indicates that “macro stabilisation will be difficult to achieve... in the absence of adequate micro adjustment” (Svejnar, 1991) and that institutional reforms and privatisation are insufficient for efficient and effective economic restructuring without entrepreneurship (Acs and Audretsch, 1993) aiming at successful new venture creation.

Pre-transition comparative research in the economic structures of capitalist economies and planned communist economies identifies the existence of a “hole” in the latter economies (see e.g. Gibb, 1993; Vahcic and Petrin, 1989). The “hole” represents a remarkable absence of small firms in the economic structures of economies of Eastern Europe. Gibb (1993) gives another interpretation of the hole comparing the market economy distribution of firm size (curve A) with the corresponding distribution in the transitional economies (curve B) – see Figure 1. The characteristics of firm size distribution, expressed by curve B, are inherited from the years of communist megalomaniac economic development, characterised by severe restrictions on the development of small private businesses and lack of property rights guaranteeing such development.

**Table 2: Characteristics and Requirements for types of Entrepreneurship in Eastern Europe**

Type of Entrepreneurship	Features of Entrepreneurship	Necessity for Innovation	Importance of Risk Taking	Significance of Profit Making
Productive [Owner(s) of small businesses are often also manager(s)]	Develop from successful single proprietorship by hiring additional workforce.  Financial markets supply funds from savers to provide productive entrepreneurs with capital.	Very big	Crucial	Crucial
Financial	Savers who chose among the variety of opportunities differing according to their attitudes to risk taking and eagerness to fortune making	Very big	Crucial	Crucial
Productive Managerial	Deciding on education and employment opportunities and acting in direction of creating and improving position in the enterprise.  Risk and awards are related to career development and income increase and not to the amount and value of assets.	Crucial	Very big	Crucial
Financial Managerial (Managers in the financial institutions)	Agents acting as intermediaries of financial markets offering investment opportunities for savers and funds to productive entrepreneurs for creation and development of private businesses	Very big	Very big	Very big

**Figure 1: Size of Firms (Number of Employees)**



The macroeconomic role of the entrepreneurs in Eastern Europe is presented on Gibb's model of the structural gap in Figure 1. Graphically expressed, their role is to gradually change the form of curve B so that it can be transferred in curve A. In real dimensions this task is interpreted with the increase in the number of firms with size from 0 to 50 employees, mostly through creation of new private ventures and restructuring of large state-owned firms to overcome their significant absence in firm size 51 to 250 employees.

The latter firm size group is seen by Banasch (1990) as the major route to small business development in the industrial and service sectors of Eastern European countries. Banasch's suggestion is appropriate for the conditions in the region where the most significant obstacle to new firms set-up of 51 – 250 employees size is the scarcity of financial resources, mostly concerning domestic entrepreneurs. On the basis of the entrepreneurial task in macro aspect, tasks on micro level can be broadly defined. Their successful implementation can result

in macro restructuring of the transitional economies in Eastern Europe. The entrepreneurial task on micro level can be summarised as follows (Tyson *et al.*, 1994):

- Entrepreneurs have to play active roles and implement the processes of privatisation and restructuring of state-owned companies. The realisation of these tasks needs a broad range of activities. Entrepreneurs have to divide large firms in smaller more efficiently functioning and giving better effects enterprises. By doing this the scarce resources could be freed up and utilised in a better way, existing excessive diversification can be reduced, better and more effective configuration of related businesses can be created. In the meantime the entrepreneurs have to restructure and reorganise the smaller privatised firms in order to create appropriate managerial network in the restructured enterprises, stimulate the development of managerial skills needed in a market economy, invent new incentive schemes, introduce total quality management, make the reorganised companies innovative, flexible and globally orientated to the market.
- Entrepreneurs have also to start from scratch new modern small businesses that will contribute to “filling in the hole”. As Arzeni (1992) shows the average employment share of small firms in Eastern Europe is 3 per cent because in 1980s two completely controversial processes took place in the market and centrally planned economies. While the small-firm share of employment in the developed Western economies has recently increased considerably (see e.g. Duche and Savey, 1987; Storey and Johnson, 1987), that share has been decreasing till the start of transition in the former centrally planned economies (Carlsson, 1989). Although this negative trend has been successfully reversed in most Eastern European countries the bulk of the job for the fulfilment of the second task of micro character still has to be done.
- Entrepreneurs have to help the process of global change of the characteristics of the industrial structure of the economies of Eastern Europe. Such a shift must result in fundamental industrial restructuring replacing the excessive dependence of the economies upon outdated heavy industries with more balanced industrial structures resulting from the development of industries where individual countries can gain comparative advantage. Through the exposure to new markets the influence of market forces have already created conditions for such changes, as prices of goods have been permitted to reflect their actual supply on the world markets. The pricing policy, related to the situation on the domestic markets, faces the restriction of the very small purchasing power of the domestic customers. Entrepreneurs will have to find a good answer to this complication as well.

Regarding the operational activities needed for the start-up of a new venture or restructuring of an existing business the principal entrepreneurial tasks at any

stage are: production/operations, finance and marketing (Arendarsi and Mroczkowski, 1994).

*Production/Operations:* The environmental characteristics and their restrictions are the most important factors that determine the particular kind of business to pursue, especially if it is of a bigger size. In Eastern Europe as well as in Western countries, previous experience and business contacts play crucial role. This is especially true for businesses with international markets, trade and service companies. The recession in Eastern Europe is forcing more thought and creativity into the production/operations task. The manufacturing start-up firms in manufacturing usually have to restrict their activities by applying low-cost, low-technology production processes because of the lack of sufficient capital and significant difficulties in obtaining modern equipment and technology. Some help in this aspect has been provided by foreign entrepreneurs usually resulting in creation of international joint ventures.

*Finance:* Initial capital is needed for the establishment and early development of new ventures and often for the restructuring of existing businesses. Studies in many Eastern European countries have revealed the extreme significance of own capital for start-up businesses. Bank credits have had very limited role as well as the financial help through various foreign investment funds. New ventures are usually undercapitalised due to the macroeconomic specifics accompanying recession (high inflation, high interest rates, constantly decreasing availability of domestic credit opportunities). Some of the new ventures act as competitors from their birth which decreases their chance for profit as competition has kept prices down despite the contrary effect of recession. The global evaluation of the financial task of entrepreneur in Eastern Europe gives it complicated and controversial description which significantly hampers its fulfilment.

*Marketing:* The recession in Eastern Europe has created hard time for the new private companies since their pricing policy is severely restricted by their undercapitalised conditions. The underdeveloped and unsuitable for market economy infrastructure in the region has created many problems with distribution of products for most new private businesses. In some countries, like Bulgaria, the wholesale and retail systems undergo very significant changes and this process creates additional burden for entrepreneurs. For many new private businesses the most important customers are state-owned companies, that being bigger and stronger, enjoy strong bargaining power, especially when supply is provided on highly competitive basis. This makes the respective small businesses substantially dependent on the condition of the public sector that in most of the countries is poor or very poor. Such entrepreneurs have to cope with very sophisticated problems. Consequently the worsening health of the state-owned companies can produce equivalent result in otherwise healthy private firms. Being new and small, the established private businesses are generally of local importance oper-

ating within the boundaries of a single town or smaller part of it. In such cases the owners of the businesses often act as distributors and retailers (small firms on family basis in agriculture are good examples). International markets are usually regarded by small venture start-ups as a potential for the expansion of their markets, creating an international joint venture or seeking additional opportunity for technology transfer and source of credit.

#### *Conditions and Requirements for Entrepreneurship in Eastern Europe*

Using the model developed by Hatton and Raymond (1994) (See Figure 2) the overall evaluation of entrepreneurship in Eastern Europe can be based on elements of which it consists. The variable *environment* represents the variety of all internal and external factors actively and potentially relevant in the process of business decision making. *Strategy* is regarded as a pattern in a continuous stream of decisions (past, present and future) that is expressed in two aspects:

- guides the progressing adaptation to and influences on the environment of a business;
- forms the business internal policies and procedures (Miles and Snow, 1978; Mintzberg, 1978). *Task* and *technology* are conceptually almost inseparable. The *task* represents the major objective of the business, and the *technology* provides a detailed description of how this objective can be realised. The *structure* of a business includes the official organisational hierarchy and lines of communication, as well as the existing informal structure and actual lines of communication during the functioning of this business. The *individual*, a controversial variable, is analysed by the authors in the aspects of bureaucratic orientation and degree of strength needed for higher order.

Analysing the entrepreneurial model, presented in Figure 2 with the use of information given in Table 3, both entrepreneurial and administrative aspects of the organisational activities of small private businesses are considered. The original idea of the model is to provide guidance for entrepreneurial decisions from the start-up phase of a small business combined with the analysis starting from the outermost layer of the model and progressing toward the centre.

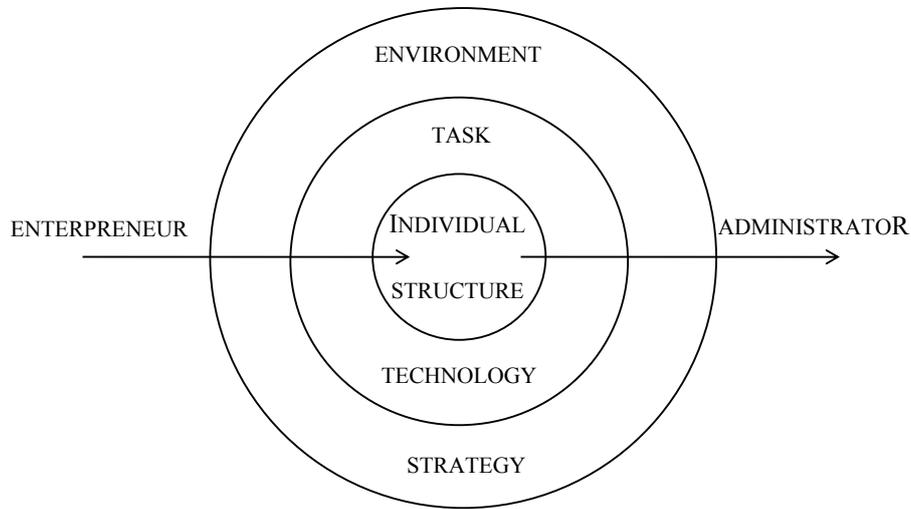
The environmental characteristics for small business creation and development in Eastern Europe are assessed as very complex and dynamic. The reason for complexity, both for domestic and foreign entrepreneurs is the fact that the macro environmental characteristics lack as elements the necessary institutional business support infrastructure. For a domestic entrepreneur crucial from a financial point of view is the insignificant amount of domestic investment funds and the willingness and availability of supply through financial help provided by foreign investment funds and the international financial institutions. The reality is that the supply of finance is far less than the existing demand. Macro environment is characterised with significant volatility caused by the processes of politi-

cal and government instability in most of the countries in the region. In most of Eastern European countries governments change often and each comes with new programme for the restoration of the entrepreneurial system. This hampers the restructuring process and causes continuous changes in the legislation and institutional structure, delaying the appropriate re-establishment of the indispensable for the market economies entrepreneurial system.

The overall existing economic system also changes as result of the restructuring processes, transfer of ownership of productive assets and liquidation of the existing state owned enterprises. Many niches in the existing markets are available that creates good opportunities for entrepreneurial development in Eastern Europe. However, many problems exist, related to both macro and micro specifics of the environment. They are caused by the need for integration of the new start-up businesses in the existing economic structure that itself undergoes considerable changes continuously since the beginning of the transitional process.

Considering the characteristics of the environment it is of fundamental importance for the entrepreneurial development in Eastern Europe that the determining business characteristics match the environment and the market specifics in the best possible way. The problem of the most significant importance of Eastern European markets is the small purchasing power of the individual industrial customer. The high inflation causes high level of interest rates on loans that cools down the ambitions of the less enthusiastic and risk adverse entrepreneurs. From strategic point of view a new venture comes into existence after the analysis of all aspects of the environment. The niche strategy is very suitable for small business creation where economies of scale cannot be exploited because of the limit of market for certain products or services and the theoretical optimal size of an enterprise is not achievable. The existent economic structure in Eastern Europe provides opportunities for many industries to specialise on product/service and market basis to serve well targeted market segments. If based on a well developed niche strategy a small business start-up is expected to have better chances. Most successful small private businesses in Eastern Europe, created during the transitional period, can be identified as niche enterprises.

**Figure 2: A Small Business Concentric Congruence Framework**



Source: Hatton, L. and B. Raymond (1994)

**Table 3: Variable Dimensional Characteristics of Entrepreneurship in Eastern Europe**

Variables	Dimension	Predominant Dimensional Characteristics in Eastern Europe
External Environment	simple – complex static – dynamic	very complex very dynamic, unsettled, turbulent
Internal Environment	simple – complex static – dynamic	very complex very dynamic
Business Strategy	defenders – prospectors	mostly prospectors for start-up businesses mostly defenders in later phases
Task	simple – complex predictable – uncertain interdependence: pooled – sequential – reciprocal	complex to not very complex mostly uncertain reciprocal or sequential, rarely pooled
Technology	mediated – long-linked – intensive	mediated, rarely long-linked or intensive
Structure	centralised – decentralised organic – mechanic	mostly decentralised mostly organic, rarely mechanic
Individual	bureaucratic orientation: high – low higher order needed strength: higher – low	mostly low medium

The specifics of the environmental characteristics define the entrepreneurs at the start-up phase as prospectors. The overall complexity of the environment combined with the absence of knowledge, experience and skills among the Eastern European entrepreneurs; the lack in most of the cases of efficient competition and rudimentary, inefficient and inexperienced financial markets; the insignificant amount of domestic capital; the phenomenon of high inflation and unemployment rates and the macroeconomic and political instability, often turn the strategy of entrepreneurs from prospector to defender.

As seen from literature data (See e.g. Arendarski and Mroczkowski, 1994; Bartlett, 1993; Marinov, 1993; Puchev, 1990) and based on authors' personal experience in small business consulting, it is evident that the task of entrepreneurs in Eastern Europe can be described as with significant complexity because of the unfavourable and turbulent characteristics of the existing economic structures. Related to these the tasks are unpredictable, that is rarely due to the character of the business. The predominant interdependence of tasks' characteristics is sequential or reciprocal, rarely pooled. This is to a large extent due to the lack of market knowledge and experience of Eastern European entrepreneurs and the market characteristics of the region that do not provide sufficiently strong and distinctive market signals.

The technological characteristics of small private businesses in Eastern Europe if viewed as the extent and scope of computer technology applied in the organisation can be described as relatively scarce, primitive, if at all existing. Application of information technology is very limited. When technology is analysed as the application of knowledge to perform work, then it could be suggested that in Eastern Europe it is mostly mediated, rarely strategy related or intensive. This fact results in competitive disadvantages for most of the small businesses in Eastern Europe compared with Western companies of the same type. These are especially true in terms of product quality corresponding to the requirements of international standards, market and customer information gathering and handling and information flow efficiency and consequent results for the organisations.

The organisational structure of newly created small businesses in Eastern Europe is predominantly decentralised h-form or a certain mixture of functional and decentralised form with comparatively low rigidity. Being in most of the cases organic enterprises, small private businesses in the region are in the form of mutual collaborations with few well defined rules and procedures. These organisational characteristics affect the potentials for production and market flexibility of small businesses. The latter is rather restricted by the scarce financial resources and mainly domestic market operations of small private businesses in the region. Organic business creation and development differ from the ones related to small business establishment resulting from the restructuring and privatisation of large

former state owned companies. Their structural characteristics tend to be more centralised and less flexible. Additionally, while in newly created small businesses the formal and informal organisational structures tend to be identical to a great extent, differences in this aspect are more common for the small businesses born from the break-ups of former state owned mega-businesses.

Entrepreneurs in Eastern Europe have in most of the cases low bureaucratic orientation and tend to be independent decision makers. Their activities are mainly determined by the environmental constraints that are complex and restrictive in nature.

As the characteristics of the variable dimensions suggest, entrepreneurship in Eastern Europe functions in a mostly very complex and dynamic environment that is highly volatile. The new business creation in the region has had explosive character since the start of the reform and this process is without a parallel in the recent economic history. Only those businesses that apply the approach of dynamic entrepreneurs can hope of survival combined with successful growth and development. Table 4 gives information that contrasts the features of the transitional SME owners and dynamic entrepreneurs.

**Table 4: Major Features of Traditional SME Owners and Dynamic Entrepreneurs**

Feature	Traditional SME Owners	Dynamic Entrepreneurs
Business Development	Static	Growing/Expanding
Vision	Status Quo	Opportunistic
Scope	Local	Global
Focused on	Internal Resources	External Resources
Approach to Market	Fear Competition	Seek Competition
Attitude to Risk	Risk Adverse	Risk Taking
Predominant Goal	Survival	Success

If the environmental characteristics and conditions for business functioning in the developed market economies are considered, entrepreneurs described through features similar to those of traditional SME owners might be successful, whereas that cannot be the case in Eastern Europe. The unsettled political, economic, legal and business environment in the region impose indispensable requirements to all the features that characterise the dynamic entrepreneurs.

#### *The Venture of Roda Car Ltd. Bulgaria – Entrepreneurial Characteristics*

The international joint venture between Rover Group Ltd. (United Kingdom) and Daru Car Ltd. (Bulgaria) started in Bulgaria in November 1994.

### *External Environment*

The macro- and microenvironment in Bulgaria was characterised by lack of tradition of SME support. The industrial and political power was strongly concentrated both in powerful large private business lobbies and large state owned industries. The available rudimentary business support structure was mostly oriented to state owned businesses while the infrastructure in the country was very underdeveloped.

The political decision making power with deeply embedded centralism was still too much concentrated in the central government, the latter not demonstrating any enthusiasm and support for the success of the venture. Instead, many difficulties and obstacles including taxes, tariffs, civil servant heavy bureaucracy were in place. The company was situated in the town of Varna, far from the capital and local government authorities were not empowered to really improve the conditions for the functioning of the firm. The last parliamentary and municipal elections in the country have been won with absolute majority by the former communists (Bulgarian Socialist Party) whose government initially strongly opposed private SME development out of total government control.

The small business sector in Bulgaria was very weak, financially dependable, and providing insufficient in quantity low quality goods and services. Opportunities for physical distribution were extremely very limited and logistics in a bad condition. Therefore, the company could not rely on regular supply and had to keep enormous amounts of stock as huge buffers at the front and at the back of the factory. That was freezing considerable amount of capital, creating production problems mostly with material flows and slow turnover.

The whole market in Bulgaria was far from being competitive. The management defined the marketplace as “inhabited by half legitimate – half crook companies”, dividing absolutely everything among themselves – markets, raw materials, zones of operation. In that way the approach of the command economy when the cake had been divided among the producers by the Communist Party making everybody happy except the customers, was still in place. Some illegitimate, violent competition was appearing, but it was much more of a “Mafia” type rather than exhibiting characteristics of a competitive market.

### *Internal Environment*

The company used greenfield approach to people and started recruiting workers for its business. Cultural problems of managerial character developed between the British management and Bulgarian workers that were solved in process by processes of mutual adaptation. The most important was the application of team work and related issues of decision making responsibilities that Bulgarians had to accept and build on.

Meeting high quality standards was a serious obstacle to business development. The process of mutual adaptation between the British and Bulgarian parties was there in progress as well, which for both sides was a totally new, very complex and dynamic environment. The Bulgarian workers had to deal mainly with new technology and new management know-how, while the British managers faced mainly different culture, environment, work practices and standards.

### *Business Strategy*

From a strategic point of view the company owners were clear prospectors. They aimed at becoming market leaders at the Bulgarian car market and then possibly expand their leadership position beyond the Bulgarian boundaries. They wanted to influence the quality perceptions of their potential customers through introducing much higher quality standards than the existing ones.

### *Task*

Both in manufacturing and marketing aspects the task of the company can be described as very complex. They simultaneously aimed at establishing and getting recognition for their very high quality standards, realising backward integration with local suppliers, becoming market leaders in Bulgaria and beyond in a broader region through increasing the volume of production and product diversification.

The company management was trying to implement pool – sequential approach of their task realisation that would very much depend on the economic development of the country in the near future. After an overall estimation this task could be described as mostly predictable.

### *Technology*

In co-ordination with task new technology approach based on intensive development was in the process of implementation. Plans for technology integration were in process of development.

### *Organisational Structure*

The organisational structure was a lean, fully decentralised organic one.

### *Individual*

Bureaucratic orientation was as low as possible in spite of the internal and external environment of significant cultural differences. Higher order needed strength was medium, tending to become low.

### *Marketing Conditions*

The recession in Eastern Europe had created hard times for this new private venture since the purchasing power of customers was severely restricted. Consequently, the pricing policy of Roda Car Ltd. was planned to be very flexible, adapting to these conditions, but offering high quality product.

The underdeveloped and unsuitable for market economy infrastructure in the region had created many problems mainly related to distribution and communications. As in Bulgaria the wholesale and retail system was undergoing very significant changes, this process created additional burdens for the new venture.

The company relied on local marketing expertise, which was limited and inadequate. There was much of unawareness and lack of practical skills in marketing research and marketing the very product of Roda Car Ltd. That proved to be a major internal drawback in the whole venture.

### *Features of Entrepreneurship*

When summarised the entrepreneurial features of the company were typically dynamic because:

- business development could be described as growing;
- business vision was opportunistic;
- scope of business – currently local but tending to become regional in the near future;
- the business was focused and combined both internal and external resources;
- the approach to market was seeking competition of domestic and international origin;
- according to the attitude to risk, they were gradual risk takers;
- the business goal was success.

Roda Car Ltd. as a new venture in Eastern Europe combined all types of entrepreneurship: productive, financial, productive-managerial and financial-managerial. They were also a combination of foreign and domestic entrepreneurial expertise, the former being dominant. However, those were necessary, but not sufficient prerequisites for the success of the entrepreneurial venture. The complicated and extremely unstable private business environment in Bulgaria – political, legal, economic and financial, as well as the inadequate marketing expertise of the Bulgarian partner were putting obstacles in the future development of the Roda Car Ltd. venture, that could bring eventually to serious problems with the functioning of the company, if not to its failure.

### *Conclusion*

Eastern Europe has to resolve a very complicated and unprecedented task of its transformation from central planning to market orientation. Global economic restructuring is the most important precondition for a successful transformation. The implementation of this restructuring is an extremely difficult task of entrepreneurial character. Although having to cope with mainly constantly changing problems entrepreneurs in Eastern Europe have achieved some distinct successes. The change of the whole industrial structure is based on several processes as privatisation and restructuring of former state owned companies and creation of new small business ventures. In spite of having been in progress for more than six years the bulk of work related to transition has yet to be done. The major doers in this process have to be the dynamic entrepreneurs, needing appropriate entrepreneurial system that is a controversial process of creation, development, growth, failure and success.

P.S. Roda Car Ltd. stopped its existence two months after the submission of this paper. That outcome was suggested by the authors as a possibility, that emerged from the analysis in the paper.

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## Woman's role as owner/manager in the framework of Albanian business\*

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*Even in the current civilized society, the women have not yet taken their deserved place. Despite the obvious difficulties in Albania, as well as in the rest of the world, the number of female owners is increasing every day. As their businesses are new, most of them are in the introductory phase of their existence (survival, consolidation and control). Women as managers are facing several problems related to the lack of resources and inadequate knowledge and skills in management. The difficulties are increased by the fact that they are women. However, based upon the analysis of the characteristics of a strategic model of management in business owned by woman, we can state that the behaviour of female entrepreneurs is equal to that of male counterparts, but with some characteristics in the management style.*

### Research methodology

The desire to be the boss, your own boss, and to manage a business of your own is an idea that has tempted many people. This idea has elevated some people to the highest point of fame and success, and crashed some others in the dark abyss of failure. It has to be accepted that business is an enterprise that involves considerable risk, long and hard hours of work, and often very tough sacrifices. For female owners of business, the difficulties and challenges to cope with are probably greater than for the other entrepreneurs, whereas the chances of success are perhaps fewer. Despite the obvious difficulties, as in the rest of the world, the number of the female owners/managers is increasing in Albania.

In this framework, this article aims to achieve some main objectives:

- Through a brief analysis, to describe the social-economic status of women and their struggle for emancipation
- To introduce the basic characteristics of women owned/managed businesses in the context of Albanian business
- To identify the main factors that have had an impact in the level of women's participation and the distinguishing features of management in businesses owned by females
- In order to achieve these objectives, the following have been used;

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- Interviews with managers/owners of business firms, upon which the questionnaires are based and compiled
- Questionnaires distributed in about 50 women's businesses.
- Statistical data and results provided from the processing of questionnaires
- Conclusions of analysis

## I – Background

The history of mankind since ancient times has shown that all aspects of social, political and economic life are dominated by males, while the female has been treated as a second-class citizen, able to perform only the kind of jobs determined by society under the name and right of the omnipotent owner, the man. Even in current civilized society woman has not yet taken her deserved place, particularly in a practical sense of implementation of the legal framework that already exists.

In this context, Albania is a country, which for the reasons of its history, culture and traditions cultivated through centuries, has suffered more than other European states from the mentality of undervaluing women.

The beginning of this century was promising for Albanian woman. The development of capitalism albeit very slowly, created promise for the civilization of our society as a whole, and particularly for women. For the first time they began to go out of their houses to work in the factories and small enterprises, but still few in number and without any special protection by the law.

Several well-educated women who came back from emigration during the 20's – 30's, founded the first representative associations. In 1920, in Shkodra, the first magazine of its type was published, entitled: “ The Albanian Woman”. This magazine and others that followed were forced to close down because of the indifference of the state and society as well as the almost total illiteracy of women. Patriarchy in Albania existed in a tough form of masculine absolutism until the middle of the century. This patriarchal influence isolated the woman from public life.

On the eve of the Second World War according to the statistical data of the time, (excluding peasant women, who were involved in the agricultural sector) only 668 women were working in Albania, and 94 percent of females were illiterate<sup>1</sup>. This situation was worse for those living in the countryside. The “fight” of the progressive elements of that time for an improvement in the situation of women were limited to simple forms of protests and debates. The tradition that began to be created in the 1930s to discuss in the media women's problems not only as humanitarian and dignity issues, but as affairs linked with social development,

1 This very small number of working women was consequence not only of the old mentality, but also of the very limited development of business firms.

too, continued in the period of the Liberation Anti-fascist War, where a great number of women fought together with men. For the first time after liberation, women gained the right to vote, and the law stressed equality for employment, payment, social security, education, etc.

After second World War, Albania was the most backward country in Balkan Peninsula, with a very high level of illiteracy (over 80 percent) and the majority of the population working in agriculture. The first economic measures undertaken by the communists in power were to nationalize the few existing factories and trade, and in 1946 they launched the collectivization process. The Party-state presented collectivization as "the only just possible way to edify socialism in the countryside" and stressed that economic policy should follow communist theory, according to which heavy industry constitutes the basis of socialist industrialization.

Up until the mid – 70s, Albania had achieved significant social and economic progress: the high illiteracy rate had been successfully tackled and education was being extended to the whole population. The economy had undergone an effective development process, and national income had more than doubled in the 1960's and 70's, maintaining a high growth rate until 1980. These impressive rates of development rates depended mainly on economic support from abroad (financial credit, semi manufactured raw materials, tools, machinery, projects, etc., provided initially from BRSS and then from China).

During these first two decades of the postwar period, the changes in woman's position in comparison with the past were dramatic as far as employment, education, cultural and social life were concerned. For the first time, it was possible to argue that females were integrated into every aspect of social, economic and political life.

By way of departure from tradition, a sound social opinion was created which encouraged female personalities to make a name for themselves. Across a wide strata of the society, especially for the most progressive, there was engagement in the fight against conservative and patriarchal inheritance, domestic violence and physical mistreatment of woman in general.

In reality, high employment of women in that period was due to economic factors, but also the favourable social policy of the state towards them stimulated this. Job security, remuneration equality, pay for maternity leave, the creation of a health and social services network, increasing number of kindergartens for children firstly in the city and later on in the countryside (despite of their level and quality), the assistance for mothers with many children, were for that time concrete measures that had a positive impact on the position of women.

Later on, especially during the 20 last years of the socialist regime, the political and economical factors that had conditioned woman's development, the growth of her dignity and personality, started to vanish and social action gradually died.

Economic regression was accompanied by the impoverishment of spiritual life. Isolation from the civilized world, lack of information about the world development, propagate darkening of achievements in West, and primarily the thorough-going imposition of a ruling ideology and politic caused the restriction of free political, economic and social thought.

The bureaucracy of the whole system incorporated the women's organization, too, which lost its independence in the context of a monopolistic power position of the Party. Its work was reduced in meetings and congresses where political and ideological party problems were dealt with, and specific problems of women and their real concerns neglected.

The absolute state control of economic life, lack of private property even in its small forms, the suffocation of free initiative, the general bureaucracy that occupied the state institutions, high levels of centralization and the pursuit of isolation from the rest of the world (western world) with rigid restriction of foreign trade brought about a deep crisis that covered all aspects of the political, economical and social life. In these conditions, somewhat paradoxically, there was nearly total female employment, although the nature of such employment was rendered difficult by the lack of electrical domestic equipment, the existence of a small rations of many food articles, lack of sufficient water, and restricted living space in apartments, etc.

For all the reasons we have mentioned, such as political activism, confidence in their efforts, dissatisfaction towards the regime, very difficult economic conditions, women participated in the movement for a democratic society, based on a market economy.

When transition began, euphoria and illusion gave way to severe reality. Clearly such a transformation can not be done without winners and losers, but the women that entered it with the hope of winning, see themselves as losers in reality. Their interests are being sacrificed for the sake of the transition interests. It was quickly understood that the overflow of products for daily and luxury usage so desired in the past, with the elimination of long queues, etc., could not spontaneously promote an increase in the standard of living level in a sustained way, because of deep inherited poverty. In the cities, mass closure of enterprises, factories, especially those in the light and food industry where women comprised of the largest number of employees, made a large proportion of women workers unemployed. The reconstruction of state administration, closure of some institutions of science, education and culture, and reduction of job places in many other institutions in the shift towards a market economy, first of all touched women

who, it must be said, although educated equally to men were attributed an inferior status.

In countryside the situation is different. Private ownership has incited free initiative, increased agricultural production and as a consequence has raised incomes. On the other hand, it is tremendously increased workload for women, because of male emigration, apart from technical, cultural and psychological factors.

In general, social and political developments have meant that women have emerged to a new position

## **II – Woman's request for emancipation in today's agenda**

The social and political developments that occurred in our country in the early '90-is, determined a new position for women. The Albanian woman today is trying for an equal participation in social life. This is not a new problem set before us for solution and not even restricted to our country. It is a permanent women's request in all countries, because despite nationality, women have much in common to be solved. What is different is the time and the priority of issues in the agenda for solution. These are closely linked with the level of social-economic development of a country, traditions and its distinguishing features. We would like to provide an historical dimension also.

The main reason why the problem for equal treatment is still on the agenda today, despite the progress of human society, is because we still do not know any society where women and men are equal in practice. Even the simple fact that the discussion of sex inequality still goes on, is an indicator of the continuing commitment of society to this very important issue, and that the inequality that really exists is not seen as normal in the modern society of the twentieth century. What is special for Albania is that this question must be again on the agenda as a necessity of the new conditions of our country.

Recently, in the public sector, but in many private firms as well, the hiring of employers through interviews is occurring. This may be viewed as a democratic form that seeks to eliminate inequality and has as its main criteria the ability and professional skills of the candidates. Also, for the first time in Albania, after 50 years, the law sanctions the right to be employed in two jobs in the same time. However, we must admit that the low level of economic development of the country, the slowness of the privatization process, and the lack of creditable institutions for private initiatives, have created difficulties in the real application of employment right for all people and especially for women.

According to the official statistics, the percentage of unemployed women is 24.1 percent, while for males it is 21 percent. In 1990, the women represented 45 percent of the workforce. This percentage was high, compared with the European average, which for the same year was 35 percent. Actually, about 50 percent of

the unemployed are women. In the big cities this figure is 60 percent. Meanwhile of the total number of unemployed women, 65 percent are 35-45 years old (data from the report of NGO's in Albania in 1995).

In this framework, it would be appropriate to instigate a policy with fiscal and economic advantages for those businessmen that invest in new jobs.

NGO's are aiming at this direction through several projects, financed by international and national organizations for new activities where the women's employment is possible. Special attention must be given to the countryside where about 60 percent of the population live and work in a state of economic backwardness.

Despite efforts up to now, it is a fact that the old-fashioned attitude towards women still dominates in Albanian society. Particularly evident is the difference between women in the cities with those living in the countryside, between the women from south and north regions of Albania, between worker and intellectual women. Under these circumstances, if the law recognizes the woman as an equal subject with the man, it is the social mentality that is an obstacle to realize in practice her own rights. Regardless the big changes in the real status of woman in the society, actually she has not taken her deserved place although she represents a great potential not yet exploited properly for the transformation of social-economic life of our country. This idea is reinforced even more if we keep in mind that females represent 50.5 percent of our population, and nearly half of the persons with secondary and higher education.<sup>2</sup>

In a questionnaire organized from UNICEF, in 1994 about the conditions of the woman today, taking into account, as well, the changes in the social-economic situation since the Second World War, we can draw some conclusions:

In response to the question: "what was the reason of working?", 39.5 percent answered that this helped the spiritual enrichment and life recognition. Ten percent of the respondents stressed as the main reason for working was to keep the family, 24 percent emphasized the need for independence and for only 4.2 percent of the total – the wish to be equal with the men.

2 Source: Statistical Annual of Albania, 1991.

**Table 2.1: The reason of working**

The reason of working	Percentage (%)
To keep the family	10
To be equal with the men	4.2
To be independent	24
The work enriches the spiritual life	39.5
It would be better to stay home	10.8
I don't know	11.5

Source: UNICEF-Questionnaire organized in 1994 for Albania

**Table 2.2: Areas where the success achieved in the past is in peril?**

Which are the areas where the success achieved in the past is in peril?	Percentage
Family	7
Society	9.3
Politics	12.8
The three above elements	6
Is not in a peril	34
I don't know	30

Source: UNICEF-Questionnaire organized in 1994 for Albania

In response to the question: "what was the level of women emancipation and in what period it was achieved?", 10 percent of the interviewers supported the totalitarian regime and 54.2 admitted that it was achieved in the period of democracy. Sixteen percent of the total believed that emancipation is a problem yet unsolved and 18 percent did not answer at all.

Under these circumstances, the question naturally arises: which are the factors that hinder the woman's employment in general, and particularly her employment in important positions in the economic life? Several of these factors are listed as follows:

- The social patriarchal mentality. Despite the fight declared against this mentality over a century ago, it is still evident in our society, and it reappears strongly in its difficult moments. It is displayed in the society, in the family, in the public/private employer and to the woman herself, too.
- The lack of concrete and clear strategies for women's employment and encouragement. Such strategy, has to foresee not only the creation of new working places, but also to include the encouragement and the support for her self-employment. As in some other foreign legislation, in Albania, too, there does not exist yet special laws for woman's defense in the area of employment.

This means that perhaps more efforts from the society are needed for eliminating her discrimination by men, and more support for female reintegration in the context of active labor force. It is important to emphasize that her participation in business activities should be encouraged more than has been the case up to now.

- The insufficient resources of institutions for supporting private initiative of small and medium businesses, where women can be involved successfully.
- The lack of training with “the rules of the game” in business. The transformation of woman’s ideas in small or medium business, and even in a big business, as well as the creation of her self-confidence for such enterpreneurships. In this direction is the declaration “On the equality between men and women” approved by the Committee of Ministers of European Council, on the 16th, 1988, where we can cite the following:

“The strategies that should be implemented in this area must allow the man and woman to have an equal treatment from legal viewpoint, equal possibilities to use their rights and to develop their own talent. These strategies should foresee, also, suitable measurements, including here special and temporary mechanisms, which aim at the acceleration of a real equality among man and woman”. In this context, it is necessary that the employment, education and qualification of Albanian women should be more stimulated and supported by special laws with temporary application, or to be developed governmental programs in collaboration with non-governmental organizations that would stimulate equal opportunities for women in these areas.

### **III – Main characteristics of Albanian business**

In order to be able to judge properly and to draw practicable conclusions for the particularities of owner/manager women in the Albanian conditions, it would be specially interesting to analyze briefly the main characteristics of Albanian business in general.

The deep crisis in which the Albanian economy was involved, burst out in all its components at the beginning of 1990, causing huge unemployment accompanied by ruined industry and agricultural sector. The worse thing was the fact that the country was in depression and this situation seemed to last for a long time. The resolution of these negative consequences would be achieved only through the orientation of our country toward a market economy, whose advantages, particularly in the second half of this century, were displayed in all the areas of social, economic and political life, and especially in the human rights. It was also evident through the economic development in comparison with the ex-Eastern Block. The archaic legislation of the command economy was substituted in a relatively short time by a new economic structure, which with its base in a very long and successful practice experience of industrialized countries, opened new

perspective for the Albanian society as a whole, and for business development in particularly.

Economic reform started in July 1992, when the governmental program was supported by a "stand-by" agreement from IMF. At the core of this reform were three main principles:

Firstly, macroeconomic stabilization that aimed at the reduction of budget deficit, inflation control and the liberalization of prices.

Secondly, the restructuring of state-owned sector that aimed at the elimination of government subsidies, the consolidation of the free competition and the reorganization of public sector and the banking system, as well.

Thirdly, privatization of the economy, including industry, agriculture and public services.

Economic reform undertaken in these three main directions brought about many progressive changes. So, the inflation from 400 percent in 1992, fell to 37 percent in 1993, 16 percent in 1994 and 11 percent in 1995. It is to be emphasized that the IMF has evaluated the inflation to be 12 percent by the end of 1995. The main reason for price stability has been the stability of "Lek" – the domestic currency, accompanied by the introduction of a tight fiscal and monetary discipline. The unemployment during these years fell to 13 percent in 1995, and according to the statistical data of Ministry of Labor in 1996 it achieved 10.7 percent of the labor force.

In order to have a more general and understandable picture of the changes that Albanian economy has undergone in a short time, we can look at the figures presented in the table 3.1.

**Table 3.1: GDP real growth rate (in percentage)**

GDP growth rate Sector	1990	1991	1992	1993	1994	1995
Total GDP	-10.0	-28.0	-7.2	9.6	9.4	11.5
Industry	-14.2	-42.0	-51.2	-10.0	-2.0	3.7
Agriculture	-5.4	-17.4	18.5	10.4	10.3	13.0
Construction	-12.0	-30.0	7.0	30.0	15.0	18.8
Transport	-10.0	-30.0	-15.0	13.0	18.0	10.0
Other	-8.0	-14.0	9.0	16.0	11.0	9.0

Source: Department of Economic Development and Aid Coordination (In the Council of Ministers)

Foreign aid has been one of the main factors that has ensured the success of economic reform and the transformation of Albanian society during the period of 1992-1995. The orientation and the concentration of this aid have changed according to the phases of economic reform. It has changed gradually from emergency humanitarian aid in technical assistance and macroeconomics support and lastly as an aid for development (mainly investments).<sup>3</sup> So, the humanitarian aid in 1991 including the food aid represented 85% of the total, while the support for investment or development projects was zero.

In 1996 the situation was quite different: the humanitarian aid was shifted in aid for investment and development projects representing about 84 percent of the whole aid. The foreign aid is offered by many donors, but the principal donors during these years have been the European Community with 37 percent, Italy with 22 percent, World Bank with 17 percent, Germany with 12 percent and USA with 12 percent.<sup>4</sup>

**Table 3. 2: Foreign aid during 1992-1995 (in million \$)**

Year	Technical assistance	Development projects	Food aid	Others	Total
1992	11.7	0	139.9	52	203.6
1993	37	17.4	71.7	107.5	233.5
1994	66.4	43.9	20.7	72.5	203.6
1995	73.0	140.8	.4	73.7	287.4

Source: Human Resource Development Report-Albania 1995. Published by UNDP

During the transition period in Albania, there gradually began to flow even foreign capital in the form of direct investments. According to the Albanian Center for Foreign Investment Promotion, the capital invested in Albania in 1996 was 276.1 million \$.

The level of foreign investments in 1995 represented 3.5 percent of GDP of that year. If we take into consideration this indicator Albania can be ranked after Hungary with 10.2 percent, Estonia with 5.8 percent and Czech Republic with 5.6 percent, leaving behind Rumania with 1.0 percent, Bulgaria with 0.8 percent, Slovene with 0.8 percent and Poland with 0.7 percent. The majority of foreign direct investments were concentrated in productive sectors: 34 percent in

3 When speaking about economic reform we have in mind the period up to the overall crises which burst out with the collapse of pyramidal firms. This new period needs a special attention which we hope will be presented later on. But for a full analysis it is necessary to know how Albania was performing generally from 1992-1996. On the other hand, the main objective of this article is the role of woman as owner/ manager in the frame of albanian business in the first five years of transformations.

4 Review: "Ekonomy&business" Nr 1/1996, p.27.

tourism, 20 percent in light industry, 15 percent in construction, 18 percent in food industry, etc. The orientation of these investments in these sectors is closely linked with natural resources, and the cheap labor, etc. As far as their origin is concerned, it can be said that the main investors were from Western Europe, where Italy comes the first with 50 percent of the total, followed by Greece with 20 percent and Germany with 17 percent, etc.<sup>5</sup>

In Albania like in other Eastern countries, the economic reform was accompanied by many difficulties in the social aspects because of the reduction of many jobs in government administration as well as a result of closing down many inefficient enterprises (with which Albania was "very rich"). An important factor for softening these pains, together with the aid from abroad, has been the incomes from more than 400 thousand Albanian migrants working in foreign countries.

The exodus during '90-'91 is well known, when about 28 percent of the labor force emigrated to Greece (about 80 percent of the total of refugees) and the rest to Italy (which is ranked after Greece in the number of Albanian refugees), Germany and France. The emigrants are an important source of money coming into Albania. According to the approximate evaluations the sum of money from this source is about 400 million \$ in a year or nearly 1/4 of the GDP.<sup>6</sup> Based on these figures we can draw the conclusion that without this aid, the West should have "paid" more for assisting Albania to enter the world of the market economy.

Under these new conditions the first businesses appeared in our country. Characteristic of them was that at the very beginning they were created in trade and service sectors as a result of the privatization, with priority of the retail network which was followed by other sectors of economy, like construction, transport, industry, etc. The successful promotion of SME-s has been the basis of economic reform in the area of private business development. The technical assistance programs and the credit through banking system, SME foundation and regional agencies, business organizations like the Chamber of Commerce as well as other public institutions have supported this process. On the other hand, the rapidly growing number of new businesses and their distribution in many sectors of economy are a very clear reflection of the entrepreneurial spirit of the people engaged in the new world of business that is built according to the rules of another economy: the market economy.

5 Review "Ekonomy&business" Nr. 1/1996, p.28.

6 Albanian Human Development Report-UNDP 1995, p 14.

**Table 3. 3: The distribution of Albanian businesses according to sectors of economy and their legal status<sup>7</sup>.**

Sector	Physical persons	Domestic firms	Joint ventures	Foreign firms	Total	In %
Agriculture	1194	283	26	7	1510	2.7
Industry	3255	1394	292	123	5064	9.0
Construct.	152	961	71	53	1237	2.2
Trade	24762	3655	1002	592	30011	53.6
Transport	8654	280	64	48	9046	16.1
Services	8551	505	77	67	9200	16.4
Total	46568	7078	1532	890	56068	100.0

If we make some simple comparisons only with a year and a half before, we can see a general growth of the businesses more than 22.5 percent, where we can separate construction businesses with 49 percent (because the construction is an industry with a rapid growth because of the high demand for new constructions and reconstruction in public and private sector.) and the trade businesses with 21 percent (this is normal if we keep in mind that trade is an area of a high profit, with relatively small capital and a short rate of return of investments), etc.

In general, Albanian firms have a simple hierarchical structure: at the top is the owner/manager who has one or two assistants – mainly family members or his relatives, and the workers. A main characteristic is the small number of management levels (usually only one level), relationships that are more or less informal, a quick communication with subordinates – which implies relatively quick decision-making, too.

Usually the managerial positions are held by those who have blood relationships with the owner/ manager, and as a consequence of this, managerial performance is not evaluated periodically, because it has no any special value for being in managerial positions. Even in those bigger firms, which have a staff of specialists, there does not exist a real and clear line of promotion in the managerial hierarchy.

are flexible, they rarely are expressed in quantitative terms or in a written form.

<sup>7</sup> Albanian Human Development Report, UNDP, 1996, p 50.

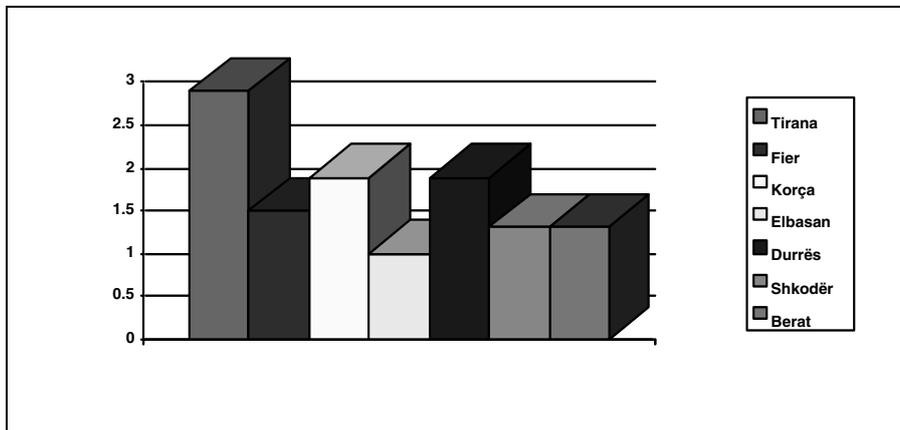
**Table 3.4: SME's distribution for any 100 people<sup>8</sup>**

Some main cities of Albania	SME-s for every 100 people
Tirana	2.9
Fier	1.5
Korça	1.9
Elbasan	1.0
Durrës	1.9
Shkodër	1.3
Berat	1.3

Undoubtedly the principal motive of entrepreneurship in our country has been profit, but we cannot say that this is the only one. The new businesses of Albanians should fulfill several objectives of their proprietors and of their family members – and it is well known that the needs in Albania are greater than in other Eastern Countries. A lot of businesses start with a limited capital and with typical characteristics of family businesses, which have not only to keep their families, but also to fulfill a span of other needs such as for new apartments, life insurance, education, etc. Sometimes, these objectives take on so much importance that the owner/ managers can restrict, even stop at least temporarily, the investments for business expansion. On the other hand, since the objectives of such businesses The majority of businesses are concentrated in the bigger cities (like Tirana, Shkodra, Korça, Durres, etc.) and in the area of trade and services. The distribution of SME-s for any 100 people is shown in table 3.4.

This situation can be presented in the following graphic:

**Figure 3.1: SME's distribution for any 100 people**



<sup>8</sup> Processed by data on "Albanian Human Development Report" 1996, p.9.

Incomes of individuals working abroad have played a great role along with the support from the banking system and foreign institutions. Also, in this area there are several foreign assistance programs such as the Phare program as well as other projects with German, American and Italian governments. The credits issued by second tier banks with interests ranging from 2-19 percent and one to ten years repayment periods, have greatly stimulated the financial resources of existing and newly started businesses.

The rapid development of new businesses contributes significantly in softening the sharp social problem of unemployment inherited from the past, particularly in the Eastern Countries. According to the data published by EBRD, in the Czech Republic 37 percent of workers are employed in SME-s, in Poland 23 percent, in Rumania 27 percent and in the Slovak Republic 23 percent. In Western European Countries there is an average figure of 69 percent, and in America nearly 53 percent<sup>9</sup>. In the Context of more than 56 thousand SME-s in Albania there are employed more than 128 thousand people. If we compared this figure with the year 1992 when the number of employed people was only 60 thousand, we can easily see that for only 3-4 years there has been a growth of more than 200 percent of people employed in the private sector.

The level of qualification of Albanian managers/ owners is still low compared with the requirements of the market economy. The presence of foreign business firms in the Albanian economy has made competition more tough and with international features – hence an intensive training is needed for them. The poor background in this important issue has a negative impact on business success and is reflected in the high level of business failure. Now the manager/owner training can be realized through Faculty of Business & Economics – UT and other specialized institutions like the Institute of Management & Public Administration and The Banking Training Center.

Considering the main characteristics mentioned above, we can draw some conclusions, the most important of them are listed as follows:

- The geography of Albanian business shows for a disproportional distribution of firms throughout our territory. Clearly there could not be a “proportional development”, but despite this, a greater business development in small districts is necessary. The state can play a major role in its stimulation for a more rapid development through a more stimulating legal framework for the businessmen that invest in such areas. Foreign experience shows that the state intervenes with economic mechanisms to encourage the business investment in the relatively less developed areas, as well as to create “economic obstacles” for those wishing to enter super industrialized areas. The free trade zones are potential opportunities yet unexploited for business encouragement to expand in certain areas.

9 EBRD “Transition report” 1995, p 140.

- Bearing in mind the special characteristics of our country in comparison with other Eastern Countries, in the context of our economy the agro-industrial business should be developed and modernized. Economic policy in this direction must continue even more in the further stimulation of this kind of business, because in this area the state with its legislation plays an incentive role.
- The number of businesses in the productive sector still is far from what is possible and the requirements set by the actual stage of development. It was normal that at the first phase of their birth (for many reasons, and above all because of the need for a high profit, the small capital requirements and the high demand for every thing) the businesses would be oriented toward the trade activities. There are a lot of businessmen who actually wish to invest in production, but they still hesitate because of the size of capital they have, the relatively long period of capital return, as well as the high risk and the strong competition especially from foreign companies. The banks and other financial institutions should play a more active role in the process of business credit giving different interest for production and service investments. On the other hand, the pursuit of a protectionist policy for some businesses and products would be an encouraging factor for Albanian investors.
- The danger of failure is a normal phenomenon for those who do not obey in a proper way the rules of the game. Being in the role of referee, the state should take care that all the players are honest and respect fair play. A failure for economic reasons or for the bad management of the firm, but it is undesirable to be out of the game from the fiscal evasion of competitors. The state control and the penalties for such cases should be very tough.
- Up to this moment, business firms have asked very rarely for advice and only in the accounting area. Now it is the appropriate time, at least for bigger and stable firms, to ask for expertise with respect to production specialists, marketing and human resources specialists, etc. The competition and the relatively high level of failure because of lack of expertise in management, represent a very strong incentive in the demand for the mature thought of business specialists.

#### **IV – Characteristics of behavior of women as owners**

In this paragraph we wish to identify some of the characteristics of the female behavior as owners. To accomplish this objective, 50 questionnaires were sent to women-owned businesses. Respondents were asked about their personal and business characteristics; their reasons for going into business; the disadvantages and advantages of being a woman business owner; how important income from their business was; and whether their expectations had been met.

### *Personal characteristics*

Sixty percent of the women entrepreneurs who participated in this study had gone into business on their own initiative. The others had had the encouragement of their husbands or relatives.

Of 50 women entrepreneurs answering the questionnaire, 90 percent were married and only 10 percent were single or divorced.

Forty percent of the respondents had prior experience in their field of endeavor. The majority had not had previous managerial experience.

More than fifty percent of the businesses started by women were 2- 4 years old. Before going into business for themselves they had held a wide variety of jobs in state enterprises. About 64 percent of the respondents have had 4-5 years of business experience. (Table 4.1)

**Table 4.1: Prior experience in work and business age of 50 women entrepreneurs.**

	Percentage
Prior work experience	
Under 5 years	9
5 to 10 years	62
over 10 years	29
Years managing your own firm	
4-5 years	32
2-4 years	62
Under 2 years	6

The educational attainment of the group was above average. Of 50 women entrepreneurs responding, 35 indicated that they had graduate degrees, 10 had done some mini courses in the field where they exercise their activity.(Table 4.2)

Medicine was the most common area of study (dentist or pharmacist). Very few had studied business. The major part of the respondents had worked as employees in the state administration.(table 4.3)

**Table 4.2: Women educational level**

	Percentage
Graduate degree	70
High school	20
High school plus a short specialization	10

**Table 4.3: Women profession before going into business**

Profession	Percentage
Engineer	12
Artist, painter	12
Economist	13
Seller	15
Doctor, dentist or pharmacist	28
Householder	5
Worker	13
Student	2

### *Nature and Characteristics of Business*

According to "The economist" "Until now, women managers have generally been concentrated in a few areas, especially public administration...Women are also more likely to be managers in fields in which there are lots of women to manage: health, say, rather than steel making. That may change as women acquire qualifications in subjects that were once exclusively male".<sup>10</sup>

The majority of the businesses begun by women were service oriented – most commonly retailing. However, the respondents owned many different types of businesses. Included were professional services (pharmacist, dentist) apparel manufacturing, wholesale dealer, designing service, beauty salon etc.(table 4.4)

Some entrepreneurs that operated in non traditional businesses (gathering and manufacturing tobacco, construction etc.), continually felt they had to "prove themselves to be better than male competitors", in order to build and keep clientele.

Of 50 respondents, 64 percent preferred to own their business alone. Twelve percent owned it together with their husbands, 17 percent with foreign partner and only 7 percent with Albanian partner.

<sup>10</sup> "The Economist", August 1996, p.55.

**Table 4.4: Nature of women businesses**

	Percentage
Retailing	30
Apparel manufacturing	5
Beauty salon	25
Wholesale deals	18
Pharmacist	8
Dentist	9
Advertising, designing and photographs	5

In general, the majority of the respondents exercised their activity in the locality where they live. Only 15 percent of them had expanded their activity in 4-5 other localities. These were mainly wholesale dealers, gathering and manufacturing tobacco or industrial plants and pharmaceutical products.

In response to the question, “Do you reinvest your business income in your firm, use for informal credit or spend for daily food?”, 50 percent of the respondents indicated that they reinvest all the profits. 30 percent reinvested only a portion of the profit and the remainder gave with interest rate and 20 percent stated that they lend all the profits.

In response to the question: “Have you technical assistance or consultancy in the management of your business?”, the largest part of the respondents (60 percent) said "no". About 20 percent pretended to exchange experience with their friends or relatives. The remainder were aware for the need of technical assistance but they had not undertaken any concrete step in this direction.

#### *Reasons for Entry*

“Uncomfortable in a male world, female executives are more likely to move on than their male colleagues. Judith Rosener, of the Irvine school of management at the University of California finds that female executives leave because they feel that they are undervalued, or that they do not fit in. They often move to smaller firms in which the hierarchy seems more permeable, or start their own business.”<sup>11</sup>

In a questionnaire organized by UNICEF in 1994, asking for their preferences, 73.6 percent of the respondents would like to work for themselves, 8.2 percent dependent work and 10.2 percent for the state.

11 “The Economist”, August 1996, p.55.

**Table 4.5: Preferences**

Preference for:	Percentage
Working by himself	73.6
Dependent work	8.2
Working for the state	10.2
Don't know	8

The question: "where is easier for you to find a job", 73.6 percent of the respondents indicated that was easier to find work by oneself.

**Table 4.6: Where is easier for you:**

Where is easier for you	Percentage
To find work by oneself	73.6
To find a dependent job	15.9
don't know	20.9

The responses of this sample suggest that the motivation of women entrepreneurs is similar to that of their male counterparts. Asked for the reasons of entry in the business, women entrepreneurs have ranked the following reasons.

The main reason indicated related to economic conditions. They do not see any other prospect or opportunity to be employed, in conditions when the majority of existing enterprises were shut down as not efficient.

The second one is the need to be engaged, to gain personal satisfaction, being one's own boss, the opportunity to make more money, etc. Ten percent of the respondents said that owning a business was the best way for a woman to do the kind of work she preferred, while fifteen said it was the best way for either sex.

Some of the respondents stated that they had gone into business for themselves because of the lack of opportunity for women that they had experienced while working in state organizations. One woman said that she had given fifteen years of her life the work for the state, "doing the work for three men, but getting neither moral nor material promotion".

**Table 4.7: The reason for entering into business**

The entry reasons	Rank
Economic conditions	1
Financial independence	2
High profit	3
The need to be involved in work	4
Personal satisfaction	5
Desire to be your boss	6
Career/security	7
Family responsibility	8
Time to do something new	9

#### *Disadvantages and Advantages of Being a Woman*

In a survey organized by IOD, London, most common reasons given for a perceived lack of equal opportunities were:

- Male attitudes towards women (37%)
- Fewer opportunities for women in senior positions (33%)
- Difficulties with women returning to work, childcare, flexible working (18%)
- More difficult for women to prove themselves in the workplace(14%)
- And obstacles to career progression of women:
- Responsibilities to children (35%)
- Need for career breaks (29%)
- Male prejudice (23%)
- Not been taken seriously (21%)
- Lack of childcare (16%)
- Domestic responsibilities (16%)

(Source: IOD (1992) Members'Opinion Survey: Women's' Participation in the Workforce, London, IOD.)

About forty percent of the respondents of our sample did not think anything would be different if they were men. Thirty percent said that it would be easier to borrow money and 35 percent said it would be easier to deal with the customers

About 75 percent of the entrepreneurs of this group remarked that women are more skilled in dealing with people. They thought that are more flexible, more energetic, independent, competitive, social, self confident and goal oriented. Some others thought that the skills developed in running a household, transfer well to the business world.

All the women entrepreneurs surveyed indicated that they had problems in start-up operations. The biggest problem during start-up was lack of financial planning, lack of appropriate education and the need to spend the time for taking care to the family.

What would help these entrepreneurs to overcome their problems? Three things:

1. A support system
2. Further education or qualification
3. Perseverance

The first factor is a strong moral support system of family and friends, clients, business associates and state organisms. Some women entrepreneurs felt that their support system was the key in helping them to overcome problems at start-up.

Besides a support system, many women entrepreneurs noted the importance of obtaining an education in business skills. This can be achieved by returning to college, seminars, continuing education courses, conferences, regular reading of trade publications and self help books, as well as help from experts.

While continuing education from a variety of sources is always beneficial, there is no substitute for perseverance, preparation, hard work, and belief in one's product or service. Perhaps the best advice is offered by one entrepreneur: "Be tenacious but realistic; but more important, you have to gamble and take risks. This requires perseverance".

#### *How Successful Have Been the Businesses Owned by Women?*

Eighty-eight percent of the respondents found running their own business to be either "more profitable" or "about as profitable" as they had expected. Yet, interestingly, 80 percent found that running their own business was only "about as difficult" or "less difficult" than they had expected.

Fifty percent of the respondents said that their businesses provided at least 90 percent of their income. Only 3 percent reported that the business furnished less than 50 percent of their total income. Despite the great engagement of time and energy, the income an entrepreneur provides from his/her business is sometimes more than the income provided by dependent work (5 – 20 times higher)

**Table 4.: 8 Attitudes of women entrepreneurs toward profitability and difficulty of endeavors.**

Running my own business has been:	Number of responses
More profitable than I expected	29
About as profitable as I expected	15
Less profitable than I expected	6
More difficult than I expected	12
About as difficult as I expected	28
Less difficult than I expected	10

### *Conclusion*

In the light of these problems the entrepreneurs cited, to make it easier for women entrepreneurs to start and successfully operate new business ventures it is necessary:

First, women entrepreneurs should gain experience in dealing with money, negotiating, and performing financial responsibilities.

Second, women entrepreneurs should attend seminars and courses on finance, marketing and planning. These practical seminars will help entrepreneurs to learn the most recent management techniques while developing skills and confidence.

Third, women entrepreneurs should not hesitate to hire experts, to look for consulting, moral and financial support.

These suggestions will help women entrepreneurs to compensate for weaknesses in their management skills and become more confident and more successful in their endeavours.

### **V – Characteristics of Management in women owned businesses**

According to the statistics, the businesses owned by women account for 5 percent of all small businesses in Albania. This indicates an insufficient involvement of women in business. In agriculture, for example, in about 38.000 private farmers, only 50 women have received credits from the Rural Development Fund, in values from 20.000 to 50.000 Leks.

Survival rates in women owned businesses are comparable to those of male-owned ventures. It would be useful, therefore, to gain a better understanding of the factors that explain the success of these ventures.

Previous research suggests that the success of an enterprise is a function of the "fit" among seven strategic elements: shared values, strategies, structures, systems, staff, skills, and styles<sup>12</sup>

To test the configuration of these seven strategic elements seven Albanian businesses owned by women are analyzed. As a first step in this direction, from 50 questionnaires distributed, we selected seven of them. All these businesses operate in Tirana (the capital of Albania) and successfully have outgrown the early start up phase in their respective industries. These cases are summarized in table 5.1 and discussed in more detail in the next part of the paragraph.

*Shared values:* Three entrepreneurs (owners of a beauty saloon, dentist service and gathering and manufacturing tobacco firm) rated profit much lower than other goals, such as desire to provide a unique service or to fulfill an unaccomplished need of the customers. For the remaining four, however, economic goals such as income, revenue growth and earnings were the prime objectives. The owner of an advertising center is expressed in this way: "One reason I entered into business was because I wanted financial independence in order to do with my life what I wanted". All of these female entrepreneurs expressed the desire to stress the quality of their products or services.

The female entrepreneurs indicated, too, that they wanted to see their firms become the best in their businesses. Of the seven firms studied, the firm of gathering and manufacturing tobacco was at least five times as large as any other, and operated in five districts of Albania and intended to be expanded geographically.

As a key motive for going ahead, its owner envisaged the growth and building of her firm into the best business of its kind. All of those women entrepreneurs display the need for a hard work to make their business successful. The owner of the beauty saloon, the designer center and the gathering & manufacturing tobacco firm, initially had found difficulty in finding capital.

*Strategies:* Customer orientation, finding a market niche and establishing a credible market image appeared to be key marketing strategies for this group of women entrepreneurs. They also emphasized superior customer service and innovative or unique products or services.

The owner of the pharmacy stressed the sophisticated service. She observed: "We offer qualified service. For this I work very closely with my clients and don't laze to serve my clients at home". The owner of designing center felt that her business should offer good design and good response to the client's needs. She stated: "We try to look at what the client wants and help him/her with our expertise".

12 Miles/ Snow (1984), p.1-19.

The financial strategies of the group reflect the fact that in the start-up phase they all had difficulty in procuring capital. This is confirmed by experience cited by other observers of women owned enterprises. Financial problems should be a key factor in the management of the seven businesses taken as a sample. All the women entrepreneurs stated that they preferred a moderate growth. Three of them reinvested only a part of the profit. Two of them reinvested all the profit and only one, the owner of the beauty saloon, stated that she does not reinvest the profits. Apart from the owner of the Gathering & manufacturing firm who used the credit lines, the other six had not any dealings with banks. They had used for start-up capital their savings or the money gained by emigration.

*Structures and systems:* As noted in the table 5.1, all the firms have an average growth, and as a result, their structure has remained informal. Three of the entrepreneurs stated that there exist in their firms a mutual confidence and understanding atmosphere. Only the owner of the Gathering & manufacturing tobacco said that she exercised rigorous supervision over the subordinates. The majority of these firms, however, have remained relatively small, so that the owner continues to maintain simple, but consistent procedures for keeping records of revenue and expenditure. Some observers have found, also, that successful women entrepreneurs are focusing in maintaining close cost control and good planning.

*Staff and skills:* Some of the respondents stated that they have attended courses related to the fields where they exercised their activity. They declared that they were willing to attend courses in areas such as financial management and business planning, supporting the statement that women entrepreneurs tend to be willing to undergo self-training. All the women, too, regarded the expertise as necessary, but none of them had taken any concrete step. This peculiarity can be explained by the specific conditions in Albania, where there does not exist a real market for this service. These entrepreneurs knew their weaknesses and made efforts to minimize them.

The great majority of the respondents purported to have a lack of time to attend courses or seminars. Nevertheless, we think that by a better organization of the work and delegation of the responsibilities, they can and must fulfill this duty, in order to do the best for their businesses.

Do women entrepreneurs hire more women employees? Yes, when the firms offer services that are typically provided by women-such as the beauty saloon and the design firms. In other firms, however, the owners stated that they tried to have the right persons for each job, regardless of the sex. Almost all the women stressed the experience and skills of the employees.

*Styles:* Describing their management styles, nearly all owners confirmed that they motivated their subordinates through wage differentiation and promotion. "We try to work as equals – said one of the owners – If people feel they're re-

spected, they will be productive”. Because of the large size of her business, the gathering and manufacturing tobacco firm owner described her style as goal-oriented. On the whole, the women entrepreneurs showed a high degree of concern for their employees and preferred to use a delegative style of management. Compared with their male counterparts, female entrepreneurs seem to prefer a more “employee-oriented” and less autocratic management style.

*Performance:* All entrepreneurs of the group stated that they had an average growth with average profits. They suggested that they had a good reputation. Conservatism with regard to both financial management and growth perspective were characteristics of the female entrepreneurs. The majority liked high profits and growth, however, they remain small.

**Table 15: background and management style in 7 women enterprises**

<b>Business type</b>	<b>Retailing</b>	<b>Textile production</b>	<b>Beauty salon</b>	<b>Pharmacy</b>	<b>Dentist service</b>	<b>Tobacco Gathering processing</b>	<b>Graphic center (Advertising)</b>
<b>Age (years)</b>	5	4	2	4	3	4	2
<b>Previous experience</b>	Architect	Textile engineer	Literature critic	Pharmacist	Dentist	Student	Painter
<b>Reasons of starting-up</b>	Economic conditions	Need of getting involved in a job	Personal satisfaction, Economic conditions	Economic conditions, high profits	Financial independence, high profits	Financial independence, high profits	Economic conditions, desire to work in an unexplored field before
<b>Values they want to achieve</b>	Revenue increase, Profits	Profits and satisfaction of unsatisfied customer needs	Satisfaction of unsatisfied customer needs, revenue increase	Profits, revenue increase, financial independence	Creation of a unique service, revenue increase	Creation of a unique service, revenue increase	Creation of a unique service, profits

<b>Business type</b>	<b>Retailing</b>	<b>Textile production</b>	<b>Beauty salon</b>	<b>Pharmacy</b>	<b>Dentist service</b>	<b>Tobacco Gathering processing</b>	<b>Graphic center (Advertising)</b>
<b>Strategies, structures, systems</b>	To satisfy customer wants, to create customer loyalty, Expenditure control, cost reduction, reinvesting profits	Customer orientation, reliable market, high quality products, financial expenditure control, reinvesting profit.	Customer orientation, high quality service, self financing, sound control on expenditure non reinvesting profits, no contracts with banks	Very polite service, at home service, advertise, rigid control on services, partly reinvesting profits, no contracts with banks.	Customer orientation, funds of starting-up the business come from savings, control on financial expenditure, partly reinvesting profits.	Securing a center market, high quality products. Control on expenditure through norms, usage of bank loan, reinvesting profits.	Satisfying customer wants on time and in a high quality. Usage of loans, control on expenditure, partly reinvesting profits.
<b>Performance</b>	Average growth, 10% per annum. Medium profits, good reputation.	Medium growth, medium profits, good reputation	Medium growth, medium profits, very good reputation	Medium growth, medium profits, good reputation	Medium growth, medium profits, good reputation	Medium growth, medium profits, very good reputation	Medium growth, medium profits, good reputation

<b>Business type</b>	<b>Retailing</b>	<b>Textile production</b>	<b>Beauty salon</b>	<b>Pharmacy</b>	<b>Dentist service</b>	<b>Tobacco Gathering processing</b>	<b>Graphic center (Advertising)</b>
<b>Staff &amp; management style</b>	Trusty environment in the firm. Staff employed by criteria of experience and age. Enforcing employee motivation through supplementary remuneration and status from employees. Reliability and respect to customers.	Rigid supervision on subordinates, staff employed by criteria of experience and age. Motivation through wage differentiation and supplementary remuneration. Demanding from employees high quality jobs and duty accomplishment.	trusty environment in the firm. Staff employed by the criteria of experience. Demanding from employees a high quality job and customer respect. Motivation through wage differentiation and increased responsibility	Trusty environment in the firm. Staff employed by the criteria of education and experience. Demanding from the employees a high quality job and customer respect. Motivation through wage differentiation and increased responsibility.	There is not authority delegation. Main criteria of employment are gender and education. Motivation through wage differentiation and supplementary remuneration. Demanding from employees high quality job and customer respect.	Rigid supervision on subordinates. Staff employed by criteria of experience and specialty. Motivation through increased responsibility and wage differentiation Demanding from employees loyalty and high quality job.	Trusty environment in the firm. Authority delegation. Staff employed by criteria of experience and specialty. Motivation through supplementary remuneration and wage differentiation Demanding from employees high quality job and customer respect.

**Conclusion**

In summary, we do not pretend to represent the behavior of all female entrepreneurs in Albania by a sample of seven firms. However, based on the above analysis we can state that the behavior of female entrepreneurs is equal with that of male counterparts, but with some specifics in the management style, which appears to be more “feminine”.

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## Problems Faced by Western Expatriate Managers in Eastern Europe: Evidence provided by Finnish Expatriates in Russia and Estonia\*

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*A common human resource management strategy among Western companies in international operations is the use of home-country expatriate managers although expatriate adjustment has been found to involve difficulties. In the light of this the present study analyses the issues faced by Finnish expatriate managers working in Russia or Estonia. Three aspects were studied: adaptation to society, adaptation at the work place, and company-level management problems with which expatriates have to deal in their managerial job. The results indicate that various kinds of problems appear in all these areas and that the preparation of both expatriates and companies entering these markets was usually inadequate.*

### 1. Introduction

The transformation of Central and East European societies has exerted tremendous adaptation pressures on local enterprises and individuals. Under the still relatively new market conditions there is an extensive need to develop managerial skills and thinking (see e.g. Garrison/ Artemyev 1994; Holt et al. 1994; Longenecker/Popovski 1994; Puffer/ McCarthy 1993; Wiley 1994). Recent surveys concerning Russian and Estonian managers indicate that local managers understand this (Avraamova 1995; Filatotchev et al. 1996; Üksvääv/ Nurmi 1993). There are similar problems concerning the attitudes, skills and organisational behaviour of local non-managerial employees who have learnt to work under different systems and rules than the ones applied under market conditions. Recent studies indicate that significant changes have already taken place although there is still a need for extensive transformation (Birch/ Pooley 1995; Filatotchev et al. 1996; Gurkov/ Kuz'minov 1995; Lipsitz 1995; Nurmi/ Üksvääv 1993).

Because of the pace of change, it has been commonly agreed that more information is needed on the experiences of both local and international organisations operating in Eastern Europe (e.g. Frese 1995; Grancelli 1995; Gurkov/ Kuz'minov 1995; Veiga et al. 1995:20; Welsh et al. 1993). After the opening of East European markets, the cross-border business interactions between Eastern and Western Europe have increased substantially. Thus, the understanding of the transformation needs of East-European enterprises has become important from a Western company point of view if they are to be able effectively to manage operations in Eastern Europe.

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International business operations frequently face many difficulties due to cross-cultural differences (e.g. Bleeke/ Ernst 1991; Olie 1990). The evidence of European cross-border acquisitions indicates that the acquisitions rated as not meeting their objectives had experienced unforeseen difficulties due to cultural differences in 90 % of the cases studied (Norburn/ Schoenberg 1994). Frederick and Rodriques (1994:42) have stated that few Western managers dealing with acquisitions in Eastern Europe correctly anticipated the costs of restructuring and the difficulty of creating a business culture in formerly state-owned enterprises. It has also been stated for example that the interaction of Western managers and Russian employees is very problematic (Shekshnia 1994:298), and that Western managers in Russia often fail to deal with the cultural differences that lead to different interpretations of roles, responsibilities and goals (Veiga et al. 1995:20). Similarly, Suutari (1998) has reported that Western managers commonly face strong adaptation pressures to change their leadership style in Eastern Europe.

In the literature on international human resource management (IHRM), difficulties related to expatriation are commonly pointed out (see for example Black et al. 1991) although IHRM may still be regarded as a scientific field of study in its infancy (Welch 1994 a:140). For example, a clear majority of expatriate adjustment studies have dealt with US expatriates and focused on cross-continental expatriation (Black et al. 1992:116). On the other hand, existing studies related to expatriation within Western Europe indicate that similar adjustment problems are usually faced also on such assignments (Brewster et al. 1993; Suutari/ Brewster 1998). Due to reported difficulties related to international assignments, a need for developing more effective expatriate management practices has been widely recognised.

On the other hand, the use of expatriates also brings clear benefits to the companies concerned and thus in many situations those are the best available options. The major benefits that expatriates may offer to international companies are control of foreign operations, integration and co-ordination of subsidiary practices in company policies, the transfer of organisational capabilities between organisational units, the effective communication between foreign operations and the home country, and the development of internationally competent managers. In addition, it is often difficult to find sufficient numbers of high-capacity local staff. Because of such problems, a so-called ethnocentric approach, i.e. the use of people from the home country in key positions in foreign organisational units (see Heenan/ Perlmutter 1979:18), is still widely resorted to among international companies as a basic human resource management strategy (Martinez/ Jarillo 1991; Welch 1994 b).

For the same reason, also West European companies operating in Eastern Europe largely use expatriates in the management of their local operations. Still, the

research on the adaptation problems faced by such expatriates has been scarce. This study therefore tries to increase understanding of the problems which Western expatriates face in two East European countries, i.e. Russia and Estonia. The objective of the study can be specified in the following question: *What problems do Finnish expatriate managers face when working in Russia or Estonia?* The problems which are faced will be studied at three different levels: a) problems related to the adaptation to the local community by expatriates (and their families), b) adaptation problems faced by expatriates at the work place, and c) additional company-level management problems which expatriates face in their managerial jobs.

## 2. Expatriate adjustment

Problems faced by expatriates during international assignments are dealt with in adjustment theories. One common model of international adjustment has been proposed by Black et al. (1991) on the basis of a literature review. In their model, the adjustment process has been divided into dimensions of adjustment to the general non-work environment, work responsibilities and intercultural interaction. The model distinguishes also more specific factors influencing adjustment. Non-work elements influencing the adjustment included two factors which were called family-spouse adjustment and culture novelty. Later, a social interaction factor has been proposed as an additional factor for the model (see e.g. Black/Gregersen 1991; Kauppinen 1994). The second main element in the model, organisation culture, consisted of three factors: organisation culture novelty, social support and logistical help. Kauppinen (1994) has later suggested two additional factors influencing adjustment: perceived need for the expatriate by the host company and preparations for repatriation. The job environment element on the other hand consisted of four factors: role clarity, role novelty, role conflict and role discretion (Black et al. 1991). Black et al. have also included a fourth element in their adjustment model. This element, named "individual factors", included three subcategories: self-efficacy, relation skills, and perception skills.

As already stated in the introduction, there have only been a few studies on expatriation within Europe, but one recent study has been carried out by Suutari and Brewster (1998). That study indicated that difficulties were faced by expatriates within Europe in all three major areas of adjustment problems proposed in the model by Black et al. (1991). Starting from adaptation to social interaction, it was reported that problems were faced in the form of inadequate language skills and in the creation of contacts with local people. Adjustment problems appeared with regard to the general non-work environment also. Family-related problems in areas like social interaction, job availability for the spouse, schooling of the children, and health care systems were commonly reported. Difficulties with practical arrangements were also commonly faced – often in the form of difficulties in dealing with local authorities, in arranging suitable ac-

commodation or in dealing with other arrangements necessary for daily life. Adaptation to work and job responsibilities was another issue. Adaptation problems which can be linked to 'organisation culture novelty' in the model by Black et al. (1991) were commonly reported. Because that factor was criticized as being a very broad factor a further differentiation of adaptation problems into three major groups was proposed by Suutari and Brewster: leadership styles, organisational systems and communication. Adjustment problems were commonly reported in all these areas. In addition, job environment related problems appeared in the form of inadequate role clarity, role novelty and role conflict between the local unit and the headquarters.

The above classifications of problems of adjustment and factors influencing it will be used as a framework in the analysis of research findings on issues faced by Finnish expatriates in Russia and Estonia. In addition to issues usually covered in studies on expatriate adjustment, the present study adopts a somewhat broader view by studying company-level management problems which expatriates face in their managerial jobs too. Thus, we are able to identify more clearly all the major difficulties faced by Western expatriates when working as managers in Russia and Estonia.

### **3. Characteristics of East European communities and organisations**

This section of the paper provides a brief examination of East European environments and organisations in order to form a context-related preliminary view of the difficulties which may be faced by Western expatriates. Post-communist communities and organisations have been described as having characteristics which differentiate them from Western communities and organisations. Although many East European countries have their own history and culture, after half a century of Soviet domination they also have much in common due to similar requirements imposed by the Communist system. For example, Nurmi and Üksvärav (1993) have with regard to Estonia stated that the fifty-year Soviet legacy has left its marks on the attitudes of the Estonian people and on the organisational cultures of Estonian companies. Still, it is also clear that there are differences between ex-communist countries due to their different histories and national cultures.

According to Healey (1994:4) there have been many characteristics like the earlier central planning framework, nascent market systems, inflation, lack of fiscal discipline, and economic recession which East European communities have commonly shared. From the point of view of Western expatriates, it is obvious that the standard of living is still usually much lower in that area than in West European countries and thus one could expect expatriates to face problems related to the general non-work environment.

After the collapse of communism, East European economies have been unstable, which causes problems in managing business operations. With regard to local companies, the new environment of the enterprises has become much less protective, compared to the previous command economy situation (Grancelli 1995:5). Fey (1995) reports that problems caused by an unstable environment are also commonly faced by Western joint ventures in Russia. The various kinds of regulatory guidance existing in the market economies did not exist under communist rule; a huge number of new laws had to be developed. Because of this, Western companies – and the local ones – have to accept that the 'rules of the game' are frequently changing. For example, according to Kossov and Gurkov (1995:22) there have been some estimations that amendments to tax rules are made every two working days.

East European organisations have also been said to have many typical characteristics which differentiate them from West European companies. The increasing interest in East European markets has been reflected in many recent writings on management and organisation in Russia or Estonia (see e.g. Garrison/ Artemyev 1994; Ivancevich et al. 1992; Kozminski 1993; Liuhto 1991; Nurmi/ Üksväre 1993; Pearce 1991; Rappoport et al. 1993; Shekshnia 1994; Suutari 1998; Vlachoutsicos/ Lawrence 1990). From such writings one can get a picture of organisations which are hierarchical, bureaucratic and centralised in comparison with Western companies (see e.g. Bollinger 1994; Garrison/ Artemyev 1994; Ivancevich et al. 1992; Kozminski 1993; Liuhto 1993 b; Nurmi/ Üksväre 1994). Technologies and machinery are often outdated and there is furthermore a lack of capital to carry out any needed changes.

From the point of view of leadership styles and management practices in Russia and Estonia, a major theme in the literature has been the discussion on the inadequate skills of local managers to manage business operations in a market economy. Even local managers have been reported to agree with this (Avraamova 1995:42; Filatotchev et al. 1996:94; Üksväre/ Nurmi 1993:90). During the communist era the role of managers was mostly to solve daily operational problems (Puffer 1994:46). The leadership styles of managers in the East European area are commonly stated to be very authoritarian from a Western point of view (see e.g. Garrison/ Artemyev 1994; Puffer 1994). In a recent study it was reported that both Russian and Estonian managers are less active than their Finnish counterparts in most areas covered by Western leadership theories (Suutari 1998). Issues like a lack of open communication and initiation of new ideas and practices have also been commonly discussed elsewhere in the literature (see e.g. Ivancevich et al. 1992; Kozminski 1993; Lawrence/ Vlachoutsicos 1990; Longenecker/ Popovski 1994; Nurmi/ Üksväre 1994).

In addition to differences between typical East European and West European managers, it has been widely agreed that attitudes, skills and work behaviour of

local employees differ clearly from their West European counterparts. Thus, effective human resource management has been stated to be a key issue in the successful transformation of East European organisations (see e.g. Frederick/ Rodrigues 1994; Gurkov/ Kuz'minov 1995; Ivancevich et al. 1992; Puffer/ McCarthy 1993; Shaw et al. 1991; Smith 1990). Similarly, in a survey concerning Russian managers, effective motivation of subordinates was considered a major concern (Ivancevich et al. 1992:47). A view one gets from the literature is that work morale and efficiency at the work place have been very low (see e.g. Birch/ Pooley 1995; Holt et al. 1994; Longenecker/ Popovski 1994). A lack of independent initiative and quality thinking, and low ethical standards have been frequently discussed (see e.g. Garrison/ Artemyev 1994; Grancelli 1988; Hertzfeld 1991; Kiezun 1991; Liuhto 1993b; Rapoport et al. 1993). Furthermore, overstaffing has been common because of the previous low level of efficiency and cost consciousness.

In the light of this, it is easy to predict that Western expatriate managers will face many difficulties because they have to deal with these differences across countries in order to be able to manage business units in Eastern Europe and to adapt themselves to the local community and organisation.

#### **4. Methods**

The sample of the present study comprised 51 Finnish expatriates who were all working in Russia or Estonia. The study was carried out during 1996. 34 expatriates were interviewed and a further 17 expatriates responded to questionnaires. Due to the extensive transformation of East European economies, it was seen as necessary that the expatriates were working in their assignment during the time of the interviews and thus the interviews were carried out by telephone. The companies operated in a range of sectors of industry (metal, food, chemicals, paper, electrical products and instrument manufacturing, telecommunication, and machinery and equipment manufacturing). The expatriates were all Finns of an average age of 39.4 years. A clear majority of them were males (69%) and had technical (27%) or business education (61%). Their international assignment had lasted 2.5 years on average and 49% of these expatriates were on their first assignment. All expatriates worked in managerial-level positions, as managing or vice managing directors, accounting managers, production managers and area managers.

During the interviews the expatriates were asked to talk freely about adaptation problems they had faced when they started work in a new country and in a new foreign organisational unit. Secondly, expatriates were asked to discuss company-level management problems faced by expatriate managers. They were also asked about preparation and the advice they would give to new expatriates on the basis of their experience. Open interviews were seen as the most appropriate

research method because this allows the expatriates to talk freely about problems which they see as important. When questionnaires were used, the same questions were presented in a written form. Because the results of the two countries are mostly the same, they are presented together below. Where there are differences they will be noted.

There are inevitably several limitations to the present study. First, the number of expatriates is not large. Second, all the expatriates are Finns, which causes limitations to the external validity of the findings. Third, most expatriates were working in several major cities in Russia and Estonia, which are located near Finland. Because of these limitations, one should beware of making broad generalisations on the basis of the present findings, in particular with regard to Russia, which is an extensive country.

## **5. Results: problems faced by Finnish expatriates and companies in Russia and Estonia**

In this section findings regarding adaptation problems reported by Finnish expatriates are presented. The presentation is divided into three sections. The first covers adaptation to the general non-work environment of society. Second, the adaptation at the work place is dealt with. Third, more general management problems faced by expatriate managers in Russia /Estonia are considered. The major problems reported by Finnish expatriates can be seen in Table 1.

As can be seen from Table 1, with regard to adaptation to the general non-work environment the most common problems faced were *practical arrangements*. This gives support to the importance of practical arrangements as a separate adjustment factor as was also seen in a study concerned with a West European context (Suutari/ Brewster 1998). Black et al. (1991) discuss logistical help and social support as factors influencing adjustment and thus the focus is more on the role of the company or host-country employees to help with these arrangements. Because of the lower standard of living, many expatriates reported difficulties in finding suitable accommodation. Availability of electricity, hot water and all kinds of services needed in daily life was found to be problematic although several expatriates also commented that the situation has improved in recent years, in Estonia in particular. About half the expatriate group reported that dealing with the public authorities was very difficult because of the extraordinarily high level of bureaucracy.

Problems related to *family-spouse adaptation* did not appear as commonly as in many other adaptation studies simply because few expatriates had brought their families with them. One of the major reasons for this was that Finland is located so near to the cities in Russia or Estonia in which expatriates worked that it was possible to visit Finland frequently. All the expatriates who had brought their families with them reported family adaptation problems. Typically those prob-

**Table 1: The major problems reported by Finnish expatriates working in Russia and Estonia**

	Percentage of respondents who reported the problem in question
A) General non-work environment	
1. Practical arrangements	78%
2. Family-spouse adaptation	29%
3. Security issues	22%
4. Social interaction	16%
5. Culture novelty	14%
B) Work and job responsibilities	
1. Leadership styles	79%
2. Organisational systems	33%
3. Communication	27%
C) Major company-level management problems	
1. Frequent changes in legislation	53%
2. Interaction with public authorities	44%
3. Human resource management	38%
4. Too optimistic expectations	31%
5. Security issues	10%

lems included inadequate language skills, lack of outside family contacts and security issues. Those who had their children with them stated that they had problems because there were not very many friends or playing fields for them. In some cases the children were of school-age and that had caused additional problems. However, in some cities like Tallinn and St. Petersburg there were Finnish schools, which made the situation a lot easier.

*Security issues* were often mentioned. Most expatriates talked about the stress which the fear regarding security caused, and in several cases real problems were also faced (for example, an armed robbery at home). Because security issues were so commonly mentioned they were classified as a separate adjustment factor in the present study. Inadequate language skills and problems in creating contacts with the locals were mentioned as problems related to *social interaction*. On the other hand, it should be taken into account that in Estonia one can manage with the Finnish language: which is of course a very important thing for expatriates. Furthermore, there are a lot of Finnish expatriates in Estonia to mix with and thus the need for local contacts may not be so extensive as is usually the case during expatriate assignments at least as far as personal comfort is concerned. With regard to Russia, almost all expatriates already had some kind of language skills in Russian. The social interaction factor was here included in the general non-work adjustment dimension although in a model by Black et al.

(1991) it is presented as a third dimension of adjustment. This was done because expatriates were asked about adjustment to the general environment and at the work place as separate questions. Problems related to social interaction appeared in both cases, as will be shown later.

Furthermore, expatriates discussed at a more general level cultural differences which caused difficulties when one did not know for example how to act in different kinds of everyday situations. Several expatriates in Russia also mentioned that they had experienced a so-called culture shock during their assignment. Such difficulties can be linked to the *culture novelty* factor in the model by Black et al. (1991). In addition to these major problems, issues like pollution of the environment, the dirt of cities, and traffic problems were pointed out, but not frequently enough to be classified among the major adaptation problems.

Adaptation at the work place was another matter. Almost all the expatriates reported difficulties created by differences in *leadership styles*, hence supporting the identification of such a factor as a separate adjustment factor by Suutari and Brewster (1998). Two major issues were frequently pointed out. First, it was reported that expatriates were required to use a clearly more authoritative style than they were used to. It was commented for example that "one has to be tough and give direct orders", and that "one has to be extremely authoritative". Second, expatriates often mentioned the need continuously to supervise the work of local employees because otherwise it was not carried out in the required manner. For example, it was stated that "one has to supervise the work in every work phase", and that "a manager has to be present all the time because otherwise they start to do whatever they want". In addition to these major issues, it was reported for example that "one could not use team working with the locals". All these comments give support to the picture of leadership styles in Russia and Estonia presented in the literature (see e.g. Garrison/ Artemyev 1994; Liuhto 1991; Puffer 1994; Suutari 1998).

With regard to *organisational systems*, 31% of the expatriates reported difficulties. This supports the classification of such an adjustment factor as a separate factor. First of all, many expatriates stated that in local organisations there has been a very high level of formalization and thus the employees expect their job descriptions to be very clear and the limits of their responsibilities to be clearly defined. Expatriates state for example that "the work of employees has to be organised very specifically", and that "there has to be clearly defined tasks and rules". Second, it was reported that bureaucracy in the functioning of organisations was very marked. Third, it was commented that many functions common in the West (like marketing) have not appeared in East European organisations at all. Similarly, the tasks of the management group and the Board were unclear to the locals and had to be explained. All in all, the interpretation of tasks in general was totally different from Western approaches and caused communication and

other problems. The evidence again supports the view given in the literature (see e.g. Bollinger 1994; Garrison/ Artemyev 1994; Ivancevich et al. 1992; Liuhto 1993 b; Nurmi/ Üksvärav 1994; Suutari 1998).

Many expatriates had met difficulties due to differences in the mode of *communication*. This was not related only to inadequate language skills – other difficulties were also faced. First of all, in line with the comments presented in the literature (e.g. Ivancevich et al. 1992; Kozminski 1993; Lawrence/ Vlashoutsicos 1990; Longenecker/ Popovski 1994; Nurmi/ Üksvärav 1994; Suutari 1998), it was commented by many expatriates that the local communication style was not so open as that in Finland. Hence, it was not easy for expatriates to get into the organisation or to get the information they needed. The communication style in Estonia and Russia was less direct than in Finland. Furthermore, it was stated that it was very difficult to start a critical discussion of existing problems. Rather, expatriate managers had to identify problems by themselves and then order someone to take care of them in a defined manner.

Comments related to the job environment (i.e. role clarity / novelty / conflict / discretion) were not commonly reported although for example several comments related to role novelty did appear. This might be at least partly due to the fact that the expatriates stressed more the problems related to the lack of experience of locals with respect to organizational roles than problems related to their own role. In addition to the major groups of adaptation problems at the work place, several other issues were raised, though less frequently: the misuse of company property and involvement of employees with the black market, quality and efficiency problems, different ways of interpreting contracts, a fear among locals of contacting public authorities, and no strict adherence to timetables.

Company-level management problems in conducting business in Russia and Estonia were also explored in order to get a broader view of difficulties faced by Western expatriate managers. The most common difficulties at company level concerned *frequent changes in legislation*. The changes were reported to be so frequent that it was almost impossible to keep up with them. The laws and regulations are often very complex and it was hard to interpret them. This finding is in line for example with the finding by Fey (1995) regarding common problems in joint ventures in Russia. The second major area of problems was *interaction with the public authorities*. The public authorities are very bureaucratic. Expatriates reported for example that "you must have local people to help you with the bureaucracy", and that "it is very difficult to know where one can get information".

Expatriates also frequently reported problems related to *human resource management*. Human resource issues thus play a central role in the success of companies in Eastern Europe (e.g. Frederick/ Rodrigues 1994; Gurkov/ Kuz'minov, 1995; Ivancevich et al. 1992; Shaw et al. 1991; Smith 1990). In the present

study, expatriates found it difficult to recruit employees with adequate professional skills. It was also commented that one should avoid recruiting local employees who are over 30 years old because they are too used to the traditional customs. Similar findings have been reported in the literature (Liuhto et al. 1993). On the other hand, other expatriates point out that age is highly respected in Russia, and that young people do not have the necessary personal contacts which are important in the local culture. The major differences between Finnish and local employees was reported as a lack of individual initiative among local employees. Local employees are not willing to take responsibility, their level of performance is low, and quality thinking is not common among them. Several expatriates also mentioned that local employees might have several jobs at the same time and that the stealing of company property was a common problem. All these observations give support to the picture presented in the literature (e.g. Gurkov/ Kuz'minov 1995; Liuhto 1993 a; Puffer/ McCarthy 1993; Shaw et al. 1991). Because of these facts, the training needs of local employees were seen as extensive. Traditional training methods did not work with local employees, and expatriates were trying to develop more efficient ones.

Many Western companies in Russia and Estonia start with *too optimistic expectations* which are impossible to meet. Expatriates commented for example that "everything takes more time than expected", "the basic issues do not work out as easily as in Finland", and that "it takes clearly more time to start a business over here than expected". This causes extra pressures on the expatriates because often expectations from the headquarters were not realistic. Some expatriates argued that companies should be prepared to develop their business little by little and prepare themselves well for local markets before entering. With regard to *security* it was commented that expatriates should "prepare themselves well for security problems"; "stay in legal business only, because otherwise there will be problems with the Mafia"; and "check the background of business partners carefully".

In addition to these problems several other ones were mentioned occasionally. For example, it was stated that cultural differences are very difficult to deal with, and that promises are not kept equally well by business counterparts as in Finland. Lack of capital in Eastern Europe, eagerness of local shareholders to take the money out of a company as soon as possible rather than to invest it, and long payment times had also caused problems. The basic understanding of business principles is poor among local employees and planning and budget making is problematic because locals are not oriented to the future.

There were also some differences between expatriates' experiences in Russia and in Estonia that should be pointed out. First, expatriates in Estonia reported that things have developed quickly and circumstances do not any longer differ so clearly from Western ones as they used to do. Furthermore, the transformation

within companies was stated to be quite rapid, although at the same time it was commented that it is difficult to get rid of old customs. A similar picture of quite rapid transformation in Estonia has been reported by Nurmi and Üksvärav (1994:5).

## 6. Conclusion and implications

All in all, various problems were faced by Finnish expatriates in Russia and Estonia. The results of the study also indicated that previous classifications of expatriate adjustment, problems and factors influencing them, were found to be useful. In particular, when combined with existing knowledge of special characteristics of East European communities and organisations, the literature could provide a good preliminary understanding of problems faced by Western expatriates in Eastern Europe. The major problems were faced in the same areas as in a study concerned with the West European context. However, this does not mean that the problems were very similar although they were related to issues like leadership styles and organisational systems in both cases. In addition, some special characteristics like the frequent emergence of security issues appeared in the East European context.

One of the causes of the problems faced by expatriates themselves was inadequate preparation for the international assignment. In a similar manner, expatriates commented that the preparation made at company-level before entering Russian or Estonian markets was often inadequate and thus the expectations were reported to be too optimistic. Among the present expatriates, 62% thought that their preparation for the assignment was inadequate. Among those who considered that their preparation was sufficient the majority consisted of those expatriates who had earlier expatriate experiences (40% of the expatriates had such experience) and / or longer prior experience of East – European markets. When some preparation was received, a prior visit to the foreign unit (50%) and language training (41%) were the most common forms of preparation. 25 per cent of the expatriates had also sought information on their own initiative, most often from the literature. Job-related training had been received by every third expatriate, and country-/ culture-related training only by 13 per cent of the expatriates. Almost half of the expatriates (42%) left for their international assignment without any preparation at all. Several expatriates were quite pessimistic about the possibilities of receiving relevant training before assignments, because very few Western people have the necessary understanding of Eastern Europe to provide up-to-date training.

As the results of the present study indicate, Eastern Europe is not an easy area for Western expatriates. In order to be able to help new expatriates to learn from the experiences of previous ones, the expatriates were asked what kind of advice they would give to a new expatriate going to Eastern Europe. The results can be

compared with findings from expatriation within the West European context (Suutari/ Brewster 1998) in order to discover some special features of Russian and Estonian markets from the point of view of Western expatriates. The most commonly given bits of advice are presented in Table 2.

As can be seen from the table, the most commonly given piece of advice was related to the need to be patient and have a high level of tolerance. This finding is clearly related to the specifics of East European markets, because it was not reported in the study within West European expatriation. Expatriates offered comments like "try to be very patient because everything takes so much time"; "try to stay calm even when issues don't go like you planned"; and "be prepared for hard work, because it takes a long time before any results are achieved". It was also commented that expatriates should be very flexible and tolerant of stress, and that this should be taken into account when expatriates are selected.

**Table 2: Expatriates' advice to future expatriates**

1. Be patient and have a high level of tolerance
2. Acquire good language skills beforehand
3. Obtain knowledge of the country and its culture and history
4. Be careful concerning security issues
5. Try to adapt your thinking and behaviour to local customs
6. Don't go to Eastern Europe as "a great Western master"
7. Discuss with earlier expatriates
8. Make a prior visit to the country / organisation
9. Take care of your family during the assignment
10. Make sure that you have good professional skills in your new job

About half of the expatriate managers also stressed the need for acquiring good language skills beforehand and for obtaining prior knowledge of the characteristics of the local community and culture. These comments are in line with findings in earlier expatriate research. A second commonly offered piece of advice which did not appear in the study within the West European area, was the importance of security. It was commented that "one should take care of security issues as well as possible", and that "companies should formulate specific security rules for their employees both for work time and free time".

The fifth most commonly given piece of advice was that expatriates should actively try to adapt their own thinking and behaviour so that it is appropriate for an East European context. Thus, the picture is partly similar to that which emerged in the study of Western-Europe expatriation. In the present study expatriates stated that "Finnish models cannot be applied in the East European context as such"; that "one must also himself be prepared to adopt his working style and not just expect locals to adapt their styles"; and that "one has to be prepared to adapt himself also and to respect the local system". It was also stated that

"cultural differences are so extensive that it takes two thirds of our energy to cope with those and thus it leaves only one third for work".

A third distinctive piece of advice to new expatriates when compared to findings from the West European context, was the suggestion that expatriates should not be arrogant and behave as if they were the only ones who knew how things should be carried out (i.e. one should not behave like a great Western master). For example, one expatriate said that "Russian people are not always willing to adopt Western methods but would rather like to develop their own applications of such methods". Furthermore, expatriates commented that "many Western businessmen do not honour local manners at all and insult local people, but one should not behave in that manner because they will remember it for a long time". This supports the view by Holt et al. (1994:137) who have commented that the Russians do not for example adopt Western practices easily without testing and resistance (see also Frederick/ Rodrigues 1994:46; Holt et al. 1994:137; Shekshnia 1994).

The rest of the advice was similar to that reported in a study by Suutari and Brewster (1998). One should consult with expatriates who have earlier worked in the country in question, make a prior visit to the country in order to get things arranged, take good care of ones family during the assignment, and take care that one has good professional skills for the new job. Among those who brought their family with them, the importance of family-related preparation and arrangements was frequently mentioned. Other advice includes "create good connections with important locals because personal relationships are here very important when doing business", "be careful with taxation issues", "take care of repatriation issues beforehand", and "have realistic objectives from the beginning".

Looking at these comments and the results of the study from a company point of view, many implications appear. First, clearly most expatriates felt that their training was inadequate and thus they had faced more problems than would have been necessary. This is supported by a review of studies on expatriate training because it was found that training had been considered useful when received (e.g. Black/ Mendenhall 1990). Expatriates' advice presented in Table 2 points to other specific areas which companies could take into account in their expatriate management practices, and indicates several special characteristics of East European environments as compared with West European environments. The results also indicate many common company-level management problems in operations in Eastern Europe. These findings should help companies to know more about what to expect and to prepare themselves better for operations in Eastern Europe. As many expatriates commented, Western companies' expectations are usually too optimistic. For example, the training needs of local employees are extensive and time consuming. Recruiting employees was described as one area in

which companies should be very careful. Furthermore "companies should be prepared to meet surprises related to personnel issues". The importance of good preparation for security issues also appeared frequently both at individual and company level.

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## Managerial Resistance to Change: Romania's Quest for a Market Economy\*

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*This exploratory investigation relates traditional theories on resistance to change to privatization of the Romanian economy. The authors identified several "inhibitors" which have served to stall Romania's attempts to achieve a free-market economy. While a lack of practical training in western-style management practices may be a limiting factor, Romanian managers are generally open to change. However, they are still deeply rooted in the thought processes instilled during Romania's command economy and a belief that the size and economic importance of their firms will serve as buffers against the "agents of change". To the extent that change is viewed as a threat to their personal interests, resistance can be expected. The question, "what is in it for me?", must be satisfactorily addressed if Romanian managers are expected to become active partners in implementing necessary changes.*

### Introduction

In Romania, the rate of transition toward a market economy is dependent on managerial behaviour. In particular, the attitude of managers toward change and their vision related to the changes which their firms face. While resistance to change is a common response, it is not uniform. Research shows that it varies from one industrial sector to another and from one organisation to the next. Even when change occurs as a positive programmed response of an organisation to either internal or external environmental pressures, resistance can still surface. In these cases, it is often viewed as a negative response by either individuals or groups based upon special interests.

Regardless of the rhythm of reform in Romania, the market economy's shock has induced decisional stress and managerial anxiety. Some managers, particularly those employed in state-owned enterprises, feel uncomfortable when using the expression "managerial resistance to change". In response, the current study

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*During the preparation of this special issue, Alexandru Catana died from a severe disease. With him we lose a trustful friend and a highly engaged researcher and critical observer of Romanian organizations and management. We consider this reprint a tribute paid to him and to his outstanding work. – The Editors*

of 200 top-level managers has been designed to point out some of the aspects of this reaction.

In this study, the expression “resistance to change” has no political connotation but simply describes a negative response to the pressure for organisational and structural change. Lower or higher resistance to something new is a normal behavioural response. The economic, social, political and moral crisis currently faced by Romania is correlated with such a behaviour. It would be a nonsense to deny the existence of some resistance to such a major, unique change in Romania’s national and regional history.

Secondly, this is not an isolated phenomenon but one observed in all market-driven economies. While the reasons for its existence vary, they are at least partially due to an accelerated rate of change in both the internal and external environments. Currently, managerial resistance to change constitute a central theme of management science and a highly relevant topic for empirical studies concerning managerial behaviour.

In order to more fully understand the most important variables which could increase resistance to change, the authors conducted an extensive review of the literature. This review revealed a number of empirical studies concerning employee resistance to change and a few which suggest that this phenomenon may be endemic in the organisation itself.

### **Literature Review**

Changes must occur if an organisation is to evolve and these changes will have an impact on employees at all levels of the organisation. While some of the effects of change will bring positive benefits and others will bear negative consequences, both will have an impact on the lives of employees and managers alike. This personal dimension ensures that organisation change cannot be accompanied without encountering some degree of resistance.

### **Sources of Resistance:**

In their theory of structural inertia, Hannan and Freeman (1977, 1984) depicted an organisational environment in which change was difficult to achieve and dangerous to attempt. They argued that successful organisations are reliable and accountable and these characteristics are enhanced by institutionalised goals and routine behaviour. These very characteristics, which are so essential to corporate success, also serve to generate resistance to change.

In a recent interview, Douglas Wolford, the general manager of GE Internet Consulting and Services likened this phenomenon to the human immune system.

“A corporation, as a collection of individuals, is a living organism. As such, it has its own immune system – and any time the immune system identifies some-

thing foreign, it will isolate it. From there, it will weaken or outright kill the “invader”. When change is introduced into an organisation it can trigger that immune response, even if the change is good.”

Petrini and Hultman (1995) point to personal feelings as a primary factor which causes resistance to surface. They identified six factors which cause employees to reject change:

1. Personal needs are currently being met
2. Changes are perceived as making it harder to meet personal needs
3. Risk is perceived as outweighing benefits
4. Change is perceived as being unnecessary
5. Change is perceived as being mishandled
6. Change is perceived as “doomed to failure”

The findings of Petrini and Hultman are similar to those in an article by Gerald Graham (1997). While Graham argues against the “inevitability of resistance”, he does agree that changes will be accompanied by resistance when it causes economic loss, inconvenience, threat, or social disruption. This psychological dimension is also pointed out by Allen Fishman (1997).

In their article on the organisational culture in Romania, Wall, Catana, and Catana (1997) attribute psychological resistance to certain characteristics of the Romanian psyche. It is their position that Romanians, as a group, seek stability, fear uncertainty and avoid risk. Romanian managers tend to procrastinate and react to situations rather than taking a proactive approach to their environment. Long run planning is limited to a risk-free process of creating “daydream scenarios” which are unlikely to materialise.

Lally and Truell (1997) indicate that fear of the unknown lies at the heart of resistance and the concern which many employees face is job security. The perception of top management often is “what is good for my employer is good for me”. Lally and Truell point out that employees often cannot grasp this concept, particularly when change requires them to abandon old habits, learn new skills, or accept alterations in the power structure. In fact, Schaefer (1998) argues that changes in an organisation's policies and procedures upset the power structure and increase the opportunity to influence activity.

While we generally associate this type of resistance with employees, managerial personnel can also pose barriers to change. Managerial resistance has been attributed to a variety of factors. Miller and Friesen (1984) and Tushman and Romanelli (1985) suggested that satisfaction with the “status quo” increased complacency and increased the resistance to change. Articles by Milliken and Lant (1991) and Miller (1994) both contend that this complacency is further increased by past managerial success.

Abbasi and Hollmann (1993) identified two factors as primary sources of managerial resistance. These were frustration in dealing with the new breed of worker and the impact of technology on the workplace. Spreitzer and Quinn (1996) found that resistance to change by middle managers was positively related to affect, self-esteem, social support. They also suggested that a lack of correlation between prior or current promotions and any of the dimensions of change sends a message to managers regarding the value of organisational change.

A number of researchers attribute resistance to a lack of understanding of the market. Sinkula (1994) argues that a market orientation provides strong norms for sharing information and also with reaching consensus on its meaning. In two studies, Slater (1995) and with Naver (1995) demonstrated a strong relationship between the behaviours exhibited by market-oriented firms and learning-driven performance outcomes. Taken as a group, firms which are consumer oriented are inherently more receptive to change.

### **The Impact of Resistance on Implementation:**

Research by a variety of authors has pointed to the potential of failure for projects involving a major degree of organisational change. Studies by Dervitsiotis (1998) and De Cock (1998), point to the high costs associated with the traditionally high failure rates of organisational reengineering projects.

Reynolds (1994) quotes a study by Gateway Information Services, a New York based consulting firm, which revealed a 70 percent failure rate for corporate reengineering and cultural change programs. This is mirrored in a study by Maurer (1997) which placed the percentage of success for reengineering at 33 percent and quality improvement at 50 percent. In an interview with Michael Hammer, Moad (1993) reported complete success in only 30 percent of business process reengineering projects. Raymond and Begeron (1998), in an optimistic view of the situation, point out that 70 percent achieved some of their goals. While such a positive viewpoint is encouraging, the results still raise serious concerns as to the likelihood of success.

### **Implications for Eastern European Privatisation:**

The process of privatisation draws opposition from public employees in all economies. Eggers and O'Leary (1994) reported that this political process elicits resistance due to the perception that it entails massive layoffs. They cite a 1989 study of 34 city and county privatisation's conducted by the National Commission on Employment Policy which revealed a dislocation factor of only 7 percent. This is in line with similar information which they obtained from Massachusetts. During the early 1990's, the Governor of Massachusetts instituted a privatisation process which resulted in declines in public employment of 8.8 percent. While the cost-savings which result from these actions is highly attractive

to tax payers, public employee unions see these losses as a threat to their survival and an erosion of their power.

With organised resistance to privatisation being such an important issue in the United States, one would expect that it would be even more deeply rooted in the controlled economies of Eastern Europe. As these nations abandoned their command economies and surged forward in their attempts to develop market-based systems, dislocations of the most extreme magnitude occurred. Scott (1993) reported declines in GNP from 1990 to 1991 which ranged from 11 percent in Hungary to 43 percent in Albania. The fall into total trade was even larger ranging from 15 percent in Hungary to 69 percent in Bulgaria. As with any planned change to which the majority of the participants are not full partners, resistance is to be expected. In Hungary, where the declines were 11 percent and 15 percent respectively, privatisation has proceeded at "warp speed". Not surprisingly, the rate of movement in Romania, where GNP dipped by 19 percent and total trade by 55 percent, has been frustratingly slow.

Healy (1994) partially attributes the variance in rates of privatisation to popular resistance to change. He points to a widespread suspicion of Western management throughout Eastern Europe. This is particularly true in those post-communist societies, such as Romania, in which unionisation was extremely strong or where the old communist elite still exercised control. Nagy (1994) indicated that the communist elite still control leading posts in the new systems. The institutions which they represent are both rigid and highly resilient and within this structure, these individuals create resistance to increased competition, diminished state intervention, and increased efficiency.

Workers and managers alike have been susceptible to efforts to encourage their resistance. Scott (1993) points out that under state control the interests of management and workers were the only ones voiced within the political system. Without some sort of safety net to catch these individuals, resistance to privatisation is inevitable. These same thoughts are echoed in an article by Brada (1996) in which he attributes this reluctance to employees and managers at state-owned firms who fear the loss of power and income. Furthermore, they fear that private owners will reduce workforces and will not provide the social benefits previously found with state owned companies. This latter conclusion which was also been voiced by Rondinelli and Yurkiewicz (1996) in their study on Polish privatisation efforts.

### **Objectives of the Study**

Extensive research on resistance to change has been conducted over the last two decades. Since 1990, this has been broadened to include the issue of privatisation both in the United States and in those nations which are striving to develop

market economies. The current study is one of the few to examine the existence of this phenomenon among Romanian business executives.

The objectives of this exploratory investigation were to identify the primary factors that cause resistance to occur and to isolate methods which make change more acceptable. To accomplish this task, the respondents were asked to identify: (1) the major “inhibitors” of managerial resistance within their firms; (2) the nature of managerial resistance to change; (3) causes of managerial resistance; (4) status – related motivators in opposing to change; (5) forms of resistance; (6) organisational areas less resistant to change; (7) how can resistance to change be demented; and (8) how can managers be more directly involved in the process of change.

### *Research methodology*

The current study, which was conducted in 1997, was based on mail survey of 200 top managers representing state-owned enterprises within the central-western portion of Romania known as Transylvania. Two types of firms were represented. “Societati comerciale” which are producers of goods and services and “regii autonome” or public utilities. These firms had an average employment of 1800 and annual sales of \$4,000,000 (U.S.).

The questionnaire was pre-tested on a micro sample of 10 managers. Particular attention was paid to the respondent’s understanding of the questions and their interpretations of the variables. No problems were encountered with the underlying constructs and no major points of confusion were noted which would impact the validity or reliability of their responses. From 142 returned questionnaires (71% response rate), 14 were excluded, producing a data base consisting of 128 valid responses. The profile of the typical respondent was male (92%), age 24 – 49 (62%), with at least one college degree (97%). These gender, age, and education levels are typical of the managerial force within government industries.

### **Findings**

The following tables summarise the responses from the respondents. The questions were closed end with varying response alternatives. The numbers reported reflect the percentage of managers ranking a particular response alternative as the most important.

#### **Structural Inhibitors to Change:**

The data summarised in Table 1 were designed to measure the respondent’s perceptions of the major driver of resistance to change. The answers suggest a direct positive relationship between each of these inhibitors and resistance to change. By combining the first two items, it is clear that the economic importance and size of the firm are viewed as the primary variables of the resistance to

change (which, in fact, are inhibitors of change). A total of 63.4 percent of the respondents rated one of the two factors as a primary inhibitor of change. This suggests that the more important a company is to the national economy and the larger its size, the less likely its managers would be to view change as necessary.

A continued obstacle to creating a free-market economy in Romania has been that the privatisation of giant state-owned companies has been delayed much longer than in other Central and Eastern European countries. These data suggest that size alone may have been a determining factor in producing these delays. This finding supports those of Miller and Friesen (1984) and Tushman and Romanelli (1985).

**Table 1: Structural Inhibitors to Managerial Resistance**

Inhibiting Factors	Percentage of Responses
Relative economic importance of firm	35.2
Firm size	28.2
Opposition by lower levels of management	26.3
Union's power in company	9.1
Others	1.2

Of additional importance is the view of 26.3 percent of the respondents concerning the importance of middle and lower level management resistance to change. A finding that resistance by managers at these levels makes change more difficult to accomplish is supported by both Milliken and Lant (1991) as well as Miller (1994). This is particularly interesting since the respondents were all members of top management.

### The Nature of Managerial Resistance to Change

The data in Table 2 summarise the respondents' opinions on the nature of managerial change. The following research definition were established for these variables and were validated in the pre-test.

**Education:** seen as a measure of the manager's preparation for the position, this refers to the instruction or training through which individuals learn basic managerial skills

**Professional:** seen a measure of professional skills, it refers to the methods managers use to perform their tasks

**Psychological:** viewed as a measure of the manager's psyche, it refers to the mental and behavioural characteristics exhibited by managers

The data appear to show no definitive position among the respondents with respect to the nature of managerial resistance to change. A total of 36.2 percent considered the resistance to the market economy's methods and techniques as

being primarily professional in nature, with 32.4 percent selecting psychological and 28.9 percent educational.

**Table 2: The Nature of Managerial Resistance to Change**

Nature	Response Percentage
Professional	36.2
Psychological	32.4
Educational	28.9
Others	2.5

Taken as a group however, the data suggest that these issues could be representative of managerial competence. The inability of managers to feel competent to handle the ramifications of change would be a major barrier to adopting a vision for their firms to compete in a market driven economy. It is currently unclear if Romanian managers, particularly those whose careers have been associated with state-owned enterprises, fully understand the full meaning of management. As a profession, management is a combination of art, science, and expertise. In a market economy, the old ways of managing firms are no longer workable and a full understanding of marketing, finance, and human resource management is essential for success.

While top-quality managers are a scarce resource in many nations, this is particularly true in Romania. Traditionally, this has been due to a lack of opportunity for training during the pre-revolutionary period. With the increased availability of training, it now seems to be more of an excuse relating to time pressures in acquiring the needed knowledge and the lack of financial resources for managerial training. Even with these constraints, the scarcity of competent managers must not be used as an excuse for maintaining the country's prior practices of appointing or maintaining managers according to their political status rather than their qualifications.

### **Causes of Managerial Resistance to Change:**

In order to obtain their personal perceptions of the organisational factors which impede change, the respondents were presented with the list of alternatives summarised in Table 3.

The data again seem to reveal a lack of commonality in the responses. The largest group of respondents, 28.3 percent, identified managerial mentality as the most likely cause of resistance followed by personal characteristics (20.4%) and bureaucracy (17.5%). These responses are consistent with the findings of Lally and Truell (1997) and seem to have a common thread since they are all intensely personal responses. The more objective reasons such as team atmosphere, organisational structure, and union claims were cited far less frequently. It is likely

**Table 3: Causes of Managerial Resistance to Change**

Causes of Resistance	Percentage of Responses
Attitude toward managerial responsibilities	28.3
Interpersonal skills	20.4
Adherence to formalised rules	17.5
Internal managerial conflicts	11.2
Organisational structure	9.4
Unions power	9.2
Others	4.0

that these managers are still deeply rooted in these previous thought processes and are still strongly anchored in the patterns of a state-controlled economy.

### **Status-Related Factors Which Motive Managers to Resist Change:**

The data in Table 4 reveal a strong degree of agreement among the respondents on the motivators of managerial resistance to change. Over half ranked maintaining jobs, income, and relationships as a primary motivator of resistance to change. In addition, nearly ninety percent indicated that these motivators, combined with the decisional stress related to change would result in attempts to undermine the change process.

**Table 4: Status-related Factors Which Increase Managerial Resistance**

Motivators of Resistance	Percentage of Responses
Maintaining the status-quo	50.3
Decisional stress associated with change	36.3
Lack of authority	10.8
Others	2.6

Maintaining one's position and the associated income and relationships is a strong motivating factor in any economy. In Romania, where relationships with political and administrative authorities have been the source of personal welfare and social position, it carries a far greater significance than in a free-enterprise system. As reported by Brada (1996), this may be the major subjective factor, which has led to opposition of the new managerial mentalities and practices, which are taking hold.

The importance of decisional stress is indicative of a managerial environment in which individuals at all levels were accustomed to waiting until someone told them what, when, how, and for whom to do things. Centralised planning overwhelmed personal initiative, encouraged risk and responsibility avoidance, and increased the so bureaucratic pitfalls associated with decision making. One did

not question the directives received so at each level, compliance with directives was assured. By changing this approach, managers see a threat to their personal lives and this concentration on personal interests exacerbates the authority crisis. Furthermore, they perceive that change is a threat to their image and fear the admission that they are not infallible.

### **Forms of Managerial Resistance to Change:**

*Table 5: Forms of Managerial Resistance*

<b>Forms for Resistance</b>	<b>Percentage of Responses</b>
<b>Inertia</b>	36.2
<b>Fear of change</b>	24.6
<b>Non-involvement</b>	20.4
<b>Indifference / hostility toward change</b>	10.8
<b>Others</b>	8.0

The data in Table 5 reveal a more definitive perception among the respondents. The largest percentage of those reporting (36.2%), identified inertia as being the most important form of resistance. This was followed by creating fear of change (24.6%) and lack of personal involvement (20.4%). The three main forms of resistance reflect a mindset in which the willingness to change is anathema.

Some managers mask their resistance behind a façade that while they are willing to change, it is simply too costly, unrealistic and too risky for the future of their firm. Still others delay the change with excuses such as “don’t have the needed experience”, or “we should find our own way to achieve this”. This form of resistance is more difficult to overcome since it is hidden behind a false acceptance of change. This is consistent with the contentions of Wall, Catana, and Catana (1997) and suggests that the prevalence of these attitudes at governmental and managerial levels have contributed to delaying the process of privatisation.

### **Receptiveness to Change Within the Organisation:**

The authors also attempted to identify those areas of the organisation which are perceived to be friendlier to change and where resistance would be less intense. The data, which are summarised in Table 6, clearly reveal that the previous findings about personal fear, need for personal incentives, and resistance to loss of control make the personnel area least receptive to change (19.5%). This is consistent with the findings of Petrini and Hultman (1995) and Graham (1997) and further underscores the importance of the “human factor” in the equation of change.

When the data as a whole is considered, the fact that changes in organisational structure (44.6%) and technology (35.6%) are perceived by the managers the

easiest areas to instil change is not surprising. Given the findings on human resistance, acceptance on changes with less of a "personal dimension" is not surprising.

**Table 6: Organisational Areas Receptive to Change**

Area most receptive to change	Percentage of responses
Organisational structure	44.6
Technology	35.9
Human resources	19.5

### Facilitating the Acceptance of Change

If change is to occur in an environment of fear and mistrust, the implementers must be cognisant of the means for bringing about acceptance. In Table 7, the data show the approaches which our respondents indicated as being most effective in gaining compliance and avoiding obstruction. The largest group of respondents indicated that the mentality of managers must first be altered for change to be accepted. In addition, 25.3 percent indicted the need for an emphasis on performance. Both of these are educational issues and the fact that nearly one-third of the respondents identified these as major factors (see Table 2) suggest that learning may be the key to this dilemma. Through the adoption of a new mentality toward managerial tasks and by training employees to respect performance, organisations in Romania have a greater chance of success in implementing needed reforms.

**Table 7: Facilitating the Acceptance of Change**

Means for facilitating the acceptance of change	Percentage of Responses
Change mentality toward management	37.5
Create respect for performance	25.3
Strategic diagnosis of the company	18.2
Training a team to induce change	11.1
Designing a plan for the change	7.9

These responses reflect an often-voiced opinion in Romania: "We have changed the system, but failed to change the people." What these data suggest is years of socialism have created a critical need for education to bring about changes in the thought processes of managers and employees in state-owned firms.

### Involving Managers in the Process of Change:

Having gained the perceptions of respondents to the organisational areas that are perceived as most receptive to change, and the means facilitating the change ac-

ceptance, the authors proceeded to gather their impressions of the best methods for achieving managerial involvement. The findings are presented in Table 8.

**Table 8: Methods of Involving Managers in the Change Process**

Methods of involvement	Percentage of Responses
Persuading managers about the necessity of change	33.4
Managerial control of the reward process	27.1
Monetary incentives for managers	20.1
Punishment	12.6
Managers involved in govt. decisions	6.8

The data in Table 8 reveal that while it is critical that the necessity for change be impressed on those involved (33.4%), personal factors cannot be discounted. The respondents clearly stated their perception that managerial control of the reward system (27.1%) and direct monetary incentives (20.1%) are critical concerns. The latter item was mentioned previously by Rondinelli and Yurkiewicz (1996) and suggests that the traditional response, “what is in it for me?”, must be addressed if managers are expected to become active partners in implementing necessary changes.

### Conclusions and Implications

Although this study was exploratory in nature, a number of important preliminary conclusions can be drawn from these data.

1. The relative economic importance and physical size of the firm are viewed as the primary inhibitors to change.
2. Managers are still deeply rooted in their previous thought processes and are still strongly anchored in the patterns of a state-controlled economy.
3. Managers perceive change as a threat to their personal lives and this concentration on personal interests exacerbates the authority crisis.
4. Preservation of personal status appears to be a strong motivating factor. Managers fear that privatisation may lead to the creation of a new management team.
5. The most important forms of managerial resistance to the transition from a controlled economy to a free-market are inertia, creating fear of change and non-involvement.
6. Changes in “non-human” areas such as organisational structure and technology are more likely to gain acceptance than those in the area of human resources.
7. Adoption of a new mentality toward managerial tasks and training employees to respect performance are essential if Romania firms are to implement needed reforms.

8. The question, "what is in it for me?", must be addressed if managers are expected to become active partners in implementing necessary changes.

### **Need for Further Study:**

An extremely interesting finding which deserves further study is the source of resistance within the managerial hierarchy. Although all of the subjects chosen for this study were members of top management, over one-fourth identified lower-level managers as a key impediment to change. A logical extension of this work would be to obtain responses of managers at various levels of the organisation and compare them for consistency.

Another highly interesting avenue for further exploration would be to compare the attitudes of managers by demographic factors, such as gender, religion, education, and cultural and political backgrounds. This would allow future researchers to isolate those perceptions, which have been created by a historical or cultural perspective and those which are related to personal protection. The need for further study is underlined by the current government's inability to accomplish full privatisation of Romania's "economic giants". Only with full knowledge of the factors, which created resistance to this goal, can success be expected.

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## Cultural Transformation at Enterprise Level: Case Study Evidence from Poland\*

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*This paper presents an analysis of the business cultures of four post-socialist Polish enterprises. Western capitalist orthodoxy emphasises the development and management of an 'appropriate' organisational culture as a key component of organisational effectiveness. Within an East European context it is likewise suggested that the development of appropriate market behaviour is necessary if transforming economies are not to hit a ceiling of recovery. However, what constitutes an 'appropriate' organisational culture within an East European context is open to speculation and debate, particularly if it accepted that there is no dominant model of capitalist work organisation which might represent a template for transforming economies. This paper draws on empirical case study material to appraise the business cultures of four post-socialist Polish enterprises. Findings suggest that ownership, turnover of human capital and management philosophy and ideology represent key factors in the development of market oriented behaviours. However, findings also reinforce the strength and endurance of the socialist culture.*

### Introduction

Within western capitalist societies, the development and management of organisational culture is seen as a key component of organisational effectiveness (Denison, 1984, Barney 1986, Williams et al 1993). Similarly, within an East European context it is suggested that successful transformation to free market capitalism requires (in addition to institutional and structural reform) the 'un-freezing' of a dysfunctional socialist culture and the embedding of entrepreneurial attitudes and behaviours (EBRD1997)

However, the concept of organisational culture remains problematic and there are wide-ranging and unresolved debates as to the meaning of organisational culture and the extent to which organisational culture may be successfully manipulated and changed. Moreover, economic and political transformation in post-socialist Central Eastern Europe (CEE) has specific characteristics and features which distinguish it from western restructuring initiatives. The concept of path dependence (Stark 1992) suggests that individual CEE economies will follow different paths to a free market economy which reflect their specific historical, social and cultural legacies. Furthermore, as Whitley (1995, p11) suggests,

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the corresponding lack of any dominant model of capitalist work organisation which might represent a template for transforming economies reinforces the likelihood that institutional, socio-technical and attitudinal change will be contingency constrained. However, the concept of path dependence needs grounding empirically if it is to provide a meaningful basis for understanding the differential nature of the transformation process in CEE. Path dependence can operate at enterprise level as well as nationally and it is the nature and complexity of transformation at enterprise level that this paper aims to address. Accordingly, the following structure is adopted: firstly we draw upon existing literature to conceptualise organisational culture and to identify relevant issues in the management and implementation of cultural change. Secondly, we consider literature in relation to the characteristics of organisational culture within Polish socialist firms. Thirdly, we present and discuss empirical data in relation to cultural transformation within four post-socialist Polish enterprises and identify significant factors in the adjustment to free market conditions.

### **Conceptualising organisational culture and the process of culture change**

Western capitalist orthodoxy emphasises the development and management of organisational culture as a key component of organisational effectiveness. The 'excellence' literature, (Kanter 1989, Peters 1987, Peters / Waterman 1982) together with studies of Japanese corporations, (Ouchi 1981, Pascale / Athos 1981) highlighted organisational culture as a key factor in the achievement of competitive business advantage. The emergence of the concept of Human Resource Management (HRM) as an approach to managing the employment relationship, has likewise served to emphasise the development of a management ideology and set of practices aimed at creating an appropriate (or changing an inappropriate) organisational culture. HRM policies and practices in areas such as recruitment and selection, socialisation, development, promotion and reward represent mechanisms for translating dominant organisational values into action in a way that supports the business strategy (Keenoy / Anthony 1992).

However, the concept of organisational culture remains problematic and there are wide-ranging and unresolved debates as to what organisational culture is (see e.g. Frost et al 1991) and the extent to which an organisational culture can be managed and changed. Mabey et al (1998) point to a polarised treatment of organisational culture identifying at one extreme a consultancy-based, prescriptive treatment (Willmott 1993, Williams et al 1994) which has an instinctive appeal to managers, particularly those within an individualistic, Anglo-Saxon culture with a bias for action and fascination with business leaders (Lundy/Cowling 1996). At the other extreme are located more theoretical, analytical approaches which illustrate the shortcomings of managerial prescription. For example as Legge (1995) suggests, a 'positivistic/structural/functionalist' perspective which

conceptualises organisational culture as something the organisation 'has' results in a view of organisational culture as 'somehow unitary and the collective conscience of the organisation', (Legge 1995, p186), whereas an alternative view of culture as the product of social interaction, or as something the organisation 'is', emphasises the essentially pluralist nature of organisations (Legge 1995, p185).

This polarised treatment of organisational culture, reflecting differing epistemological standpoints, likewise extends to debates as to the extent to which organisational culture may be manipulated and changed. Viewed from a pluralist perspective, it is questionable whether organisational culture may be successfully changed (Legge 1995, Ogbonna 1996). Group dynamics processes may be effective in changing attitudes and behaviour and Schein (1987) sees behavioural change as a precursor of cultural change. However, Ogbonna (1996) questions the degree to which employees readily replace existing values with new ones and suggests that employees may learn to adopt the language and behaviour of a new cultural paradigm without fundamentally altering their beliefs and values. Furthermore, the achievement of permanent or deep-rooted change through the use of behavioural change strategies may in itself pose an obstacle to future change.

Pragmatic approaches to changing culture (e.g. through changing job roles, reward strategies and styles of management) on the basis that these will result in culture change likewise equate behavioural change to culture change (or the assumption that behavioural change will result in culture change) and reinforce epistemological questions about the conceptualisation of culture. As Legge suggests, it is a structuralist/functionalist approach which emphasises the role of the leader in developing an appropriate collective consensus and suggests a '...culture created by senior management for the lower orders to follow', (Legge 1995, p186). An alternative view of culture as an outcome of social interaction casts doubts over the degree or even the feasibility of senior management's ability to unilaterally change organisational culture. As Legge points out, 'If the corporate culture makes no sense of the organisational realities experienced by the employees other than senior management, it will not become internalised outside that small sub-group', (Legge 1995, p187). A managerial view of culture change serves to explain why much vaunted culture change programmes have been less than successful in winning the hearts and minds of employees within western capitalist organisations, (Lundy / Cowling 1996, p169). The failure of TQM and BPR programmes likewise bear testimony to the mistaken assumption that enterprise culture (in both western and eastern enterprises) can be transformed as quickly and as easily as other organisational assets and resources. (See e.g. Schaffer / Thompson 1992, pp80-89)

Within the transforming economies of CEE it would be naïve, therefore, to assume that organisational culture change would be any less straightforward and

unproblematic than within western capitalist organisations. Case studies of strategic change in Polish enterprises emphasise leadership as a key factor in responding to new markets, (Lempkowski 1992, Kozminski 1995), while other commentators point to structural change, management turnover and the removal of senior managers associated with the past regime as key factors in enterprise restructuring and improved enterprise performance (EBRD 1997, Obloj / Thomas 1998). However, many of the pre-1989 elites, power structures and vested interests remain within enterprises and it would be simplistic to underestimate the strength and pervasiveness of the socialist culture. It is to a consideration of the Polish context and the characteristics of state socialism that we now turn.

### **Characteristics of organisational culture within Polish socialist enterprises**

It has been suggested that the socialist system resulted in a degree of uniformity which militated against the formation of distinct organisational cultures (Czarniawska 1986, p313). This uniformity stemmed from a homogeneity of organisational structures at enterprise level which in turn reflected the economic and political structures of the socialist planning system.

Polish socialist enterprises operated within a hierarchically administered system (union of enterprises, ministries and the Planning Committee), subject to the influence and interference of external power centres (the Communist party and the bureaucratic hierarchy), (Otta 1996, Kostera / Wicha 1996). Thus vertical authority structures were undermined by external agencies with the result that management roles, responsibilities and levels of accountability were blurred. Management attention was focused on the supply side of the value chain. Enterprises were not required to sell their output or to finance their production or investment; this was the role of central agencies. However, managers had to ensure they received sufficient supplies of raw materials (including labour) to ensure plan fulfilment. Here two skills were particularly important; getting soft targets which could be easily achieved and stockpiling resources (including labour) to meet tight deadlines, (Peiperl / Estrin 1998) – both depended on connections within the administrative hierarchy, the authorities, the party and the secret police (See Kostera / Proppe / Szatkowski 1995) for the nature of the ‘bargaining’ role of Polish enterprise managers and the development of reciprocal networks. Kostera and Wicha (1996) describe the environment of Polish socialist enterprises as one of ‘cultural schizophrenia’ where economic considerations were subjugated to political rationality as the dominant logic. This resulted in ‘introversion’ in economic terms characterised by an aversion to risk and innovation and unwillingness to take responsibility for economic decisions alongside ‘extraversion’ within the political arena manifested by close relationships with communist party members and political interest groups. The results were economically

damaging – there were few incentives for efficient performance and the short-term orientation worked against risk-taking, innovation and accountability – but they likewise impacted on employee behaviour and work relationships.

Labour relations within Polish socialist firms were likewise shaped by the features of central planning. The combined effects of an illusory shortage of labour, low levels of labour mobility, the socialist ideology of each worker's right to work and basic survival guaranteed by minimum monetary and supplementary social wage, contributed to what Thirkell et al (1997, p19) have described as an 'apparently indulgent style of labour relations' whereby supervisors tolerated poor quality work and low levels of labour discipline in return for worker support and flexibility in meeting plan targets and coping with shortages of supplies. Lax labour relations were reinforced by a lack of differentiation of work roles between supervisors and workers and close informal working relationships and were further exacerbated by the repressive political climate of socialist enterprises (Staniszki1979). In the absence of a specific workers' culture or organisation or the opportunity for protracted lasting action (as opposed to periods of labour unrest and militancy), Kramer (1995, p78) suggests that Polish workers sensed their limited capability to challenge decision-making at enterprise level and instead used '...their lacklustre job performance as a means of 'exit' from the system'. Such sentiments also support Soulsby and Clark's (1995, p99) conclusion that '...one of the few freedoms of a worker was the 'right' not to work hard'. Not working hard could be considered patriotic because it represented a protest against the socialist system.

Within this context of worker 'voice' (or lack of), it is appropriate to consider the concept of the state-dependent worker as a normative type of personality created by state socialism. The concept of state-dependent workers relates to the relationship of the worker to the state and to specific work habits and behaviours developed under state socialism which might be said to contribute to an attitudinal and relational legacy which conditions the attitudes of workers and impacts the process of transformation (Miszalska 1996, Staniszki 1979, Kolarska-Bobinska 1994). To develop the first point; the socialist system of bureaucratic redistribution guaranteed job availability, job security, price stability and a largely egalitarian incomes policy. In doing so it minimised individual risk, generated apathy and passivity of behaviour, promoted attitudes of dependency and created a state of 'learned helplessness' (Miszalska 1996, p47) combined with a distrust of the authorities. This state of psychological resignation manifested itself at the workplace in a 'low-productivity-anti-individualist' mentality (Miszalska 1996, p47), low levels of accountability and initiative, the suppression of difference and interest representation and a low work ethic.

The dismantling of the socialist system and the process of transformation from a centrally planned economy to free market capitalism has had an enormous im-

pact on the functioning of enterprises but the endurance of the socialist culture and an 'old cultural mind frame' (Kostera / Wicha, 1996) is seen as inhibiting effective restructuring and transformation to free market conditions and undermining the effects of technological change. Within this context the concept of organisational culture presents a potentially useful means by which to identify enduring patterns of behaviour from the socialist past but also in demonstrating changed behaviours and their drivers.

### Research design

The aim of this paper was to explore the business cultures of four post-socialist Polish enterprises through the perceptions of those involved in organisational change and transformation. We noted earlier the epistemological difficulties inherent in the conceptualisation of organisational culture (whether this represents behaviour, or values and take-for-granted assumptions) and the consequent lack of a convincing conceptual model that demonstrates how cultural change may be successfully undertaken. We are also mindful of the dangers inherent in a monolithic approach to organisational culture where typologies of culture suggest the imposition of a specific category on an organisation (Handy 1986). We have therefore adopted a process approach, building on the work of Schein (1984), which views organisational culture as a dynamic process and which takes account of the perceptions of participants in the process of culture formation, management and change.

Schein (1984, p3) defines organisational culture as:

*'...a pattern of basic assumptions that a given group has invented, discovered or developed in learning to cope with its problems of external adaptation and internal integration, and that have worked well enough to be considered valid and, therefore, to be taught to those new members the correct way to perceive, think and feel in relation to those problems'.*

Schein's definition recognises that organisations face two fundamental demands – that of external adaptation and internal integration, both of which have particular resonance within transforming economies. External adaptation, Schein suggests, comprises five elements; strategy, goals, means, performance measures and correction systems while internal integration demands shared meanings, definition of organisational boundaries and the legitimisation of power. Schein's definition likewise suggests that culture embraces the concept of morality in determining what is right and appropriate in advocating acceptable behaviours and thus underscores the ethical dimension of culture change and manipulation. Furthermore, he acknowledges that any group within an organisation has the potential for developing its own sub-culture, particularly if it enjoys stability of membership and has a history of joint problem resolution.

We take the view that organisational culture is socially constructed; that it represents both the experience of past actions and acts as a conditioning element of

future actions. Thus organisational culture is influenced by the environment and socio-technical systems of the enterprise which are in turn influenced by the values and beliefs of the groups and individuals making up the enterprise. Viewing organisational culture both as an input and as an output suggests that it is likely to be self-perpetuating and resistant to change. A process view of organisational culture demonstrates the challenge facing socialist enterprises in adjusting to free market capitalism and highlights limitations of neo-classical economic orthodoxy which emphasises privatisation, enterprise re-structuring and introduction of hard budget constraints as principal mechanism for the operation of a free market. Organisational transformation is more complex than such analyses suggest.

The research design adopted a case study approach which incorporated participant observation, analysis of company documents, interviews with enterprise directors and senior managers and a survey questionnaire to assess worker perceptions of the prevailing organisational culture together with their perceptions of how this has changed and their aspirations for future change. Fifteen interviews were carried out across the four enterprises with enterprise directors and senior managers. The interview protocol focused on the use of open questions (with prompts on specific issues), hypothetical questions and unpacking critical incidents in order to obtain different perspectives on different issues. A qualitative approach was felt to be more sensitive to processes in terms of how changes had taken place but nevertheless allowed for an holistic view rather than a narrow focus on component elements. In designing questionnaire items we were concerned with incorporating features identified within the literature as characteristic of the culture of socialist enterprises. Thus questions focused on worker perceptions of levels of individualism, collectivism and egalitarianism at work, management styles and authority structures. Table 1 summarises the sample size and response rates.

**Table 1: Sample size and response rates**

Enterprise	No. Employed	Sample	Response
A	480	48 (10%)	43 (89%)
B	450	98 (22%)	98 (100%)
C	1,700	170 (10%)	155 (67%)
D	480	48 (10%)	26 (54%)

The questionnaire required workers to indicate their perceptions of 'how things were, are and should be' in relation to a number of items. In this way we were able to construct a model of worker views of their preferred organisational culture. Given the emphasis in the literature of the difficulties of rapid culture change we were also able to identify prevailing features of the socialist culture.

The study focused on four post-socialist Polish enterprises which were at different stages in the transformation process. We were concerned with evaluating the purpose and effectiveness of programmes aimed at enabling enterprises to adjust and compete within free market conditions and specifically we were interested in the techniques employed to change organisational culture to match the perceived requirements of the organisational environment. The enterprises within the study were differentiated by size (number of employees), by product and technology used (although all enterprises were within the manufacturing sector), location and nature of ownership. All enterprises shared similar origins as state-owned enterprises and all were concerned with finding a foreign strategic investment partner from the same industry. Two of the enterprises within the study had strategic investors whilst two were still in the process of trying to attract one. Table 2 provides brief details of study enterprises.

### **Discussion of findings**

The enterprises within the study were at different stages in the transformation from socialist central planning to free market capitalism. Enterprise A was in a very difficult economic situation. In 1989 the enterprise employed 1,200 people and this had reduced to 480 but the enterprise was still making losses largely because a substantial part of its production (over 50%) was geared towards military production and repair and there had been no substitution for this loss of production. Since 1989 the enterprise had been fighting to survive through a variety of cost-cutting and restructuring measures. The restructuring process, which had been largely financed internally and which had required enormous effort on the part of the workforce had been of limited effectiveness. Worker frustrations and disillusionment with the restructuring process were evident in questionnaire responses (see Table 3) which indicated that workers felt that things were better five years ago than currently. For this enterprise a strategic investor represented the only way out of its economic crisis but despite widespread recognition of this situation, there were considerable fears about the implications for job security and remuneration particularly amongst administrative staff. Many skilled and competent production workers had left the enterprise and secured employment elsewhere but administrative staff were particularly vulnerable.

Enterprise B also did not have a strategic investor but here the situation was slightly different because the enterprise was part of a much larger company, PG-NiG which dealt with gas extraction and distribution. The gas industry was regarded as of strategic importance to the economy and the parent company thus enjoyed the protection of a strong entry barrier. This protection did not extend to Enterprise B who produce transmission stations and valves and who are subject to competition, but nevertheless, the parent company has sheltered the enterprise from the exigencies of the market and had provided funding for restructuring initiatives such as modernising machinery, the introduction of computerised sys-

Table 2: Enterprise Characteristics

Enterprise	Size	Product	Ownership		Characteristics of Transformation
A	400	Manufacture oil tankers & trailers	5 <sup>th</sup> NIF	33 %	Contraction of operations (workforce reduction from 1,200 by natural wastage) sale of machines, land, buildings outsourcing of transport, maintenance
			State Treasury	27 %	
			Other NIFs	23 %	
			Employees	17 %	
B	450	Manufacture transmission stations and valves for gas industry	100% ownership by PGNiG (state owned)		Defensive: partial rationalisation of operations (closure of foundry, outsourcing) moves towards greater regulation & standardization
C	1700	Manufacture loud speakers	JV – Pioneer		Defensive Re-structuring of production process, introduction of new, automated assembly line ISO 9000 Search for foreign 'know-how'
			Treasury	33 %	
			Pioneer	11 %	
			Employees	20 %	
			Bank & Life Ass. Comp.	1 %	
D	480	Manufacture integrated systems for gas & water supply	JV		Heavy investment by parent in production technology, computer systems, management & staff training ISO 9000 Quality circles 50% staff t/o since 1991 New functions – sales, marketing,
			Danish Co.	70 %	
			Treasury	18 %	
			Employees	2	

tems and large-scale training programmes. The enterprise began looking for a strategic investor two years ago; the driver was awareness of growing competition within this industrial sector coupled with the need for a technologically and economically sound partner to support the enterprise's diverse activities. Through a process of elimination, the enterprise began to co-operate with a German concern as a pre-requisite for acquisition. The nature of this co-operation involved exchange visits by managers and workers and a sharing of information and know-how.

In relation to worker attitudes there was a similar apprehension on the part of administrative workers to organisational restructuring but the key opponents of the acquisition process were the trades unions who feared substantial job losses particularly as small scale job losses had already been experienced as part of the restructuring process. A large proportion of the workforce, particularly older workers believed that the enterprise was in a strong enough position to survive and prosper independently within a free market which represented an optimistic scenario. Within the remaining two enterprises there was evidence of co-operation of Polish workers and managers with foreign owners and partners. This is not to say that the initial stages of working with a foreign investor were free from conflict and tension and that Polish managers and workers had to adjust to new ways of working and managing. Strategies for co-operation varied in their nature and scope.

Enterprise C was a large monopolistic enterprise employing 1,700 people in the production of loudspeakers and was one of the first enterprises privatised by public sale of share on the Polish stock exchange following a joint venture with a Japanese investor. The Japanese investor had incrementally increased financial shareholding and involvement in business decision-making but this was not reflected in a clear strategic direction for the enterprise. The Japanese investor had concentrated on the education and training of employees on new production lines and in emphasising quality and continuous improvement issues. They saw their role as bottom-up socialisation of the workforce in Japanese styles of working whilst difficult economic decisions about the functioning of the enterprise (e.g. decisions about job losses) were left to the Polish management team.

By contrast to the Japanese approach, Enterprise D had adopted a clearly defined strategic vision and direction based on developing market share and exploiting the advantages of low cost production. Enterprise D manufactured integrated systems for the supply of gas and water to utility companies and entered into a joint venture agreement with a Danish investor in 1991. The Danish partner had invested heavily in a widespread programme of technological change and the development of a distribution network backed up by large scale training and development programmes. Entry barriers in this market were low but the enterprise competed on the basis of providing an integrated technology with comprehensive pre and post-sales service which gave it a competitive advantage and the company has enjoyed rapid expansion of the Polish and East European markets. The workforce numbered 480 and was predominantly young, qualified and relatively highly paid. Within Enterprise D the workforce were enthusiastic and supportive of the joint venture agreement largely because of the personal style and interpersonal skills of the enterprise director who was instrumental in selling the advantages of foreign partnership to the workforce. During the period of the joint venture there had been no reduction in staffing levels and the workforces had actually grown by 30% through the recruitment of young, qualified people

into newly created positions within finance, sales and marketing functions. Initial enthusiasm for the joint venture had been sustained throughout the eight year period of foreign investment and workers at all levels were very positive about their role within the enterprise.

Table 3 presents questionnaire extracts which reflect worker perceptions of aspects of organisational culture and how this has changed within enterprises studied. Responses also indicate worker aspirations for the future.

**Table 3: Extracts from questionnaire showing worker perceptions of how things were, are and should be.**

**Enterprise A**

Question	People co-operate to solve problems		People are responsible for results			People are able to make decisions in their work			
	<i>5 yrs ago</i>	<i>now</i>	<i>5 yrs ago</i>	<i>now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	
To no/small degree	42%	66%	28%	47%	9%	70%	76%	18%	
To adequate degree	16%	16%	35%	20%	-	19%	9%	9%	
To great degree	42%	18%	37%	33%	91%	11%	15%	73%	
Question	People are free to exercise individual initiative			People build close working relationships			People have to abide by rules & regulations		
	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>
To no/small degree	42%	44%	7%	49%	63%	7%	12%	26%	14%
To adequate degree	33%	28%	2%	21%	16%	7%	18%	19%	14%
To great degree	25%	28%	91%	30%	21%	86%	60%	55%	72%
Question	People take responsibility for their own development			People take responsibility for colleagues' development			There is a strong link between performance & work		
	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>
To no/small degree	42%	42%	7%	67%	75%	24%	77%	90%	9%
To adequate degree	21%	23%	9%	19%	12%	16%	16%	2%	-
To great degree	37%	35%	84%	14%	13%	60%	7%	8%	91%

**Enterprise B**

Question	People co-operate to solve problems		People are responsible for results			People are able to make decisions in their work			
	<i>5 yrs ago</i>	<i>now</i>	<i>5 yrs ago</i>	<i>now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	
To no/small degree	23%	10%	31%	11%	1%	61%	19%	4%	
To adequate degree	40%	38%	42%	30%	3%	28%	34%	9%	
To great degree	37%	52%	27%	59%	96%	11%	47%	87%	
Question	People are free to exercise individual initiative			People build close working relationships			People have to abide by rules & regulations		
	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>
To no/small degree	46%	5%	1%	31%	14%	-	24%	5%	-
To adequate degree	33%	30%	6%	39%	34%	2%	42%	21%	8%
To great degree	21%	65%	93%	30%	52%	98%	34%	74%	92%
Question	People take responsibility for their own development			People take responsibility for colleagues' development			There is a strong link between performance & work		
	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>
To no/small degree	38%	4%	-	55%	22%	6%	55%	42%	4%
To adequate degree	42%	32%	11%	29%	37%	15%	30%	29%	4%
To great degree	20%	64%	89%	16%	41%	79%	15%	29%	92%

**Enterprise C**

Question	People co-operate to solve problems		People are responsible for results			People are able to make decisions in their work			
	<i>5 yrs ago</i>	<i>Now</i>	<i>5 yrs ago</i>	<i>now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	
To no/small degree	26%	31%	25%	18%	4%	61%	48%	13%	
To adequate degree	35%	31%	39%	21%	6%	26%	31%	23%	
To great degree	39%	38%	44%	35%	90%	13%	21%	64%	
Question	People are free to exercise individual initiative			People build close working relationships			People have to abide by rules & regulations		
	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>
To no/small degree	18%	18%	8%	30%	31%	6%	14%	8%	5%
To adequate degree	43%	36%	6%	36%	32%	5%	15%	8%	7%
To great degree	39%	46%	86%	34%	37%	89%	71%	84%	88%
Question	People take responsibility for their own development			People take responsibility for colleagues' development			There is a strong link between performance & work		
	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>
To no/small degree	30%	20%	5%	51%	53%	20%	63%	54%	11%
To adequate degree	34%	34%	16%	33%	31%	29%	18%	21%	5%
To great degree	36%	46%	79%	16%	16%	51%	19%	25%	84%

**Enterprise D**

Question	People co-operate to solve problems		People are responsible for results			People are able to make decisions in their work			
	<i>5 yrs ago</i>	<i>now</i>	<i>5 yrs ago</i>	<i>now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	
To no/small degree	43%	-	19%	-	-	62%	10%	-	
To adequate degree	24%	48%	38%	24%	10%	38%	38%	10%	
To great degree	34%	52%	43%	76%	90%	-	52%	90%	
Question	People are free to exercise individual initiative			People build close working relationships			People have to abide by rules & regulations		
	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>
To no/small degree	29%	-	-	34%	19%	-	29%	-	-
To adequate degree	33%	24%	5%	29%	19%	5%	24%	14%	10%
To great degree	38%	76%	95%	37%	62%	95%	48%	86%	90%
Question	People take responsibility for their own development			People take responsibility for colleagues' development			There is a strong link between performance & work		
	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>	<i>5 yrs ago</i>	<i>Now</i>	<i>should be</i>
To no/small degree	38%	5%	-	66%	24%	15%	57%	19%	-
To adequate degree	33%	33%	10%	24%	66%	33%	19%	24%	5%
To great degree	29%	62%	90%	10%	10%	52%	24%	57%	95%

It is possible to conceptualise the transformation process from a socialist culture to a market led, entrepreneurial culture as a continuum with the ultimate goal of what EBRD (1997) describe as 'deep restructuring'. Viewed in this way the enterprises within the study can be viewed as occupying different positions along this continuum. We have identified key factors impacting on this progression and driving culture change as ownership (in particular foreign ownership), management style and ideology and strategies for performance and reward management. These factors are not mutually exclusive but rather reinforce each other in the development of a new cultural paradigm.

**Ownership as a factor in cultural change**

The enterprises within the study were at different stages in the transition from a socialist to a market led culture. At one extreme Enterprise A faced an uncertain and insecure future particularly if NIF support was not forthcoming. This uncertainty was evident in worker questionnaire responses where replies on all items suggested a perception that things were worse now than they had been five years

ago. In particular workers felt that levels of accountability, co-operation and teamworking had deteriorated. Workers at Enterprise A also reported the widest discrepancy in their perceptions of the present and their aspirations for the future, particularly in relation to the recognition and reward of individual performance and responsibility at work. At the other extreme, Enterprise D represented an example of a commercially successful and prospering enterprise which had undergone a radical transformation in all aspects of its operation and, of all the study enterprises, could be said to approximate to an entrepreneurial, market driven organisational culture. A key factor in this transformation had been the role of FDI and know-how with practically all innovations (production technology, logistic systems, integrated computer information systems, managerial techniques and processes) having been brought in from the parent company. Such innovations underpinned by strategies for recruitment, development and reward had been influential in hastening successful adjustment to a market economy.

Enterprises B and C had made some 'defensive' adjustment measures in response to competitive market pressures and a hardening of budget constraints. Enterprise B was planning a rationalisation of operations through the outsourcing of ancillary activities, while Enterprise C was anticipating a restructuring of production processes through the introduction of new, automated assembly lines. Managers within both of these enterprises saw restructuring as an expansion of operations to exploit the profit potential of the enterprise as the appropriate response to competitive market pressures (as opposed to a contraction of operations as at Enterprise A). However, neither enterprise had made any significant attempts at 'deep' organisational restructuring. Functional hierarchies remained in place and there had been limited initiatives to change working methods or to improve existing resources. Worker perceptions highlighted improvements in opportunities for individual development and teamworking but also indicated wide discrepancies between existing arrangements and worker aspirations particularly in relation to the development of effective working relationships, levels of responsibility and accountability and involvement in decision-making.

### **Management styles and ideology**

We found little evidence within the enterprises studied of a rational, strategic, management driven approach to culture change. Within Enterprise D, the impetus for a clearly defined vision of the future was provided by the foreign parent company and was underpinned by a strategic business planning and budgeting process implemented by appropriately trained and qualified personnel. Within the remaining enterprises, managers demonstrated a lack of clarity of organisational goals and strategic direction. They had an incomplete picture of business strategy, strategic management or how to address employee expectations as expressed through questionnaire responses. Through interviews with senior managers we detected that Polish managers had enthusiastically adopted the rhetoric

and vocabulary of western management (regardless of the degree of foreign involvement) but that this has had a largely symbolic value in enabling them to re-define their role and legitimising their authority within free market conditions. The following quotation is illustrative of how western management rhetoric has enabled Polish managers to nail their colours to the mast of free market capitalism:

‘I consider myself to be a young man in my outlook although I am 45 years old. I am now working in the ‘second’ company, as this is the best way to describe it. Previously the enterprise was a state monopolist, customers were an afterthought; for western managers this would be inconceivable. I had the good fortune to study western organisational structures and systems at university and wrote my thesis on this subject. I took every opportunity to visit England. I tried, but was unable to apply the practical principles here because of the inertia of the state enterprise system. Now (following his appointment as Enterprise Director in 1994), I am able to influence the organisation and apply the principles of a healthy organisation’. (Enterprise Director, Enterprise A).

However, to see the adoption by Polish managers of the rhetoric of western managers as evidence of any real change in management roles and behaviour is superficial and premature. As suggested earlier, managers had an unclear and incomplete picture of business strategy and lacked confidence in their own ability and expertise to implement change which manifested itself in the tendency to seek outside help and know-how through seeking strategic foreign investors and the use of academics and consultants. Whilst privatisation may have removed the political and economic straightjacket of socialism, insider control within enterprises, has meant that the informal networks and reciprocal arrangements characteristic of the management of state owned enterprises have been largely preserved.

### **Management strategy for the development of human resources.**

Despite the differences between enterprises outlined earlier, workers across all enterprises demonstrated a large degree of consistency in respect of their perceptions of ‘how things should be’ and the characteristics of their preferred organisational culture. Particularly significant were issues in relation to people being free to exercise initiative at work, taking responsibility for their own development, building close working relationships and linking individual performance to rewards. Worker preferences indicated support for a strong culture which was individualist rather than collectivist in character. In addition, workers saw the need for clear rules, policies and procedures governing their role at work and their responsibilities, and emphasised the social role of the enterprise in meeting welfare needs. In one sense this can be seen as feature of the socialist legacy which provided extensive social protection but is also a feature of the employ-

ment policies of foreign organisations although in the latter case protection is dependent on performance. In contrast with the collectivist provision of social protection within socialist firms, such provision by foreign firms is used as a motivational tool and for many Polish workers represents an attractive approach. Anecdotal evidence suggests that Polish workers respond very positively to the activities of foreign enterprises such as foreign trips, parties and social events.

In order to probe worker aspirations we asked additional questions in relation to what workers felt would make them more effective in their jobs and again we found a high level of consistency in responses across all four enterprises. 84% highlighted 'better resources to work with'; 75% having clearer goals and targets to work to; 74% better understanding of how their work was evaluated; 72% better understanding of the organisation's purpose and mission; 71% greater freedom to use individual initiative and judgement at work. Whilst caution needs to be exercised in relation to the interpretation of such aspirations of the workforces within the enterprises studied, our findings do seem to reflect a reaction to the uniformity of a socialist culture together with a desire by individuals across all enterprises to have a greater degree of involvement and influence over their work and a greater level of responsibility. To this extent findings indicate a preparedness for change on the part of the workforce.

However, despite formal institutional arrangements for employee representation and the existence of trade unions within all of the enterprises studied we found little evidence of a collaborative, 'social partnership' approach or any desire by managers to engage workers in the process of organisational transformation. As a senior manager at Enterprise C commented, 'as a good capitalist, I see no role for the trade unions in the process (of organisational transformation)'. Enterprise D, through the use of quality circles, direct forms of communication and increased delegation could be said to be moving in the direction of a more participative management style. However, within the remaining enterprises the management style remained largely authoritative and there was no evidence to support a management ideology that saw human resources as a source of competitive advantage. Nevertheless, we found no evidence that employees were frightened of, or intimidated by their managers, but rather that both workers and managers were disempowered by the need to follow established rules and procedures, although paradoxically, there was widespread agreement that such regulations were necessary and appropriate. Within Enterprise B the emphasis in responding to competitive market pressures was to increase the use of management regulation and measurement. In this context bureaucratic rules and procedures represented less an effective form of management control as an opportunity to maintain the status quo and as a rationalisation for mistakes and inaction.

## Strategies for performance and reward management

Reward and remuneration arrangements for workers under the socialist regime were very flat and undifferentiated. Within the enterprises studied, only enterprise D had used the leverage of higher wages and performance based pay. Although pay rates remained considerably lower than within the parent company's operations in western Europe, wages within Enterprise D were relatively high for the locality and twice the national average. With the exception of Enterprise D, there was no evidence within the remaining enterprises of any serious control or motivation systems in place which resulted in a continuation of a somewhat *laissez faire* approach to discipline and the management of the employment relationship. Such a situation mirrored the socialist past and reflected a lack of managerial expertise and experience in creating effective internal performance management arrangements. However, it also reflected wider social attitudes and values. It was suggested to us that Polish people do not differentiate between their work and private lives; that employees know each other as friends and neighbours within the same community and consider it inappropriate to make judgements and possibly reprimand friends.

## Conclusion

Within the enterprises studied, Enterprise D demonstrated the most persuasive evidence of deep organisational restructuring and cultural adaptation to free market conditions. This was achieved through foreign intervention and investment and underpinned by extensive training and development programmes. However, rapid organisational change within this enterprise took place not only because of changes in institutional processes but because both parties were willing to adapt and to co-operate with each other. This lends support to the view of a 'third way' or an adjustment to changed market conditions which reflects neither a complete emulation nor rejection of foreign approaches but the possibility and value of a joint approach which takes account of the particular circumstances of the enterprise. Such an approach reflects the value of a 'path dependency' approach to the study of transforming enterprises. Within the remaining three enterprises studied it was difficult to point to any large degree of cultural change or adjustment. Privatisation may have removed the political and economic straightjacket within which socialist enterprises had to operate and thus given enterprises a greater degree of autonomy but existing structures, hierarchies, relationships and ways of working remained largely unchanged. We conclude therefore that the speed and consistency of the direction of cultural change and adaptation is more pronounced in situations where there are strong external influences in the form of foreign investment and involvement, clarity of organisational goals and strategic direction and an acceptance of the need to change.

Despite difference between the enterprises studied, there was a high degree of consistency in worker perceptions of the characteristics of a market oriented en-

terprise. These characteristics were felt to include a transformational element in leadership style, a more individualistic employment relationship which included a link between individual performance and reward, higher levels of worker involvement in decision-making and improved levels of cross functional co-operation and teamworking. Changing organisational culture is a lengthy and complex process but our findings indicate that this process may be hastened through the creation and articulation of clear organisational goals and the direction of their achievement, improved communication throughout the organisation and increasing worker accountability through improved training and development programmes and transparent systems of performance review and reward. Given the characteristics of the socialist legacy, a key factor in the successful implementation of the identified strategy is the constant reinforcement of strategic goals and the behaviours required to achieve these in order for these to be internalised by workers.

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## Industrial Relations in 'Post-Communism': Workplace Co-operation in Hungary and Slovenia\*

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*The paper is derived from a survey conducted in the second half of 1999. According to the data, two different types of industrial relations exist in Hungary and Slovenia. Both are strongly influenced by regulatory patterns formed within the two different 'communist' traditions. Hungarian industrial relations are unitary in nature. They are characterized by trade union integration in managerial structures. At workplace level, Slovenian trade unions are more worker-oriented. In accordance with this basic feature, the whole scene is more pluralistic and more conflicting. Processes of forming industrial relations structures in the two countries are divergent. The divergence is significant, in spite of early implementation of German model in both cases. In both 'transitional' societies the roles of capital and labor differentiate in accordance with the patterns, which are stronger than the imported intermediary institutions.*

### Introduction

According to the basic conceptualization within the industrial relations tradition, it is possible to identify two broad approaches to industrial organizations: the unitary and the pluralistic (Fox, 1966). Difference between the two could be summarized in terms of recognition of stake-holders interests.

Within the unitary perspective different stake-holders in the organization are illegitimate; the organization is understood as a team 'unified by a common purpose' (Fox, 1966:2; 1985: 31), leading by a single authority (in authoritarian or paternalistic manner), and integrated by a common values. Within the pluralist perspective, where the stake-holders' interests are recognized, the organization is understood as 'a miniature democratic state' (Fox, 1966:2) consisting of 'a coalition of interest groups presided over by a top management' (Fox, 1985:26).

In terms of workplace relations, the unitary pattern fits in with co-operation, the pluralist includes conflict as well as co-operation. Co-operations appearing within the two patterns are of an essentially different kind: the unitary one is based on unrecognized and the pluralistic on recognized stake-holders interests. The first one is more traditional and the second one more modern.

A good examples of the co-operative variant of the modern pluralistic pattern could be find within the German industrial relations system. Being an important factor behind the economic prosperity enjoyed by Germany since the war (Jaco-

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bi, O. et al., 1998:190), the system has been copied in some post-communist CEE countries.

The system's central institution is the works council – a form of workers' collective interest representation, which is strongly sensitive to the interests of capital. Streeck explained the essence of the model using the metaphor of 'a mutual incorporation of capital and labor by which labor internalizes the interests of capital just as capital internalizes those of labor'. He contrasts defining features of the German model with the adversarial relations between management and workers' representatives, where workers' representatives – who do not internalize the interest of capital, try to influence manager decision-making (Streeck, W., 1992:163-164).

Streeck's conceptualization supports a differentiation between two types of industrial relations regulation within the pluralist pattern: 'adversarial relations' and 'mutual incorporation'.

On the basis of unitary and pluralistic views combined with Streeck's clarification, it is possible to identify three ideal types of industrial relations present in advanced societies: the unitary, the adversarial and the mutual incorporative. The second and the third type are the sub-types of the pluralist pattern.

According to the typology, the German works council is an institution, which concert workers collective interests with those of capital within the pluralist pattern. Concertation is a form of interaction with capital, whose agents strongly respect (internalize) the basic interests of labor. In this sense, the works council is an intermediary (Muller-Jentsch, 1985) institution.

At the beginning of the 90's, the key features of the German model were used in forming new systems of industrial relations in Slovenia and Hungary. In both cases, the application of the German system promised the forming of highly cooperative industrial relations, which would assure better social integration within the two 'transitional' economies and, generally speaking, better performance of their economies.

In the second half of 1999, a survey about trade union operations at workplace level was conducted in Hungary and Slovenia. /1/ This survey enabled comparisons to be made of the extent of co-operation present in industrial relations in the two 'post-communist' societies.

After a brief overview of the two industrial relations backgrounds, I shall present the most important differences identified by the comparison. I shall then attempt to explain these differences. In the conclusion an evaluation of the extent of co-operation in industrial relations in Slovenia and Hungary will be offered, including an assessment of the effects of the German model in the two transitional environments.

## The two industrial relations backgrounds

### *Historical background*

Hungarian and Slovenian variations of 'post-communism' are derived from different types of communism (Feher, Heller and Markus, 1986:11-12). Hungarian 'communism' was formed within the borders of the soviet empire. Its basic feature was the command economy system (Pollert, 1999: 34-49). At company level the trade union was a link in the command economy chain (Feher, Heller, Markus, 1986; Pollert, 1999: 133).

Slovenian/Yugoslavian 'communism' was formed outside the empire's borders. In comparison to the Hungarian variant, it was more open and more market oriented. In the 50's the system of command economy was combined with **workers** councils and later dismantled and replaced by a system of 'self-management'. The system provided unusually high autonomy for companies within the former Yugoslavian 'real-socialistic' society (Mencinger, 1997: 214). At workplace level, the logic of self-management implied inclusion of elected workers representatives (works council members) into re-distributive social conflicts. These conflicts periodically manifested as (usually short) work-stoppages/strikes (Jovanov, N., 1979). Alongside the works councils, trade unions also existed at the company level. Within the dismantled command economy, trade union functions were unclear and were additionally marginalized by the works councils 'from below'.

**Table 1: Selected economic indicators for Hungary and Slovenia, 1990-1998**

a.) GDP real growth rate (%)						
	1990	1994	1995	1996	1997	1998
<b>Hungary</b>	-3.5	2.9	1.5	1.3	4.6	5.1
<b>Slovenia</b>	-4.7	5.3	4.1	3.5	4.6	3.9
b.) GDP per capita (USD at exchange rate)						
	1990	1994	1995	1996	1997	1998
<b>Hungary</b>	3189	4046	4367	4433	4504	4694
<b>Slovenia</b>	8699	7233	9431	9481	9163	9847
c.) GDP per capita (USD at PPP)						
	1990	1994	1995	1996	1997	1998
<b>Hungary</b>	7610	8380	8890	9340	10010	10680
<b>Slovenia</b>	10660	11520	12390	13220	14150	14890
d.) Unemployment rate in % (ILO standards)						
	1990	1994	1995	1996	1997	1998
<b>Hungary</b>	-	10.7	10.2	9.9	8.7	7.8
<b>Slovenia</b>	-	9.0	7.4	7.3	7.4	7.9

e.) Average gross monthly wages (in DEM, average exchange rate HUF/DEM and SIT/DEM) and real growth of net wages (%)						
	1990	1994	1995	1996	1997	1998
<b>Hungary</b>	343.53	512.13	442.85	461.90	531.85	554.76
	-3.7	7.2	-12.2	-5.0	4.9	3.6
<b>Slovenia</b>	1453.14	1192.11	1354.89	1435.04	1565.90	1674.28
	-26.5	6.0	4.7	4.4	2.9	1.5

Sources: Countries in Transition 1999, Vienna: WIIW; Central European countries' employment and labour market review, European commission, Eurostat, No. 1, July 1999 (Table 1.d)

### *Economic development*

After a deep recession at the beginning of the 90's, there was recovery in both countries, with GDP real growth rates being somewhat higher in Slovenia up to 1998 (Table 1, a). In 1998 Slovenian GDP per capita was 9,847 USD and 13,200 USD in purchasing power parity (PPP) respectively – a level close to some less developed EU member countries. Hungarian GDP per capita was significantly lower – 4,694 USD, and 9,300 USD in PPP (Table 1, b, c).

In 1998 the monthly gross nominal wages and salaries was 1,674.28 DEM in Slovenia. In the same year comparable wages were approximately one third in Hungary – 554.76 DM. When survey was carried out, pay growth was essentially faster in Hungary than in Slovenia.

In the second half of the 90's a system of social partnership was formed in Slovenia (Luksic, 1997). The system reduced pay growth, accommodating it to the needs of macro economic stability. In this system collective bargaining is centered at the multi-employer (sector and general) level. In Hungary, social partnership institutions were arranged earlier, but faced problems (Pollert, 1999: 164), dilemmas and a reduction in its functions (Hethy, 1999: 62) in the second half of the 90's. Payment regulation is centered at workplace level. The prevalent form is single-employer bargaining (Neumann, 1997:198)

There is greater foreign direct investment (FDI) in Hungary than in Slovenia. Total value of FDI was significantly higher in Hungary than in Slovenia in 1993 as well as in 1998 (Table 2).

### *Legislation on participation:*

In the early 90's laws on worker participation were passed in both countries. In Hungary new institutions were defined within a new labor code from 1992 (Toth, 1997:167). In Slovenia separate legislation defined worker participation in 1993. Both laws replicate the German co-determination system. To start with Hungarian trade union confederations opposed the law, but later they accepted it.

**Table 2: FDI in Hungary and Slovenia, 1993 and 1998**

	Hungary	Slovenia
	<b>1993</b>	
<b>Value (mill. USD)</b>	5,585	954
<b>Share in GDP (%)</b>	14.5	7.5
<b>Per capita (USD)</b>	543	479
	<b>1998</b>	
<b>Value (mill. USD)</b>	18,255	2,863
<b>Share in GDP (%)</b>	38.5	14.7
<b>Per capita (USD)</b>	1,809	1,444

Source: Rojec, 2000,: Hunya & Stankovsky 1999; WIIW 1999.

Slovenian trade unions supported the new legislation from the beginning. The new law was directly implemented in Hungary. In Slovenia the law was facultative, in the sense that its implementation was conditional on the collective initiative of employees.

*Trade unions and employee representation at workplace level:*

Sharp ideological and political cleavages between trade unions caused dramatic fragmentation of the trade union movement in Hungary (Toth, 1999:19). The fragmentation in Slovenia has not been so intense, in spite of similar cleavages appearing at the beginning of the 90's. At the end of the 90's the general trade union density rate was 20% in Hungary (Robert, P. and Medgyesi, M. 1999) and 40% in Slovenia (Stanojevic, 2000). We can say that, within the last decade, Hungary was faced with radical and Slovenia with moderate de-unionization.

According to Toth, who writes that the new trade union organizations in Hungary 'had only limited success in penetrating workplaces and attracting membership' (1997:164), it is possible to say that one trade union organization usually appears at the workplace level in Hungary. Slovenian findings reveal a similar picture (Kavcic, 1996). Works councils are present in Hungarian as well as Slovenian companies (Toth, 1997; Kavcic,1996).

### **Comparison of the survey results**

*The samples*

The survey from 1999 focused on trade union effectiveness at workplace level in Hungary and Slovenia. The respondents were local union leaders – presidents of company unions. The survey included 98 questions on the leaders' perception of workplace relations and some 'factual' questions, for instance about the econo-

mic situation in their companies, trade union density and demographic characteristics of the respondents.

The survey took place in the metalworking/engineering and food processing industries, representing two relatively large industrial sectors in both countries. According to data from 1997, the metalworking industry created 30.6% of total manufacturing production in Slovenia and 31.9% in Hungary, and the food industry 15.4% in Slovenia and 21.5% in Hungary (source: Countries in Transition 1999).

Fieldwork was conducted during the second half of 1999. Because of the high failure rate of mail surveys in Hungary, students from the Central European University in Budapest assisted with the survey. They collected 113 questionnaires from 120 companies selected proportionally according to the six geographical regions. The selected companies included 60 out of a total 340 unionised metalworking companies, and 60 out of 186 unionised food processing companies. In Slovenia the mailed surveys were more successful: 39 questionnaires were returned out of 62 unionised companies in food processing industry and 67 out of 173 unionised companies in the metalworking/engineering industry. In Slovenia 106 questionnaires were collected.

According to a part of collected factual data, it is possible to form a rough comparison of the companies included in the samples. In terms of FDI, our samples confirm the above-mentioned differences between the two transformational patterns. Within the Hungarian sample, almost every second privatized company is predominantly foreign owned. The share of these companies is almost four times higher in the Hungarian sample than in the Slovenian sample. Our samples suggest that foreign senior managers have a strong presence in Hungarian (foreign owned) companies in the metalworking and food processing industry. Within the corresponding Slovenian industries, the number of foreign senior managers is negligible.

Within the two samples the number of mainly state owned companies is significantly higher in Slovenia than in Hungary: a quarter of Slovenian companies were mainly state owned compared to one tenth in Hungary. The Slovenian sample suggests that employee ownership has spread to almost all Slovenian companies. In one third of 106 Slovenian companies, employees control more than 31% of shares. This type of ownership is significantly less widespread in Hungary.

Within the Hungarian sample, the portion of big companies with more than 500 employees is higher than in Slovenia. Within the last decade the portion of companies with less than 100 employees was lowering in Hungary and increasing in Slovenia.

One third of Hungarian companies are export oriented. The proportion of these companies is higher within Slovenian sample – one half of them are export oriented.

The respondents were asked to evaluate the successfulness of their companies. According to the responses, the proportions of successful and unsuccessful companies are similar in both cases: approximately one third of them are successful and one third unsuccessful in Hungary as well as in Slovenia. In this article I shall suppose that local union leaders are familiar with their company's performance. That is why I shall treat their evaluations as factual data.

#### *Trade union leaders*

We found some striking differences between Hungarian and Slovenian trade union leaders. Within the Hungarian sample, most of them were women; one half of all Hungarian respondents were older than 51 years; two thirds of them had been at trade unions posts for more than 10 years. The majority of Hungarian respondents were holders of managerial/supervisory functions. Almost all of them declared themselves as leftists.

Slovenian trade union leaders are younger. Most of them have been elected in the post-communist era. Workers are strongly represented. In political terms they are moderate, center oriented persons.

#### *Trade union power*

Strong, statistically significant differences appear in a comparison of trade union density. In Slovenian companies, usually more than half of the employees are unionized. In one third of Slovenian companies, trade unions cover more than 81% employees. In Hungarian companies, usually less than a half of employees are unionized.

Mobilization capacity (Offe, 1985) in Slovenian trade unions is essentially stronger. In a hypothetical situation of worsening working conditions, Slovenian leaders would be able to mobilize union members to go on strike. Hungarian leaders, faced with member passivity, would have serious problems in same situation.

According to the respondents, Slovenian workers are essentially more dissatisfied with pay and working conditions in their companies. Compared to Hungarian workers, they are also significantly more dissatisfied with their trade unions. Workers see their union as ineffective in representing their interests in half of Slovenian and one third of Hungarian companies.

**Table 3: Trade union leaders**

	Hungarians		Slovenians	
	%	N	%	N
Women	68.0	113	24.5	106
Older than 51 years	47.6	113	12.3	106
Occupation				
Manager *	67.7	106	5.8	105
Worker **	14.5		39	
Others			55.2	
Var 85: What is your occupation? 1. Personnel manager; 2. Other manager, 3. Technician, engineer; 4. Supervisor; 5. Skilled worker; 6. Unskilled worker	17.8			
Political views				
Left***	80.4	102	28.5	98
Centre				
Right ****	17.4		64.3	
Var 86: How would you describe your political views? 1. Far left;				
2. Left; 3. Centre. 4. Right. 5. Far right	2.2		7.1	
Union representative less than 10 years	36.3	112	80.0	106
Mean duration	16.58		6.62	

\* Categories 1,2 and 4 are merged.

\*\* Categories 5 and 6 are merged.

\*\*\* Categories 1 and 2 are merged.

\*\*\*\* Categories 4 and 5 are merged.

Almost half of Slovenian leaders are of the opinion that their union **does not** possess real power at the workplace. Hungarians, as opposed to the uncertainty of their Slovenian counterparts, believe that their unions possess real power.

In terms of our analysis, we could assume that trade union density and mobilization capacity are the two key indicators of trade union power (Kelly, 1998; Offe, 1985; Tilly, 1978). The two different estimations of real union power are obviously incompatible with more objective evaluations of trade union power, derived from the two key indicators.

In spite of high trade union density and high mobilization capacity, a relevant group of Slovenian leaders think, that they (their union) have no real power.

Hungarian leaders perceive 'real power', in spite of comparatively low density rates and the significantly weaker mobilization capacity they possess at workplace level.

Both Hungarian and Slovenian trade unions exert very little influence on managerial strategic decision-making. Hungarian trade unions are consulted by managers more frequently than are Slovenian trade unions. Slovenian trade unions are involved in negotiation more than Hungarian trade unions, mostly about wages and social benefits for workers. The influence of the Hungarian trade union is higher in decisions dealing with health and safety.

#### *Workplace relations*

Within the five-year period (1995-1999), more strikes have appeared in Slovenian than in Hungarian companies. In Slovenia, workers have gone on strike in 17.0% of all cases. Strikes have appeared in 6.8% of Hungarian enterprises.

**Table 4: Trade union power**

	Hungarians			Slovenians		
	%	Mean	N	%	Mean	N
Trade union density: more than 51% employees	38.8		112	82.0		106
Mobilization capacity: able to mobilize members to strike Var 32: Could you mobilize union members to go on strike if working conditions become very bad? 1. Yes; 2. no	44.3		106	80.0		105
Workers are not satisfied with their wages* Var 40: Overall workers perceive their wages as fair. 1. Strongly disagree; 2. Disagree; 3. No view; 4. Agree; 5. Strongly agree	64.0		113	86.5		105
		2.40			1.92	
Union is ineffective in representing workers' interests** Var 15: Workers do not see union as effective in representing their interests. 1. Strongly disagree; 2. Disagree; 3. no view; 4. Agree; 5. Strongly agree	34.0		113	54.4		92
		2.69			3.22	
Evaluation of trade union power: my union has real power*** Var 44: My union does not possess real power in this workplace. 1. Strongly disagree; 2. Disagree; 3. No view; 4. Agree; 5. Strongly agree	76.7		113	50.0		106
		2.12			2.89	

\*Categories 1 and 2 are merged.

\*\*Categories 4 and 5 are merged.

\*\*\*Categories 1 and 2 are merged.

The perception of strikes is significantly different. Slovenians are more militant – a half of Slovenian respondents and a quarter of Hungarian respondents had supported strikes.

When evaluating the main problems ‘unions encounter in trying to implement union policies’, Slovenian leaders express essentially higher levels of mutual consent than Hungarians. /2/ This manifestation of militant attitude is systematic and significantly higher among Slovenian respondents.

Four fifths (80.6%) of Hungarian respondents believe relationships between management and unions are co-operative at their workplaces. The same opinion is expressed by half (52.4%) of Slovenian respondents. For Slovenian trade union leaders, the opposition between trade unions and employer interests is out of the question. For Hungarians opposition is not so clear. This type of difference systematically appears in all cases when respondents were asked to express their understanding of differences between employer interests, on one hand, and union and workers’ interests on the other. For instance, Slovenian respondents clearly express strong tensions between workers and managers at workplace level (‘them-and-us’ feeling). A similar stance is weakly expressed by Hungarian respondents.

Hungarian trade union leaders, in comparison with their Slovenian colleagues, express a significantly higher level of trust in management. Two thirds (70.8%) of them believe management of their companies ‘to be a trustworthy partner’. According to Slovenian respondents, managers **are not** trustworthy partners in approximately the two third of Slovenian companies.

Finally, in the Slovenian sample we found a statistically significant bivariate association between the success of the company (three categories variable: 1. Better than average, 2. About average, 3. Below average) and its internal co-operation (the relationship between union and management is co-operative, three categories variable: 1. Disagree, 2. No view, 3. Agree): Chi-Square = 14.35, DF=4, sign. = .007, Cramer’s V = .26. Another statistically significant association in the Slovenian sample was between the success of the company (the three categories variable mentioned above) and a trustworthiness of the management (management is a trustworthy partner, three categories variable: 1. Disagree, 2. No view, 3. Agree): Chi-Square = 21.95, DF=4, sign.=.000, Cramer’s V=.32. Within the Hungarian sample these two measures of association are insignificant.

All comparisons presented in tables 3, 4 and 5 yields statistically significant differences (T – test).

Comparison of data collected by a survey from 1999 suggests that industrial relations are more co-operative in Hungary than in Slovenia. According to trade union leaders, the intensity of mutual trust at workplace level in Slovenian com-

**Table 5: Workplace relations**

	Hungarians			Slovenians		
	%	Mean	N	%	Mean	N
Co-operative relationships between unions and managers*	80.6		113	52.4		105
Var 33: Overall the relations between union and management is co-operative. 1. Strongly disagree; 2. Disagree; 3. No view; 4. Agree; 5. Strongly agree.		3.76			3.13	
Strong 'them-and-us' feelings between workers and managers*	18.4		113	69.8		106
Var 65: I feel a strong sense of 'them-and-us' between workers and managers at this workplace. 1. Strongly disagree; 2. Disagree; 3. No view; 4. Agree; 5. Strongly agree.		2.27			3.70	
Management is a trustworthy Partner*	70.9		113	39.1		106
Var 34: Management is a trustworthy partner. 1. Strongly disagree; 2. Disagree; 3. No view; 4. Agree; 5. Strongly agree.		3.58			2.98	

\*Categories 4 and 5 are merged.

Discussion: causes of workers' militancy in Slovenian companies and non-militancy in Hungarian companies

panies is strongly below the level of the trust between industrial relations players in Hungarian enterprises.

What is the source of identified differences? What causes them?

### **Tradition and co-operative behavior**

At the level of objective data, we found striking differences between the profiles of Hungarian and those of Slovenian trade union leaders. The differences are too strong to be explained by deviation between the samples (for instance, the higher proportion of food industry companies from food industry within Hungarian sample, etc.).

In Hungary, trade union leaders tend to be strongly integrated within the company managerial structure. The integration of Slovenians trade union leaders in the structure is weaker (see Table 3).

Hungarian leaders are old leftists; new Slovenian leaders are politically more moderate, center oriented. At a more practical level, the pictures are inverted: in terms of everyday activity, Slovenians express high militancy and Hungarians accentuated a moderate stance (see Table 3, 4 and 5)?! We are faced with a double paradox: in Hungary we found old leftists/radicals, which are moderately

oriented in their everyday activities, and in Slovenia we found the new, political-ly very moderate leaders, who are highly militant in everyday activities.

Why do militant leaders appear so systematically in Slovenian companies? Why is the militancy significantly lower in Hungary? At this point we are faced with structural differences. Slovenian industrial relations need militant, and Hungarian industrial relations more moderate leaders.

A part of an explanation of these differences could be found in two specific traditions. In the background of the Hungarian 'co-operative' and Slovenian 'adversarial' industrial relations, are different systems of 'real socialism'.

In the introduction, we mentioned that in the Slovenian/Yugoslavian type of 'real socialism' relatively autonomous workers collective activities were possible at workplace level. In a form of self-management, primarily through workers councils, workers were included in collective re-distributive conflicts at micro level; their interests were articulated 'from below'.

In Hungary, the command economy prevailed. The trade union was a link in the command economy chain. The unions were an inseparable part of the bureaucratic administrative mechanism. Within this system the autonomy in the process of workers interests articulation was impossible.

In the 'transitional' period, these two patterns have been combined with market (de)regulations. In such a new environment, the first induced 'adversarial', and the second 'co-operative' industrial relations.

### **Two modes of generating peace in organizations**

We found that Slovenian and Hungarian trade union leaders have different positions within company organizational structures: Slovenian leaders are closer to the workers, Hungarian leaders are closer to management (see Table 3).

Their different positions within organizations imply differences in perceptions of internal organizational relations.

Slovenian new trade unionists are more sensitive to the 'them-and-us' relations expressed by workers (see Table 5). They are more sensitive to workers' dissatisfaction. The trade-unionist leaders express such a radical stance that the expression of an essentially higher radical position and dissatisfaction among workers is simply not possible (see Table 4, dissatisfaction with wages).

Frege found, in an earlier survey, significant differences between workers and trade union leader perceptions of 'them-and-us' relations in Hungarian companies from clothing industry. Hungarian workers strongly expressed 'them-and-us' feelings but trade union leaders hardly noticed it (Frege, 1999).

The differences in perceptions we identified between Hungarian and Slovenian trade union leaders do not mean that we obtained a deformed image of Hungari-

an and more realistic picture of Slovenian industrial relations – far from it. Identified differences in perceptions indicate the two modes of the social construction of reality (Berger&Luckman, 1966): the 'co-operative' one in the Hungarian case and the 'adversarial' one in the Slovenian case.

Hungarian trade union leaders holding managerial positions, have an unclear perception / weak feeling for 'them-and-us' relations. If Hungarian workers have strong feeling for these relations, it means that perceptions of the two sides do not fit in with each other. Hungarian trade union leaders, on the one hand, and workers, on the other, speak different 'languages'. At the level of interest representation this difference implies that Hungarian trade union leaders are closed and/or highly selective when dealing with workers' interests. Insensitivity to 'them-and-us' relations manifested by Hungarian trade union leaders indicates a **distance** between them and workers. **It is the distance between managers, who are trade union leaders, and ordinary workers.**

The distance is a factor contributing to industrial relations **pacification** in Hungary. It is a filter that effectively reduces manifest conflicts within companies.

The main problem of the filter is that it could induce passive employee 'co-operation' only. This filter selects and fragments workers interests. The result is passive, instrumentally oriented workers.

At the level of trade union activity, the distance is manifested as a (comparatively) lower trade union density and as a weak trade union mobilization capacity. Accordingly, Hungarian leaders revealed that 'passive, disinterested membership' and 'lack of committed union representatives' are the most important problems they are faced when 'trying to implement union policies'.

To summarize: The identified Hungarian pattern generates peaceful industrial relations.

The peacefulness is based on exclusion/pacification of workers' interests. More active inclusion of workers' interest within the organization is simply beyond the capacity of the mechanism.

The distance between trade union leaders and workers in Slovenian companies is essentially lower or non-existent. Because leaders are more located at operational, workers' positions, they clearly perceive 'them-and-us' relations in organizations. They speak the same 'language' as the workers. Because they are more open to the workers, they are able to function as articulators of workers' collective interests. Accordingly, they have no problems with reducing membership and mobilization capacity of the trade union organization.

The openness has an additional implication: because they are open to workers' interests/demands, they are militant and radical in everyday activities. It explains the higher rate of manifest conflicts in Slovenian companies. Within this mecha-

nism, workers are in active exchange with their company. They are able to dictate terms of peace in the organization. A peace of this kind is not the result of pacification, but of inclusion of their interests in the organization. This mechanism enables workers active co-operation in their organization – the type of co-operation that is unreachable under pacification.

### *Trade union power*

How to explain the paradox of the essentially higher ‘power feeling’ we indicated among Hungarian trade union leaders?

Hungarian leaders, being at some distance from the workers, are not exposed to strong worker dissatisfaction. Workers simply do not express it to them. On the other hand, we detected a significant growth in wages for 1999 in Hungary. Generally speaking, wages and salaries are at low levels in Hungary (compared to Slovenia). Within the growing Hungarian economy, small, but from the workers perspective significant improvements, are obviously reachable/possible. The combination of these two factors probably stimulates the feeling that Hungarian trade unions at workplace level have ‘real power’.

Slovenian trade union leaders, being more open to the workers, are exposed to the systematic pressure of worker dissatisfaction; they are pressed from below. Simultaneously, they are ‘trapped’ in a ‘social partnership’ mechanism: the rate of wage growth is regulated at mezzo and macro level. It means, that room for negotiations at the workplace level is limited. Wages, which are essentially higher than in Hungary, are not easy to improve. The union leaders negotiate with managers, but real improvements in company wage agreements are rare. The membership, of course, judges them in accordance with results at this specific field. Because the effect of trade union action is significantly below the level of workers’ aspirations, workers strongly criticize unions.

Being relatively unsuccessful in wage bargaining, and exposed to strong workers critique, Slovenian union leaders, contrary to their Hungarian colleagues, consistently conclude that they **do not have** real power in the workplace. The primary causes of that they do not see in passive membership and ‘lack of committed union representatives’, but in **legislation** – in normative regulations. Quite precisely they see the problem in the system, which prevent them converting workers’ pressure into the real wage growth.

Successful Slovenian companies are able to give better pay deals. In this sense, in the successful companies, there is room for negotiation and a possibility for trade unions to transfer workers’ dissatisfaction into better pay. According to our data, within these companies, trade unions usually reach some improvements in single employer bargaining. Exactly within the same companies industrial relations are co-operative by rule. As I said before, there is a statistically significant

connection between the success of the company and its internal co-operation in the Slovenian sample.

Within the Hungarian sample the connection is **insignificant**. According to Hungarian respondents, co-operation is equally distributed in all Hungarian companies, independently of their success. It means that co-operation is not understood as a type of relationship conditioned by the realization of workers' collective interests in an organization. In this discourse, co-operative relations are **pacified** relations. That is why the 'co-operation' is so unselectively distributed within the Hungarian sample.

#### *Works councils in the 'transitional' environment*

We identified the two types of industrial relations. In the first, 'Slovenian type', trade unions are **more open** to workers interests. In the second, 'Hungarian type', trade unions are **more closed** to their interests.

In the form of two similar laws on co-determination, the German model has been applied to these different patterns. Is it possible to say, that the model has stimulated high internal workplace co-operation when applied to the two patterns? Data collected by the survey, reveals that works councils are present in all Hungarian companies. This type of workers' representation does not exist in one fifth of Slovenian companies. The survey also 'suggests', that the trade unions and works councils in Hungarian companies are more united. Less united representation in Slovenian companies is combined with separate contacts with management. Cases without any contacts with management appear within the Slovenian sample. This practice is unknown in Hungarian companies.

Hungarian trade union confederations were initially opposed to the works council initiative, believing that the councils would reduce trade union influence. Later they accepted the initiative and supported legislation. The law was obligatory for all companies. In accordance with the law, managers – accompanied by trade unions – helped in the formation of works councils. Now all Hungarian companies have works councils. When asked 'who is the main workplace partner of management', the majority (65.6%) of Hungarian respondents answered that 'management deals with all of us together'. According to the possibilities offered by the questionnaire, it means that Hungarians works councils are usually strongly unified with trade unions. We have already said that trade unions are represented by leaders who hold managerial posts. Strong integration of the leaders in the management structure implies the works councils are tactical extensions of managerial functions.

There is no sign that the implementation of works councils has changed the power distribution in Hungarian companies. The managerial position of trade

union leaders, where integrated in the management structure before the implementation, has been stabilized, or even improved, by this implementation.

In Slovenia, the implementation of the 'German model' works council has been strongly supported by trade unions. In the background of this policy was the specific Slovenian/Yugoslavian tradition outlined in the introduction of this paper. At the end of the 80's and at the beginning of the 90's, when the old workers councils were loosing their power, trade unions took over the function of worker interests representation. Metaphorically speaking, they occupied the self-management pattern, which enabled inclusion of workers collective interests into the re-distributive conflicts within the companies. When the unions stabilized in their new role, they were faced (in 1993) with the Law on co-determination. They understood the 'German' works councils, offered by the law, as an additional chance to stabilize their own position and, more pragmatically, to secure more effective control over the privatization process. That is why Slovenian trade unions functioned as the key factor in the formation of works councils. /3/ Their high engagement was additionally stimulated by the **facultative** character of the law. /4/

In Slovenia, the new 'German model' works councils, being formed under trade unions initiatives/pressures, are the tactical extensions of these 'radical', more worker-oriented trade unions. Managers know this, and quite realistically understand the councils as an additional trade union body. For the works council, which was normatively constructed as an **intermediary** institution, it has been huge burden.

The intermediary approach, defined by law, in spite of strong trade union orientation, fixed the 'constructive partner role' for the works councils. They have made some 'partner contacts' with management in order to influence companies' policies. Simultaneously, this new 'contact' institution relieved trade unions of their intermediary duties. The works councils pushed trade unions into a 'pressure group' role, which is primarily focused on wage negotiations. As we explained before, the room for workplace bargaining is very narrow and restricted in Slovenia. The real bargaining happens at other, multi-employer levels. Within this system, the workplace trade unions are pushed into a corner. Being pressed by high worker aspirations, on the one hand, and their inability to realize these aspirations, on the other, they radicalize their stances. Frustration must be strong among them as well as among the workers they represent.

To summarize: It seems that the German model has also not induced a higher level of workplace co-operation in Slovenia. Causing the implementation of an additional institution specialized in more modest policies, it has even stimulated trade union radicalization at workplace level.

### **Conclusion: the evasive intermediary character of the representative institutions in post-communism**

Two different types of industrial relations exist in Hungary and Slovenia. Both are strongly influenced by regulatory patterns formed within the two different 'communist' traditions.

Hungarian industrial relations are **unitary** in nature. They are characterized by trade union integration in managerial structures. The integration is clearly revealed by their non-selective co-operation with successful as well as unsuccessful managers. Within the Hungarian sample, there is no connection between a company's success and trade union – management co-operation. Hungarian trade unions simply do not condition their co-operative stance with their company's success.

The 'co-operative' workplace relations we identified in Hungarian companies stem from inherited pacification of collective workers interests. Hungarian workers are passive. Under the actual prosperity, manifested as significant improvement of (generally low) wages, the co-operation of instrumentally oriented employees is secured. Within this type of co-operation, the oppositional stance is absent as well as an intensive identification of employees with their firms.

At workplace level, Slovenian trade unions are more worker-oriented. In accordance with this basic feature, the whole scene is more pluralistic and more conflicting. From time to time workplace relations are overloaded by distrust and even hostility.

Slovenian trade unions do not co-operate with unsuccessful managers. The key condition of co-operation is company success. This stance explains the 'islands' of co-operation and high trust relations within the industrial relations system in Slovenia. The 'islands' are clearly limited to successful companies.

'The conditioned co-operation' in Slovenian and 'the unconditioned co-operation' in Hungarian companies are two essentially different phenomena. 'The conditioned co-operation' in Slovenia implies intensive inclusion and identification of employees with their successful companies, but is accompanied by a sharp, severe, open rejection of unsuccessful companies. In such circumstances the successful firms get additional impetus to be more successful, but unsuccessful companies are faced with internal conflicts, which worsen their position and block their 'restructuring processes'. It could be understood as a factor, which relatively autonomously generates' state intervention – a relatively high level of state owned companies in Slovenia.

Generally speaking, the Slovenian system is characterized by extremes of high co-operation and high non-cooperation. Formation of these extremes is less possible in the environment of 'unconditioned co-operation' we identified in Hungarian companies.

In the introduction, we identified three types of industrial relations in advanced economies: the unitary one, and the two pluralistic – adversarial and incorporative.

Our analysis revealed similarities between Hungarian industrial relations and the unitary and the Slovenian system with the pluralistic, adversarial pattern. The two processes of industrial relations structuration are obviously **divergent**.

The divergence is significant, in spite of early implementation of German model in both cases. It appears that the implementation of the same ‘German model’ institutions have had opposite effects in the two environments. In Hungarian companies the works councils stimulated the integration of functions of capital, in Slovenian companies they stimulated trade union radicalization.

In both transitional societies the roles of capital and labor differentiate in accordance with the patterns, which are stronger than the imported intermediary institutions. The intermediary institutions are functionalized by these patterns. The old patterns convert new institutions into factors that stabilize them.

It seems that the ‘transplantation’ of the same model into the two transitional environments stimulates formation of a two essentially different industrial relations structures.

#### Notes:

- /1/ The survey is part of wider project dealing with industrial relations in transitional societies. Authors of the questionnaire are Carola M. Frege (London School of Economics) and Marc Weinstein (University of Oregon). The field work was coordinated by Zoltán Ádám (Central European University) in Hungary, and Miroslav Stanojevic (University of Ljubljana) in Slovenia.
- /2/ The differences are systematically significant. For instance, insufficient legal rights for unions is an important problem for two thirds (69.9%) of Hungarian and almost all (92.3%) Slovenian respondents. Lack of public support is accentuated by 68.0% Hungarian and 83.6% Slovenian trade union leaders, etc.
- /3/ It means that in non-unionized Slovenian companies, works councils did not appear. The facultative character of the Slovenian law caused doubled workers representation in trade-unionized companies, simultaneously enabling (in practice rare) cases of companies without any form of workers representation.
- /4/ Hungarian and Slovenian cases suggest that the mode of implementation of a foreign institution is also very important. The obligatory Hungarian mode probably would reduce the intensity of trade unions engagement in Slovenia. On the contrary, the facultative law probably would stimulate more independent initiatives in Hungarian companies.

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## Intertwining organisational learning and institutional settings: Evidence from organisational case studies in East German context\*

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*This paper is an attempt to develop a less normative conception of organisational learning which allows for more practice-oriented research on the topic. Our research, conducted in East-German companies in the context of societal transformation, can be understood as a process of building a particular understanding of organisational learning through the use of multiple case studies. With our comparative research framework we will show how key actors and strategically dominant groups of actors socially construct the opportunities and constraints that they experience in the process of organisational learning within a context of macro-level structures previously enacted. In conclusion, we underline the benefits of the enactment perspective developed here and its use in analysing paths of organisational learning.*

### Introduction

This paper suggests a combination of the arguments of two seemingly different academic research approaches: organisational learning concepts and neo-institutionalist ideas. Whereas the first approach stresses organisational learning as a chance to create more human, participative and emancipatory work forms in modern organisations, neo-institutionalism emphasises that the chances for such forms of organisational learning are limited in typical organisations because institutional structures and frameworks within capitalist societies are constraining.

Both conceptually as well as empirically we introduce a particular analytical perspective, the enactment concept, to study learning in and of organisations as interactive processes. We want to stress the social embeddedness of organisational learning and thus consider how actors and groups of actors actually learn in practice. Our research can be understood as a process of building understanding of organisational learning through the use of multiple case studies<sup>1</sup>.

We developed a research design which gives a detailed insight into micro-level organisational learning processes and their macro-level consequences in a transforming society. The study of three East German enterprises shows how organisational learning processes and institutional settings have been intertwined. Thus, our research provides both a better understanding about institutional ten-

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sions as well as the differences in the structuration (Giddens, 1984) of cultural systems emerging in the process of organisational learning.

### **The neglect of institutions in mainstream theories of organisational learning**

Organisational learning and more recently the 'Learning Organisation' seem to be buzzwords in the current debate about management education, knowledge management or organisational change. Journals, readers and conferences about this topic are in fashion. So, it is unremarkable that more and more consultancy firms are discovering managerial and organisational learning as new business areas now. However, even in the more serious areas of organisation theory these topics have lost their rather eccentric outsider positions and became central themes. Thus, Miner and Mezias (1996: 88) have succinctly pointed out that organisational learning is an 'ugly ducking no more'.

In the mainstream discussion about organisational learning two distinct scientific communities has been established; the first is largely made up by academics, while the second consists more of practitioners such as consultants and human resource managers (Easterby-Smith et. al., 1998). However, despite the differences in interests, there seems to be a kind of common ground about the meaning of organisational learning in both camps:

1. The argumentation has the functional bias that because the external environment is becoming increasingly unstable and less predictable, organisations cannot just improve established ways of learning, but must develop new forms of learning. The organisation's success in the past is seen as a learning barrier in the future (Argyris, 1992 a; Senge, 1990, et al.).
2. The discourse is largely normative, because radical forms of organisational learning such as double-loop or deuterio-learning are seen as the key for enterprises to deal with the new challenges of the external environment (markets, technological change, etc.). Thus, these forms of learning are positively valued as a kind of 'liberation management' method (Argyris, 1992 a; Field & Ford, 1995; Peters, 1994, et al.).

In other words, the main task of the 'Learning Organisation' is seen in developing radical forms of learning. In the centre is the voluntary creation of revolutionary organisational change processes that do not just transform organisational structures, rules and technical systems, but the organisation's deeply grounded culture. In this sense the 'Learning Organisation' is understood as the opposite of the traditional Weberian model of bureaucratic organisation: with rather decentral forms of learning, less hierarchical networking relations, broad skilling and training. The development and implementation of ground-breaking transformations in organisational culture is seen as a task of intervention researchers who guide, advise and educate local management in fostering double-loop learn-

ing modes and developing learning organisations. The idea is that invention researchers enable local managers to discover and overcome intra-organisational learning barriers, become change managers and, thus, take over the leadership of the learning organisation (Argyris 1992 b; Garrat 1987; Senge 1990, et al.). In this sense, Argyris sees the task of an 'interventionist (in) seeking to help members of client systems to reflect the world they create and learn to change it in ways more congruent with the values and theories they espouse' (1992 c: 220).

One can draw two lessons from this understanding of organisational learning: First, intervention research is a voluntaristic model that implies that individuals in organisations can be helped to learn more effectively and also humanely. Second, the quotation is based on the idea that more congruence between the two forms of theories of action, between 'espoused theories' and 'theories-in-use', will lead to more productive learning results (Argyris, 1992 c).

The particular problem of these learning models is, despite their humanitarian claims, their neglect of social and societal context where learning processes in and of organisations take place. Instead, there is a kind of idealism that more radical forms of organisational learning are the best solution to deal with the challenges of turbulent technological and market changes.

It can be concluded that the cardinal weakness in the debate about organisational learning is the neglect and misinterpretation of the role of institutions within the process of organisational learning. Either institutions are seen as inward looking learning barriers that hinder radical change<sup>2</sup> or they are just ignored, especially the characteristics of the institutional settings beyond the intra-firm level.

### **Bringing institutions back in: neo-institutionalist scepticism of the idea of radical organisational learning**

The most prominent stream in current organisation theory which discusses the relationship between organisational learning and institutions is neo-institutionalism. Contrary to mainstream research in organisational learning, which has a rather limited technical and economic perspective on organisational environment, neo-institutionalist scholars are 'bringing society back in' (Friedland & Alford 1991; et al.) by stressing the importance of institutional environments to understanding the behaviour of organisations.

The change of interests in organisational analysis from technical and market requirements to institutions has an important impact on how leading neo-institutionalist scholars, such as DiMaggio and Powell (1991 a and 1991 b), Meyer and Rowan (1992), Scott (1995 a and 1995 b), et al., understand the idea of intra-organisational learning. The neo-institutionalist conceptions of organisation and

2 In this sense institutionalised deeper structures disturb the positive outcome of double-loop learning.

action are quite different from assumptions prevailing in organisational learning approaches. Organisations are not seen as technical artefacts or as constructs of more or less rational decisions, but as institutionally constituted. Contrary to the mainstream view on organisational learning, it is not the development of reflective modes of acting and learning that is at the centre of the analysis, but the ways in which routinised organisational practices occur and the reasons behind their emergence. Thus, the focus of research has moved away from the question of how far incremental or radical learning approaches fit better with challenges of new markets and technologies to the problem of adopting and imitating certain social practices.

In this sense, organisational learning appears to be a process of adopting and imitation which is expected to improve the social legitimacy of an organisation in a specific organisational field. Indeed, the explanation of organisational learning is not limited to a single organisation in which individuals learn, or in which the organisation learns as a system. Instead, learning is seen as an interorganisational phenomenon. Organisational fields are conceived of as specific sectors in a society that are constituted of similar organisations. In this sense it is assumed that organisational learning in and between organisations leads to the emergence of a shared cognition, and as common rules and ideologies. The so-called institutional isomorphism appears as a process where organisations increasingly adopt similar strategies in an 'organisational field', and therefore converge in terms of both their structure and their culture (DiMaggio & Powell, 1991 b: pp. 63-82). Imitation of other organisations and the adoption of legitimised social practices are seen as effective for organisations because it allows them to win increased acceptance by other organisations and societal bodies. As such it can contribute to the improvement of their reputation and make it more feasible to gain support from public and private sponsors.

### **Organisational learning as social practice**

As we have seen above, both the micro-perspective of mainstream organisational learning theory as well as the macro-perspective of neo-institutionalists about the relationship between institutions and organisational learning, has been unable to comprehend the dynamic relationship between institutional settings in transitional societies and the processes of learning in post-socialist companies. Both perspectives, interventionist learning theory and the neo-institutionalist perspective, suffer from overestimation either of individual voluntarism or of the convergence of the organisational forms into institutional arrangements of society:

Whilst students of organisational learning stress the active role of individuals to improve the conditions for learning, for neo-institutionalism passive reaction and conformity to institutionalised environments is considered to be the fore-

most form of learning. Arguments on both sides overstate their contribution to the understanding of organisational learning at the expense of the other, because they fail to understand the social character of the ongoing process of organisational learning.

This leads us to the concept of enactment developed by Weick (1995). His view is very close to Granovetter's (1992) idea of social embeddedness because it rejects the inherent assumption of organisational learning research and neo-institutionalism that the environment, be it defined in technical or institutional terms, determines how actors in organisations learn<sup>3</sup>. The enactment perspective can rather be seen as an intermediary position which combines radical ideas of the interventionists with the sceptical ideas of the neo-institutionalists.

The essence of the enactment perspective is on interactions of various actors and groups of actors, inside and outside the organisation. In this sense, the focus of research moves from seeing actors as therapists or rule-followers to viewing them as practitioners. At the centre of our research is the practice of learning; how actors socially construct their environment through various intra-organisational and interorganisational interactions. Thus, compared to intervention research and neo-institutionalism, the focus of analysis moves from questions of how internal learning barriers or disabilities can be overcome or how organisations respond to social influences, to the practice of social learning (See table 1!).

The enactment concept understands organisational environments differently. On the one hand the deterministic argumentation that organisations must adapt to social influences, which is common to neo-institutionalist approaches, is avoided. On the other hand, the enactment concept is different from the intervention research perspective which explains environments as something which can more or less be perceived perfectly. As we have seen, this refers to the individuals' ability to avoid the errors and improve the correctness of their perceptions. However, in spite of the conceptual differences, both views stress the importance of outside influences, either technical/economic or institutional, as being responsible for the outcome of learning processes. From an enactment perspective, organisational environments cannot be separated from the process of organising. It is assumed that actors in organisations 'enact' their environments (Weick, 1995). This idea combines both the assumptions of interventionists about the consequential role of actors to develop broader prospects for future learning, as well as the arguments of neo-institutionalism that organisations are not closed

3 The basic ideas of both views fit with the distinction between an undersocialised and an oversocialised conception of social action in sociology and economics (Granovetter, 1992). The undersocialised conception of organisational learning of interventionists, and the oversocialised interpretation of neo-institutionalism, are based on a rather static and mechanical view about the relation between organisations and their external environment, about the interdependence of structure and action, as well as about the role of social context.

systems, but that institutions bring society back into the organisational context. Enacted environments are understood as entities which are actively created by members of organisations. They can select, decide and influence what belongs to their organisation (Czarniawska-Joerges, 1996; Orton, 1996; Weick, 1995).

Through the redefinition of the role of actors and the introduction of the idea of enacted conception of environments, the concept of organisation has to be re-considered. The idea that organisations are socially constructed is different from seeing organisations as an information-processing system that enables individuals to perceive their environments more or less correctly. Nor can organisations be directly influenced through external institutions. The focus of analysis thus cannot be reduced to the question of common organisational learning research, namely how individuals overcome learning barriers and disabilities in organisations. Equally lacking is the neo-institutionalists emphasis that learning through adoption and imitation is a consequence of the institutional environment. From an enactment perspective, organisations cannot simply be characterised accordingly to more or less accurate organisational designing principles or how ideas, rules and routines are adopted in response to their institutional environments, but as should be viewed as a 'community of practice' constructed through social relations (Gherardi et al., pp. 275-279). This view has consequences for the conception of organisational learning. It can neither be reduced to the successful improvement of individual cognition and information-processing capacities of the whole system, nor to the extent of adoption and imitation for the purpose of increasing the organisation's social legitimacy. Rather, organisational learning as a social practice occurs through interaction and participation in social relations, inside and outside of the organisation.

**Table 1**

	<b>Organisational Learning</b>	<b>Neo-Institutionalism</b>	<b>Enactment concept</b>
<b>Theories of actors</b>	Individuals are designers and therapists.	Actors are rule-followers.	<i>Actors are practitioners.</i>
<b>Theories of organisation</b>	Organisations are information-processing systems.	Organisations are constituted by institutionalised rules of the society.	<i>Organisations are socially constructed.</i>
<b>Theory of environment</b>	Concept of technical environments	Concept of institutional environments	<i>Concept of enacted environments</i>
<b>Theory of organisational learning</b>	Learning occurs through individual learning and learning of the whole system	Learning occurs through adoption and imitation	<i>Learning occurs through social interaction and social engagement</i>

Thus, we can summarise that the enactment concept allows for the explanation of how organisational learning processes at the micro-level are linked with insti-

tutional change at the macro-level of society. However, different to mainstream organisational learning approaches and neo-institutionalism the macro-level institutions are not seen as distinct from the interactionist learning processes. In our view the institutional constraints and choices emerging from within the process of organisational learning are understood as socially constructed through social interactions and engagement.

### **Empirical background and analytical concepts**

In the discussion about the social and economic transition in Central and Eastern Europe, the changes in the institutional context<sup>4</sup> are closely linked to the transformation of work systems and organisation. Thus, institutional change produces various 'triggers' for organisational learning in former state-owned companies. In this sense Merkens et al. (2000) argued that even when radical changes in former state-socialist countries triggered organisational learning generally from outside the organisation, the speed, direction, and the results of organisational learning must be understood rather as an interactionist process where structuralist (change of structures) and constructivist learning (change of behaviour) come together (ibid.).

Consequently, the empirical background of social and economic transition in Central and Eastern Europe seems to be ideal for our particular interest in how institutions affect organisational learning and vice versa. Thus we agree with Weick (1985), that one can obviously learn more about the significance of institutions and culture in organisations when the daily routines break down (p.386); and this might be happening with differences in time scale and intensity in most of the former state-owned firms in this historically unique time of societal transition.

However, we are not looking for general features of organisational learning in the social and economic transformation of former East German firms, the empirical background of this study. Our thesis is that societal change as a whole, such as has occurred in the former GDR or in Central and Eastern Europe, does not directly influence how and why certain organisational learning forms appear. Rather, the macro perspective of societal change has to be related to the actual practice of organisational learning in a specific social context. Thus, we are interested in understanding how certain social and economic conditions influence the learning opportunities in an organisation, and, vice versa.

4 According to Whitley (1995, p. 13-19) institutional change in former state socialist societies in Eastern Europe comprises: 1. privatisation of state-owned enterprises, 2. an emerging lack of an indigenous class of capitalists, 3. an emerging lack of intermediary institutions, 4. the remaining central role of the state in the transforming process of these societies.

Although we used structural features, such as the origins of the organisation, products and services, product differentiation and manufacturing type, to describe the specific differences in learning situations, we want again to stress that the focus of this project is the analysis of organisational learning as a social process (See table 2!). Strictly speaking, our interest is in understanding those events that give the process of organisational learning direction and meaning. Once organisational actors start to make commitments (Weick, 1993) or strategic choices (Child, 1972 and 1997) they lay down the constraints and opportunities they face when they are learning. In this respect we agree with Weick (*ibid.*) when he emphasises that small events, such as the decision to stay within an established market niche, can have large consequences for the emerging organisational possibilities. Subsequently, we want to find out how specific starting conditions such as whether actors can refer back to traditional markets or not, whether they persist within or change their manufacturing type, whether they develop customised products or are just starting to search for or create new markets, influence the ways in which organisational actors actually learn.

### **Research design: Building theories from case study research**

The discussion above can be summarised as an attempt to criticise established theory of organisational learning and institutional analysis. As we have seen, in both concepts the dialectic between organisational learning is neglected. However, the developed enactment perspective should be seen as an attempt at theory building. In this sense, our comparative case study research will show what can be gained from such an interactionist framework. In line with Eisenhardt (1989 and 1991), we want to show that multiple case studies can be used as powerful tool to create novel conceptual insights.

Table 2 shows that we have selected quite different case studies, from a supplier in the automobile market to a profit centre in the tool-making industry to a platform organisation in the job creation sector, to explain the dialectic relationship between institutional settings.

The selection of the three case studies was based on two principal assumptions: Firstly, we decided to select firms with a broad variety in their institutional embeddedness at the macro-structural level. Our presumption was that what people learn, how they learn with each other and what this means for their prospects of further learning is influenced by the institutions which constitute and are constituted by a particular 'community of practice' (Gherardi et al., pp. 275-279). In this sense, we searched for organisations which are socially embedded in quite distinct communities of practice for the purpose of analysing and comparing how interactive learning processes are represented differently in the local cultural systems. Secondly, we decided to select firms which have implemented reor-

organisation strategies or have announced plans to do so. In such firms organisational learning could be expected to play a critical role<sup>5</sup>.

**Table 2**

Key characteristics	CASE STUDY: SUP	CASE STUDY: TOOL	CASE STUDY: CREAT
<b>Key organisational tasks</b>	Assembly of standard price-competitive products	Creation and production of customised quality products	Job projects and spin-offs of small businesses
<b>Construction of the organisational system</b>	Highly-structured manufacturing	Medium-structured profit centre organisation	Low-structured platform organisation
<b>Focus of organisational learning</b>	The implementation of effective organisational design principles	The development of customer-specific organisational forms	The development of employment projects

At the same time, local managers of these firms seemed interested in learning more about their own strategies such as introducing new management ideas in form of 'Team orientated Production' (TOP) or 'Continuous Improvement Process' (CIP) in SUP, the creation of profit centre structures in TOOL or the development of job creation projects in CREAT. Even when the interests of management in some kind of action research were rather diffuse, their focus on this issue helped to create a relatively open research environment.

Each firm belongs to a quite distinct community of practice with different resources, social competencies, rules and routines. SUP represents an established international supplier of car headlights in the automobile market. TOOL represents an established producer of tools and machine tools, which was transformed into profit centre organisation and is in search of a market niche. CREAT represents a newly founded job creation centre, which had just started spinning-off new business activities and developing projects to establish long-term employment prospects through public sponsorship.

Our question is how these quite different starting conditions in each community of practice (here characterised by key organisational tasks, social construction of the organisational system, and the focus on organisational learning and employment development) influenced the opportunities and constraints which emerged when actors and groups of actors learned from and together with each other. Each of the above mentioned characteristics draws our attention to three quite

<sup>5</sup> With respect to questions, which have occasionally raised about how the selection of the cases influenced my research and whether the number of case studies is sufficient, I want again to refer to Eisenhardt's (1991) idea of using case studies for theory building: 'the concern is not whether two cases are better than one or four better than three. Rather the appropriate number of cases depends upon how much is known and how much new information is likely to be learned from incremental cases...' (p. 622).

distinct organisational domains with specific interaction, work and organising patterns which are the subjects of our analysis.

Contrary to the single-case study methods, primarily used by the leading scholars in the organisational learning literature to illustrate their normative learning models, we not only developed a multiple-case study research design, but actually carried out longitudinal case studies by having regularly visited all three firms over a period of approximately 2 years. The first contact to the field was 1993 when we started our intensive research in TOOL. We concluded intensive field research in 1996 in SUP.

For the prementioned purposes, our comparative case study research is mainly based on qualitative research methods such as open and semi-structured narrative interviews, analysis of documentation, group discussion and participant observation. We examined a broad number of interviewees (key players) in each firm, some of them several times.

### **Intertwining organisational learning and institutional settings**

In this section we want to describe the interdependence between social context and organisational learning. We will emphasise the dialectics of institutional tensions emerging in the observed organisational learning processes and differences in the social construction of cultural systems that appeared to be central to understanding the relationship between organisational learning processes and institutionalisation such as:

- tensions between traditional and novel tasks (old and new)
- tension between intended and non-intended forms of organisational learning (theory and practice)
- differences in the awareness of the cultural systems (conformity and diversity)
- differences in the structuration of the cultural systems (imitation and creation).

#### *The tension between traditional and novel tasks*

The tension between traditional and new tasks in institution building does not only influence how organisations learn, but also how they forget. Moreover, it seems to be the case that the openness to new tasks is more related to ignoring the established organisational knowledge base rather than improving it. In the conventional literature these aspects are often discussed as a problem of ‘unlearning’; it is assumed that the learning of novel tasks requires unlearning (Hedberg, 1981; et al.).

In the comparison of our three case studies we have seen that the openness for novel tasks cannot be compared with an intentional discovery process. Instead

the emergence of more open learning approaches and the forgetting of established ways of thinking and acting are driven by the dialectic between the decline of established institutional arrangements and the building of new ones. In this sense, organisational learning cannot be understood as a cumulative process, which delivers more detailed information about a certain problem and increases the organisation's knowledge base. Equally, 'unlearning' cannot be understood as deleting a certain amount of past learned behaviour in order to increase the firm's flexibility. We have seen that only knowledge which is institutionally supported is developed further and refined as in the case of SUP, and that the decline of institutional stability influenced the processes of forgetting as in the cases of TOOL and CREAT (Douglas, 1991; Johnson, 1992). In the case SUP, the reorganisation process was seen traditionally as the improvement of the firm's technical core and its functions. In this sense, the implementation of teamwork was not understood as a process that gives more space for direct participation and self-organisation, but as an attempt to optimise production processes. In SUP, forgetting played a functional role in the management's attempts to optimise the production process in order to increase competition within the established organisational domain. Functions and departments which did not directly contribute to the manufacturing task were closed. The remaining activities within the firm were focused on the 'continuous improvement' of the production task. In the other two firms, the decline of established institutional settings, the ambiguity about the future ownership of the firm and the market situation did not support the development of more systematic forms of forgetting, but led to the development of forgetting patterns which Johnson has called 'creative forgetting' (1992: 29-30). With 'creative forgetting' the author implies that institutional forgetting can be reasonably proactive. Learning and forgetting can, as in SUP, be directed along the established technological trajectories or it can be more orientated to develop and do different things as in the case of CREAT. In this enterprise the decline of traditional institutional arrangements did lead to more radical learning attempts, which not only led to the forgetting of past learned habits and routines, but also involved, more than in the other two case studies, a certain ignorance about the risks at stake and the ambivalence of the output. In TOOL, the ties between traditional and novel tasks are closer than in CREAT, but, contrary to SUP, the search for new market segments involved forgetting and more radical learning approaches. The loss of traditional user-producer-relations led to the recombination of established work routines and the creation of new customer relations.

Contrary to common arguments about learning organisations and their improved capabilities to develop systems thinking (Senge, 1990) or their well-directed interventions that seek to uncover and defeat internal learning barriers (Argyris & Schön, 1996), processes of ignoring and forgetting appear to deal with institutional dynamics and its ambiguities. In SUP, we have seen that the actors tried to

avoid interruptions and failures in order to improve the established routines and procedures. But in the other two case studies, the actors learned to deal with the discontinuities of the institutional environment. Especially in the case of CRE-AT, organisational learning was not guided by elaborated learning recipes to regulate the avoidance of failures and interruptions as was the case in SUP. The openness to such novel tasks as the realisation of uncertain project ideas required the company to ignore, to a certain degree, the risks and failures that could well be faced during the realisation of the project.

It can be concluded that organisational learning processes that are developed in tension to the traditional task environment have less to do with continuous perfection of the organisation's knowledge base or the development of accurate goals for learning, than with the 'art of ignoring' (Kühl, 2000; Luhmann, 1999). Moreover, the comparison of the case studies showed that the 'creative forgetting' of traditional modes of organising and openness for novel tasks is not a question of improving reflexive learning modes (Senge, 1990) or of improving the speed of organisational learning (Wildemann, 1996), but of practising learning.

#### *The tension between intended and non-intended forms of organisational learning*

The dialectical relationship between intentional and non-intentional organisational learning can be conceived of in terms of the metaphor of a game. Gehlen distinguishes two kinds of learning games (1986: 205ff.). The first type, so-called 'polyphone games', lack both an obvious goal as well as a clear intention. People play such 'amusing' games just for the purpose of having fun and entertainment. More serious purposes of such games at best develop at a later stage of the organisational development. The second type of games becomes more structured and serious over time. They are played with quite specific goals in mind. Such games take place in the context of stricter rules of the sort that characterise chess games or soccer matches. However, compared with 'polyphone games', the new quality of these more institutionalised games is not just their seriousness, but the increasing regularity and homogeneity of the learning process between the players of the game.

Comparing the organisational development in our three case studies, we found that games were most institutionalised in SUP. Games in CREAT, on the other hand, exhibited the lowest degree of institutionalisation, with TOOL occupying a position somewhere in between these two extremes. The more institutionalised a game was, the more specified its goals became and the more detailed its rules were.

The discussion showed that all attempts to increase efficiency, such as technological perfection in the case of SUP or cost awareness in the case of TOOL, led

to the disappearance of creative learning modes and to the decline of spontaneous co-operation. It also became evident that the lower degree of intended learning approaches in CREAT (to a lesser extent also in TOOL) appeared to be useful for creative learning and for openness towards novel tasks. In contrast to the conventional debate about organisational learning, which is concerned about the limitations of institutions in terms of deuterio-learning or neglects it altogether, one can argue that those institutional arrangements that are not created for economic reasons are beneficial to the emergence of creative learning modes. In reference to Streeck (1997), one can argue that emerging side effects, which differ from intended learning modes, are the prerequisites for creativity and further learning.

In this sense, we can conclude that 'polyphone games' as described by Gehlen (1986) are always in danger of losing their openness and creative character. Even in CREAT the more playful character of projects changed when goals became more closed and focused upon more specific outcomes. Organisational arrangements became more functional and came to be characterised by settled rules and work routines. However, what makes the case study CREAT different from the more structured learning processes in SUP, is that learning goals were less precisely defined beforehand and that they were often acknowledged by the actors retrospectively. Learning processes in CREAT were more pragmatically driven by sub-optimal solutions than by the search for accurate designing principles for a single problem.

In brief, the perfection of internal designing principles are, in contrast to the postulates of the conventional organisational learning debate, not important for the development of more open organisational learning processes. This appears to be a dilemma for organisations to understand how less structured creative forms of learning can be developed and maintained. Weick and Westley (1996: 440-458) use the 'oxymoron' metaphor to provide more understanding of this problem. For them organising and learning are essentially antithetical processes, because they see learning as a process of disorganising and increasing variety, and organising as a detached process and reducing variety.

#### *Differences in the awareness of the cultural systems*

Scholars such as DiMaggio and Powell (1991 a and 1991 b), Meyer and Rowan (1992), et al. describe institutional environments as relatively abstract, monolithic and compelling systems. However, our comparative case study research has shown that the degree to which actors saw their internal and external environment as a given reality differed greatly in each of the three case studies. Societal transition and 'external triggers' of institutional change (Merken et al., 2000) have not affected all three companies in the same way after the wall came down. However, the question now is how can we explain all these differences at the

micro-level of organisational learning. The conclusion reached by this study is that the micro-macro problem reveals the significance of local cultural systems. The systematic comparison of the empirical findings has provided evidence in favour of Weick's thesis, that in the practice of learning, people are most likely to notice the cultural dimension of their institutions when their daily routines break down (1985: 386). Moreover, we have criticised the ideal of continuous learning organisations and demonstrated that occasions for more open organisational learning processes were more likely to appear in crisis situations when established modes of organising became ambiguous. However, even in such situations, traditional ways of thinking were not simply abandoned, nor was it the novelty of the new situation alone that caused organisational learning processes to become more open. Instead, our comparison has shown that the actors in the case studies of TOOL and CREAT became more aware of their organisational culture and thus learned more actively. This does not indicate that the actors in SUP have not learned, but rather that, in contrast to the other two case studies, most of the people in SUP learned more repetitively and did what they always had done. In contrast to the other two case studies, the concentration on the failure-free and continuous learning circles hindered actors in becoming more aware and thinking about alternatives to their traditional ways of thinking and producing. This shows that the degree of awareness of culture or the extent to which institutions were taken for granted varied greatly in each case study. In this sense we agree with neo-institutionalism that the institutions incorporated in the heads of actors as cognitive frames influence organisational behaviour (DiMaggio & Powell, 1991 a; Scott, 1995 a). However, what the authors neglect to discuss is that the degree of institutionalisation between organisational forms can differ greatly, even when they belong to the same population or organisational field.

We have noticed that actors in organisations which see their internal and external environment as less changeable than really is the case, fit better into the context of the arguments made by neo-institutionalists, who stress that extra-organisational institutions such as national or branch cultures influence the processes of organising. However, whether and which part of these ideological patterns are interpreted as being given cannot be predetermined as in the case of macro-institutional approaches. In highly structured cultural systems, how actors interpret organisational design, technology or potential customers seems to be significantly linked to how an organisation conforms to institutional expectations of relevant interest groups as seen in the case study of SUP. However, the increase in cultural diversity stimulated through the co-existence of different organisational forms led to less conformity and more adaptive learning forms. This refers closely to the idea of Weick that perfect adaptation would exclude adaptability and with this more open forms of organisational learning (1995: 265).

*Differences in the structuration of the cultural systems*

Even when the context of social and economic transformation can be understood as conditions or "triggers" that initiate organisational change, we have seen that how organisations transform can be quite different because of the way in which actors structure their local cultural system (Geppert & Merkens, 1999; Merkens et al., 2000). As we have demonstrated, based upon our systematic comparison of the empirical findings, when actors are strongly committed to their past experiences and traditional ways of thinking, the openness of organisational learning is underdeveloped.

Despite such structural triggers as the shift of ownership or the decline of established markets in Eastern Europe resulting from institutional change at the macro-level of society, in SUP traditional forms of learning survived. Here it is evident that the commitment to and justification of traditional organisational design had significant consequences for how the firm enacted their internal and external environment. Through concentration on planning and the perfection of organisational design principles etc., the 'map became the territory' for SUP (Weick 1995: 355-358). Thus we saw that highly institutionalised or structured cultural systems created a sort of collective senselessness or ignorance which hindered their ability to learn from their present actions. At one point, actors began to take their ways of organising and even their enduring economic success on the car supplier market for granted. Because of the focus on their past experiences, new management concepts such as 'team work' or 'continuous improvement' were seen merely as instruments to improve the accomplishment of traditional tasks. There seemed to be no alternative to the traditional production systems and markets. However, this TINA ("There Is No Alternative") effect was less evident in the other two case studies. Here the structural triggers were interpreted differently, although not voluntarily so. In firms TOOL and CREAT, the actors discredited their old causal maps (Weick 1995: 355-358) and with it the structuration of their cultural systems. However, unlike in the case of SUP, the change of formal structures in the other two companies had greater consequences, because learning processes involved the transformation of established ways of interpreting and making sense of things. However, the main difference between the case studies TOOL and CREAT became evident in the degree to which each firm started to act as a newcomer. Despite the fact that TOOL became a new competitor in the local market, it was no real newcomer; unlike CREAT, the transformation of the cultural system was quite moderate in order to meet the new demands of a more customer-oriented production. The discrediting of the established cause map was basically less marked than in CREAT, where the actors were actual newcomers with no established route by which to gain access to future markets. While the other two firms had fewer problems in justifying their business activities or the existence of their firms because of their established status as professional production firm and because powerful interest

groups more or less supported their business activities, in the case of CREAT, actors had just begun their search for potential interest groups and had more difficulties in convincing these groups of their loyalty. These less structured commitments and the ongoing problems in justifying job creation projects and commercial activities led to emergence of a much more weakly structured cultural system.

In line with neo-institutionalism, we have explained the central role of legitimacy for organisational behaviour, an aspect which is completely neglected in the mainstream studies about organisational learning. Yet, unlike neo-institutionalism, we have shown that not only is legitimacy important, but even more so its meaning and how it is created, and that this, as we have examined, differs according to the degree to which organisational learning processes have been institutionalised. We agree with neo-institutionalists that the adoption or imitation of institutionally legitimised formal structures is one way to improve the image of an organisation. Especially for developmental entrepreneurial ventures and projects in CREAT it was important to develop strategies to achieve a wider reputation and to document the organisation's professionalism and accountability. However, what neo-institutionalist approaches fail to address is that the degree to which these commitments and justifications are directed can be quite different. In this sense it can be concluded that less structured cultural systems, such as projects, seem to be better suited for dealing with uncommon and novel situations than highly structured and well-established organisational forms.

## Conclusions

The main empirical finding of the systematic comparison of our three case studies is that institutional inertia and creative learning cannot be discussed separately from each other. Contrary to the basic assumptions in the debate about organisational learning, even more radical learning approaches in the cases of TOOL and CREAT were institutionally intensive. Thus institutional settings and the observed forms of learning are interdependent. In line with Weick (1993), we see organisational learning as 'micro-events with large consequences' on the level of (macro-level) institutional settings. Thus, we criticised the fascination with the universal behavioural model of organisational learning and suggest instead the search for paths of organisational learning which can be more or less open to novel tasks, to creative acting and even to radical organisational change (Geppert, 1996).

We have seen that the development of organisational knowledge in our three East-German companies has been interdependently linked with institutional settings which changed or stabilised in the ongoing processes of learning. Thus, organisational learning cannot be explained just in reference to organisational design principles that more or less closely correspond with the ideal of the learning

or holographic organisation (Morgan, 1986: 77-109). Rather, there seems to be different extents to which the goals for organisational learning are internally or externally generated. This, again, has implications for the emergence of more creative forms of interacting, where original goals of learning might change and novel possibilities for learning might appear.

Insofar, organisational learning can be understood as 'pervasive learning', which can be characterised as institutionally intensive, in bringing forth distinct (or new) institutional settings that are continuously linked with previous dispositions and developing them into new manifestations<sup>6</sup>. The openness or closeness of such pervasive learning paths can be contrasted through analysing the ongoing dialectic of stability and change in the deeper institutionalised structures.

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<sup>6</sup> This apposite term I adopted from Arndt Sorge, who used it in one of his thoughtful comments on my research.

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## Outward Foreign Direct Investment from Economies in Transition in a global context\*

Kálmán Kalotay\*\*

*They are barely visible on the global scene. But it is in part so because official statistics have difficulties in reflecting their real size. They are nevertheless gaining in importance, representing a challenge for those who want to understand why and how they expand. Analysts are at the beginning of their quest for explaining how transnational corporations from economies in transition fit into a new “zoology” of international business, in which there is space for many more species than previously believed. Policy makers in economies in transition, too, are trying to grasp with the dilemma that outward FDI presents for them: on the one hand, it strengthens the international competitiveness of the firms; on the other, it is an outflow of resources. On balance, some of the countries in transition, e.g. Hungary and Slovenia, have decided to promote outward FDI.*

*Key words: Outward foreign direct investment / international business / transnational corporations*

### 1. Barely visible

It is barely visible on the global scene. According to balance-of-payments records, outward foreign direct investment (FDI) from the economies in transition<sup>1</sup> represents less than 1% of world FDI stock (Figure 1). It is significantly less than the grouping's share in inward FDI stock (more than 2%). Developed countries in fact dominate both inward and outward FDI. Their dominance is nevertheless more pronounced in the latter. As a result, it is the only net outward investing group of the world. The situation is the reverse in developing

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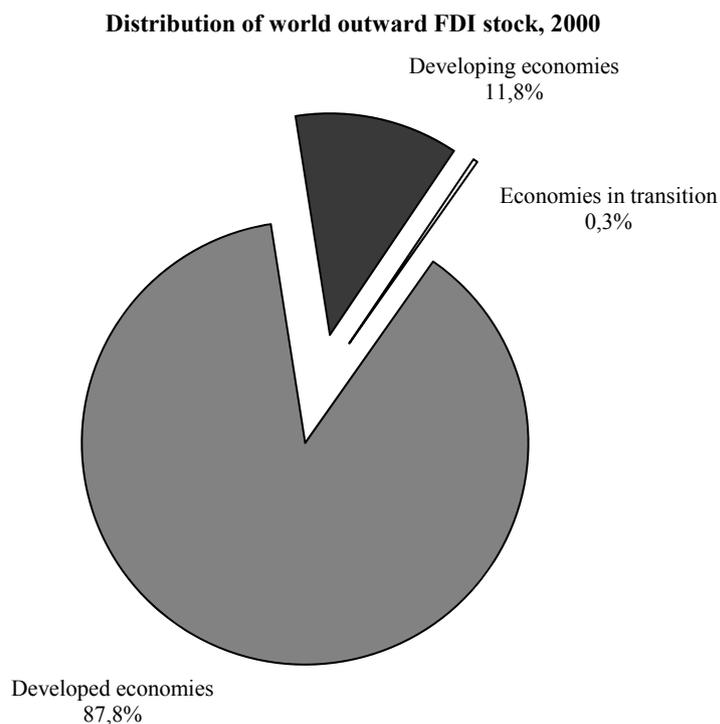
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<sup>1</sup> The terms ‘economies in transition’, ‘developed economies’ and ‘developing economies’ used in this article follow the country classification of the United Nations Department of Economic and Social Analysis (UN DESA). According to UN DESA, the following 27 countries are ‘economies in transition’: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Macedonia (TFYR), Moldova (Republic), Poland, Romania, Russian Federation, Slovakia, Slovenia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan, and Yugoslavia. The group of ‘developed economies’ consists of the following 36 countries and territories: Andorra, Australia, Austria, Belgium, Canada, Channel Islands, Denmark, Faeroe Islands, Finland, France, Germany, Gibraltar, Greece, Holy See, Iceland, Ireland, Isle of Man, Israel, Italy, Japan, Liechtenstein, Luxembourg, Malta, Monaco, The Netherlands, New Zealand, Norway, Portugal, San Marino, South Africa, Spain, Svalbard and Jan Mayen, Sweden, Switzerland, the United Kingdom, and the United States. The remaining 174 countries and territories of the world belong to the group of ‘developing economies’.

economies and economies in transition, where inward FDI largely exceeds outward FDI. But there is a difference in degrees between the two latter groups: according to balance-of-payments statistics, the stock of outward FDI is more than one third of inward FDI in developing economies. In the economies of transition, this ratio is less than one fifth.

Data on individual leading outward investing countries – whether measured in absolute values or relative to GDP – delivers a similar conclusion (Table 1). In absolute terms, 9 of the 10 largest outward investing countries are developed economies. Hong Kong (China), a special case with a large amount of ‘round tripping’, which probably inflates the numbers, is the only one that enters the top league. Russia, which is the largest outward investor economy in transition, trails far behind. In relative terms (FDI stock per GDP) special-case Hong Kong (China) is the world leader with an almost unbelievable 200% ratio. Here Singapore, another developing economy, enters the top 10. Russia and the economies in transition are far behind the world average. In fact, the world average is almost 10 times higher than the average of the economies in transition.

**Figure 1**



Source: UNCTAD FDI/TNC database.

A closer look at all the possible details of FDI outflows from economies in transition reveals that the share of this grouping in world FDI outflows increases painfully slowly. It is also difficult to discern a clear trend because in 1997 there were some large one-off transactions carried out by Russian firms that lay off from any trend line. But once that outlier is discarded, there is a trend to increase the share of the economies in transition from 0.1% in the early 1990s to around 0.3% towards the end of the decade.

**Table 1. Selected Leading Outward Investor Countries, 1999–2000**

	Largest outward FDI stock, 2000		Highest outward FDI stock per GDP, 1999	
	(USD million and percent)	Total	Share	(Percent)
<b>World</b>	<b>5,976,204</b>	<b>100.0</b>	<b>World average</b>	<b>16.7</b>
United States	1,244,654	20.8	Hong Kong (China)	202.8
United Kingdom	901,769	15.1	Belgium/Luxembourg	97.5
France	496,741	8.3	Switzerland	73.9
Germany	442,811	7.4	The Netherlands	65.7
Hong Kong (China)	384,732	6.4	Singapore	57.6
Belgium/Luxembourg	339,644	5.7	United Kingdom	49.8
The Netherlands	325,881	5.5	Sweden	47.4
Japan	281,664	4.7	Canada	30.6
Switzerland	232,045	3.9	Finland	26.8
Canada	200,878	3.4	Norway	25.3
Italy	176,225	2.9	South Africa	25.2
Spain	160,202	2.7	France	24.7
Sweden	115,574	1.9	Malaysia	22.6
Australia	83,220	1.4	Australia	22.5
Singapore	53,216	0.9	Denmark	21.5
Finland	53,046	0.9	Chile	19.0
Taiwan, Pr. China	49,187	0.8	Spain	19.0
Denmark	46,111	0.8	Germany	18.9
Norway	44,133	0.7	Italy	15.8
South Africa	33,557	0.6	Taiwan, Pr. China	14.7
China	27,212	0.5	United States	13.0
Korea, Republic	25,842	0.4	Austria	9.2
Austria	21,100	0.4	Japan	5.7
Malaysia	19,799	0.3	Korea, Republic	5.5
Chile	18,293	0.3	China	2.5
Russian Federation	11,637	0.2	Russian Federation	2.3
Economies in transition	19,833	0.3	Economies in transition	1.9

Source: UNCTAD FDI/TNC database.

Moreover, in the 1990s, with the exception of Hungary, the inward FDI stock of countries in transition for which data are available grew faster than their outward FDI stock (Table 2), indicating that these countries are in an early phase of the investment development path, under which the inward FDI grows faster than the outward FDI. Setting the Hungarian exception aside, as expected, Slovenia and the Czech Republic experienced the smallest difference between the growth rates of inward and outward stocks.

These FDI outflows registered in the balance of payments are much concentrated in the Russian Federation that alone accounts for more than half of those flows, and Hungary (since 1997), with a share of around one tenth. When it comes to relative measures such as the share of outward FDI flows in gross fixed capital formation, the Russian Federation and Estonia tend to be the leaders, followed by Hungary and Croatia (the data for Azerbaijan raise question marks as far as their reliability is concerned).

**Table 2. Growth of OFDI Stock vs. Growth of IFDI Stock<sup>2</sup>, 1993–2000**

	Ratio	OFDI (%)	IFDI (%)
Albania	0.36	203.70	562.18
Bulgaria	-0.02	-21.67	1263.73
Croatia	0.03	52.24	1907.03
Czech Republic	0.64	332.43	516.27
Estonia	0.58	582.34	1000.81
Hungary	3.08	790.45	256.22
Latvia	-0.04	-33.11	837.58
Poland	0.51	652.94	1291.64
Romania	0.04	17.89	499.93
Russian Federation	0.58	375.84	643.06
Slovakia	-0.01	-9.22	1123.06
Slovenia	0.67	133.29	200.18
Ukraine	0.05	34.18	693.68

Source: UNCTAD FDI/TNC database.

Partial data on the industry composition of outward FDI from economies in transition (Table 3) reveal that at least in some countries (the Czech Republic, Estonia and Poland) services industries (especially trading and banking) dominate. This is apparently different from the sequence of outward FDI from developed countries where manufacturing firms are usually the first outward investors (Stare, 2002). But the case of services OFDI is difficult to generalise at least for

2 OFDI stands for outward foreign direct investment and IFDI inward foreign direct investment.

three reasons: first of all, in Hungary and Slovenia, the two most important countries in the partial sample, it is the manufacturing industries, which dominate. Secondly, if similar data were available for the Russian Federation, they would be probably dominated by petroleum and gas or other mining firms, and not by services. Thirdly, industry composition is only one way to categorise corporate activities. Another way is to look at the distribution of corporate functions among affiliates, independently of the industry.

In this respect, firms differentiate between ‘production’ in the broad sense (including the production of goods or services) and a wide range of ‘upstream’ (headquarter, research and development, training, information technology, technical support, logistics etc.) and ‘downstream’ services (sales and marketing, distribution, shared services, customer services etc.). In this respect, the typical sequence is the location of ‘downstream’ services abroad. Besides, anecdotal evidence on the activities of firms from economies in transition suggests that they follow that normal sequence.

**Table 3. Services in Outward FDI Stocks in 2000 (selected CEE countries)**

*(in USD million)*

Country	Total OFDI	Ser- vices	Share of services in total
Hungary	1 287	449	35%
Slovenia	794	303	38%
Czech Republic	738	637	86%
Poland	463	368	79%
Estonia	259	215	83%
Total	3 541	1 972	56%

Source: Stare (2002).

**Table 4. Geographical Distribution of Outward FDI from Central and Eastern European Countries (USD million)**

<i>Home country</i>	<i>Croatia<sup>a</sup></i>	<i>Czech Republic</i>	<i>Estonia</i>	<i>Hungary<sup>b</sup></i>	<i>Latvia</i>	<i>Russia<sup>c</sup></i>	<i>Slovakia</i>	<i>Slovenia</i>
<i>Date and measure</i>	11.2001 stock	11.2001 stock	11.2001 stock	1999–2001 flows	12.1999 stock	1995–1999 flows	12.1999 stock	12.2000 stock
<i>Host region and country</i>								
<b>Central and Eastern Europe</b>	<b>395.4</b>	<b>529.9</b>	<b>356.1</b>	<b>765.9</b>	<b>6.4</b>	<b>1,692.1</b>	<b>203.4</b>	<b>1,618.9</b>
Belarus	...	2.4	0.1	...	0.7	...	...	1.2
Bosnia and Herzegovina	146.3	0.1	...	...	...	...	...	61.9
Bulgaria	...	8.5	...	...	0.0	45.4	8.7	1.1
Croatia	--	3.6	...	15.5	...	10.2	...	1,357.7
Czech Republic	0.0	--	...	50.4	0.0	11.7	106.4	10.4
Estonia	...	0.2	--	...	...	34.2	...	...
Hungary	0.1	62.5	...	--	...	32.9	28.7	4.5
Latvia	...	3.8	150.3	...	--	94.7	...	...
Lithuania	...	0.5	188.2	...	1.5	2.7	...	0.2
Macedonia, TFYR	16.2	...	...	283.1	...	...	...	66.1
Moldova, Republic	...	...	...	...	...	55.5	...	...
Poland	190.8	76.4	3.6	25.2	0.0	1,112.2	7.7	55.7
Romania	...	16.6	...	86.4	...	3.2	...	5.5
Russian Federation	0.0	24.4	6.6	22.5	1.2	--	12.1	15.8
Slovakia	-0.3	282.2	...	277.7	...	...	--	5.2
Slovenia	41.4	33.9	...	...	...	1.6	...	--
Ukraine	...	7.1	7.3	...	1.6	287.7	39.7	7.4
Yugoslavia	0.6	7.6	...	...	...	...	...	26.6
<b>Developed countries</b>	<b>84.4</b>	<b>251.1</b>	<b>25.1</b>	<b>348.1</b>	<b>8.0</b>	<b>3,625.4</b>	<b>71.9</b>	<b>157.9</b>
<b>European Union</b>	<b>84.4</b>	<b>172.0</b>	<b>27.3</b>	<b>265.6</b>	<b>6.1</b>	<b>2,045.6</b>	<b>66.7</b>	<b>125.9</b>
Austria	15.7	17.4	...	44.0	...	28.9	...	27.7
Belgium	...	-0.1	...	...	...	33.9	...	-10.0
Denmark	...	0.1	...	118.6	0.0	2.2	...	8.3
Finland	...	2.2	-4.8	...	...	5.3	...	...
France	...	2.5	...	...	0.2	...	...	8.0
Germany	1.7	65.5	...	38.5	5.3	1,053.9	6.9	70.5

<i>Home country</i>	<i>Croatia<sup>a</sup></i>	<i>Czech Republic</i>	<i>Estonia</i>	<i>Hungary<sup>b</sup></i>	<i>Latvia</i>	<i>Russia<sup>c</sup></i>	<i>Slovakia</i>	<i>Slovenia</i>
<i>Date and measure</i>	<i>11.2001 stock</i>	<i>11.2001 stock</i>	<i>11.2001 stock</i>	<i>1999–2001 flows</i>	<i>12.1999 stock</i>	<i>1995–1999 flows</i>	<i>12.1999 stock</i>	<i>12.2000 stock</i>
<i>Host region and country</i>								
Greece	...	0.0	...	...	...	14.2	...	0.2
Ireland	...	12.1	...	...	...	8.4	...	0.5
Italy	2.8	19.4	30.6	...	...	10.2	...	8.2
Luxembourg	-0.3	-0.3	...	...	...	10.2	...	0.1
The Netherlands	42.1	25.8	...	59.0	0.5	296.8	...	-0.6
Portugal	...	0.1	...	...	...	0.5	...	...
Spain	...	4.6	0.7	...	...	205.8	...	1.0
Sweden	...	1.9	0.9	...	...	39.7	...	1.2
United Kingdom	6.3	20.8	...	...	0.0	335.7	59.8	10.8
<b>Other Western Europe</b>	...	<b>38.3</b>	<b>-2.3</b>	<b>30.7</b>	<b>0.1</b>	<b>25.3</b>	<b>5.2</b>	<b>10.6</b>
Liechtenstein	...	23.4	...	...	...	...	...	1.7
Switzerland	...	15.1	...	0.7	...	25.3	5.2	8.4
<b>Other developed countries</b>	...	<b>40.9</b>	<b>0.1</b>	<b>51.7</b>	<b>1.8</b>	<b>1,554.5</b>	...	<b>21.4</b>
Canada	...	9.2	...	...	...	...	...	-0.7
Japan	...	...	...	...	...	11.9	...	...
United States	...	30.3	0.1	51.7	1.8	1,544.2	...	22.1
<b>Developing countries</b>	<b>38.5</b>	<b>111.9</b>	...	<b>50.3</b>	<b>147.3</b>	<b>651.3</b>	<b>6.2</b>	<b>17.7</b>
<b>Africa</b>	...	<b>0.1</b>	...	<b>0.1</b>	<b>129.5</b>	...	...	<b>24.8</b>
Liberia	...	...	...	...	129.5	...	...	23.7
<b>Latin America and the Caribbean</b>	<b>39.0</b>	<b>78.6</b>	...	<b>0.5</b>	<b>6.9</b>	<b>3.5</b>	...	<b>1.5</b>
Antigua	17.9	...	...	...	...	...	...	...
Brazil	...	6.0	...	...	...	...	...	...
Virgin Islands	...	72.6	...	...	...	...	...	...
<b>Developing Asia</b>	<b>-0.4</b>	<b>33.1</b>	...	<b>49.7</b>	<b>11.0</b>	<b>647.8</b>	<b>6.2</b>	<b>-8.6</b>
Azerbaijan	...	1.4	...	...	...	237.0	...	...
China	...	2.3	...	...	...	117.1	...	...
Cyprus	-0.4	14.9	...	47.5	10.7	27.0	6.2	-24.8
India	...	3.7	...	...	...	4.5	...	...

<i>Home country</i>	<i>Croatia<sup>a</sup></i>	<i>Czech Republic</i>	<i>Estonia</i>	<i>Hungary<sup>b</sup></i>	<i>Latvia</i>	<i>Russia<sup>c</sup></i>	<i>Slovakia</i>	<i>Slovenia</i>
<i>Date and measure</i>	11.2001 <i>stock</i>	11.2001 <i>stock</i>	11.2001 <i>stock</i>	1999–2001 <i>flows</i>	12.1999 <i>stock</i>	1995–1999 <i>flows</i>	12.1999 <i>stock</i>	12.2000 <i>stock</i>
<i>Host region and country</i>								
Kazakhstan	...	2.2	...	...	0.0	28.4	...	...
Korea, Republic	...	...	...	1.1	...	9.7	...	3.0
<b>Other and not specified</b>	<b>-4.4</b>	<b>14.3</b>	<b>2.1</b>	<b>-7.2</b>	<b>1.2</b>	<b>731.6</b>	<b>14.9</b>	<b>0.0</b>
<b>Total</b>	<b>514.0</b>	<b>907.2</b>	<b>425.0</b>	<b>1,154.3</b>	<b>162.9</b>	<b>6,700.3</b>	<b>296.3</b>	<b>1,794.5</b>

Note: This table aims at complementing the scattered statistics available with partner country reports, partial reports from previous years and other estimates. By no way should it be taken as the reflection of a full and exact picture of outward FDI from CEE.

<sup>a</sup> The data for the 2001 stock were complemented with information on the flows in 1999 and 2000

<sup>b</sup> FDI equity flows only.

<sup>c</sup> Estimates based on the information available from host countries, complemented by information from Goskomstat, 2000.

Source: Author's estimates, based on the UNCTAD FDI/TNC database.

The geography of outward FDI follows different patterns between the Russian Federation and the rest of the region (Table 4). While Russian firms have significant investments in Central and Eastern Europe (especially in Poland), too, they mostly target developed economies, especially the United States. In turn, the firms from other countries usually target other economies in transition, especially with which they have traditionally close business links (for example, Slovenian firms target former Yugoslavia). Nevertheless, given the bad quality and lack of data, these findings remain to be confirmed. The estimate for the Russian Federation, for example, had to be based on home-country reports, as only very partial evidence was available from national sources.

Another note of caution is to be added here, too. It seems that in various economies in transition, and in the Russian Federation in particular, official statistics have difficulties in reflecting the real size of outward FDI. In the Russian Federation, officially reported FDI may be ten times less than real outbound FDI is probably was noted as early as the mid-1990s. Some part of Russian assets abroad may be financed through outflows registered under other flows (such as portfolio flows, trade finance or service payments), increasing the whole outward FDI stock substantially (Table 5). In this respect, Russian 'capital flight' is not 'classical' in the sense that it cannot be proxied by the usual methods focussing on the 'errors and omissions' item of the balance of payments.

In Russia, capital flight is linked with the phenomenon of 'round tripping'. Round tripping refers to the transfer of funds abroad in order to bring some or

all of the investment back as FDI and claim the tax and other benefits offered to foreign investors (UNCTAD, 1998). One indication of the existence of round tripping in the Russian Federation, especially before the financial crisis of 1998 was a fast parallel increase of inflows and outflows itself. Another proof was the persistent high share of offshore Cyprus in both inflows and outflows – a small island that otherwise has no ownership advantages at its local firms (UNCTAD, 2000). Finally, the discrepancy of home and host country statistics is also pointing towards the existence of round tripping. A large part of Russian investment into OECD countries is not reflected in host country statistics either because the individual transactions are too small to be registered, or are transferred through third countries, typically outside the OECD area (Sheets, 1996).

**Table 5. Estimates of Unregistered and ‘Misregistered’ FDI Outflows from the Russian Federation, 1992–2001 (USD billion)**

Year	Narrow definition <sup>a</sup>	Broad definition <sup>b</sup>
1992 <sup>c</sup>	20.6	29.0
1993 <sup>c</sup>	14.3	26.5
1994	4.3	15.9
1995	12.9	14.0
1996	18.7	31.7
1997	19.3	37.5
1998	17.8	17.3
1999	12.4	16.0
2000	14.6	14.5
2001 (first half)	3.1	6.2

<sup>a</sup> Including ‘Non-returned export earnings’, ‘Advanced payments for undelivered import merchandise’ and ‘Net errors and omissions’.

<sup>b</sup> Including, in addition, ‘Migrants’ capital transfers’, ‘Portfolio investment’, ‘Loans of banks and other sectors’, ‘Current accounts and deposits of banks and other sectors abroad’ and ‘Cash foreign currency’.

<sup>c</sup> Excluding CIS.

Source: Adapted from Bulatov (2002), following the methodology of Bulatov (1998).

## 2. Transnational Corporations from Economies in Transition

There is something else that makes balance-of-payments statistics a rather imperfect proxy for what outward investing firms are really doing. “*Foreign Direct Investment is a rather inappropriate name for the process by which productive activities in different countries come under the control of a single firm. The essence of this phenomenon is not foreign investment, which is an international transfer of capital, but the international extension of managerial control over certain activities*”, wrote McManus (1972, 66). He was echoing the ongoing

concerns of Vernon (1966), who also felt uneasy about the use of 'foreign direct investment' when analysing the activities of transnational corporations.

Moreover, if the outward investing activities of firms from economies in transition is really so unimportant, then why bother to analyse it? Beside the expectation that soon more and more countries in transition should enter the third phase of the investment development path, under which outward FDI gradually outgrows inward FDI, the observer may be misled by the relative smallness of the outward-investing firms. But as Mathews (2001) has presented it under the new "zoology" of transnational corporations (TNCs), there is space under the sun for small TNCs, too. In fact, taking the data of UNCTAD (2000), there are 63 312 TNCs around the globe. Dividing the world stock of outward FDI by this number, the average international position of TNCs should stand at USD 94 million only.

A focus on outward investing firms is also important from the point of view of giving a face and a name to otherwise anonymous outward FDI data. It also recognises the fact that each firm follows its individual and unique internationalisation strategy. Moreover, firm-level information can better serve the purpose of raising awareness about, and acceptance of, outward FDI.

With all the caveats in mind, the list of the top 25 outward investing firms from Central and Eastern Europe – a new feature of UNCTAD's *World Investment Reports* since 1999 that the author personally helped to design and launch – is intended to serve that purpose (Table 6).

It complements well the path breaking work done by Liuhto (2001), especially on Russian firms and their strategies and by Svetličič and his team (see Svetličič & Trtnik, 2000; Svetličič & Jaklič, 2001) on Central European firms. Sure, the firms ranked in the top 25 list are very small. Of the 25 listed in 2000, only the first 15 exceeded the global average of 63 312 TNCs (USD 94 million) mentioned above. And if this list were to merge with the list of the top 50 TNCs of developing countries, only one (Lukoil) would qualify, and for position 7. And if it were to compare with the list of the 100 largest TNCs of the world, no CEE firm would qualify for it. Indeed, the 100<sup>th</sup> largest firm of the world (Philip Morris from the USA) has almost twice as many foreign assets as Lukoil.

**Table 6. The Top 25 Non-Financial Transnational Corporations Based in Central and Eastern Europe <sup>a</sup> (ranked by foreign assets, 2000)**

Rank (asset)	Rank (TNI) <sup>b</sup>	Corporation	Country	Industry	Foreign assets	TNI <sup>b</sup> (Per-cent)
1	11	Lukoil	Russian Fed.	Petroleum and natural gas	4189.0	34.7
2	6	Novoship	Russian Fed.	Transport	963.8	53.7
3	1	Latvian Shipping <sup>c</sup>	Latvia	Transport	459.0	87.3
4	5	Primorsk Shipping	Russian Fed.	Transport	256.4	59.4
5	24	Hrvatska Elektroprivreda	Croatia	Energy	296.0	4.3
6	7	Gorenje Group	Slovenia	Domestic appliances	236.3	46.9
7	10	Far Eastern Shipping	Russian Fed.	Transport	236.0	38.8
8	13	Podravka Group	Croatia	Food and beverages/ pharmaceuticals	..	31.6
9	9	Pliva Group	Croatia	Pharmaceuticals	181.9	39.7
10	3	Atlantska Plovidba <sup>c</sup>	Croatia	Transport	138.0	63.2
11	8	Krka	Slovenia	Pharmaceuticals	129.2	40.0
12	20	MOL Hungarian Oil and Gas	Hungary	Petroleum and natural gas	102.7	9.6
13	14	Tiszai Vegyi Kombinát	Hungary	Chemicals	101.2	25.4
14	2	Adria Airways <sup>c</sup>	Slovenia	Transport	116.3	64.0
15	19	Petrol Group	Slovenia	Petroleum and natural gas	98.8	10.6
16	22	Mercator	Slovenia	Retail trade	65.1	4.5
17	4	Zalakerámia	Hungary	Clay product and refractory	60.0	60.8
18	15	Skoda Group Plzen	Czech Rep.	Diversified	..	26.2
19	12	Malév Hungarian Airlines	Hungary	Transport	41.4	33.9
20	18	Matador	Slovakia	Rubber and plastics	..	13.1
21	21	Merkur	Slovenia	Trade	37.3	7.5
22	25	KGHM Polska Miedz	Poland	Mining and quarrying	32.3	2.7

Rank (asset)	Rank (TNI) <sup>b</sup>	Corporation	Country	Industry	Foreign assets	TNI <sup>b</sup> (Per-cent)
23	23	Petrom	Romania	Petroleum and natural gas	28.0	4.5
24	16	Iskraemeco	Slovenia	Electrical machinery	25.8	24.4
25	17	Intereuropa	Slovenia	Trade	23.0	16.7

<sup>a</sup> Based on survey responses.

<sup>b</sup> The Transnationality Index (TNI) is calculated as the average of three ratios: foreign assets to total assets, foreign sales to total sales and foreign employment to total employment.

<sup>c</sup> 1999 data.

Source: UNCTAD (2002).

The list of the top 25 TNCs is not exempt of weaknesses. Perhaps the most important one is the lack of comprehensive lists of potential respondents that could be used to make sure that 100% of the potential sample is covered. Moreover, the list cannot include financial firms (banking, insurance etc.) because its methodology (listing based on foreign assets) cannot handle the problems of comparisons between financial and non-financial firms. Nor can it cover secondary OFDI (foreign affiliates investing abroad) as its method follows the global principles of final ownership and consolidation of reports.

Finally, of the various methods of potential outward expansion and activity it can deal with equity investment only as the ranking is based on assets abroad. This may leave out from the radars firms that follow less orthodox ways of internationalisation. As for the representativeness of the results, each year it depends on the responsiveness of firms because of the almost full lack of secondary sources that would fill the missing information. Finally, because of the use of consolidated and audited accounts as a main source, there is an important time lag between the actual year covered in the data and the year of publication. In CEE where the map of outward investment changes fast, it is a major handicap that can be mitigate only through anecdotal evidence on recent developments.

The way forward of the top 25 list should be through the fine-tuning of the method and improving the responsiveness of firms, which may become more and more used to this routine survey. On a more conceptual level, the dilemma is between choosing a narrow (foreign assets only) and broad (exports, licensing, management contract or any other form of international involvement) definitions of international involvement. The first approach may be criticised as a 'straight-jacket' limiting real life research while the latter one may be criticised as a too 'shoreless' method. A commonly agreed new definition will probably strike a compromise between the two by probably introducing one or two new variables into the now three-leg (assets, sales, employment) transnationality index.

### 3. Implications for the Theory

How does economic and business theory explain OFDI from economies in transition? On the basis of the classical theory of international trade only, based on the comparative advantages, and extended into the movement of the factors of production by Heckscher (1919) and Ohlin (1933)<sup>3</sup>, even the world of inward FDI would be difficult to explain. If those flows followed the classical theory, it should be the developing countries and the countries in transition the main recipients of FDI, and not the developed economies (Figure 1). IFDI is badly explained (it would not flow to developed markets). And probably outward FDI from economies in transition should not exist at all.

International business theory, especially the eclectic paradigm of Dunning (1977; 1993; 1999) is better equipped to explain the outward FDI of economies in transition. The internalisation aspect (I advantages) of the eclectic paradigm, drawing on Coase's work (1937) can be used as one point of reference to explain the behaviour of outward investing firms anywhere, including the economies in transition. As for the ownership (O) advantages, originating in Hymer (1960) and Vernon (1966), there application is less straightforward. In principle, it should be the firms of the most advanced countries that should possess those advantages and exploit them through international expansion. No wonder that back in the 1960s Raymond Vernon described those advantages as typical for United States firms. However, the fact that there are TNCs originated from developing countries was already observed by Wells (1977/1983) in the late 1970s. However, an original explanation talking about reverse motives and eventual ownership *disadvantages* is very recent (Sachwald, 2001).

In the case of the economies in transition, the question of ownership advantages has been presented in quite contradictory ways. On the one hand, Elenkov (1995a/b), based on the experience of Russian aerospace industry, claimed that firms in transition were typically possessing high-technology advantages and thus in their expansion they should build their strategy on ownership advantages – just like firms from developed countries do and from developing countries can not do. It turns out however, that the author has been generalising from the experience of a rather exceptional industry. The spacecraft industry represents 0.02% of Russian exports only (UNCTAD TRAINS database). Of the largest 10 Russian exporting firms (accounting for close to one-third of total national exports), 8 are oil and gas companies, and two of them are engaged in non-ferrous metallurgy (Table 7). This situation should the prevalence of natural resource-based firms in the Russian economy – a far shot from the optimism about the importance of high-technology activities.

3 Based on Heckscher and Ohlin, the equalisation of factor prices was fully elaborated by Samuelson (1948/1949).

Svetličič and his co-authors (1994) and Bulatov (1998) thought that it was rather escaping a difficult business environment (including the restrictions of the socialist economy) that prompted Slovene firms in retrospect and Russian firms today to invest abroad. If the first push really came from these motivations, then the region should be closer to the situation of ownership disadvantages. The lack of high-technology ownership advantages is also evident from the list of the top 25 TNCs, where some natural-resource based firms dominate.

A special question to be raised in this context is to what degree are TNCs from countries in transition descendants of the 'red multinationals' (see McMillan, 1987, and UNTCMD, 1992 for a comprehensive listing). If someone looks at the list of largest outward investors today and 15 years ago, there is indeed some overlap in names, especially in countries where the State's foreign trading monopoly had been kept till the last moments of planned economy. But even in those firms, the motivations have changed from system escape to the standard motivations of either efficiency or market, resulting in some cases in a reorientation of target countries (system escape targets the developed countries, especially efficiency seeking targets lower-cost countries).

**Table 7. The 10 Largest Russian Exporting Firms (2000)**

(USD million and %)

	Firm	Industry	Volume of exports	Share in National total
1	Gazprom <sup>a</sup>	oil and gas	15,933	11.7
2	Lukoil <sup>a</sup>	oil and gas	5,714	4.2
3	Yukos <sup>a</sup>	oil and gas	5,248	3.8
4	Tyumen Oil Co. <sup>a</sup>	oil and gas	3,478	2.5
5	Tatneft	oil and gas	2,630	1.9
6	Norilsk Nickel	non-ferrous metallurgy	2,247	1.6
7	Russian Aluminium <sup>a</sup>	non-ferrous metallurgy	2,162	1.6
8	Surgutneftegaz <sup>a</sup>	oil and gas	1,701	1.2
9	Sibneft <sup>a</sup>	oil and gas	1,700	1.2
10	Rosneft <sup>a</sup>	oil and gas	1,295	0.9
	<i>Total</i>		<i>42,105</i>	<i>30.8</i>

<sup>a</sup> Consolidated holding data.

Source: Based on *Expert*, No. 27 (287), 16 July 2001.

At the same time, there seems to be a gradual move from trade/distribution to manufacturing as the main function of foreign affiliates, and the share of merg-

ers and acquisitions in foreign expansion has somewhat increase at the expense of greenfield investments.

#### **4. Some Policy Implications**

From the point of view of political economy, the most important stakes of outward FDI are where and how locational decisions are taken and where higher quality, management-type jobs are created. Naturally, governments will always face the dilemma that if they help the creation of better jobs at home by giving a hand to their firm's international competitiveness, they let out financial resources that in principle could be used productively at home, too. However, they have to understand that outward FDI is not a zero-sum game, under which money and jobs are transferred from the home to the host economy, for at least three reasons. First of all, for many outward investing firms, the alternative of going abroad is going bust. In this sense, outward FDI is a job saver at home. Secondly, when some simple jobs are created abroad, there is a need to create additional, higher-quality jobs at home, especially in 'upstream' coordinating functions (management, logistics, information technology etc.). Thirdly, the establishment of an affiliate abroad usually boosts the sales of the parent firm in the host economy, indirectly creating jobs at home.

For these reasons, governments in economies in transition – especially in countries with very small domestic markets – have no choice but support outward FDI once the pre-conditions are met. This is also a major issue if governments wish to meet the aspirations of the population for fast improving standards of living, especially in countries where the fact of negotiating accession to the EU in itself raises expectations.

It is also to be understood from a more macroeconomic point of view that OFDI is a sine qua non in any middle- or high-income economy for its successful participation in the global context. The lack of OFDI may lead to the disappearing of firms that were stopped from investing abroad, due to intensive international competition.

The motivations for outward FDI may be somewhat different between accession countries, where there is a growing search for more cost-efficient locations and the non-accession countries, which typically need to get a foothold in the enlarged EU area. But in both cases, it seems that government assistance may play a major role, especially in reducing the market entry barriers in areas and countries where in an initial phase, private institutions would be reluctant to be involved. In perspective, however, the promotion of OFDI may be based on public-private partnerships.

Policies on outward FDI have three levels. The first one is capital account liberalisation. The second one is passive promotion, usually through bilateral investment treaties and double taxation treaties. The third level is active promotion. In

the latter area it is to be emphasised that even in the largest developed home countries (the United States, the United Kingdom, Japan, Germany etc.) outward FDI requires and receives active public assistance, going beyond a simple liberalisation of capital account transactions (UNCTAD, 1999). The institutional setting comes either in the form of an outward investment promotion agency, a development finance institution, or an investment guarantee scheme. Their services cover a wide range of areas, including information and promotional services, feasibility studies, project development, financing and guarantees.

If this is the case with the leading outward investing countries, probably the nascent outward investors of the countries in transition, too, would require help. Some countries in transition already do it. In 1999, the Czech Export Import Bank reported having an investment guarantee scheme (UNCTAD, 1999). Currently, the Slovene Export Corporation provides long-term (3–15 year) investment insurance (up to 90%) against both commercial and non-commercial risks (including war and civil disturbances, expropriation including regulatory expropriation, currency conversion and transfer restrictions, denial of justice and natural catastrophes). In Hungary, Corvinus International Ltd. provides both finance (in the form of participation in the share capital, loans or guarantees) and advisory services (consulting on firm strategy, matchmaking and partner search, and valuation and credit rating) to potential outward investors, typically medium-sized Hungarian manufacturing enterprises.

In other countries active outward investment promotion does not exist either because local firms have not yet reached the stage of feeling the need to expand abroad, or, in the case of Poland, because the relatively large domestic market and important slack of labour force apparently provide sufficient opportunities for private firms envisaging to expand. It remains to be seen, however, whether Polish firms will be able to cope with increased international competition if their expansion is limited to the Polish market, once the country joins the EU.

The test of the plausibility of the hypotheses and preliminary conclusions drawn in this article written at an early stage of outward FDI from economies in transition and research on it will be the situation of those countries in at least two decades from now. Will their outward FDI become more visible, more important at least in the European context? Will some of the even become global players? How will they fit into an international scene characterised by increased outsourcing by very large TNCs? Will there be a place for them in the new “zoology” of international business, or will they become extinct? To what degree will EU accession differentiate between the firms who will become ‘from within’ and those who will be ‘from the outside’? To what degree are and will be the policy responses sufficient to cope with the context in which this outward FDI takes place and will take place? The answers will be known in twenty years from now.

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## Decision making in organisations hostile to knowledge sharing\*

Snejina Michailova, Kenneth Husted\*\*

*This paper focuses on some of the specificities of decision making in Russian organisations. These companies usually have a highly centralised decision-making. Paradoxically, Russian firms are also known for their relatively high level of hostility towards knowledge sharing. Both characteristics constitute a dangerous combination for strategic decision-making processes in organisations and their ability to commit resources to adequate actions. On the basis of 53 interviews in 25 companies over the last six years, this paper analyses the interface between different dimensions of knowledge sharing hostility and the consequences they have for strategic decision making.*

*Keywords: Russian organisations / knowledge sharing hostility / strategic decision making*

### Introduction

Organisations can be seen as networks of decisions and decision makers (Choo 1998; O'Reilly et al. 1987), and management can be viewed as decision making (Monahan 2000). Decisions are the basis of action – purposes are defined, after which resources are allocated and authorized and efficient decision making in organisations relies upon, among other things, access to relevant knowledge and the ability to process it. Consequently, organisations hostile to knowledge sharing present particular challenges to managers as decision makers.

Traditional Russian companies, e.g. those established in the Soviet period and operating in the manufacturing sector, serve as powerful examples of organisations hostile to knowledge sharing (Michailova/Husted, 2002 a, 2003). Additionally, these companies usually have a highly centralised decision-making structure (Czinkota 1997; Lawrence/Vlachoutsicos 1990; McCarthy/Puffer 1992; Puffer/McCarthy 1993), which increases the need for bottom-up information and knowledge flows. Russian employees generally expect strong leadership (Bollinger 1994; Holden et al. 1998; Michailova 2000, 2002), and superiors are

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viewed as authority figures who take the important decisions. In fact, Russians feel that 'a good boss should not work, but simply sit around the office and make decisions' (Wilson/Donaldson 1996, 140). Together, knowledge sharing hostility and the need for centralised one-way knowledge flows constitute a dangerous combination for strategic decision-making processes. This paper analyses the interface between the different dimensions of knowledge sharing hostility and their consequences for strategic decision making.

The paper takes its conceptual starting point in two theoretical streams: the first relates to knowledge sharing hostility, while the second is associated with decision making. We focus on knowledge sharing as it relates to individual behaviour (Katz/Allen 1982; Leonard 1995; Husted/Michailova 2002 b; O'Dell/Grayson 1998) and elaborate on the dimensions related to knowledge hoarding, knowledge rejection and apprehension about failures by investigating their implications for decision making. Rather than focusing on standard and routine decisions in organisations, this paper concentrates on the complex and dynamic nature of strategic decision processes as discussed by Mintzberg et al. (1976). These authors have proposed a process-oriented model of decision making, focusing on the stages, activities and dynamics of choice behaviours for generating multiple options and alternative solutions. In the analysis of our empirical data, the model's distinction of identification, development, and selection as the three central decision-making phases is applied.

### **The study and its purpose**

This paper is based on empirical research from 53 interviews conducted in 25 Russian companies over the past six years. For company selection, four main criteria were used. First, companies had to be established during the Soviet period. Second, they should represent different manufacturing sectors and industries. Third, they had to be recognised as high-performing and successful companies within the local business community. In order to satisfy this criterion, the opinions of Russian experts from the business community, higher educational institutions in the field of economics, and the business media were taken into account. Revenue growth rate figures from the Russian business magazine *Expert* covering a period of five years were used as the quantitative criterion in identifying particularly successful companies. Fourth, regardless of whether they were operating with or without foreign involvement, companies had to be managed by Russians. All the companies studied were located in large Russian cities in the European part of the country. Therefore, these findings do not necessarily apply to companies in other parts of Russia.

All interviewees held positions at top or middle management level. The respondents' average age was 49 and all had been educated to university level or equivalent. Only five of the 53 respondents were female. All interviews, each

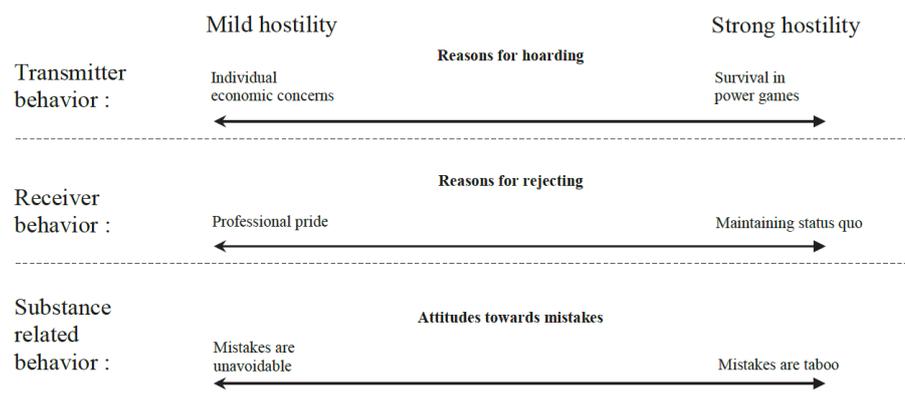
lasting between one and two hours, were conducted in Russian language, tape-recorded and transcribed verbatim.

As stated above, the empirical data used in this study were collected over a period of six years. The raw data directed our attention to several key topics, which can be clustered under the umbrella of the decision-making issue. The interview data in this paper are used to illustrate analytical arguments related to the consequences of knowledge sharing hostility for the decision-making process.

### Knowledge sharing hostility

Some business environments and organisational cultures are more hostile to knowledge sharing than others (Husted/Michailova 2002 b). In environments strongly hostile to knowledge sharing, additional obstacles make sharing knowledge more problematic and frequently impossible. Figure 1 presents the three dimensions of individual behaviour as related to (a) knowledge transmission, (b) knowledge reception, and (c) the substance of the specific knowledge sharing activity.

**Figure 1. Dimensions of knowledge sharing hostility (Husted/Michailova 2002 b: 65)**



### Knowledge hoarding

Transmitter behaviour can be expressed by the willingness to share knowledge with other organisational members on request, the decision to share or hoard knowledge being largely individual. The decision to hoard knowledge is destructive from an organisational point of view but, at the same time, is often rational and justifiable from an individual perspective. In organisations that are less hostile to knowledge sharing, knowledge hoarding is mainly used as an instrument to support individual economic concerns. In organisations that are more hostile towards knowledge sharing, features such as avoidance of exposure, hoarding knowledge as a strategy for coping with uncertainty, a focus on hierarchical

structures and involvement in power games are dominant. A certain philosophy, according to which people are measured by what they know and do individually, instinctively invites knowledge hoarding and perpetuates the behaviour of keeping one's cards close to one's chest. In contrast with this individualistic behaviour, organised collaboration and sharing knowledge are key words in today's successful organisations, which work towards breaking the 'knowledge is power' paradigm and instead associate power with those who, by sharing what they know, become a knowledge source.

### **Rejecting knowledge**

Knowledge rejecting behaviour is captured in the notion of the 'Not-Invented-Here' (NIH) syndrome, i.e. the resistance towards using knowledge created elsewhere (Katz/Allen 1982). Some of the main reasons for rejecting knowledge are a preference for developing individual ideas and knowledge, general doubt about the validity and reliability of the knowledge, strong group affiliation, and group thinking. In organisations less hostile to knowledge sharing, doubt concerning the validity and reliability of external knowledge and a preference for developing individual knowledge are usually associated with organisational members' professional pride. At the opposite end of the hostility continuum are those organisations that strongly desire to maintain the status quo, sometimes explicitly, but more often under the mask of minor changes (see Figure 1).

### **Attitudes to mistakes and failures**

Mistakes and failures have long been recognised as vital sources of insight, much too valuable to be buried and consciously kept secret (Kanter et al. 1992). Often the result of exploring unknown territory, mistakes and failures also allow for the development of new insights. These insights offer significant learning potential, especially for later expeditions into the unknown. In other words, learning from mistakes is highly valuable not only at an individual level, but also at group and organisational levels.

Organisational reality is, however, often different: individuals do not freely and openly share knowledge about the mistakes they have made. In less hostile knowledge sharing environments, mistakes are accepted as unavoidable and, within certain limits, may even be a valuable organisational asset. However, employees may still harbour doubts that prevent them from openly and freely sharing insights about their failures, mainly due to potential negative consequences in the future. In organisations that are highly hostile to knowledge sharing, mistakes and failures are taboo. They are covered up, shared only in unavoidable situations and with an absolutely unavoidable audience. In these organisations, people apply different strategies against making (or realising) mistakes. If one makes a mistake and realises it, the aim immediately becomes to conceal it and cast off responsibility as quickly as possible. At this higher end of knowledge

sharing hostility, managers' and employees' ways of thinking are framed by the question 'Whom can we blame?' rather than 'What can we learn?'. Lack of action reflects extreme knowledge sharing hostility within an organisation. Traditional Russian organisations exhibit this and other features of strong knowledge sharing hostility (see Figure 1, right column), which affects the decision-making process in these organisations.

As outlined above, Russian managers and employees share a number of characteristics as knowledge transmitters and knowledge receivers. The Russian business environment and the culture of older Russian companies, i.e. those established in the Soviet period, constitute a particularly fertile basis for strong knowledge sharing hostility (Michailova/Husted 2003). Knowledge hoarding, knowledge rejecting, and negative attitudes towards making and recognising mistakes are not merely present, but perpetuated and intensified in many Russian companies. This is also the case in the companies that participated in the present study. Independent of industry type and whether or not the respective company was operating with or without foreign involvement, the features relating to knowledge sharing hostility were common to all companies. These are the specific conditions of the framework in which the particular characteristics of the decision-making process will now be analysed.

**Table 1. Decision-making in organisations hostile to knowledge sharing**

		Decision-Making Phases		
		Identification	Development	Selection
Knowledge sharing Hostility Indicators	Knowledge hoarding	Slow recognition of problems Imprecise diagnosis	Alternatives are not ready-made Memory search is largely restricted	Position-based power prevents knowledge sharing and consequently judgment Reliance on intuition
	Knowledge rejection		No use of search generators Alternatives based on external knowledge are not accepted	No bargaining
	Attitudes towards mistakes	Serious problems do not surface	Preference for ready-made solutions	

### Decision making in organisations hostile to knowledge sharing

Decision making is a topic that has traditionally attracted the attention of management literature. Organisations are networks of decisions, decision makers and decision making (Cyert/March 1992; Hickson et al. 1986; Choo 1998; Janis/

Mann 1977), and all organisational behaviour springs from decisions. Acknowledging that decision making can often occur randomly, disconnected from goals (Cohen et al. 1972) or as a result of bargaining among players pursuing their own interests (Allison 1971), we conceptualise decision making as a structured sequence of goal-directed problem solving. In this paper we employ the process-oriented model of decision making, which focuses on the stages, activities and dynamics of choice behaviours for generating multiple options and alternative solutions. In their ASQ article from 1976, Mintzberg et al. distinguish identification, development and selection as the three central decision-making phases. The following sections relate these three phases to the characteristics of environments hostile to knowledge sharing. The summary of this analysis is presented in Table 1.

### Identification

According to the model by Mintzberg et al. (1976), during the identification phase the need for the decision is recognised and an understanding of the decision issues is developed. The need for the decision is defined as an information need, 'a difference between information on some actual situation and some expected standard' (Mintzberg et al. 1976: 253). Consequently, identification is primarily an information and knowledge seeking activity that taps into existing knowledge bases and locates new knowledge channels.

Single-person authority, typical for many Russian companies, is closely associated with the right and responsibility to make decisions. Individual decision-making, as opposed to group/team decision-making, is the norm in those companies. A taken for granted rule is accepting the leader without question (Bronfenbrenner 1970; Pearson 1990). As pointed out by Puffer et al. (1997: 267-268), "the Russian concept of strong leadership reinforces a more authoritarian belief system for those in senior ranks, and less disposition for them to share managerial decision making with workers". Subordinates do not feel a need to challenge their superiors' power of being the sole decision makers even in relation to minor issues. Instead, they treat one-man (decision-making) authority as "given, needed and vitally important" (Michailova 2002: 183). Russian employees treat early involvement, showing initiative and offering suggestions at the beginning of the decision-making process differently according to whether they are dealing with Russian or Western managers (Michailova 2002). With Russian managers, they interpret such behaviour as intervening in their superior's domain, demonstrating disrespect or disloyalty towards their superior or questioning his or her abilities.

Russian organisations are generally characterised by a poor information culture (Wilson/Donaldson 1996). This goes hand in hand with a general business culture already disinclined to spend time analysing information to enable more ef-

fective decision making. According to Wilson/Donaldson (1996), information is often poorly collected or not gathered at all. Furthermore, it is inefficiently organised and often not released, either for reasons of lingering secrecy, lack of computers and other processing methods, or because of the prevailing belief that the public simply has no need to know. Complicating the problem is Russians' reluctance to provide information: a tradition of secrecy stemming from the past still influences people's attitudes, and standard company information such as annual reports, public relations brochures and product data is scarcely available. Managers may not know their own company's internal situation and have little more than production figures to guide them. Judging the size of a potential market, or even finding the most cost-effective contractor to supply materials for a project can be nothing more than guesswork.

The lack of employees' involvement in decision making on the one hand and the poor information culture on the other result in a slow recognition of organisational problems. When the need to make decisions is first recognised, these aspects result in an imprecise diagnosis of the problem's cause and nature. An even more serious consequence is the fact that serious problems remain hidden.

### **Development**

In the development phase of the decision-making process, opportunities are elaborated on and new solutions are outlined on the basis of two clusters of routines, known as search and design routines. The model by Mintzberg et al. (1976) identifies four types of search routines: (a) search in the existing organisational memory, (b) passive search, i.e. waiting for alternatives to appear, (c) activating search generators and (d) active direct search for information about alternatives. These four types have an inbuilt progression in at least two aspects: they move from the local to the remote on the one hand, and from memory-oriented and passive to active search on the other (Cyert/March 1992). Design routines entail the complex and iterative process of developing custom-made solutions or modification of existing 'off the shelf' alternatives.

Knowledge sharing involves uncertainty about which specific pieces of idiosyncratic knowledge are to be shared with whom in order to create benefits for the organisation (Jensen/Meckling 1996). Unawareness at both ends of the transfer is a major barrier to knowledge sharing (Szulanski 1996). Potential receivers or users are often not aware of the existence of the knowledge they need and, likewise, the potential sources are not aware that there may be use for their knowledge somewhere else in the organisation. The larger the organisation, the greater the problem of unawareness. As identified by the information cost perspective (Grant 1996; Jensen/Meckling 1996), the solution to this problem is not to share all knowledge created in an organisation, but to strive to transfer relevant pieces of knowledge. However, to achieve this, it is necessary to know in advance what

specific knowledge is relevant to whom. Hoarding behaviour in Russian organisations reaches a level where it becomes impossible to find the exact person who holds the required information. According to our field data, Russian managers view the lack of transparency in who-knows-what as a major barrier to accessing the information and knowledge they need, and finding a trivial piece of information can take weeks. The lack of transparency in the location of relevant knowledge combined with resistance to knowledge sharing results in a situation where alternative ready-made solutions are not available either off the shelf or in organisational memory (see Table 1).

Formal power is highly valued in Russian organisations. However, hierarchical differences are an impediment to knowledge sharing, both top-down and bottom-up. Russian managers treat information as a source of power, status and authority rather than as a basis for making decisions. Managers are mainly occupied with seeking and receiving information, i.e., to adopt Mintzberg's (1973) vocabulary, they play a 'monitoring' informational role. At the same time, they avoid diffusion, transmission and sharing of information, i.e. play carefully a 'disseminating' informational role, which leads to engaging in the role of 'resource allocator' and 'disturbance handler' at the cost of 'negotiating' and 'acting as an entrepreneur' (Mintzberg 1973).

In Russian companies, there are usually long-lasting relationships among organisational members, making individuals feel strongly attached to a group, both formally, in terms of membership, and emotionally (Michailova 2000). This strong group affiliation, which should not be confused with team spirit, reinforces the resistance to knowledge sharing. As a consequence, Russian managers and employees tend to resist new ideas from outside because the new information and feedback could fracture the stability and familiarity of the particular group, thus upsetting the organisational order and continuity which they value and respect so highly.

This respect for formal power coupled with strong group affiliation leads to the failure to use search generators in the decision-making process. At the same time, alternatives based on external knowledge are not accepted. Environments hostile to knowledge sharing seem to prevent the inbuilt progression of search routines mentioned above. The search, in this case, is not merely local, but fragmented down to the boundaries of the group. Additionally, the search remains passive mainly because hierarchical power prevents knowledge sharing.

### **Selection**

The selection phase of the decision-making process aims to evaluate alternatives and choose a solution. Evaluation choice routines are at the heart of this stage. These routines apply judgment (making an individual choice), bargaining (col-

lective exercise of individual judgments) or analysis (evaluating the decisions against a cluster of criteria and making a final choice) to reach a decision.

The majority of Russian respondents in top managerial positions perceive the distribution of power related to decision making as a zero-sum game. Naturally, they try to occupy all decision making space. They typically have difficulties delegating authority and consider discussions irrelevant. Russian employees, too, find discussions with colleagues, joint setting of priorities, developing frameworks as a team and informing one another about ongoing issues and processes as not very productive. Instead, they have developed a relatively high level of tolerating ambiguity and the skills and ability to act on the basis of insufficient and fragmented information. This is combined with an individually-oriented work ethic according to which one gets ahead in life by self-reliance and one should avoid depending on others (Puffer et al. 1997).

Environments hostile to knowledge sharing create a weak foundation for judgment. This may partially explain why Russian managers have a tendency to make decisions based on intuition (see Table 1). Holden et al. (1998: 37) quote the conclusions of the mixed Russian–Western team of the Russian Privatisation Centre: ‘Russian managers base their decisions on intuition; this approach seriously conflicts with the western approach which emphasises the gathering and analysis of hard facts.’ This observation is confirmed by the findings of a survey to which we contributed and which was conducted among 170 Russian top and middle managers between 1999 and 2000. All participants in the survey were attending a Nordic Management Training Programme, conducted in Russia from 1997 to 2000, and represented a number of different Russian firms related either directly or indirectly to Nordic companies. The survey participants ranked intuition as one of the most important managerial attributes along with being energetic, analytical and well organised.

## Conclusion

Most of the research on decision making is conducted by Western researchers in Western organisations, who implicitly assume culturally-bounded Western views of the world and its management processes. This paper focuses on some specificities of decision making in Russian organisations; however, rather than analysing the process per se, we have examined the way in which decision making is intertwined with knowledge sharing hostility, exploring the dimensions related to knowledge hoarding, knowledge rejection and apprehension about failures by investigating their implications for decision making as viewed in the process model.

In organisations hostile to knowledge sharing, the *identification phase* of decision making is characterised by employees’ lack of involvement in the process on the one hand, and a poor information culture on the other. This results in a

slow recognition of problems in organisations and, when the need for making decisions is first recognised, in imprecise diagnosis of the problem's cause and nature. Another negative consequence is that serious problems remain concealed. In the *development phase*, the high respect for formal power and the strong group affiliation lead to a failure to use search generators in the decision-making process. At the same time, alternatives based on external knowledge are not accepted. Environments hostile to knowledge sharing seem to prevent the in-built progression of search routines. The search, in this case, is not merely local, but fragmented down to the boundaries of the group. Additionally, the search remains passive mainly because hierarchical power prevents knowledge sharing. Finally, in the *selection phase*, environments hostile to knowledge sharing create a weak foundation for judgment. This may partly explain why Russian managers have the tendency to make decisions and act largely on the basis of intuition.

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## Which club does your Alliance belong to? - An empirical classification of strategic alliances in post- transition Hungary\*

Zoltán Buzády\*\*

*The article focuses on possible typologies of strategic alliance. The first section gives a brief overview of the major groupings of alliances followed by the detailed description of strategic alliance history in Hungary. Former alliance theories were not able to describe sufficiently the characteristics of Hungarian strategic alliances because those theories origin in the business environment of western economies. The author presents a new classification of strategic alliances of post-transitional Hungary based on empirical researches. Three new groups arise, namely „cautious partner”, „members only club” and „waiting for the white knight”.*

*Key words: Strategic alliances / strategic management / organisational change / post-transition economies / empirical research,*

### 1. Introduction<sup>1</sup>

Over the last one or two decades research into the phenomenon or seeming contradiction of cooperating competitors, that is strategic alliances, has highly proliferated. This article is to test the validity of the western models describing strategic alliances within the Central European region (Hungary) during the transition years of the late 1990's. On a more fundamental note, the basic issue raised in this paper is the transferability and appropriateness of western management models to the Central European region.

The goal of this paper is to empirically research the validity of western typologies of strategic alliances. Alternatively, the goal is to explore whether observed alliances can be better regrouped along other, newly defined dimensions.

The methodology chosen for the present research was to collect a representative, large-scale database of companies engaged in strategic cooperations, whilst the appropriate unit of observation was chosen to be the given strategic alliance. Factor analysis was used for better describing the numerous characteristics of the observed alliances along fewer, new dimensions. In the second step cluster analysis was used to create groups of strategic alliances based on their relative closeness to each other. Thus we obtained an operational number of groups of

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alliances. In the third step both findings were combined to create a new typology and so to interpret the new clusters of strategic alliances with the help of the newly found explanatory dimensions.

This paper is structured in following sections. First, the most common western typologies and models describing strategic alliances are introduced. Second, alliances are explored in the Hungarian context, whilst great emphasis is placed on demonstrating their roots in the national state-system (such as monolithic corporations, forced and not market-based economic exchange mechanism). Hungarian and Central European economic and management context of the 1990's in general can be characterised by the influx of western business strategies and management approaches. This flow is the second stream which strongly influenced the development of strategic alliances in Hungary. This fact raises the fundamental question of this paper: did all that influx affect the types of alliances observed in Hungary? In how far did they differ from those described in western academic literature? In the subsequent sections we describe the rigorous statistical methodologies applied in the empirical research and we present the results. Finally, findings are interpreted, which results in a new typology of strategic alliances in Hungary of the late 1990's.

## **2. Typologies of strategic alliances – the western „classics”**

With the continuous spread of inter-company cooperations over the last one or two decades academics and business consultants have developed a number of different models aimed at classifying the various forms of cooperations. The dimension along which alliances are being classified into separate groups can be related to the characteristics of the alliance, to the nature of the partners involved, to the dimensions of the parent company or even to the industry structure. The many typologies include both normative and descriptive approaches to describing alliances. They also differ in their research methodology. The method chosen by most researchers (in this field) is the questionnaire study. It has been used by Faulkner (1995), who observed about 70 alliances, Dussauge and Garrette sampled 128 reported alliance cases (1995) and Garcia-Canal's study was based on 663 alliances (1996). Hergert and Morris even worked on 839 collaborative agreements (1987). The other major research stream is to base the alliance models on a collection of case studies. This activity compiles sets of separate monographs and reports of highest clinical precision. The results and observations on a series of strategic alliances, gained through a limited number of deep interviews, are then extrapolated to the wider context of company strategy (Dussauge/Garrette 1993; Bidault/Cummings 1994; Dussauge/Garrette 1995; Child/Markóczy 1993).

The next section will be presenting different approaches, which will be helpful in clarifying and structuring the various possible types of alliances.

### 1.1. *Types of alliances - a historic overview*

The most basic and most frequent line of distinction drawn between alliances is linked to *ownership* in companies. As already described in detail in the section on transaction theory, equity is used to differentiate between so-called equity alliances. They are defined to be either organised as an equity joint venture, which involves the creation of a new and independent jointly owned entity, or alternatively equity alliances can occur when one of the partners takes a minority equity position as the other partners (Pisano 1989). Thus Hennart distinguishes between equity joint ventures which create a new legal entity from various sponsors' assets on the one hand and non-equity joint ventures on the other. For the former questions related to ownership and profits become relevant while the latter encompasses all contractual forms, licences, distribution arrangements and contracts to manage.

The reasons for choosing equity relationship for a cooperation is that a joint venture can be a useful device to bypass inefficient markets for inputs, whereas the market failure i.e. high transaction costs, can depend on many factors.

Another important early attempt to classify alliances in terms of *their competitive impact* has been made by Michael Porter. He uses the term „coalitions“ for what most scholars refer to as strategic alliances. His terminology includes long-term agreements among firms that reach beyond normal market transactions but fail to reach outright mergers. Coalitions include licenses, supply agreements and joint ventures. They are ways to broaden the scope without broadening the firm by contracting with an independent firm to perform value activities or cooperating with an independent firm to share activities. „Coalition partners remain independent firms. The relative bargaining power of each partner is thus central to how the gains are shared, and determines impact of the coalition on a firm's competitive advantage“ (Porter 1985).

Coalitions can potentially be formed to perform any activity or group of activities in the value chain. The following basic types of alliances, focusing on different parts of the value chain activities, tend to emerge, namely technology-development coalitions, operations and logistics activity coalitions for scale and learning economies, and marketing, sales and service coalitions to cope with national differences. In fact, alliances may cover more than one valued activity, so they are multiple-activity coalitions (Ghemavat et al. 1986).

As it becomes obvious from above earlier writings focused mostly on some *general form of cooperation*. The term *alliance* itself has only emerged subsequently. The above quoted authors focused their articles and books on other aspects than cooperation. They merely raised those questions, which now form the core of *strategic alliance* research. All earlier pieces of literature on cooperations can

be considered not exhausting because they analysed cooperation only along one *single* dimension.

### 1.2 Taxonomy of strategic alliances

Lorange and Roos propose a two-step conceptual scheme for the classification of strategic alliance (see figure 1). Following the first step of identifying possible motivations for alliance formation, generic strategic alliance types are established „based on the resource input/output perspective” (Lorange/ Roos 1992). Regardless of underlying motives, a fundamental concern of each prospective strategic alliance parent is the question of how much of its resources are put into and retrieve from a strategic alliance. At the one extreme, of the input side, a parent may wish to put in only organisational resources such as people, technologies, funds and staff support. At the other extreme it may be willing to put in sufficient strategic resources for the alliance to adapt to an array of potential changes in the environment. A self-adapting alliance would require more resources. The value created in the alliance can also be considered on a continuous dimension. On the one end, Lorange and Roos identify the parents’ taking back all the output resources of the alliance (profit taking, staff call-back et cetera). At the other extreme, all of the output created is retained and built up in the alliance itself.

**Figure 1. Archetypes of strategic alliances (Lorange/ Roos 1992)**

		Parents' input of	
		short-term	operations long-term
<u>Parents' retrieval of output</u>	To parents	<b>Ad hoc pool</b>	<b>Consortium</b>
	Retain	<b>Project-based JV</b>	<b>Full-blown</b>

A number of different aspects can be identified as important characteristics of alliances. Consequently, certain inadequacies and ambiguities arise when classifications of alliances are only researched along two dimensions. Faulkner therefore suggests to cluster alliances along dichotomous dimensions (see figure 2) (Faulkner 1995): The first dimensions distinguishes between collaborative arrangements established to meet a clearly defined set of circumstances in a partic-

ular way on the one hand and so-called ‘complex alliances’ on the other. The latter may involve certain parts of or even the entire organisation of each partner. The companies recognise that, in combination, they form a potentially much more powerful competitive enterprise than they do individually, but they wish to retain their separate identities. The second dimension draws a line between separate legal-entity joint ventures and more flexible, increasingly project-based collaborations. The third dimension groups alliances according to the number of partner companies: bilateral or consortium.

Figure 2. The strategic alliance options (Faulkner 1995)

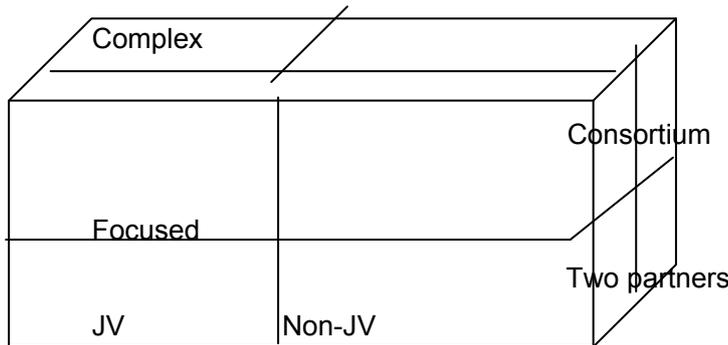
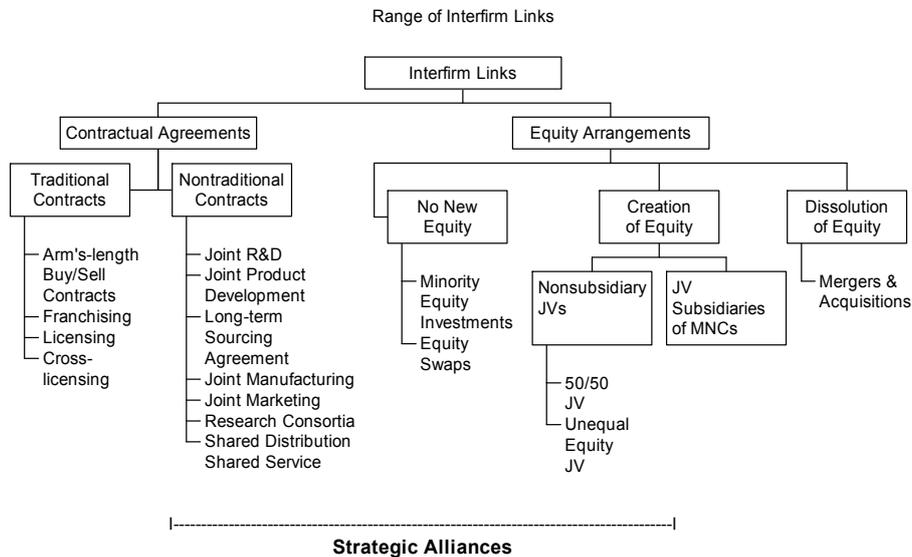
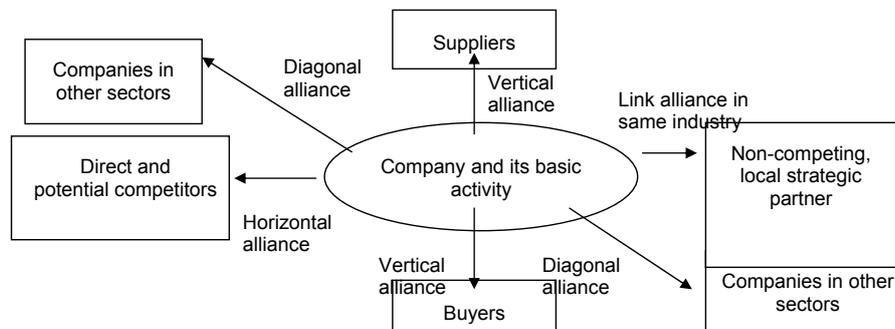


Figure 3. Inter-firm links (Yoshino/Rangan 1995)



Similarly to this is the categorisation by Bühner (1993), who uses several criteria to distinguish between alliances, namely by the direction of the alliance (such as horizontal or vertical), by the scope of the alliance (that is different functional areas) and by the type of partners involved (such as *medium-sized* or large companies). Yoshino and Rangan (1995) (see figure 3) have a more limited view on inter-firm arrangements. They exclude overseas subsidiaries of multinational corporations, even if they are joint ventures, from strategic alliances. These collaborations are undertaken for the purpose of entering new geographic markets solely. They are often tactical or reactive responses by MNE to host nation government pressures. The 'jointness' of a venture is rather a compromise than a goal, and control tends to rest with the MNE. Similarly, licensing and franchising agreements are not strategic alliances because they do not call for a continuous transfer between the partners. The following figure however illustrates the authors' range of possible interfirm links and the subset encompassed by their definition of a strategic alliance.

**Figure 4. Directions of strategic alliances and potential partners (Tari/Buzády 1998)**



But alliances can also be divided into several other clearly distinct categories. At a first level, it seems important to distinguish partnerships forged between companies from different industries, which are therefore not in direct competition with one another, and from alliances between rival firms, which raise specific problems, both from an anti-trust point of view as well as in terms of managing the relationship between the allied competitors. At a second level, within partnerships between non-competing firms, a useful distinction can be made between international expansion joint ventures, vertical partnerships and cross-industry agreements. As for alliances between rival firms, Dussauge and Garrette (see figure 4) have suggested an original analytical model derived from extensive research conducted on a large sample of such alliances. Their model shows that strategic alliances uniting rival firms can be divided into three main categories: shared-supply alliances, quasi-concentration alliances and complementarity.

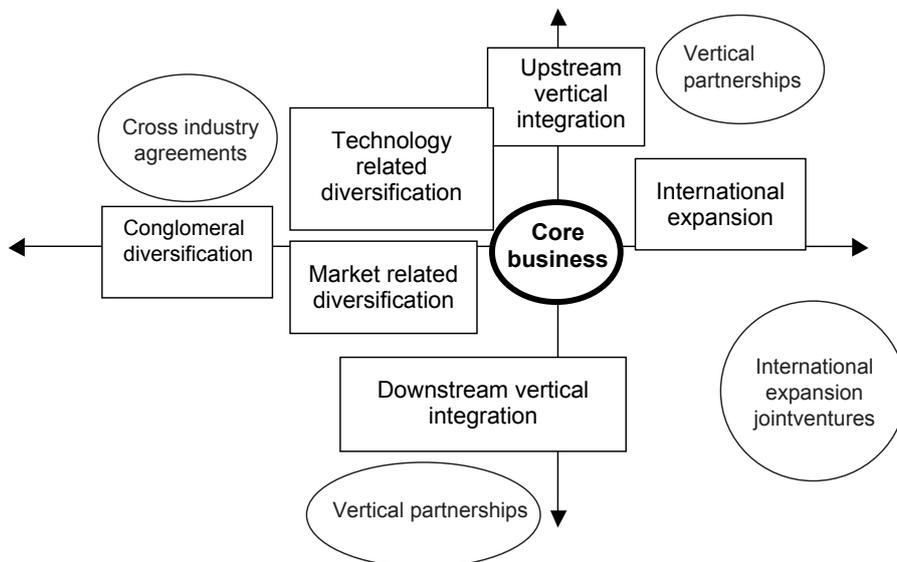
### 1.3 Partnerships between non-rival firms

These alliances are formed by companies belonging to different industries (see figure 5). The companies concerned aim to expand into areas new to them, areas in which the partner can make valuable contributions. These alliances are an alternative to more traditional forms of expansion such as Greenfield investments or acquisitions. Growth options are international expansion, vertical integration or diversification.

### 1.4 Partnerships between competing firms

The very existence of alliances between rival firms is paradoxical. Competitors are expected to compete with one another rather than to join forces. The nature of the relationship between allies has been interpreted in two totally opposing ways:

**Figure 5. Expansion options and types of non-rival partnerships based on (Dussauge/Garrette 1995; Tari/Buzády 1998)**



- For some commentators, all alliances between competitors should be considered as collusive behaviour. They are assumed to eliminate competition between the allies and to collectively strengthen the partners' position in relation to their environment, i.e. other competitors, suppliers, customers etc. (Arndt 1979).
- For others, alliances between competitors do not eliminate inter-partner rivalry, they only modify the forms that this rivalry takes. According to this perspective, such alliances are a zero-sum game in which one partner is bound to

lose what the other gains (Doz et al. 1989). Alliances are thus predicted to generally result in unbalanced outcomes.

An equal mistake will be to assert either to be paramount truth.

### 3. Strategic alliances in the Hungarian context

#### 3.1 Historic overview

Nationalisation and merging enterprises were an important tool for the artificial centralisation of the Hungarian economy. After the forced merging of numberless small- and medium-sized enterprises during the 1950's the newly formed industrial enterprises with a single, main location predominated. The newly created large enterprises were hoped to increase national economic output and efficiency levels. „Many subscribed to the fundamental belief that the larger enterprise produces superior efficiency in all aspects. After this period of forced merging virtually no Hungarian management research has been conducted about the new forms of division of labour between companies and cooperation at the top level of enterprise management” (Tari 1988).

The centralisation process led not only to production, organisational and strategic inertia but also to shortages and to the inefficiencies caused by the lacking of a market co-ordination mechanism. In order to counterbalance these problems, the economic policy action taken was to enhance the vertical integration of larger enterprises. First, the small supplier companies were merged into to the structures of the larger enterprises, later the whole production processes were planned in such a manner that the total vertical production chain was done within the large enterprise.

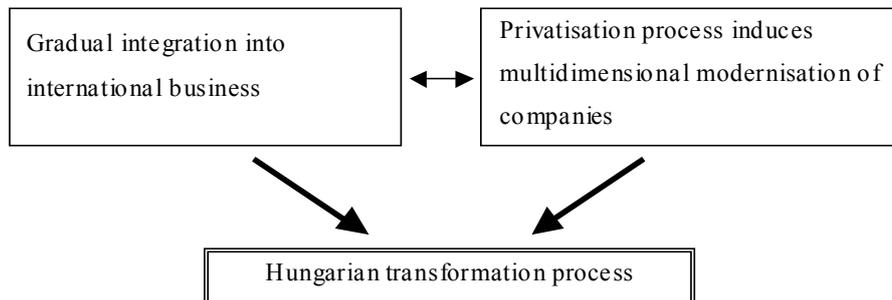
Large Hungarian enterprises thus tried to solve as many problems within their own organisation as possible; they aimed at becoming as independent as possible. During the 1980's a certain amelioration of the economic climate was observable and the supplier enterprises started to grow: the large state enterprises gained the autonomy to differentiate between the various suppliers and to build relations with potential entrepreneurs and subcontractors. In this way they managed to „create semi-autonomous *partnerships within the large state enterprise*” (Bruszt/Stark 1998). Despite of these partnerships, this development cannot be considered as a fundamental structural change because the possible advantages (such as economies of scale and scope or the building of core competencies) arising from specialisation and cooperation did not materialise, mostly due to the remaining monopoly position of the large enterprises.

Functioning inter-organisational networks and relationships based on *the principles of the market* such as inter-organisational information networks, joint projects or strategic alliances only emerged during the 1990's.

One of the basic legal frameworks for the fundamental political, social and economic changes of the 1990's was postulated by the *Business Companies Act in 1988*. The main goal of placing economic actors, i.e. companies, into a more modern legal context was to accelerate the economic processes and to enhance their efficiency. The result was expected to show itself in the development of market cooperations, the realisation of capital investments and in the increase of foreign direct investments.

The political changes and the new legal regulations governing the status of companies, however, induced the gradual decline of activity co-ordination by central governmental authorities and gave place to market-based competition and enabled the establishment of new inter-organisational relationships. Some companies have worked as subcontractors for western companies as early as the 1970's and their products appeared on western markets. This situation was an opportune moment for managers to participate in the learning processes induced by organisational changes, and to the acquisition of individual and organisational skills needed for successful continuous change" (Balaton et al. 1996). However, the two companies could then also obtain additional (i.e. western) financial means, which helped to survive the first years of radical transformations in Hungary. The existing tight cooperation relationship with strategic investors enabled the company to invest well below the Hungarian bank interest rates.

**Figure 6. Factors of company transformation (Buzády 2000)**



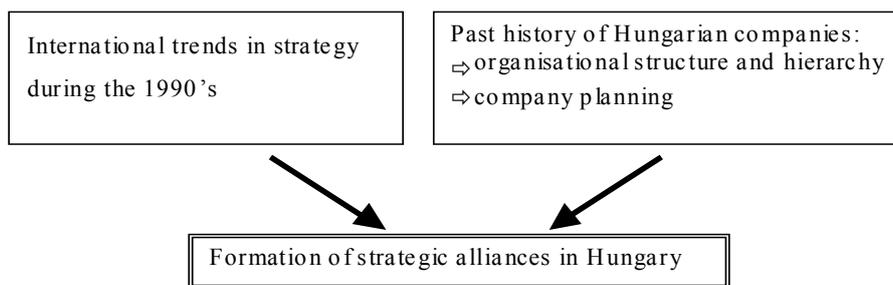
### 3.2 Strategic Alliances in Hungary

What kind of factors can be found to have influenced the reorganisation of organisational structures and inter-organisational relationships during the 1980's and 1990's? It is argued that decentralisation and the gradual introduction of market elements (see figure 6) triggered organisational restructuring as well as adjustments, and that organisational changes have been strongly embedded in the changes of whole social and economic mechanism in Hungary.

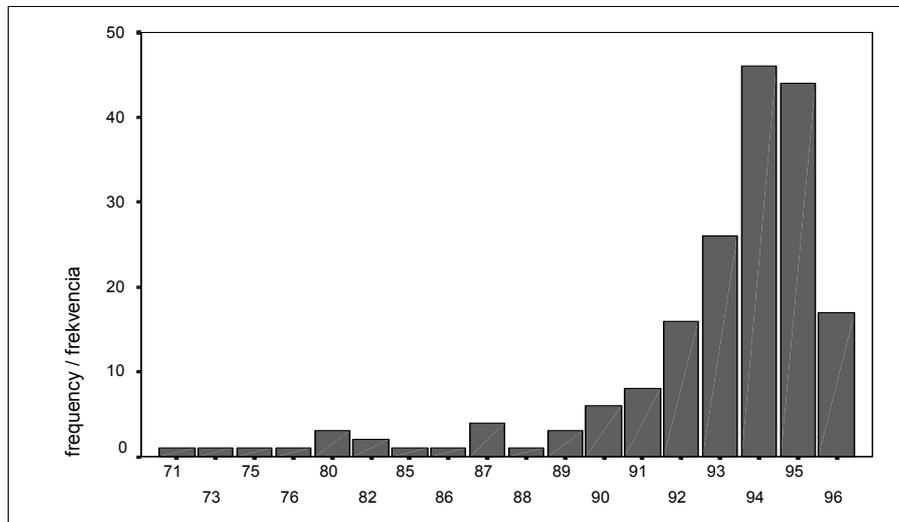
The two important and interrelated factors for the transformations in Hungary are the gradual integration of the Hungarian economy into the system of international business (such as international company cooperations and the creation of various forms of strategic alliances) and the privatisation process which simultaneously modernised Hungarian companies in many different dimensions (simultaneously).

The formation of strategic alliances in Hungary has also two main influencing factors (see figure 7). The spread of new forms of cooperation can be linked to the changing global company environment and thus Hungarian companies increasingly start to follow international trends in strategy. Second, one has to consider the past history of Hungarian companies. The companies' search for new solutions to increase competitiveness (such as outsourcing, joint ventures or strategic alliance formation) can be regarded as a *movement of reaction* against the forced centralisation and against the interference with strategic decision-making and against the obstruction of building inter-organisational relationships during the past system.

**Figure 7. The context of strategic alliance formation in Hungary (Buzády 2000)**



Although the number of strategic alliances has dramatically increased in Hungary, too (see figure 8), little work has been done on exploring the nature of these alliances. At the same time the existing (western) models and theories did not fully represent the observed realities and characteristics of these new cooperations. In the following section a new model, based on empirical studies, will be presented giving a new approach to classify business cooperations in post-transition Hungary.

**Figure 8. Year of strategic alliance formation (sample taken in 1996 summer)**

#### 4. Research Methodology

Because no systematic analysis data of strategic alliances in Hungary has been conducted to date, the aim of the empirical research was to explore patterns of cooperation and to give new insight into this topic by applying multivariate statistical methods. First to explore new dimensions which simplify the description of the data sample by reducing the number of variables into new factors. Second, to explore possible clusters of Hungarian strategic alliances, which will subsequently be reused to validate the results of the factor analysis.

Despite the fact that the organisation is the dominant level of analysis in alliance research (Oliver/Ebers 1998), the *unit of analysis* in the present study was the *individual strategic alliance* of a respondent company.

The strategic alliance questionnaire (see appendix) formed an integral part of the wider questionnaire on Hungarian competitiveness. The respondents were the leading general managers or managers in charge of strategy of the company, i.e. financial, technical or marketing managers were not asked. 13 questions were asked in relation to various aspects of the strategic alliances; each question allowed one respondent company a maximum of three different strategic alliances simultaneously. The characteristics of maximum three different strategic alliances of one respondent company were treated separately. All questions were taken from published research in the field of strategic alliances in order to *ensure reliability of scales*.

Concerning the collection of empirical data and its processing the following remarks are necessary. In March 1996 the companies were asked by letter to take part in the survey. A follow-up call by our 78 interviewers resulted in positive answers from 325 companies. Our interviewers visited the companies during a period of two months. *Data collection* was completed by the end of the third month. The data was entered into a computer database by TARKI (Research Institute for Social Sciences) who edited the basic statistics, too. Subsequently, the data was analysed (factor analysis, cluster analysis) by the author using SPSS.

## 5. Research Findings

### 5.1 The sample

The *companies in the sample were chosen* from the computer database of the Ministry of Finance. Five thousand six hundred and eighteen companies met the initial requirements. 10% of these companies received the questionnaire and 325 returned it. According to the data of the Central Statistical Office, *the selected companies in 1994* represented 0.6% of Hungarian enterprises, produced 18% of GDP and 46% of exports and employed 18% of the active population.

In the sample of 325 companies approximately 102 respondents answered the questions related to strategic alliances. The respondents had the possibility to give simultaneously detailed information up to three different strategic alliances at their companies. This gives a total of 196 strategic alliances as a basis for our analysis.

### 5.2 Descriptive Statistics

Concerning the potential influence of the companies' ownership on strategic alliances the following findings were made (table 1). Most crosstabulations between ownership variable and other variables did not produce highly reliable significance levels and thus significantly reduced the importance of the ownership criteria in the context of post-transition alliances and joint ventures. The following table shows that almost 90% of the alliances were still in process at the time of the survey. However, a tendency towards a more „administrative mode“ of dealing with the dynamics of strategic alliances formed by the state-owned companies can be detected. 8% of alliances by companies in state ownership have been terminated „according to plan“ or „prolonged“. In contrast to these, alliances by companies in domestic and foreign private ownership show more market dynamics in the way alliances develop. 8 to 12 % of the alliances have been renegotiated, prematurely terminated or bought out by one of the partners.

**Table 1. Crosstabulation Ownership and outcome of alliance (sign.:18)**

Outcome of the alliance:	State-owned company	Hungarian privately-owned company	Foreign-owned company	Total
Still in progress	89.8%	87.5%	91.7%	89.9%
Terminated according to plan	4.1%	?	?	2.5%
Prolonged	4.1%	?	5.6%	3.8%
Premature termination		4.2%	2.8%	1.3%
Partner bought out	2%	8.3%	?	2.5%
Total	100%	100%	100%	100%

An interesting although not significantly reliable picture emerges from the following table (table 2). Foreign-owned companies do not seem to differentiate between domestic and foreign-owned alliance partners. In contrast, Hungarian companies (much more) prefer fellow Hungarian alliance partners. The companies in state ownership have the highest proportion of mixed alliance partners.

**Table 2. Crosstabulation Ownership and Ownership of Alliance Partner (sign.:38)**

Alliance partner	State-owned company	Hungarian privately-owned company	Foreign-owned company	Total
Domestic	56.3%	70.8%	48.6%	56.8%
Foreign	38.5%	29.2%	48.6%	39.4%
Both	5.2%	?	2.9%	3.9%
Total	100%	100%	100%	100%

Significant predictions can be made concerning the strategic position of the companies at the start of the cooperation process (table 3): Foreign companies only enter alliances from dominant or at least equal strategic positions. Hungarian privately-owned companies show the strongest tendency to be either in strong or in weak strategic position, whilst alliances of state-owned companies are mostly made from balanced, equal strategic positions. It should be noted, however, that the judgement of the company's strategic position was made by the questioned company CEOs themselves.

With sufficient level of significance we can observe (see table 4.) that state-owned companies are more likely to enter alliance with identical inputs by the partners, that is quasi-concentration horizontal alliances. Hungarian privately owned companies tend to make complementary horizontal alliances or vertical cooperations.

**Table 3. Crosstabulation Ownership and Strategic Position at entering into alliance (sign.:.01)**

Strategic Position at start of Alliance	State-owned company	Hungarian privately-owned company	Foreign-owned company	Total
Dominant	20.4%	30.4%	22.2%	22.3%
Equal	56.1%	43.5%	77.8%	59.2%
Subordinate	23.5%	26.1%		18.5%
Total	100%	100%	100%	100%

**Table 4. Crosstabulation Ownership and Nature of inputs into the alliance(sign.:.05)**

Nature of inputs into alliance	State-owned company	Hungarian privately-owned company	Foreign-owned company	Total
Identical	61.2%	34.8%	50%	54.8%
Different	38.8%	65.2%	50%	45.2%
Total	100%	100%	100%	100%

### 5.3 Factor analysis and cluster analysis results

The Principal Component Analysis was used to find factors which help to describe the observed variables along fewer dimensions. Although five factors were computed with Eigenvalues over 1.0, based on the Scree plot curve (see figure 9.), four factors retained for the analysis.

#### Figure 9. Eigenvalues and total variance explained

The four factors (see table 5.) used cumulatively explain almost 60%<sup>2</sup> of total variance and are therefore useful for further statistical operations.

Based on the rotated component matrix the factors can be described as follows:

Factor 1 can be explained as being

negatively related to non-equity alliances, i.e. strongly linked to equity alliances, in connection with alliances formed for a not predetermined time period and linked to multi-party alliances.

Factor 2 can be explained as being

linked to alliances formed from subordinate strategic positions and linked to the presence of both foreign and domestic alliance partners.

<sup>2</sup> Antal and Kovacs published a study on the content of corporate strategy in Hungary. They based their analysis on the same large overall questionnaire. In their factor analysis nine factors were needed to explain 62.9% of variance .

**Table 5. Rotated Component Matrix**

	Component				
	1	2	3	4	5
V16	.107	5.1E-02	.640	-.422	-.399
V18A	.659	.246	-3.63E-02	-.417	.186
V20A	.571	-.471	-.149	4.933E-03	-.231
V21A	9.946E-02	.739	.146	.136	-.184
V22TYPE	-.354	.194	.468	.419	-.339
V23CLASF	.119	5.4E-02	-.840	-.113	-8.14E-02
V24	-.750	9.2E-02	4.070E-02	-.265	-5.26E-02
V25A	-.153	.748	-.171	-.131	5.733E-02
V26A	7.554E-02	-7.E-02	1.047E-02	-6.70E-03	.897
V27A	.115	1.1E-02	2.388E-02	.834	-3.04E-03

Extraction Method: Principal Component Analysis

Rotation Method: Varimax with Kaiser Normalization, a rotation converged in 12 iterations

Factor 3 can be explained as being

- negatively related to alliances with more than two functional areas, i.e. single functional and
- linked to cases where the company has formed more than one alliance simultaneously.
- (Factor 3 is also to some extent linked to *buyer/supplier alliances*).

Factor 4 has only high factor loading scores (.83) on a single variable V27 (Strategic Impact of Alliance).

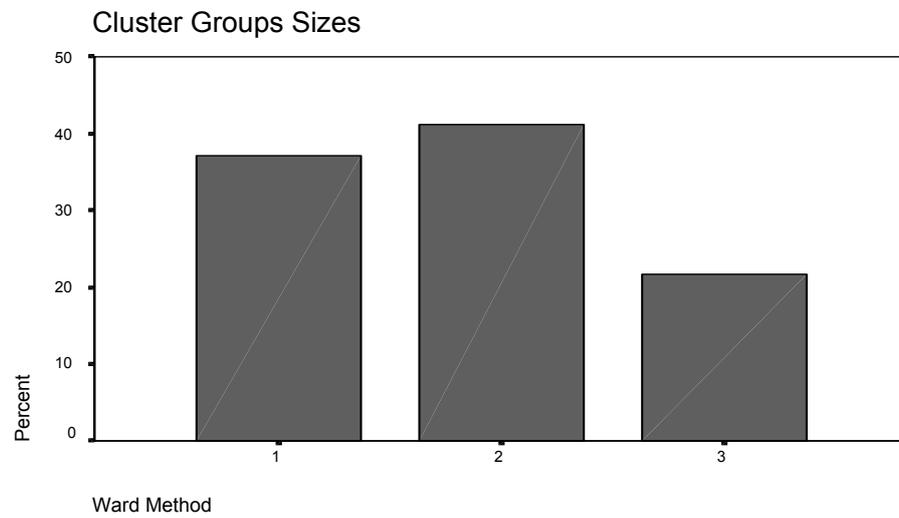
Factor 5 has only high factor loading scores (.90) on a single variable V26 (Nature of Inputs into Alliance).

Because Factors 4 and Factors 5 do not contain more information than the single variables alone they cannot further be treated as „composite factors“.

The cluster analysis produced three cluster groups. The following table (table 6.) and figure (figure 10.) shows the equal distribution of the alliances into the three clusters.

**Table 6. Clustergroup sizes**

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid Clusters	1	53	27.0	37.1	37.1
	2	59	30.1	41.3	78.3
	3	31	15.8	21.7 a	100.0
Missing Total	Total	143	73.0	100.0	
	System	53	27.0		
		196	100.0		

**Figure 10. Cluster group sizes (2)**

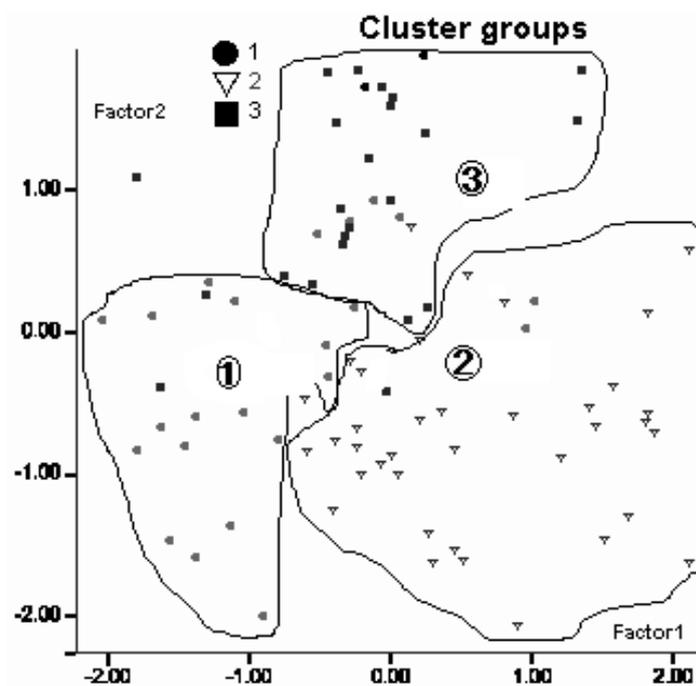
The Analysis of Variance (ANOVA) was used to test the homogeneity of the cluster groups. The following table (table 7.) shows that all three clusters have *standard deviations* of less than 1.000 on Factors 1 and 2. Cluster 1 is also homogenous on Factor 3.

The *means* shown in the same table were used to interpret the three clusters:

- Factor 1 is most characteristic for Clusters 1 and 2, although in opposite direction (-.59 and .66).
- Factor 2 distinguishes best between Clusters 2 and 3 (-.65 and .86).
- Factor 3 draws the line between Clusters 1 and 3 (.51 and -.61).

**Table 7. Cluster homogeneity and cluster means**

		N	Mean	Std. Deviation	Std. Error
Factor 1 X Clusters	1	53	<b>-.594464</b>	<b>.8680452</b>	.1192352
	2	59	<b>.6618137</b>	<b>.8664656</b>	.1128042
	3	31	-.243240	<b>.6549338</b>	.1176296
	Total	143	1.7E-16	1.0000000	8.4E-02
Factor 2 X Clusters	1	53	.2194276	<b>.9872561</b>	.1356101
	2	59	<b>-.648175</b>	<b>.6551287</b>	8.5E-02
	3	31	<b>.8584726</b>	<b>.7357056</b>	.1321366
	Total	143	3.2E-16	1.0000000	8.4E-02
Factor 3 X Clusters	1	53	<b>.5055437</b>	<b>.4838720</b>	6.6E-02
	2	59	-.134329	1.0547314	.1373143
	3	31	<b>-.608658</b>	1.1432130	.2053271
	Total	143	-3.2E-16	1.0000000	8.4E-02

**Figure 11. Scatterplot: Cluster groups on factor1 and factor 2**

The visible output (see figure 11.) also show the existence of the three distinct groups of strategic alliances, which can be described along the three Factors.

**Cluster 1** alliances are:

- Informal or contractual alliances (i.e. non-equity) for a determined time period and bilateral,
- Single functional alliances, but the company has formed more than one alliance simultaneously. In tendency these are buyer/suppliers of vertical alliances.

**Cluster 2** alliances are:

- Equity alliances, for a not predetermined time period and are multi-party,
- Formed by companies in superior strategic positions, mostly with either a domestic or foreign partner.

**Cluster 3** alliances are:

- Formed by companies in subordinate strategic positions with both domestic and a foreign partners;
- In tendency, unfocused concerning number of functions; the company has formed not more than one alliance at a time.

## 6. Groups of Strategic Alliances:

The factor analysis has presented three underlying factors with the help of which the sampled strategic alliances can be represented (48% of variance) along fewer dimensions than the initial independent variables.

The cluster analysis has presented three clusters into which strategic alliances in post-transition Hungary can be regrouped:

### *The „Cautious Partners”*

Cluster 1 represents those alliances which can be described with the motto „better safe than sorry“ or „do not keep all your eggs in one basket“. These companies are mostly in vertical buyer-supplier relationships. Their increasingly integrated activities induce them to establish strategic cooperations in form of informal or simple contractual agreements for a predetermined time period. These alliances are between two partners and for one precise function. However, these companies perceive a risk in being fully dependent on the alliance partner. They therefore form several cooperation agreements with other vertically linked companies simultaneously at a time. Characteristic for this group is that the market forces them to integrate with each other through alliances but the companies try to retain some of their independence and, therefore, chose informal or simple contractual arrangements, which are easy to exit.

### *The „Members Only Club”*

Cluster 2 represents the group of alliances which are rather closed. These alliances are highly formal and structured, in form of equity agreements i.e. joint ventures. The alliance is formed amongst a few partners, but being a joint venture also infers that the membership changes (old and new) are almost excluded. These companies are in superior strategic positions, they are clear about their interests and about the goals of the cooperation. The club members have made up their mind whether to join a club of domestic or of foreign alliance partners. For this group it is characteristic that the companies themselves initiate the process of closer integration and they have chosen to be closed for other potential partners.

### *„Waiting for the White Knight”*

Cluster 3 represents the smaller group of companies waiting for help by any possible partner willing to co-operate. These companies are in weak and subordinate strategic positions. Their alliances are less focused and cover more than two functional areas. Characteristic for this group is that the companies are forced to co-operate due to their weak strategic position, i.e. forced to be open for potential partners. However, once they have entered an alliance these companies do not enter new cooperations. They have only one alliance at a time. It is assumed that either the other partner in the stronger strategic position forces these companies to exclusivity, or they do not have any spare capacity for managing a second alliance.

**Table 8. Crosstabulation Cluster groups and Strategic Impact of Alliance**

Impact of strategic alliance	Cluster 1 „cautious partners”	Cluster 2 „members only club”	Cluster 3 „waiting for the white knight”	Total
No strategic change		11.9%	29%	11.2%
Favourable change	100%	86.4%	61.3%	86%
Unfavourable change		1.7%	9.7%	2.8%
Total	100%	100%	100%	100%

The table above (table 8.) demonstrates the described tendencies. All alliances in the „cautious partners” cluster group have had positive effects on the strategic position of companies. Alliances by the so-called „members only club” have had positive or no influence on the strategic position of parent companies. Interestingly, the alliances in the third cluster group, „waiting for the white knight”, have experienced the most disappointing effects of cooperation. Not only that these companies are in weaker strategic positions at the start of the alliance but

also less than 2/3 of them actually experienced a favourable change to their strategic position. Almost one in ten companies in this particular cluster group judged the alliance entered to have been an unfavourable one!

## 7. General conclusions:

Strategic alliances might be seen as a „management fashion“. In contrast to this statement, the present empirical quantitative research has not only shown the growing number of strategic alliances in Hungary, but has also proven that managers judge alliance to have a positive impact on the strategic position of companies. Strategic alliances are a vital element of and an important tool for the corporate strategies of Hungarian companies.

The most important result is that not all alliances follow the same reasoning and *raison d'être*. Different strategic approaches to alliances bring different results to cooperation and to partners.

The literature overview presented an extensive range of models, all aimed at demonstrating possible groupings of different strategic alliances. The present empirical research of Hungarian strategic alliances has revealed a new tripartite alliance typology (White Knights, Members Only Clubs and Cautious Partners), which much better describes the nature of strategic alliances in the post-transition market economy of Hungary.

The author intends to conduct follow -up studies on the evolution of the proposed three alliance groups and to engage in international, comparative research projects on alliances in the CEE region.

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c) Marketing and Sales	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d) Sourcing and Logistics	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e) Several functions simultaneously	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f) other, please specify	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
V24. What is the legal form of the strategic alliance?	A	B	C
a) informal agreement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b) formal, written agreement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c) separate legal entity (JV, consortium etc.)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d) minority cross-shareholding	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e) other, please specify.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
V25. Your company's strategic positioning at the beginning of the alliance:	A	B	C
a) dominant position	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b) equal position	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c) subordinate position	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
V26. The nature of the assets/know-how contributed to the alliance by the partners is:	A	B	C
a) similar	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b) different	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
V27. The effect of the strategic alliance on your company's competitiveness:	A	B	C
a) no influence	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b) positive influence	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c) negative influence	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

## Reverse diffusion of quality: Evidence from General Motors UK and Poland\*

Dorota Dobosz-Bourne\*\*

*This paper explores the concept of a reverse diffusion of knowledge, that is, the transfer flowing from a company's subsidiary to its home plant. The article presents the empirical evidence gathered in General Motors UK and Poland, where the reverse diffusion of a concept of the built-in quality took place. Lastly, the implications of our findings for future research are discussed.*

*Keywords: reverse diffusion, transformational and evolutionary knowledge diffusion, built-in quality, car manufacturer, Eastern and Western Europe.*

### Introduction

The idea of quality has travelled globally for many years because of globalisation (Crosby 1979; Deming 1989). It has become a key factor of increased competition in the global economy, which led to attempts by international companies to transfer quality to different locations and cultures in order to achieve high quality-standards globally. Car manufacture became an important field for international knowledge transfer. A quest to achieve high quality in car manufacturing has travelled along various management tools and production models since 1911 (Tolliday 1998) and after 1990 it began to travel to Eastern Europe, including Poland.

After the fall of the Berlin Wall and the collapse of Moscow's domination in the post-Soviet block, the relationship between Eastern and Western Europe has changed dramatically. Suddenly, it was freed, having previously been restricted economically and politically. The East embraced the change with not only hope but also the image of Western Europe that it both had and aspired to. People from Eastern Europe associated the West with luxury and well-being, as the images they received were vastly different to the reality they lived in. Previously, people in the East were usually the recipients of Western ideas via tales from other people, or their occasional visits to the West. However, they did not have the opportunity to take an active part in their creation or institutionalisation. Hence, their knowledge of some ideas did not include the whole institutionalisation chain. This seemingly small aspect played a crucial role in the later devel-

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opment of post-command economies. Not knowing the reality of the free market and other things in the West, people only knew the images of the final effects and products of capitalism. Additionally, the drive to make up for the lost years of stagnation under Moscow's government resulted in many cases of uncritical willingness to accept some Western concepts as miracle cure's for the problems of post-command economies.

One of the ideas that international companies attempted to transfer to Eastern Europe was the idea of quality, more specifically the concept of quality in car manufacture as something that can be procedurally built into the system – so-called built-in quality. General Motors played a particularly significant role in this process as it was a first car manufacturer from the West to open a plant in Poland.

Since its start in 1996, General Motors' plant was able to 'pass on' the notion of built-in quality, a concept of Japanese origin, to the Polish plant, Opel Polska. After this process was complete, and Opel Polska reached maturity and relative independence, the relationship between the UK (and similarly other European Opel plants) and the Polish GM plant became very interesting. One might say that a pupil transcended its master. The successful institutionalisation of built-in quality in Poland resulted in Opel Polska achieving a first place in a quality rating among all General Motors European plants in 2000. This opened a new forum for knowledge transfer in the opposite direction, from the East to the West of Europe. However, this process, which we will call reverse diffusion, proved problematic.

### **Reverse knowledge transfer**

Knowledge transfer is traditionally discussed in terms of 'diffusion' (Levitt/March 1988; Mohr 1969; Rogers 1995), a process which has 'direction'. This concept is mainly used when describing the transfer of innovation (Deutschmann/Borda 1962; Rogers 1995). Diffusion of ideas has become a crucial subject for multinational companies. Their ability to transfer knowledge and practices globally often determines their survival or failure on the market. Hence, many authors emphasise the importance of understanding the factors determining its success.

Hirschman (Czarniawska/Joerges 1995) spoke of technology transfer and development projects as a 'pseudo-imitation' technique. It involved building projects as a replica of a successful venture in an advanced country. It enabled the promotion of projects that would normally be discriminated against as too risky and uncertain to be realised. Bartlett and Ghoshal (1998) emphasised the need to diffuse world-wide innovations as an important reason for corporate internalisation. The ability to exploit new ideas and products globally in a rapid and efficient manner has become crucial for a company's survival. Boyer et al (1998) argued

that imitation or direct transplantation of ideas is rarely feasible, thus we should focus on the process of hybridisation, a complex interaction of ideas with national and societal effects.

Diffusion is a special type of communication in which participants create and share information with each other in order to reach mutual understanding (Rogers, 1995). It is a process consisting of four main elements:

1. a *new idea*,
2. is *communicated* through certain *channels*,
3. over *time*.

These are the factors which are likely to influence the difficulty or ease of the diffusion process. Different researchers emphasise different attributes which might influence the knowledge transfer. Rogers (1985), for example, places almost exclusive emphasis on the attributes of innovations. Bartlett and Goshal (1998) and Mohr (1969) consider the social system and communication channels as crucial. Nonaka (1995) and Arrow (Szulanski, 1996) stress the characteristics of the situation, such as time. Others (Szulanski, 1996) try to draw on all of these factors and create eclectic models enabling the measurement of their relative influence.

Edwards and Ferner (2004) distinguished between forward (FD) and reverse (RD) diffusion. They offered this separation as a way to analyse the process in which knowledge is transferred, not only from the country of its origin to the foreign subsidiary, but also in the reverse direction. According to Mikl-Horke (2004) bi-directional diffusion also implies the intermingling of old and new, of outside influences and inside perspectives (ibid. 115). Edwards and Ferner identified two kinds of reverse diffusion: evolutionary and transformative. Evolutionary RD occurs when an optimal mix of practices is achieved within existing modus operandi. It does not affect the assumptions concerning the way in which the organisation operates, but seeks to improve its operations through the process of learning from this organisation's subsidiary plants. Transformative RD is directed towards a much more significant impact and seeks to move the organisation towards a new modus operandi.

Reverse diffusion, despite being introduced by Edwards and Ferner in 2004, is nearly absent from literature and so far was not followed by any research to address this phenomenon. This paper presents a case study exploring the reverse diffusion of the idea of built-in quality in General Motors Europe, and discusses the implications of these findings for future research.

### **Global transfer of quality in car manufacture**

Quality represents an idea that became the main factor of increased competition between global companies. This resulted in the attempts of international firms to convey high-quality standards in all their foreign divisions and their attempts to

transfer quality to different countries (Crosby 1979; Deming 1989; Ishikawa 1986).

Quality, according to Schremerhorn (1999), is the degree of excellence defined as the ability to meet customer needs 100% of the time. Other definitions of quality include compliance with specifications (Crosby 1979), pride of workmanship (Deming 1989), minimising the gap between supplier standards and recipients' expectations (Zeithaml et al. 1990), or even 'delighting' the customer by surpassing his/her expectations regarding the final product and customer service (Moran/Riesenberger 1994).

The search for quality improvements led to various operating philosophies evolving over the years. During the past two decades, simple inspection activities have been replaced or supplemented by quality control, quality assurance and now by Total Quality Management (TQM) (Dale et al. 1997).

There is an apparent lack of a generally accepted definition of TQM. According to Crosby (1979), it is 'zero defects' or 'right the first time'. Deming (1989) called it 'plan to check action' and Juran (1993) speaks of 'fitness for use'. The British Quality Association (BQA) has provided three alternatives to these definitions. They focus on 'soft' qualitative characteristics, 'hard' productive characteristics and the third definition consists of a mixture of both 'soft' and 'hard' characteristics (Thiagarajan/Zairi 1997; Wilkinson 1992).

According to the first definition of 'soft' qualitative characteristics, TQM is seen as being consistent with open management style, delegated responsibility and increased autonomy of staff (Wilkinson 1992). This side of TQM is concerned with creating customer awareness within an organisation. The factors of soft quality are intangible and difficult to measure as they are primarily related to leadership and employee involvement (Thiagarajan/Zairi 1997).

'Hard' quality represents the production/operations management perspective. It places emphasis on the production aspects, such as systematic measurement and control of work, setting standards of performance and the use of statistical procedures to assess quality (Wilkinson 1992).

As mentioned before, one definition of TQM is a mixture of 'soft' and 'hard' aspects of quality. It combines the need for a scientific approach with the view that all employees are part of one team. Oakland (1995) sees this way of managing quality as the key to improving the effectiveness, flexibility and competitiveness of the business as a whole. According to this approach, TQM is conceptualised in a form of three interdependent factors: management commitment, statistical process control, and teamworking. Another critical aspect in this view of TQM is the concept of the quality chain, indicating the interdependence of customer-supplier links throughout the organisation. Hence, TQM focuses primarily on the requirements of the customer, internal or external to the organisation

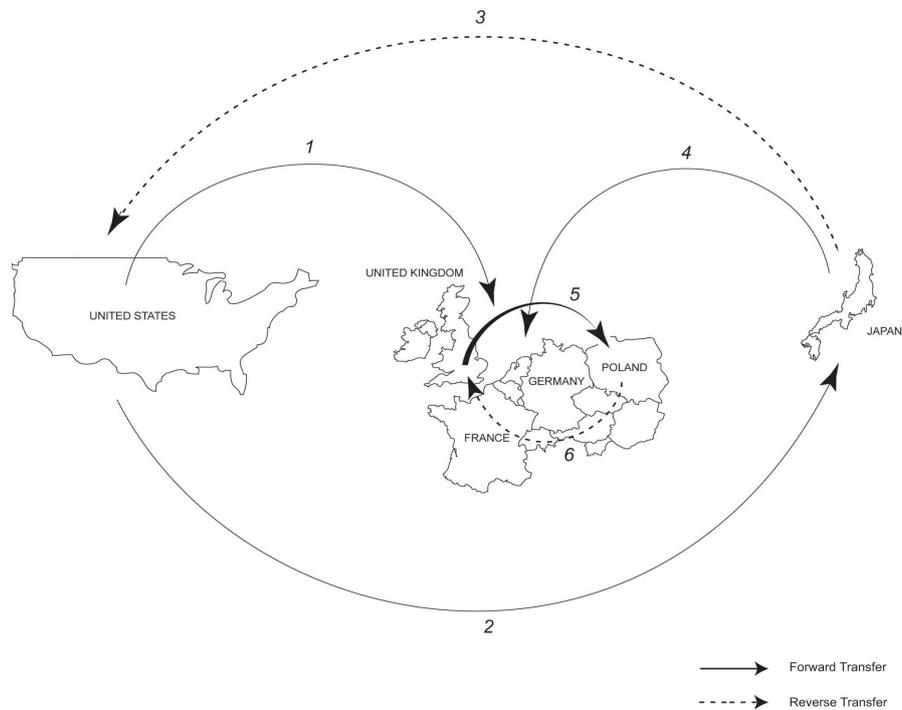
(Oakland 1995). The aim is to make quality the responsibility of all employees, rather than a specialist department, and in this way, quality becomes something 'built into' the process rather than inspected (Wilkinson et al. 1992). Good quality of the final product becomes an inevitable result of such system and culture. The benefits of such an approach are potentially huge. According to Oakland (1995), one third of an organisation's efforts is spent on repair and dealing with checks. By moving the focus from the production process to the customer (internal and external), TQM creates customer awareness within the organisation. It is a way of involving everybody in the process of improving their work, by which high quality and meeting customer requirements become inevitable and leads to quality being built into the process (Wilkinson et al. 1992).

Companies that have successfully implemented TQM and made quality the responsibility of all employees are recognised in the U.S. by being awarded the Malcolm Baldrige Award. The framework used in this prestigious award defines a total quality system as consisting of seven categories: 1) leadership, 2) information and analysis, 3) planning, 4) human resources, 5) quality assurance, 6) results, and 7) customer satisfaction (Schmidt et al. 1992). These criteria largely reflect quality management techniques developed by Juran (1993), Crosby (1979) and Deming (1989) (Shetty 1993).

Quality Management award is also present in Europe in a form of The European Foundation for Quality Management (EFQM) Excellence Model which has its origins in TQM (Sandbrook 2001). The model provides a framework for managing quality and continuous improvement in an organisation. It is composed of five 'enablers' (leadership, people, policy and strategy, partnership and resources, processes) and four 'results' (people, customer, society and key performance) (Ruiz-Carrillo/Fernandez-Ortiz 2005). The model has also the added advantage of providing a set of measures for 'hard' and 'soft' quality.

The concept of the built-in quality in car manufacture is a good example of an idea that has been subjected to both forward and reverse transfer across cultural and linguistic borders (see Figure 1). The first attempt to transfer this idea took place between America and Western Europe in 1911 (Tolliday 1998). Despite the failure of this process, further attempts at forward quality transfer occurred when Ford and General Motors established their subsidiaries in Japan in the 1930s.

Japan's search for new managerial ideas and practices begun after the World War II. The country struggled economically and the Japanese car manufacture suffered due to the poor quality of its suppliers and a domination of American car producers on the market. The search for ways of improving this *status quo* led to the modification and later adoption of ideas of Deming and Juran about the use of statistical process control and teamwork (Tuckman 1994). Their work led to the notion that fault prevention (not detection) was the key to achieving

**Figure 1. Global transfer of quality in car manufacture**

good quality results; continuous improvement was the ultimate goal. This notion of quality was well received in Japan and further developed into the concept of quality as something that can be procedurally built into the system, and adapted to local conditions. Despite a fairly limited response to these ideas in the USA, their impact on Japan was profound (Cusumano 1989) and resulted in the introduction of the concept of built-in quality by Eiji Toyoda in 1960 (Tolliday 1998).

The success of the Japanese car manufacturers in the 1970s stimulated the export of Japanese cars and led to a first attempt at reverse knowledge transfer when the Japanese car producers introduced their plants to North America (Abo 1998; Adler et al. 1998; Tuckman 1994). Furthermore, the Japanese tried to transfer their concepts of built-in quality, and its technology, to Western Europe along with companies such as Toyota, Nissan, Honda and General Motors (Inkpen 1998; Saka 2004).

In 1990s the concept of the built-in quality travelled further, this time from Western to Eastern Europe. The collapse of Moscow's political and economical regime in Eastern Europe in 1989 marked the economic transformation of the

Eastern bloc into a free market economy. This transformation was accompanied by the steady growth of foreign investment and the flow of Western economic ideas to the emerging market of Eastern Europe.

This process was particularly interesting and dramatic in Poland. Polish car manufacture prior to 1989 was relatively underdeveloped in quality standards as opposed to, say, the textile industry, which had a strong industrial tradition and its quality standards were relatively high (Kozminski 1993). The car manufacturing sector in the command economy was stimulated by the surplus of demand over supply with no competition. The quality of vehicles was a secondary issue as the production was directed to meet overwhelming customer demand. The Polish workforce was highly educated but it lacked in discipline and the understanding of principles of quality management (Kozminski 1993). Therefore, despite the ability of the workforce to handle modern technology and equipment, quality in Polish car manufacture remained poor and has never reached Western European standards.

A transition from the command to a free market economy was embraced by Poles with hope and enthusiasm. However, the drive to make up for the lost years of stagnation under Moscow's government resulted in many cases of uncritical willingness to accept some Western concepts as a miracle cure for the problems of the post-command economies. The arrival of companies such as General Motors not only brought the opportunities to acquire Western expertise of car manufacture and business management but, perhaps more importantly, it also provided Polish people with a platform to enter the Western arena of vehicle production. Poles displayed great openness to these new ideas and practices. They wanted to adopt them with a sense of urgency and leave an era of the command economy behind them. For some people, proving themselves as an equal partner to Western European countries, became a matter of national ambition (Davies 2001:300). It took just four years to fully institutionalise built-in quality along with other management and manufacturing practices in the Polish GM plant (Dobosz/Jankowicz 2002; Malone/Kirk 2000). In 2000, Opel Polska achieved first place in the General Motors Europe quality ranking, proving itself a mature car manufacturing plant.

In 1994, Tuckman suggested the development of Eastern Europe into a possible future source of management expertise in car manufacture. He compared the potential emergence of Eastern Europe with that of Japan several decades ago.

“In this regard, aspects of Eastern Europe are not just seen as mirroring of the state sector of the west – where the development of a market philosophy is but a rehearsal for the larger production – but that the product is almost the prehistory of that of Japan. The reputation of East European cars is often compared with that of Japan a few decades ago – the early imports of Toyotas with the current reputation of the Skoda or Lada. Potentially, we are seeing the opening of a new

phase in industrial development and the international division of labour – a periodization that could perhaps be Fordism, Toyotaism or Skodaism” (Tuckman 1994:746).

Now, ten years later, the presence of Eastern Europe in the global car manufacturing arena became a fact, and multinationals such as General Motors are eager to take advantage of this. The potential benefits stemming from the reverse knowledge transfer from Poland to other Western European GM plants were already appreciated by the company in 2000, when the first attempts at this process took place between Poland and Germany. However, the matter did not become urgent until 2001 when the American General Motors headquarters closed the Vauxhall Luton plant in the UK. Subsequently, two German Opel plants began to fear they may share this same fate in the future in the light of newly emerging competition from behind their eastern border (Nowak 2005). Financial and quality problems experienced by companies in Western European plants led to an inquiry by General Motors Europe headquarters in Zurich into company operations in the UK and Germany. As it happened, one of the Zurich’s directors was an ex-Opel Polska director, who set up the Polish plant and witnessed the development of the local staff there. Being familiar with the level of expertise of the Polish staff he decided to establish the reverse diffusion of knowledge between Poland and the UK as a response to the findings of this inquiry.

### **Research design and data collection**

According to Szulanski (1996), knowledge transfer should be viewed as a distinct experience depending on the characteristics of everyone involved where the identity of the recipient can determine the outcome of the process. Hence, it is important to address the sociological concepts pertaining to different cultures as well as the psychological concepts pertaining to individuals involved in the knowledge transfer between two cultures. The analysis of the cultural factors behind the knowledge transfer and the individual construction and meaning of the concept of quality will enable the identification of the factors behind the success or failure of this process, as defined by the organisational actors themselves.

This research aims to understand the meaning of the concept of quality in two different cultures and trace the process of reverse knowledge transfer of this idea. The research paradigm adopted in this paper is that of constructivism (Berger/Luckmann 1976; Kelly 1955). From this perspective, we can only interpret reality and not directly apprehend it in any absolute sense. No construction of reality is irrevocable as the alternative construction can always be offered (Bannister 1981). The purpose of constructivist enquiry is to gain sufficient understanding in order to predict future outcomes (Jankowicz 2000).

The study focuses on qualified descriptions and empirically generated theory about the phenomena under scrutiny. The organisation is treated as a social site,

a community, and therefore traditional methods of studying communities, such as ethnography, phenomenology or hermeneutics are especially useful. People in organisations as well as the researcher are seen as active sense makers, and while theory may provide important sensitising conceptions, the key concepts and understandings are created by the participants of the research (Alvesson/Deetz 2000).

The research was carried out at three General Motors plants involved in knowledge diffusion between the UK and Poland, that is, the Vauxhall Luton and Vauxhall Ellesmere Port, and Opel Polska plant in Gliwice, Poland. The study consisted of the ethnographic interviews (Alvesson/Deetz 2000) with 33 key informants (Tremblay 1982) chosen on the basis of their direct involvement in forward and reverse quality transfer between the UK and Poland. On the British side, there was a group of 16 managers, consisting of people involved in the managerial activities at the Vauxhall plant as well as the creation of the Polish plant, Opel Polska. On the Polish side, there were 15 Polish managers trained by the English ones, which included three Poles who were later employed by the Vauxhall UK as expatriate managers. The sample also included two German engineers in managerial positions in Opel Polska. All managers had corresponding roles in each of the two places. Sample size was determined by the information supplied by respondents according to ethnographic methodology, meaning the sample is enlarged until it results in a clear, unanimous picture of the phenomenon under scrutiny.

The interviews took place in all three locations selected for the study and were conducted over the period of 2000 – 2002. They were accompanied by the guided visits to every shop at the Vauxhall Luton and Opel Polska. The author was also present at the Vauxhall Luton in December 2000 during the dramatic events that followed the announcement about the plant's closure. However, the interviews and conversations carried out during this period were not recorded as requested by the respondents. All remaining interviews (approximately 60 min. each) were tape-recorded and fully transcribed. Following the ethnographic mode of data analysis (Hammersley/Atkinson 1995), the transcribed interviews were content analysed and resulted in a written account of the process by which the idea of built-in quality travelled between England and Poland, as interpreted by the author. In order to maintain the confidentiality of all interviews the names of the respondents are coded. Their quotations used in this account give the organisational position of an interviewee and location(s) where he/she was employed.

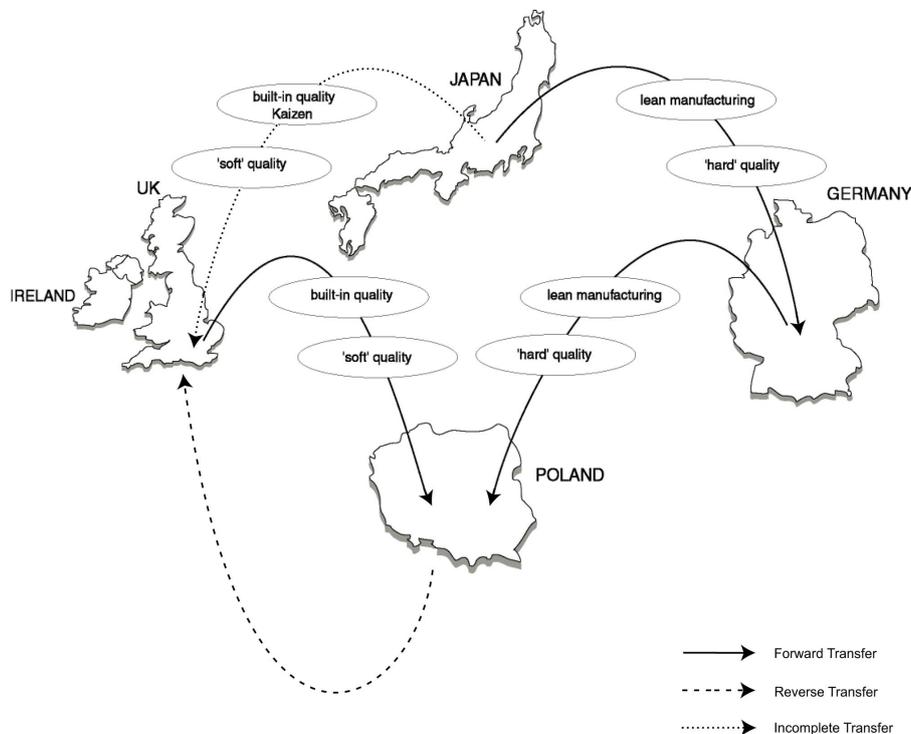
### **Built-in quality travels to Poland**

The process of setting up a new green field site in General Motors is supported by the intensive forward diffusion of knowledge between the new plant and one

or more mature GM plants. This transfer is aided by several institutions. One of them is the institution of a home plant, which represents a mature, brown field GM plant that will serve as a model for a green field site. The home plant is used as a location for an on-site training of a new staff as well as a source of experts who are often lent to a new plant as expatriate managers. The institution of an expatriate manager, called International Service Person (ISP) in GM's jargon, plays a crucial role in forward and reverse knowledge transfer.

Opel Polska received a German plant in Eisenach as its official home plant. However, the initial on-site training also took place at Vauxhall Luton. Correspondingly, a group of ISPs allocated to set up Opel Polska consisted of English as well as German managers. As a result, the development of the built-in quality in Opel Polska was influenced by the notions of quality embedded in the GM plants in these two countries (see Figure 2).

**Figure 2. Diffusion of the built-in quality in General Motors Europe**



The British managers brought in and developed the 'soft' part of quality in Opel Polska. This part of knowledge diffusion had its roots in the Japanese concepts of quality and people management, which are at the core of the notion of built-in

quality. Henceforth, the ideas and practices brought by the British to Poland represented the idea that all organisational members should be responsible for the quality of their work, and that defects should be prevented rather than repeatedly repaired. They were also responsible for establishing a built-in quality culture in the plant, something they failed to achieve in the UK GM plants (Saka 2004).

Corresponding to the notion of the built-in and 'soft' quality, there was an influence upon Opel Polska that led to the development of the 'hard' side of the quality system in the plant. This process was strongly influenced by the German managers who served as a link between Opel Polska and the German plants. The operations that took place between these locations were concerned with the 'hard', measurable aspects of car production. Henceforth, the German team was responsible for establishing in Opel Polska the processes of lean manufacturing and standardisation amongst others.

The Japanese and German ideas of quality management had an impact on different areas of the quality system in Opel Polska. The Japanese ideas influenced and stimulated the development of quality of the whole system, whereas the Germans determined the quality of the final product. Despite affecting different aspects of the quality assurance system in Poland, these two effects worked as a complimentary forces leading to the unique blend of approaches developed in Opel Polska (Dobosz/Jankowicz 2002).

### **The notions of quality in Opel Polska and the Vauxhall Ellesmere Port**

Quality is a concept defined by General Motors as something that can be procedurally built-in to the production process. The system is designed in a manner that prevents defects from occurring and shifts the responsibility for faults from the individual onto the system. The emphasis is placed upon customers, both internal and external, and on the prevention of potential defects.

There are three main components of quality as understood by GM:

1. the quality of the system;
2. the quality of the final product as defined by the customer; and
3. the quality of workmanship.

*The quality of the final product* is almost equivalent to customer expectations. It is the product as seen in the eyes of the customer. Her/ his decision as to whether or not to buy a GM product means for Opel people having a job or not. Thus, customer satisfaction lies at the core of any [General Motors] definition of 'good quality'.

*The quality of the system* consists of the mechanisms that enable employees to deliver a product of high quality. The idea of creating a system that 'automatically' leads to good quality is called *built-in quality*, and is a definition of quali-

ty that GM teaches its employees. The system of quality assurance, which gives 'built-in' quality to the product is supported by a number of techniques such as:

1. problem-solving techniques (e.g. the Practical Problem Solving Technique);
2. strategies supporting defect prevention (e.g. automation, Andon);
3. techniques enhancing employee motivation (e.g. performance related remuneration, teamwork, empowerment through Kaizen);
4. standardisation supported by visual management.

The last area of quality is quality of workmanship, often described as the most important part of quality. The quality of people and their workmanship is considered by the GM people to be the absolute base factor that determines the overall quality of results achieved in the plant.

These three elements – quality of the final product, system and workmanship – function interdependently and create a whole system of built-in quality, which is understood to be an overall approach, engaging every member of the organisation into creating high-quality products and satisfied customers, both internally and externally.

Opel Polska is a good example of a car plant where these three elements were successfully introduced and implemented. However, in order to shed some more light on this issue we will listen to the opinion of the Polish ISP.

“Gliwice is not a good example for describing the approach to quality. There were 2,000 people chosen from 20,000 applicants. And they were brainwashed right from the beginning. In this plant, if someone does not believe it, they will go crazy. The approach implemented in Gliwice is like in Chinese communism, and there is no discussion. Do not accept, do not shift defects. There are no situations where someone hid something. People were introduced to it right from the beginning and I believe in it too. If I didn't believe in it I would go crazy in the environment where this is the rule. (...) This also corresponds with the corporate visions of GM such as say what you believe, do what you say. If there is a problem you have to say it openly, it happened, too bad. This exists in Poland but in other plants no one cares about it too much. In here [Ellesmere Port] supervisors accepted that but there was only one manager who acted according to it.” (*Polish ISP, Opel Polska, Vauxhall Ellesmere Port*)

The Polish plant is a typical green-field site where the concepts of quality were implemented right from the beginning. This also applies to the quality of workmanship, itself enhanced by the high number of applicants, which allowed General Motors to choose candidates matching their desired profile (i.e. young, willing to learn and accept new ideas).

The implementation of built-in quality in Ellesmere Port was rather different. The plant was set up in 1964 and, prior to the concepts of lean manufacturing

and built-in quality being introduced, the plant operated successfully for a number of years. There are still many people employed at the plant who started there in 1964. Therefore, changing the work attitudes, a dilemma for most brown-field sites, is a major challenge General Motors has to face.

“If people have done something for 30 years in the same way and may have been successful economically, they've made a lot of volume, and all of a sudden, you come along and say, ‘I'm sorry, but this is not going to allow you to survive in the future’. They look at you and say, ‘You are crazy. We've always done it like this. It's been OK’. (...) And that's the most difficult challenge anybody has to have, to take a brown field workforce, a brown field culture, and try to change it. That is very difficult and very frustrating. I spent two and a half years trying to do it and let me tell you, all the hard work of this green field was nothing compared to the frustration of trying to change an old, traditional group of people.”(*English Manager 1, Nissan UK, Opel Polska, GM Europe Zurich*)

The most important difference between the Vauxhall Ellesmere Port and Opel Polska lies perhaps in this element of quality – the workmanship. The willingness to learn and accept new ideas in the UK plant is very low. Furthermore, the nature of people's motivation is different. The picture of the employees in these two countries that emerged in this study indicated that Polish employees are more motivated by their work-related achievements and the fact that they work for General Motors. Contrastingly, English employees are more concerned with the quality of their life, and the relative importance of work itself is much lower in England, due to higher job security compared with Poland.

### **Reverse diffusion of quality**

The development of the second element of quality as defined by General Motors – the quality of the system – was the main reason behind the reverse knowledge diffusion from Poland to England. As mentioned before, the process started in 2001 as a result of poor financial and quality results in the Vauxhall Ellesmere Port. Initially, the process was to take place through a project team sent from Poland to the UK. However, after the time-scale of the project was extended several times, the company decided to bring in the Polish staff in a role of ISPs for a longer period. The first Polish ISP was sent to Ellesmere Port along with a group of Polish staff as a support. Soon after, a similar team of another Polish ISP and support staff was sent to a German plant. However, the latter group was not included in this study.

The Vauxhall Ellesmere Port is more developed technically and better equipped compared to the plant in Poland, as it has been expanded and refitted for the production of a new Vectra in the UK. There is also a difference in the level of implementation of lean manufacturing in these two plants.

“For example, the wheel. The employee does not have to take it from the shelf. There is a special machine, which passes the wheel on and the worker has to slide it on and attach the screw. And all of this is automated. Additionally, the wheel is sequenced so s/he does not have to worry whether s/he is putting on the right or wrong wheel. This production line [in Ellesmere Port] is more automated so it’s easier for people. There are also more people on the line; the stations are more dispersed. Their work is more detailed so it’s easier for them. (...) In Poland they try to save money on everything, on equipment, on people. We employ less than 2,000; they have 3,500”.(Polish Manager 1, Opel Polska, Vauxhall Ellesmere Port)

The elements of the quality of the system that were missing in the UK plant were:

1. problem-solving techniques;
2. standardisation and visual management;
3. organisation and planning of work and production.

The process of reverse diffusion was targeted at these elements in particular. The Polish staff was introduced as a team supporting problem-solving and defect tracking in production of the Vectra. The Polish ISP took on the position of a Material and Control Production Manager. His role was to stabilise the functioning of the Material department. This would involve the introduction of production planning and control, and standardisation of the operations.

Due to different official positions, and what follows different levels of authority, given to the Polish experts their way of introducing new ideas in the UK plant varied. The Polish ISP had a relatively strong position in the company, which gave him authoritative power to implement some of his decisions. Several people initially rejected his strategy of implementing new working practices such as planning of production, thorough organisation and documentation of individual work, and visual management.

“I sacked 4 out of 5 managers. There is only one left. If he doesn’t perform, he will be replaced too. And then I will start with the middle level. Even though I am here for just 12 months, it’s enough time to remove this acrimonious structure. (...) There are no mechanisms, which would discipline them. Pure communism. If they come to work or not, they will receive the same bonus at the end of the year. If they produce 5 or 500 cars the pay is the same.”(Polish ISP, Opel Polska, Vauxhall Ellesmere Port)

The strategy adopted by the members of the Lean Manufacturing Support Team was dramatically different to this demonstrated by the Polish ISP. The rest of the Polish experts adopted the role of advisers. The decision of whether or not to adopt their advice was left entirely to the British staff.

“I tried to approach them in a friendly way, not to impose anything. It is always the case that if you try to force someone to do something they will object it. My position here is also too low for me to dictate anything.” (*Polish Manager 1, Opel Polska, Vauxhall Ellesmere Port*)

This group of Polish employees developed a more cooperative style. They tried to assist problem analysis and suggest techniques they were familiar with. They believed that if the technique proved useful, the adoption of it by local staff would follow. They also organised training introducing the UK staff to various instruments assisting communication and problem solving.

The Lean Manufacturing Support Team succeeded in the introduction of several ideas. They managed to implement a technique called PPS (Practical Problem Solving). The production line adopted the method of reporting problems introduced by the team that improved the tracing of problems and defects, and what follows the identification of a root-cause and fault prevention.

The Polish ISP managed to revive production planning in the plant. So far, the production department used to agree the volume and the model to be produced on a daily basis. This, however, was against the central planning procedure adopted by General Motors, where production is centrally planned in Germany for each GM European plant. This is closely connected to the system of material purchasing and control, which has to match and sequence the material required for the production according to the central plan. This element is considered by the Polish staff to be the most significant change that has been implemented. Additionally, the planning and documenting of individual work as well as visual management were introduced.

Although both groups of Polish managers and their approaches to introducing change were successful, the impact of the Polish ISP was more significant, and resulted in a more fundamental change. Whereas the first group of managers helped to streamline certain procedures, the Polish ISP introduced a new approach to some operations such as production planning.

The ideas and practices related to standardised work and lean production were the most difficult to introduce, as they require a disciplined approach to ones' work and high levels of motivation. These elements seemed to be missing in the UK plant, which have significantly hindered the implementation of the ideas related to quality. However, according to the Polish ISP the failure in the adoption of built-in quality does not need to have dramatic consequences for the plant as a result of organisational politics.

“The plant in England will always get the model to produce and will be there forever because it is in the UK. And the plant in Gliwice will always be at the other side of the world and sometimes it will get the model but sometimes it

won't. And there will be always people going there to learn."(*Polish ISP, Opel Polska, Vauxhall Ellesmere Port*)

The process of reverse quality diffusion to the UK is ongoing. It is also taking place between the Polish and German plants. Whether Opel Polska will ever become a home plant for any of its partners, time will show. The arena of car manufacture in Europe is fascinating and fast changing, but our journey into it has to end here.

### **Discussion and conclusions**

The analysis of the existing systems of quality assurance in the Polish and UK Vauxhall plants indicates some significant differences. The successful implementation of the system of the built-in quality in Poland, the element missing in the UK plant, creates scope for the reverse diffusion of knowledge between Poland and England. The team of Polish experts in the UK plant have introduced the elements related to the quality of a system and 'hard' quality elements, such as problem-solving techniques, enabling tracing the root-causes of problems and defect prevention, standardisation, and detailed planning of work at the individual as well as departmental level. The reverse quality diffusion was planned as an evolutionary RD in Edwards and Ferner's terms (Edwards/Ferner 2004). Henceforth, it was aimed at improving the operations and quality of the system in the UK plant by introducing some new practices and ideas. However, the analysis of an overall system of quality assurance in Vauxhall Ellesmere Port indicates that it contradicts the philosophy of built-in quality. The ideas of quality embedded in the UK plant place the emphasis on the final audit of a product and fault repair, which in itself is the contradiction of built-in quality. Moreover, the study indicated that low levels of motivation and the work attitudes of British employees might further hinder the development of quality workmanship in the plant. Therefore, the factors contributing to the lack of presence of the built-in quality are more complex than a lack of procedures or lean manufacturing principles. They involve the organisational values embedded in the culture, which were developed in the plant over the decades of its existence.

These findings indicate that the evolutionary reverse diffusion, which is aimed at introducing new practices without changing the existing modus operandi, is not sufficient to address the problems existing in the UK plant. It could be argued, that the implementation of transformative reverse diffusion would be more appropriate, for transformative transfer is directed towards a more significant impact and seeks to change the assumptions concerning the way in which organisation operates. This process is strongly dependent on learning from the subsidiary plant, in this case Opel Polska.

There is a clear difference in organisational implications of evolutionary and transformative reverse diffusion. Evolutionary transfer, dealing with mastering

the existing organisation and its operations by slight improvements, does not require the time and resources that would be necessary for the transformative transfer. The transformative change, in order to be effective, would need to involve the support and commitment of organisational decision-makers as well as appropriate resources. Furthermore, the role of experiential learning, especially crucial when transferring tacit knowledge (Nonaka 1995; Szulanski 1996) such as some elements of 'soft' quality, needs not to be underestimated. As illustrated in this study, the attempt to introduce experiential learning by the Polish staff in Ellesmere Port as well as organisational and structural changes carried out by the Polish ISP, were sufficient to bring out some improvement in the quality of the system. However, for the full diffusion of built-in quality to be complete, the quality of workmanship would need to be transformed as well. The establishment of an institution of a home plant indicates that learning from experience has a strong presence and organisational support in General Motors when forward diffusion takes place. It could be argued, that this institution and this type of on-site training are equally important in case of the reverse process. The employment of these techniques could lead to increased professionalism and expertise of staff as well as a continuous improvement of company's operations – an important element of the built-in quality philosophy.

According to Boyer et al (1998), reverse diffusion may be as equally as important as the forward process. Toyota and other Japanese car manufacturers, by transferring knowledge in the reverse direction, abandoned their payment system that was potentially counter-productive (ibid. 377). Our study showed that General Motors UK could benefit from transformative reverse diffusion and introduce the system of the built-in quality in the Vauxhall Ellesmere Port improving the plant's quality and financial results. Additionally, Poland's membership in the European Union opened more avenues for the knowledge flow to the West of Europe. However, as Poland entered global car manufacture only few years ago, its position was not yet as well established as that of Japan's. Therefore, we can expect the willingness to learn from the Polish Opel Polska plant in General Motors Europe to be rather low (Nowak 2005). As argued by Muthusamy and White (2005) the new skills and knowledge learned in the process of knowledge transfer depend on so-called ability-based trust, that is, a trust in a partner's ability. This aspect coupled, with goodwill, are necessary factors in making the exchange of knowledge meaningful and productive (ibid. 434). The nature of reverse diffusion can prove to be challenging regarding this dimension. While the willingness to absorb new managerial ideas and practices was an understandable characteristic of the Polish staff, who had an ambition to 'catch up' with the West (Kozminski 1993), the same attitude could be problematic to achieve in societies with a history of economic success such as the United Kingdom. According to Styhre (1998), the acceptance of management ideas is higher in groups, which run the risk of being excluded or marginalised. This statement is well il-

illustrated by the dramatic economic growth of Japan after World War II and Poland post 1990. However, the consequences of such a transformation can sometimes only be appreciated by others when the process proves successful.

“Before, we [Volvo in Sweden] believed we were the centre of the world, but we have discovered that there are things that are better in other places.”(*Mr. Blue in Styhre 1998: 202*).

Reverse diffusion of knowledge offers a unique opportunity to keep up with the developments and innovations taking place in the organisation’s subsidiaries. It also enables the revival of systems such as audit-based quality assurance by that of built-in quality, as demonstrated in this study. After the emergence of the post-command economies on the free market, the reverse diffusion gains a particular importance in the European context. The potential to aid the development of new core capabilities and gain competitive advantage by employing reverse knowledge transfer has been proved by Japan’s car industry, and should not be underestimated. Similarly, the potential for furthering knowledge by the CEE societies must not be overlooked (Mikl-Horke 2004). However, in order for the reverse diffusion to be successful, it needs to receive the same attention the forward transfer does.

The difference in the nature of evolutionary and transformative reverse diffusion (summarised in Table 1) draws our attention to the importance of apt evaluation of a company’s situation and needs prior to the transfer. The role of change agents taking part in this process should also be considered, as it will influence the implementation and adoption of new managerial practices by local staff. The importance of ability-based trust and willingness to learn as key factors in determining the outcome of the reverse diffusion indicates that the development of the appropriate relationship between both parties should start from the beginning of their cooperation. By creating a climate of mutual respect and learning, an environment can be built where the evolving nature of the relationship between parties during a shift from forward to reverse diffusion will become a natural consequence of organisational development, rather than reversal of power relations.

The research presented in this paper raised many questions. It demonstrated the importance of the reverse diffusion of ideas in the development of core capabilities and gaining competitive advantage by organisations. The process of RD has also great relevance to a discussion on globalisation and can contribute to the views of Amin (1997) and Holden (2002). Moreover, its importance for other industries, whether product or service, should be recognised in the context of globalisation.

This paper also pointed at some significant differences between evolutionary and transformative reverse diffusion and their organisational implications. How-

ever, there needs to be more research conducted into reverse knowledge transfer for us to better understand the factors determining its outcome, and support our discussion with more empirical results. The abundance of data to be explored, as well as the fascinating nature of this subject, leaves the author hopeful that some exciting accounts of this process will soon follow.

**Table 1. Factors affecting reverse diffusion**

	Evolutionary RD	Transformative RD
Factors calling for RD	<p>Keeping up with innovations and specialised knowledge developed in subsidiaries,</p> <p>Development of core capabilities and gaining competitive advantage,</p> <p>Slightly worse performance results comparing to the subsidiary (need to improve),</p> <p>Professionalisation of staff,</p> <p>Expertise development,</p> <p>Ongoing or short-term commitment</p>	<p>Transformation of existing modus operandi,</p> <p>Organisational culture change,</p> <p>Organisational revival of the brown-filed sites in decline,</p> <p>Significantly worse performance results comparing to the subsidiary (need to catch up),</p> <p>General restructuring of corporate strategies and structures (Edwards and Ferner 2004),</p> <p>Long-term commitment</p>
Drivers	<p>Standardisation of operations across borders,</p> <p>Good communication channels and strong network between the companies involved,</p> <p>Focus on continuous improvement,</p> <p>Structures and procedures supporting RD</p>	<p>High degree of strategic autonomy vis-à-vis HQ (Birkinshaw et al. 1998),</p> <p>Openness to new ideas and willingness to learn (domestic),</p> <p>HQ's support and allocation of appropriate resources,</p> <p>Emphasis on experiential learning,</p> <p>Movement of personnel across borders</p>
Depressors	<p>Fear of losing competitive position (subsidiary),</p> <p>Low ability-based trust,</p> <p>Economically dominant position of a domestic country</p>	<p>Fear of losing power, position of privilege and/or status (domestic),</p> <p>Low ability-based trust,</p> <p>Economically dominant position of a domestic country</p>

	Evolutionary RD	Transformative RD
Results	Continuous improvement of company's operations and performance, Professionalisation of staff, Up-to-date expertise and innovations, Increased competitive advantage and core capabilities	Increased (or new) competitive advantage and core capabilities, Standardisation of products and operations across borders, Institutionalisation of 'best' practices in a local environment, Organisational revival (brown-filed sites in decline)

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## Inside the transnational social space: Cross-border management and owner relationship in a German subsidiary in Hungary\*

Christoph Dörrenbächer\*\*

*This paper examines the social relationships in and around a German subsidiary in Hungary during the first 15 years of Hungarian transition to a market economy. It draws on a recent conceptual framework that sees multinational corporations as transnational social spaces, in which transnational communities – communities of individuals that exhibit a unique cross-national organisational identity – may emerge. Empirically investigating two basic types of cross-border social relationship in multinational corporations, the paper argues that, due to the constant interplay of cross-border management and ownership relationships, the emergence of transnational communities is a demanding process, with established communities being precarious entities.*

*Key words: Multinational corporations, Transnational social space, Transnational communities, Headquarters-subsidiary relationships, Knowledge transfer*

### Introduction

Multinational corporations (MNCs) are some of the most complex and hence most intriguing organisations in the modern world. Their organisational differentiation and geographical spread contribute to their complexity; in fact, some corporations operate in the majority of the world's countries. Moreover, assessment of MNCs and their activities differ greatly. While some consider MNCs to be “a powerful force for the good” (The Economist 2000:19), others hold a more critical view of corporations that span nation states, economic systems, cultures, and religions. This controversy, along with a colourful history of centuries of cross-border business activity undertaken by MNCs and their antecedents, i.e. medieval trade guilds, colonial trading companies and early joint stock companies, have ensured that multinational corporations attract considerable academic interest. The last fifty years, in particular, have seen a surge in attempts to explain the nature and behaviour of multinational corporations, international production, and cross-border management. To date most approaches employ distinctly economic and management perspectives, contributing to the rapidly growing field of international business (IB) literature. In contrast, organisation studies have

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played a minor but growing role in explaining the cross-border business activities of MNCs.

Early organisation studies of MNCs, undertaken in the 1970s, were limited to looking at how organisational structure is a function of corporate strategy and environmental contingencies. Subsequent studies in the 1980s examined the process by which MNCs are simultaneously shaped by different contextual influences, e.g. home and host country institutional influences or combined organisational and institutional influences. Both streams of research were deeply rooted in a structuralist tradition. Only very recently has this tradition begun to lose sway to a more open structural analysis and action perspective that conceptualises MNCs as transnational social spaces.

The notion of transnational social spaces is an offshoot of labour migration studies, ethnic studies, world society theories and the literature on economic globalisation. The concept suggests that MNCs are arenas in which socio-economic action takes place, multiple social relationships emerge, sense is made, power is exercised and the dynamics of consensus, conflict and resistance are played out (Geppert/Clark 2003; Morgan 2001 a, b; Pries 2001). The transnational social space approach can be clearly distinguished from the other approaches mentioned by the fact that it, firstly, deconstructs social reality in MNCs into a more open-ended set of cross-border social relationships and, secondly, suggests that cross-border social relationships may take the form of transnational communities. It draws attention to social relationships that exhibit a unique cross-national organisational identity and that cannot be reduced simply to the interplay of national influences and interests (Morgan 2001 a).

To date, the concept of transnational social space has been used in a rather vague fashion, and different dimensions of the transnational social space have been simply conflated. Analytical differentiation between different types of relationship in this transnational space and empirical investigation of such social relationships is required. Which social relationships co-exist in the setting of one specific MNC? What form do these relationships take and how do they interact with one another?

The purpose of this paper is to propose initial answers to these questions. Based on a longitudinal in-depth case study of Siemens-Telefongyár, a German-Hungarian venture in the telecommunications equipment industry, this paper empirically illustrates that multiple processes of boundary-crossing are inherent to all MNC activities abroad. The study shows that cross-border management relationships and owner relationships are two essential types of social relationship in an MNC. By more closely examining these two types of relationship over the 15 years of transition from a communist to a market economy, the case study demonstrates that social relationships in MNCs develop unevenly and that the emergence of transnational communities in MNCs is a demanding process.

Moreover, the case study shows that transnational communities are precarious entities, because the underlying cross-national organisational identity is constantly threatened by other social relationships in and around the MNC, as well as by changes in the business environment.

The first section of the paper provides a short conceptual discussion of MNCs as transnational social spaces based on gaps identified in existing intra-organisational research on MNCs. Moreover, this section analytically specifies relevant types of social relationship and defines the characteristics they exhibit. The following section explains the methodology. The case study is introduced in the subsequent section and the transnational social space of an MNC is investigated by exploring different cross-border management and owner relationships. The management relationships elucidated in greater empirical detail comprise the different relationships of Siemens expatriates and their Hungarian counterparts at top and the middle management levels.

Conceptually these relationships touch upon the strategic and operational dimension of the transition process at Siemens-Telefongyár. The owner relationships explored here include both intra-organisational owner relationships as well as the overall owner-management relationships at Siemens. These relationships represent the different layers of governance to which the venture was and is subject. The paper closes with a short discussion of the quality and interrelatedness of these two types of cross-border social relationship, as well as with the theoretical implications of the case study.

### **Multinationals as transnational social spaces**

For a rather long time organisation studies (and the IB literature) treated MNCs as hierarchical entities in which power resided entirely in headquarters and with managers from headquarters. It was not until research turned to corporations from different home countries that this picture changed. Thus, research carried out by Stopford and Wells (1972) on US multinationals and Franko (1976) on European multinationals showed that European MNCs were much more decentralised than their counterparts with headquarters in the United States. One of the first authors to translate these empirical findings into a more theoretical concept was Gunnar Hedlund. In his famous 1986 article “The hypermodern MNC – A heterarchy?”, Hedlund observed that heterarchical MNCs – unlike hierarchical ones – have many centres, and that subsidiaries of this type of MNC are given a strategic role, not only for their own subsidiary but for the multinational as a whole (Hedlund 1986). Similar concepts followed, such as the MNC as an “integrated network” (Bartlett/Ghoshal 1989), or the MNC as a “transnationally differentiated network”, a term coined by Nohria and Ghoshal (1997) approximately a decade later. In all of these concepts, the role of the headquarters was

relativised and power structures within the multinational were seen as diverse, context-related and relationship-based.

This new paradigm also inspired the more narrow discussion on headquarters-subsidiary relationships in MNCs. Here, extant research was basically concerned with the decentralisation of decision-making authority in MNCs and issues of coordination and control, with both aspects considered as intrinsically interrelated. Decentralisation of decision-making authority by MNC headquarters in favour of their subsidiaries was seen as influenced by a number of factors, including industry type, country of origin, type of value-chain activity and overall organisational complexity (Gates/Egelhoff 1986). Subsidiary-related factors such as subsidiary size and capabilities or advantages tied to the location of the subsidiary were considered much less important (van den Bulcke 1984; Baliga/Jaeger 1984). Despite these studies, which played down the role of subsidiaries, the overall paradigmatic change towards more heterarchic structures within MNCs shifted research attention towards the specific role and contribution of subsidiaries (cf. Birkenshaw 2001; Johnston 2005). Common to these contributions is their assumption that subsidiaries are more than just executive organs of headquarters but potentially important organisational units that produce firm-specific advantages (Taggart 1998).

Moreover, as Birkenshaw (1996; 2000) has pointed out most prominently, subsidiaries follow their own strategies, which do not necessarily accord with the intentions of headquarters, leading to subsidiary initiative and entrepreneurship both within and outside the MNC. Thus, depending on their autonomy and power position (Forsgren et al. 2005), subsidiaries struggle to enlarge their mandate, to enhance their role or to autonomously follow business opportunities in their local environment (White/Poynter 1984; Birkenshaw 2000; Kristensen/Zeitlin 2005).

While the growing emphasis on subsidiaries as partly autonomous actors with their own agendas has opened up a perspective that allows a better understanding of power, politics and conflicts in headquarters-subsidiary relationships (cf. Dörrenbächer/Geppert 2006), the literature to date still displays some shortcomings that need to be addressed by a less restrictive approach. Thus, rather little is known about key actors, their rationales and interactions in headquarters-subsidiary relationships. What kinds of managers organise headquarters-subsidiary relationships? What rationales can be assigned to them? What strategies do they follow and what kinds of social relationships emerge between headquarters and subsidiary managers? Answers to these questions are still very piecemeal and sometimes subject to rather broad assumptions. For instance, actor rationales in headquarters-subsidiary relationships are assumed to follow either general behavioural patterns such as risk avoidance (Aharoni 1966) or a 'not invented here' attitude (Edwards et al. 1999), or to be strongly shaped by the (sub-)organ-

isational origins of actors (Birkenshaw/Ridderstråle 1999). This clearly neglects other important rationalities such as functional and hierarchical background, national origins or career orientation.

Addressing these open questions, some authors have recently proposed conceptualising MNCs as transnational social spaces (Geppert/Clark 2003; Morgan 2001 a, b; Pries 2001). Two core features are encapsulated by the notion of the MNC as a transnational social space. First, conceptualising MNCs as transnational social spaces places a strong emphasis on cross-border social relationships that emerge within MNCs through continued and structured interaction between actors that belong to different organisational units. Thus, MNCs are basically understood as pluri-local entities formed by multiple and complex social relationships. This moves beyond the dominant paradigm, which claims to map the social order in an MNC by concentrating on headquarters' strategies or on headquarters-subsidiary relationships, and makes abandoning the unrealistic notion of MNCs as unified rational actors possible (Morgan 2001 a:11). Second, these multiple and complex cross-border social relationships are not seen as characterised by a single factor but by the interplay of multi-sited social realities (or "site ontologies" as coined by Schatzki 2005:471) composed of material arrangements, social practices, institutional frames and interpretative schemes of key actors (Pries 2001:28 Clark et al. 2001:5; Geppert/Clark 2003:436). Material arrangements refer to set-ups of human-made things (e.g. machines, buildings), artefacts (technologies, software) and other human beings (workforces). Social practices are defined as organised, open-ended spatial-temporal actions that are both structured by and restructure material arrangements (Pries 2001:22; Schatzki 2005:471). In the case of an MNC this includes practices on the level of the subsidiary (e.g. the management of the labour force), as well as practices on the overall MNC level (e.g. reporting, monitoring and benchmarking systems). Institutional frames refer to the impact of the wider socio-political home and host country context both on material arrangements and social practices. Actors' interpretative schemes stress the importance of actors' meanings and sense-making as logic for specific action (Weick 1995).

Depending on the interplay of these factors, it is argued that social relationships in MNCs can take different shapes. Explicitly included here is the emergence of so-called transnational communities, i.e. communities of individuals in MNCs that exhibit a unique cross-national organisational identity, despite the fact that their national and organisational roots vary. The emergence of transnational communities is understood as a result of "the interplay between top-down projects of transnationalism, pursued by powerful actors, and bottom-up processes of mutual identification and collective awareness" (Morgan 2001 b:118).

Another important difference relates to the basic rationale of social relationships in MNCs. Following findings from research on international joint ventures

(Inkpen/Beamish 1997; Shenkar/Yan 2002), social relationships in MNCs can be grouped analytically into either management or governance relationships. Governance relationships enable the discussion, definition, and modification of the constitutional rules and mandates in an MNC, while management relationships focus on how these constitutional rules and mandates are interpreted and applied operationally and strategically. These two generic types of cross-border social relationship in MNCs strongly influence each other.

Finally, social relationships in MNCs are constructed by different groups of individuals. Focusing on cross-border management issues, different kinds of headquarters and subsidiary managers are involved. Here, extant research has stressed that there are large differences between top and middle managers (Stewart 1976; Petit 1981). This does not only apply to tasks and functions, but also to behavioural patterns. Ganter and Walgenbach (2002:167) for instance consider middle managers as much more open to cultural influence, while Huy (2001:73) stresses that middle managers leverage informal networks to make organisational change possible far more successfully than top managers. Strong attitudinal differences were also reported with regard to different kinds of foreign subsidiary managers.

Following a well-established categorisation, foreign subsidiary managers are either expatriates (parent-country nationals and third-country nationals) or inpatriates, i.e. local host country nationals (Harzing 1999). These different types of staff are understood to have different orientations. Usually expatriates are seen as strongly following a headquarters orientation due to their familiarity with the MNC's overall goals, policies and practices. They are frequently seen as most efficient in exercising headquarters control over the subsidiary. Local managers or inpatriates, on the other hand, are seen as having a generally local orientation, due to their socialisation in the host country and their familiarity with the social, political and economic environment of the host country (Harvey et al. 1999).

Based on this conceptual framework, the following case study examines the transnational social space of an MNC by investigating cross-border management and governance relationships. The case study deals with issues of cross-border knowledge transfer and processes of subsidiary role development; topics well suited to research into the nature of social orders in MNCs (Morgan 2001 a:12).

### **Methodology**

Given the scarcity of empirical knowledge on the multiplicity of cross-border social relationships and on the complex and fragmented nature of social order in MNCs, a single case study was used to provide insight into these subjects. The case study was designed to be both descriptive and explanatory using multiple within-case comparisons (Yin 2003; Eisenhardt 1989). The case study focused on the following questions: What kind of cross-border social relationships exist

in MNCs? How and why do their characteristics differ? What overall picture of the social order in an MNC emerges from this empirical evidence?

The data were collected in 26 interviews carried out between 1999 and 2004 at different Siemens units in Germany, Austria and Hungary, both at the headquarters and the subsidiary level. The semi-structured interviews based on an interview guideline usually lasted an hour and a half. A few of the interviews were group interviews; some people were interviewed several times. All interviews except one were taped and transcribed. Interview sections that touched upon social relationships were coded and processed with the help of text-related information management software.

The interviews centred on the strategic and operational dimension of the transition process at Siemens-Telefongyár, with a focus on issues of knowledge transfer and subsidiary-role development. The topics addressed in the interviews were somewhat standardised. However some variations in questions occurred due to the different organisational, functional and hierarchical background of the interviewees. Given the fact that transformation in former socialist Central and Eastern European countries has taken place over a rather long period of time (Balaton 2004), the interviews aimed to map 15 years (1989 – c2004).

Access to interview partners was initially facilitated by a sponsor in the headquarters' top management. After conducting a few interviews, we decided to also use the snowballing approach (Welch et al. 2002), asking our interview partners to name and, in turn, recommend us to their counterparts in social relationships. This was mainly due to the fact that being backed by a top manager from the headquarters led to suspicions about our motives in conducting the research, resulting in monosyllabic and/or seemingly calculating answers by some interview partners. In line with the general findings of Soulsby (2004) and Michailova (2004) on problems of qualitative fieldwork in Central and Eastern Europe, this behaviour was clearly more pronounced among our Hungarian than among our German or Austrian interview partners. Using the snowballing approach not only helped us to build trust and openness among the Hungarian interviewees, it also ensured that we could interview at least one partner from each side of a social relationship in order to gain a multi-faceted view on social relationships in MNCs.

Interviews at the German headquarters and with German or Austrian expatriates in Hungary were conducted in German. Interviews with Hungarian managers and Hungarian stakeholders were conducted in Hungarian with the help of a Hungarian colleague who simultaneously interpreted. Similar to the experiences reported by Steger (2004) and Balaton (2004), in-depth discussions with this colleague on the interviews not only helped in avoiding (minimising) misunderstandings but also enabled a much better understanding of the motivation and the behaviour of the Hungarian interview partners. The discussions were also a

great help in the subsequent process of data analysis. Commentary field notes on the specific conditions, main events, immediate impressions and ideas that arose during interviews were recorded immediately after the interview and frequently consulted during the later process of data analysis.

The statements in the interviews were corroborated in other interviews and with document data. Document data that were integrated into a 'company development profile' were taken from a multitude of sources (from the company itself, from newspapers and journals, from company handbooks and other company-related databases, from national and international chambers of commerce, as well as from investment-promotion agencies). Further steps to improve the validity and reliability of the research included feedback meetings with interview partners on interim results, as well as a triangulation of the overall case by a second investigator (Houman-Anderson/Skaates 2004), i.e. the Hungarian colleague who interpreted during the interviews.

### **Social relationships in and around the Siemens-Telefongyár venture**

To understand the dynamics of the cross-border management relationships during the period under study, the strategic background of the Siemens-Telefongyár venture is presented, as well as a brief history of this venture covering the years from 1989 to 2004. We then move to the description of cross-border management relationships, addressing the transition process itself. Next, owner relationships are explored, first at the intra-organisational headquarters-subsi- diary level and then at the overall level of the MNC.

#### *Background and history*

The acquisition of the Hungarian telecommunication equipment supplier Telefongyár was one of the many acquisitions that Siemens undertook in Central and Eastern Europe immediately after the fall of the Berlin Wall. At that time, the low volume of the Central and Eastern European market for electronic products and services compared to the Western European market suggested a tremendous potential for growth, with Siemens expecting particularly high profits in infrastructure businesses such as telecommunications, energy and transportation. Additional reasons for building up major manufacturing facilities in Central and Eastern Europe included low wages and a skilled workforce in close geographic proximity to the home country (Mirow 1996). With the exception of the Czech Republic, which became the major export platform of Siemens in Central and Eastern Europe, Siemens' investments in Central and Eastern European countries generally aimed at market access. A strong correlation between local production and local market share emerged in these countries, with local production aiming at securing the market position of Siemens. This was also the case with Hungary and in particular with the Siemens-Telefongyár venture.

Prior to the fall of the Wall, the Budapest-based Telefongyár was one of the three leading telecommunication equipment suppliers in Hungary that concentrated on the development and production of transmission equipment. Since Hungary was a major supplier of telecommunications equipment in the Council for Mutual Economic Assistance (CMEA) (Müller 1998), a notable part of Telefongyár's production was exported. Russia alone accounted for about three-quarters of production in 1988 (Neumann et al. 1993). Additional exports went to other CMEA countries, as well as to some Arab countries.

It is unclear as to whether there had already been contacts between Telefongyár and Siemens regarding the most important pre-transition telecom project of Siemens in Hungary – i.e. the delivery of switching equipment for the Hungarian data network in the 1980's. However, from at least June 1989, Siemens and Telefongyár held close discussions about a cooperation agreement regarding public switching technology (Das Parlament 1990). These discussions led to a joint Siemens-Telefongyár bid in the 1990 tender by the main Hungarian Telecom operator MATAV for switching technology. With the success of the Siemens-Telefongyár bid announced by MATAV at the end of 1990, discussions about the acquisition of Telefongyár by Siemens gained further momentum. This was especially due to the formal obligation in the tender that the contractor had to maintain a local production unit in Hungary to serve the contract. This obligation was restated in the 1995 follow-up tender, imposing a requirement for local production on Siemens until 2001.

Managers were assigned from Siemens Austria to manage the acquisition and modernisation of Telefongyár. They began work at Telefongyár in spring 1991, even though the formal acquisition was not finalized until September 1991. This interim phase was characterised by ongoing conflicts between Siemens and ÁPV, the Hungarian privatisation agency regarding the conditions of the acquisition (including the price of Telefongyár). A few important changes were prepared or implemented in this phase, such as the dismantling of some operations, the screening of the stock of orders, as well as an assessment of the top management of Telefongyár. Once the formal acquisition took place, 65% of the shares of Telefongyár were taken over by the Austrian regional company (Siemens Austria). According to official statements this was mainly due to the tax breaks offered by the Austrian government for foreign direct investments. The remaining 35% were adopted by the Hungarian regional company Siemens Kft, a 100% subsidiary of Siemens AG Germany. However in the mid-1990s Siemens AG Germany adopted the shares of Siemens Austria in Telefongyár.

A complete reorganisation of Telefongyár began more or less immediately after the formal acquisition. It was based on the assessments conducted in the pre-takeover phase and affected all functional areas and hierarchical levels. Under the guidance of the Austrian expatriates, the initial years were used to downsize

the company, refocus production, train middle management and implement Siemens standards throughout Telefongyár. By the mid-1990s the transition process at Telefongyár was more or less concluded. A period of positive business development and high dividends followed. For approximately five years the profitability of Telefongyár clearly exceeded that of other Siemens' subsidiaries in Hungary, as well as those of Siemens switching subsidiaries elsewhere in Europe. However, this situation changed with the turn of the century. A downturn in the Hungarian market, unsuccessful entrepreneurial activity by the Hungarian management that did not use the plant to full capacity, as well as a failed attempt to become the European centre of competence for switching production, finally led to the closure of production at Telefongyár in early 2003. The subsidiary was downsized to approximately 250 employees and the role of Telefongyár downgraded to a marketing satellite. Recently the company was integrated as a communications division into Siemens Rt, the Hungarian regional company of Siemens.

#### *Cross-border management relationships*

We begin our journey inside the transnational social space of Siemens-Telefongyár by looking at the relevant cross-border management relationships and their characteristics. A particular focus is on the question of whether transnational communities emerge from these cross-border social relationships, and how their formation can be explained. Cross-border management relationships at Telefongyár were mainly centred around and characterised by the overall transition process and the adaptation of the Siemens production model in Hungary. There are four different but overlapping groups of managers in the centre of these developments, comprising the Hungarian top and middle managers, as well as Austrian top and middle managers (see Table 1).

**Table 1. Core management groups in the transition process at venture level**

	Expatriates	Local managers (Inpatriates)
Top Management	Two managers from Siemens Austria, for financial and technical issues, respectively, assuming overall responsibility for business.	Six, later two, incumbent Telefongyár managers; main function: securing market access, interface to the Hungarian middle management and personnel.
Middle Management	Approx. ten managers from Siemens Austria, mainly transferring knowledge to their Hungarian counterparts in transfer tandems.	Approx. ten incumbent Telefongyár managers, mainly absorbing knowledge from their Austrian counterparts in transfer tandems.

Given the frequency of operational contacts, social relationships during the transition process were strong on both the horizontal and vertical axis. However, while vertical social relationships between Austrian top and middle managers, as well as between Hungarian top and middle managers could rely on past experi-

ences, horizontal and diagonal relationships were rather new, unfamiliar and to a certain extent burdened by conflicts of interest. Moreover, these relationships linked actors with different national backgrounds. The discussion below focuses on these challenging cross-border social relationships.

The social relationship among the Austrian and the Hungarian top management is perhaps best described as a ‘Cinderella process’: The Austrian top management tried to identify with whom they had to play in order to be successful in the Hungarian market and to whom they would hand over the overall business responsibility at the end of their mission. Even prior to the company acquisition, the Austrian top managers conducted an assessment of the top management team of Telefongyár. In the words of an Austrian expatriate manager, the aim of this process was to find out which members of the Telefongyár top management “pull together and which play their own game”. According to this manager, those assessed as “playing their own game” were made redundant immediately after the acquisition had been completed. Indeed, four members of the incumbent Telefongyár top management team were fired in late 1991, among them the head of production, the head of logistics and the head of the organisation and information department. However, the remaining Hungarian top managers did not survive in their positions by agreeing to the new management ideas. In fact, they strongly opposed some decisions of the Austrian top management team, such as the cancellation of the overwhelming majority of already existing orders, mainly from Russia and the Arabic region. Moreover, they were openly critical of the overall strategy of Siemens in Central and Eastern Europe. According to one Hungarian top manager, “...Siemens was overstrained by the simultaneous opening of 15 or more markets in Central and Eastern Europe. Instead of following a strategy for the whole region they followed local strategies”. The retained Hungarian top managers could afford this frankness because they had unique personal contacts to the main Hungarian customer MATAV, contacts that were an indispensable prerequisite for success in the Hungarian market. While such early strategic conflicts were managed through the interaction of the Hungarian and Austrian top management teams at venture-level, strategic conflicts that occurred after the Austrian expatriates had left by the mid 1990s were managed on the intra-organisational level. However, irrespective of where these conflicts were located, their strategic nature and implication for the individual managers reputation generated high levels of discord and finally ended in top-down decisions from corporate headquarters. These processes and outcomes led to a certain level of disappointment among the Hungarian top management. For instance, in answer to questions as to why the Hungarian plant was closed in early 2003, one Hungarian top manager splentically said: “It is better for me, if you address these questions to my colleagues in Munich” (i.e. the location of the headquarters).

Compared to the inherent strategic nature of the social relationship between the Austrian and the Hungarian top management teams, the relationship between the Austrian and Hungarian middle managers was mainly characterised by day-to-day operational problems associated with the transition and the adaptation of the Siemens production model. The level of conflict was generally lower here and conflicts were more often solved by sharing views or looking for joint solutions. Siemens applied a tandem system (Kessel/Dörr 1998) to manage transition at Telefongyár. In this system an Austrian expatriate and a Hungarian counterpart were jointly responsible for a certain function. Usually both the Austrian middle manager and his/her Hungarian counterpart shared an office and all important information and decisions. Almost all Austrian middle managers were recruited at the Siemens switching division in Vienna. The motivation to go to Hungary differed according to the age of the expatriate team members. Despite the fact that no binding promises were made by Siemens, the younger members were basically motivated by future career options. Generally these hopes were not fulfilled but, on the other hand, neither did their careers suffer upon return to Vienna. Most of the older members were intrinsically motivated. Either they wanted to escape their day-to-day routine, or they were strongly attracted by the possibility “of really making something happen” (or both). They achieved these expectations. Especially in the beginning, the expatriates were confronted with a much more demanding (and chaotic) situation than they had envisaged. As one expatriate put it: “During the first days I said to myself, what the hell motivated me to take over this job?” Solidarity within the team of Austrian middle managers helped in solving the initial problems encountered by the individual team members at the beginning of their engagement at Telefongyár.

The Hungarian counterparts in the tandems were designated after a detailed review of their capabilities by the Austrian top managers. Initially the tandems were heavily impacted by the very different situations and expectations of their members. While many of the Austrian expatriates were especially attracted by the opportunity to “make something happen”, i.e. to implement changes that they felt they could never do at home, their Hungarian counterparts were more or less anxious about the many changes to come. Above all, according to a representative from the labour force at Telefongyár, “job security was the major concern at that time”. The anxiety of Hungarian middle managers was fuelled by many different sources, such as the general uncertainty of the transition phase, the loss of individual influence, the results of the former anti-capitalist propaganda, and the many examples of ‘transition tragedies’, such as politically motivated plant closures (to take capacities out of the market) or criminal privatisations. Thus at the outset, the social relationship in the tandems was characterised by a general lack of trust and mutual learning was scarce, as proposed by Balaton (2003). As one Austrian middle manager put it: “No matter how friendly their welcome to you and no matter how friendly you were to them and how se-

riously you took your counterpart, you were always considered a member of an occupying force.” However, after six to twelve months a cooperative climate gradually developed within the tandems, fostered by day-to-day problem-solving. In a few cases the Hungarian counterpart was replaced by another local manager if the first choice was deemed to be unsatisfactory.

Collective identity-building processes took place within the tandems across frontiers. Shared interests with regard to the handling of the many day-to-day transition problems emerged quickly because both the Austrian and the Hungarian middle managers felt they were in a lock-in situation, albeit for different reasons. While Austrian middle managers could not afford to fail to overcome these problems because of the damage it would cause to their personal reputation, the Hungarian middle managers’ professional career and social situation depended on their ability to prove they could resolve these problems successfully. Furthermore, especially the Austrian middle managers rather quickly discovered that overcoming the problems required at least some input from the Hungarian partners in the tandem. They needed local knowledge about legal provisions (e.g. in accounting, labour relations) as well as less codified knowledge, for instance on general business behaviour in Hungary (e.g. how to deal with customers, suppliers, the customs, the trade unions, local authorities). Moreover, speaking Hungarian was an important asset the Hungarian partners in the tandems held. As one Hungarian manager at Telefongyár stressed: “Just imagine an Austrian middle manager in Hungary heading a department and having to sign all these documents in Hungarian, which he doesn’t understand.”

The fact that collective identity processes took place and a transnational community of Austrian and Hungarian middle managers emerged around the notion of doing the “cumbersome and dirty work of transition”, as one Hungarian middle manager put it, does not mean that there were no differences in the underlying social relationships. While in some tandems the partners just learned how to get along with each other, maintaining existing stereotypes and asymmetric power relations, others came to know and understand each other better. This involved, among other things, a general willingness to look for mutual solutions, as the following story, reported by both the Austrian and the Hungarian partner of a tandem, illustrates: as a relic of socialist times, the offices at Telefongyár were much larger than the Austrian middle managers were used to and were often furnished with a sofa. Having a sofa in the office that usually belonged privately to the manager was seen as a privilege and a status symbol. This was also the case here and the Austrian middle manager initially wanted the sofa to be taken out to provide more space for his desk. However, when the Hungarian counterpart proposed swapping the large sofa for a smaller one he agreed, even though he did not see the necessity for having a sofa in the office at all. The Hungarian middle manager, on the other hand, settled for a smaller status symbol. Particularly tandems with such a climate of mutual thoughtfulness, in which strong cross-

border solidarity emerged, saw the partners developing close interpersonal relationships.

Unlike these two types of horizontal relationships (linking expatriates and local managers at different hierarchical levels), diagonal relationships between Hungarian top managers and Austrian middle managers, or vice versa, represent cross-border relationships without close day-to-day interaction. Two quite different kinds of dynamics were observed in the diagonal relationships, adding to the patchwork nature of social relationships in MNCs. While Austrian top managers and Hungarian middle managers had a rather distant relationship, very strong animosity was harboured by many Austrian middle managers against Hungarian top managers. In the eyes of quite a few Austrian middle managers the Hungarian top management was politically compromised. Austrian middle managers sometimes used Cold-War rhetoric, for example insulting a Hungarian top manager who had studied in Moscow by calling him a “dyed-in-the-wool communist” or a “red sock”. It was difficult to discover the origin of this strong animosity on the part of the Austrian middle managers. However, it was evident that the self-image of some Austrian middle managers as ‘white knights’ arriving to ‘save’ Telefongyár was strongly disturbed by the strategic need to cooperate with members of the incumbent top management to achieve market access. This was further aggravated by the fact that the Hungarian top management exhibited high self-esteem and did not simply execute instructions but regularly discussed, opposed and tried to modify decisions proposed by the Austrian managers. Moreover, and probably most importantly, they challenged the necessity of (so many) Austrian middle managers. As one Hungarian top manager put it: “In most cases it turned out that our former Telefongyár managers did and still do a good job”.

#### *Cross-border owner relationships*

Unlike cross-border management relationships that touch upon the strategic and operational dimension of the transition process at Telefongyár, cross-border owner relationships represent the different layers of governance to which Telefongyár was and is subject. At the intra-organisational level, particularly the relationship between the headquarters of the Siemens switching division in Bruchsal/Germany and the Austrian regional company impacted the transition process at Telefongyár.

Given the fact that local content requirements were typical in the switching industry, the headquarters of the Siemens switching division in Bruchsal/Germany had over time developed a standard procedure for building up a foreign switching subsidiary, which was carried out by a team of experts from the divisional headquarters. In the case of Telefongyár, however, this standard procedure was not employed, for two reasons. Firstly, market entry in Hungary, as a conse-

quence of the tendering process, was achieved by acquisition rather than by a green-field investment, which was Siemens switching division's usual way of entering new foreign markets. Secondly, a shortage of headquarters experts existed, resulting from the sudden fall of the Wall, instantly creating business opportunities in many different Central and Eastern European countries. Why the Austrian regional company was assigned the task of building up the switching business at Telefongyár remains unclear. Various historical and more task-related answers were given in the interviews, such as: "Austrians and Hungarians have a long common tradition ("K&K" monarchy), leading to a great cultural proximity", "much of the pre-1989 business of Siemens was transacted by Siemens due to the different political status of Austria" or "Budapest is only 200 km away from Vienna". Moreover, it was stressed that the small-scale production at Siemens Austria resembled the production to be built up at Telefongyár much more closely than did the large-scale production at the divisional headquarters in Bruchsal, thus guaranteeing a better structural fit between transfer source and transfer target. However, quite a few interview partners also saw the acquisition of Telefongyár by Siemens Austria as an expression of the Austrian regional company's general policy of increasing its autonomy in the network of Siemens companies. In the words of one of the interviewees: "Siemens Austria, being one of the largest and most profitable regional companies throughout Siemens, is always agitating for stronger decentralisation." Especially interview partners with a divisional background viewed the strong and growing position of the Austrian regional company as a major, constant source of conflict within the matrix-organisation of Siemens.

With the Austrian regional company adopting ownership shares and the responsibility for managing the day-to-day transition process, a twofold management structure was not only installed in the ownership structure (as described above) but also in the daily management. While expatriates from Siemens Austria were managing the transition process at Telefongyár, the headquarters of the German telecom division (belonging to Siemens AG, Germany) remained responsible for the strategic aspects of marketing and sales at Telefongyár (i.e. all product specifications and basic technologies came from Siemens Germany). This twofold governance structure rather quickly unleashed conflicts in the relationship between the Austrian regional company and the divisional headquarters in Germany, adding another facet to the mosaic of social relationships in and around the Siemens-Telefongyár venture. The Austrian efforts with regard to the transition of Telefongyár were considered more or less successful, but critics at the divisional level maintained throughout the whole transition process that the overall costs of the transition process undertaken by the Austrian expatriates by far exceeded the costs for the normal Siemens standard operating procedure for developing a switching company abroad. In addition, the more than respectable profits Telefongyár achieved in the years immediately after the acquisition led to

conflicts between Siemens Austria and the parent company Siemens AG in Germany as to where these should flow. The divisional headquarters welcomed the final decision by the parent company Siemens AG to adopt the shares of Siemens Austria in Telefongyár in the mid-1990s and thus to directly channel the profits to the parent company, but the managers of the Austrian regional company, as well as the expatriate Austrian top and middle managers, felt this decision negated their work and their achievements.

A somewhat more distant owner relationship which nevertheless had and continues to have an impact on the Telefongyár venture is the change in the overall owner-management relationship at Siemens. For many decades Siemens was considered *the* prototype of a large German industrial company: i.e. a somewhat bureaucratic, technology-driven, long-term oriented company, strongly rooted in its German home environment with trust-based relations both towards labour and capital (Lane 2001). However the 1990s have seen some changes at Siemens in this respect, best described by the buzzword 'financialisation'. 'Financialisation' describes the gradual change from management control to stock market control (Lazonick/O'Sullivan 2000), which many companies undertook during the 1990s. One of the first steps representing this change at Siemens was the so-called 'Ten Point Program', issued in 1998 in the wake of the listing of Siemens on the New York Stock Exchange. The 'Ten Point Program' aimed at restructuring the portfolio, stabilising troubled business segments, and introducing binding yardsticks for measuring performance throughout the entire group. Two years later a program called 'Operation 2003' supplemented the 'Ten Point Program' by setting binding profit goals for each division to be reached in the 2003 fiscal year. The deadline for reaching these goals was extended to 2007 for the troubled information and communication business area, with restructuring efforts gaining a strong momentum from 2003 on. The closure of the switching plant at Telefongyár in 2003 was among the first such restructuring efforts. The Hungarian market collapsed in 2001, the decision to close down the plant at Telefongyár was taken in 2002, and the closure was executed in 2003. With this decision, which was mainly advocated at divisional level, a good deal of the efforts that the Austrian expatriates and the Hungarian management had devoted to the transformation of Telefongyár was obliterated. Prior to this decision, the Hungarian top management unsuccessfully tried to acquire new additional orders from other Siemens divisions as well as from outside customers.<sup>1</sup> Moreover, a proposal by Hungarian top management to turn Telefongyár into the European centre for switching production and to relocate all European switching production to Hungary was not supported by headquarters.

1 Physically, switching systems consist of specifically fitted printed circuit boards. Printed circuit boards are used in many electrical appliances.

## Conclusion

The insights gained in this study into the social relationships in and around the Siemens-Telefongyár venture in the first 15 years of transition indicate that the transnational social space of an MNC is a complex amalgam of intertwined cross-border social relationships that have their own ends, trajectories and characteristics. Two generic types of social relationship interacted with one another: management relationships and owner relationships. A certain hierarchical order of social relationships is particularly evident in this case. The owner relationships strongly had a strong priority over and negated management relationships. Moreover, within management relationships, the influence of headquarters by and large dominated over the local subsidiary managers' concerns, adding to the very hierarchical setting of cross-border social relationships. This seems to be typical for East-West ventures (Geppert/Clark 2003), and perhaps also for asymmetrical ventures in general, but it is not typical for all MNCs, or more precisely for all headquarters-subsidiary constellations in an MNC. A recent case study by Kristensen and Zeitlin (2005) found a far less asymmetrical distribution of power between headquarters and subsidiaries. In their case, subsidiaries not only pursued their own agendas, as in our case, but also succeeded in making deals with the headquarters that at least partly reflected their own interests, adding to a much more dialectical picture of the MNC than our case study would suggest. Thus, more systematic comparative research is needed to generate a better understanding of the impact of distinct headquarters-subsidiary constellations as well as of different governance styles applied by headquarters (Clark/Geppert 2006).

A second conclusion, which emerges from the longitudinal scope of the Siemens Telefongyár case study, is that environments and strategic situations, as well as the interpretation of these, change over time. These changes influence the various cross-border social relationships either by altering their nature (if they still exist) or changing their ex-post evaluation. Thus, the many and costly efforts of Siemens to develop a state-of-the-art switching factory at Telefongyár were more or less destroyed after only ten years, when the Hungarian switching market collapsed, and the headquarters decided to abandon the production in Hungary rather than making more use of it as a European centre for the production of switching systems. With these decisions taken, the headquarters erased the different cross-border social relationships at the management level and by the same token the many individual efforts and emotional commitments made to these relationships. This finding demonstrates the transience of cross-border social relationships and social orders in MNCs and has two theoretical implications. First, frameworks for analysing the shape cross-border social relationships in MNCs take (e.g. Morgan 2001 b) or more generally the social orders emerging in MNCs (e.g. Clark/Geppert 2006) need to be extended to more successfully incorporate change and trajectories of change. Second, the case study re-

veals that there is a systemic trade-off between strategic decisions that negatively affect cross-border social relationships and overall social integration measures in MNCs. Closing down the switching plant at Telefongyár, which had been built up just a few years earlier, created much frustration. Whether the commitment of these people can be regained by supporting the managers' understanding of the overall corporate vision as proposed by Bartlett and Ghoshal (1989) is questionable and needs more empirical research. The Siemens' vision statement (as is the case for vision statements of MNCs in general) is highly dialectical (not to say contradictory) and open to interpretation. For example, it demands "creating the greatest possible value for our shareholders" while at the same time "upholding an exacting set of values – including humanity, equal opportunity and strict ethical standards" (Siemens 2005:5).

A third conclusion of the case study also leads to some ideas about the different shapes cross-border social relationships might take. According to Morgan (2001 a, b), cross-border social relationships might take the form of transnational communities, i.e. communities of individuals in an MNC that exhibit a unique cross-national organisational identity despite the fact that their national and organisational origin is diverse. The case study suggests that transnational communities only rarely emerge in MNCs, and when they do, their existence is temporary and precarious, rather than a long-lasting and stable. In this case study, only one out of four management relationships and none of the two owner relationships studied showed traits of an emerging transnational community. Moreover, the transnational community composed of Austrian and Hungarian middle managers only existed for a short period of time. Almost all Austrian expatriate middle managers were repatriated after three years. One important question here is whether this result is generally applicable. Little has been said so far about the conditions that lead to the emergence of transnational communities. According to Morgan (2001 b, p. 118) "prolonged structured interaction" that allows for the mutual recognition of common interests is necessary. However, this case study shows that not only the frequency and length of interaction, but also the strategic load, make a difference. Here, the underlying mechanisms and interrelationships need to be explored in more detail.

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## Toward convergence in the St. Petersburg hotel industry through the lens of institutional theory\*

Päivi Karhunen\*\*

*The article assesses the power of institutional organization theory in explaining enterprise adaptation in post-socialism. Empirical analysis of the hotel sector in St. Petersburg, Russia, shows that industry-level isomorphic forces are not at work during economic transition. Combined with market imperfections, this results in intra-industry strategic diversity. The underlying logic however changes as the transition proceeds. During the transition, diversity is based on local versus foreign management and during the post-transition on the legitimacy of operations. The majority of hotels start operating according to shared norms and practices, whereas the lack of coercive pressures from the state still allows some hotels to operate in the shadow and ignore institutional norms.*

*Key words:* Hotel industry, transition economies, Russia, institutional isomorphism, organizational field

### Introduction

Enterprise adaptation to economic transition has generated a substantial number of studies in management research. The strategies of foreign entrants and the restructuring of local incumbents have been the focus of research, and questions related to new business creation have started to receive attention. The theoretical perspectives applied in existing research have varied, but due to the emphasized relationship between institutions and business strategies in transition economies, institutional theory has become a new dominant approach (Hoskisson et al. 2000; Meyer/Peng 2005; Wright et al. 2005).

Recent research has identified a number of institutionally derived forces (Meyer/Peng 2005) that affect business strategies in a post-socialist environment through transaction costs (Meyer 2001) or relational networks (Peng/Heath 1996). Such research has aimed at advancing institutional theory by building on the evidence of post-socialist transition as a specific empirical context. For example, it has been shown that the institutional framework in transition economies constrains foreign entry strategies in terms of choice of entry mode (Salmi 1995; Brouthers/Bamosy 1997; Peng 2000; Meyer/Estrin 2001; Meyer 2001; Karhunen 2002; Meyer/Nguyen 2005) and location choice (Bevan et al. 2004).

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Another body of research has investigated institutionally derived phenomena, such as the management culture in local enterprises, without explicitly referring to institutional scholars in their theoretical framework. For example, differences between Western and Russian management cultures (Puffer et al. 1996; Ralston et al. 1997) and their implications for managerial practices regarding, for example, knowledge sharing (Michailova/Husted 2003; Hutchings/Michailova 2004), learning (Child/Markóczy 1993) and the implementation of organizational change (Michailova 2000) have been analyzed.

Characteristically, existing studies building on institutional theory have often focused on one group of enterprises (foreign entrants, local incumbents, or new start-ups) at a time. Treating these enterprise groups separately has been justified, as in the early years of economic transition, the challenges faced by each of them varied greatly (Peng 2003). Foreign entrants had to cope with a novel host environment, formerly state-owned enterprises had to restructure their operations to meet market conditions, and new businesses had to cope with institutional imperfections for new business creation. However, those studies that have investigated the behaviour of the three groups of enterprises in parallel have shown that the link between enterprise type and business strategy is not straightforward. For example, foreign entrants may apply practices deriving from the socialist past, whereas there are former state enterprises that have rapidly abandoned them (Kosonen 2004). On the other hand, it has been proposed that the institutional pressures faced by the three types of enterprises converge as the transition proceeds, which narrows the gap between their strategic behaviours (Peng 2003). Now, as the macro-level transition has been officially completed in most of the transition economies, including the Russian Federation, it is time to compare the strategic behaviours of these groups of enterprises in more detail.

In addition, I argue that existing management research on transition economies has not exploited the analytical opportunities provided by the institutional approach in full. Most of the existing research has linked firm strategies directly to the macro-level institutional context, without depicting sector- or industry-level processes. Such an intermediate unit of analysis is important to take into account, as macro-level institutional forces, such as federal and state regulations, are often mediated to organizations by field-level structures and processes (Scott 1998:130). This has been recently demonstrated in the transition context by Puffer and McCarthy (2007), who showed that the institutional change in Russia has resulted in different types of capitalism. Developing the concepts of institutional pull and institutional push (i.e., institution-building originating from companies versus the state, respectively) they identified inter-industry differences in the nature of capitalism, ranging from market capitalism in the consumer sector to state-led capitalism in natural-resource based sectors (*ibid*).

This article aims at contributing to filling the gaps in the existing literature by applying institutional organization theory to depict enterprise adaptation to post-socialism at the industry level. This is done by empirically analyzing the hotel industry in the Russian city of St. Petersburg.

The article is structured as follows. First, the theoretical background for the study is discussed. Then, data and methodology applied in the empirical analysis are presented. This is followed by the empirical description, which is divided into two sections; the transition period (1991-1998 financial crisis in Russia) and the post-transition period (1998 crisis-2005). The organizational practices of foreign and Russian managed hotel enterprises are analyzed and compared within each section. Finally, conclusions and suggestions for further research are discussed.

### Theoretical background

This article builds on the neo-institutional organization theory, which provides analytical tools for examining enterprise behaviour at the industry level. A key concept in neo-institutional organizational analysis is *organizational field*, defined as “those organizations that, in aggregate, constitute a recognized area of institutional life: key suppliers, resource and product consumers, regulatory agencies and other organizations that produce similar services or products” (DiMaggio/Powell 1983). In this article, the St. Petersburg hotel industry is viewed as an organizational field, consisting of hotel enterprises, their suppliers and customers, and related institutional actors such as the city government.

The neo-institutional organization theory assumes that organizations in a field become increasingly homogeneous over time, as they seek legitimacy within their environment. In other words, the institutional context provides organizations with field-specific “templates of organizing” (DiMaggio/Powell 1991:27), which are transmitted by the state, professional associations, regulatory agencies and leading organizations (Tolbert 1985; Greenwood/Hinings 1996).

The process of field-level strategic and structural homogenization is referred to as *institutional isomorphism*, which occurs through three mechanisms (DiMaggio/Powell 1983). *Coercive* isomorphism results from institutional pressures exerted on organizations by other, [often state] organizations upon which they are dependent, and by cultural expectations in the society (DiMaggio/Powell 1983). For example, the government may introduce new legislation, which organizations have to comply with. *Mimetic* isomorphism implies that organizations tend to model themselves after other organizations that they consider to be more legitimate or successful. This occurs indirectly through employee transfer or turnover, or explicitly by organizations such as consulting firms or industry trade associations (DiMaggio/Powell 1983). Finally, *normative* isomorphism stems from professionalization – the collective struggle of members of an occupation

to define the conditions and methods of their work (Larson 1977:49-52). Universities and professional training institutions are an important source of professionalization; another is the growth and elaboration of professional networks that span organizations and across which new models diffuse rapidly (DiMaggio/Powell 1983).

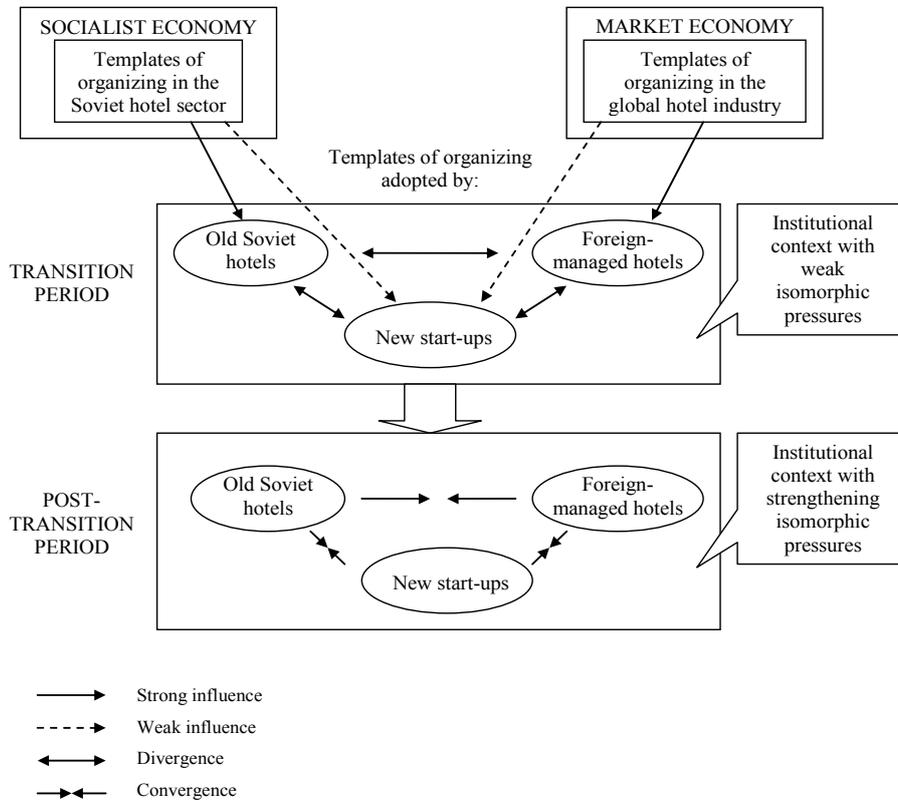
In transition economies, where the institutional context itself is in flux, I argue that the above-mentioned mechanisms of isomorphic change are not necessarily at work. In a situation where formal regulation and the mechanisms to control its enforcement need to be reformed, coercive isomorphic pressures may be expected to be weak until the new institutional framework is functioning properly. In addition, the mechanisms of diffusion of organizational models seem to need well-established field-level institutions, such as industry associations. This would predict weak mimetic isomorphic pressures in transition economies where all structures of the economy are undergoing change. Finally, I argue that professionalization is not likely to take place when managers have different cognitive bases, moulded by different education systems ranging from the ideology-flavoured Soviet party schools to Western business schools. Hence, normative isomorphic pressures are likely to be weak as well.

The weakness of the isomorphic pressures implies that the institutional context does not provide enterprises with well-established templates of organizing. As a consequence, local incumbents tend to resort to their old practices, however irrelevant they may be in the new situation (Newman 2000). The heavier the “institutional baggage”<sup>1</sup> of the organization, the more difficult it is to unlearn old practices (Roth/Kostova, 2003). In contrast, foreign enterprises are likely to import their established practices into the new context. Hence, it can be argued that during economic transition intra-field diversity of organizational practices can be expected. As market economy institutions gain strength, new shared templates of organizing would evolve. This article empirically examines whether such change from diversity to homogeneity takes place as the transition proceeds. This is done by comparing the behaviour of old Soviet-era hotels, new Russian-managed start-ups and foreign-managed hotels in St. Petersburg from the transition (1991-1998 crisis) to the post-transition (1998 crisis-2005) period.

The theoretical framework of the article is operationalised into a conceptual model, which is presented in Figure 1.

1 Defined as “The strength, ingrainment, and pervasiveness of the institutional arrangements that existed prior to the radical change” (Roth/Kostova, 2003: 316).

Figure 1. Conceptual model of the article



The model summarizes the key assumptions of institutional theory about the interplay of the institutional context and enterprise behaviour during economic transition. First, it proposes that coercive, mimetic and normative institutional isomorphic pressures towards homogeneity are weak during transition and provide organizations with no templates of organizing. Consequently, old Soviet hotels would resort to the templates of the socialist past, and foreign-managed hotels apply templates of the global hotel industry, rooted in developed market economies. New start-ups, which have lighter “institutional baggage” than old Soviet hotels, would adopt elements of both templates. Hence, there would be diversity in the practices of the three types of hotels. Second, the model suggests that as the transition proceeds and the market economy gains a stronger foothold, institutional isomorphic pressures would gain strength and result in new templates of organizing characteristic of the post-transition period. Such templates would combine elements from the socialist past with global hotel in-

dustry practices and new practices developed during the transition era. This would result in the convergence of practices between the three types of hotels.

To empirically approach the templates of organizing, I examine the structure and practices of the hotels as follows. At the structural level, I discuss the *ownership structure* and *operation mode* of hotels. Practices of hotels are analyzed with respect to their relations with other members of the production chain (i.e. *suppliers* and *customers*) and through their *HRM strategy*. In addition, I investigate the practices that hotel enterprises apply in their relations with the *public sector*.

Before going into the empirical description, the following section describes the data and methodology applied in the empirical analysis of the article.

### **Data und methodology**

The empirical part of the article builds on a qualitative case study, describing changes in enterprise structure and practices in the St Petersburg hotel sector from the socialist period until 2005. The primary empirical data of the study consists of 27 thematic interviews, conducted with the top management of St Petersburg-based hotels between 1999 and 2006. The interviewees represented foreign management companies (7 interviews), hotels dating from the Soviet period (10 interviews), and Russian-managed hotels established after the collapse of the Soviet Union (10 interviews). The hotels have different profiles regarding, for example, size (from mini-hotels to former Soviet “giants”), level of service (from budget to 5-star hotels), and the level of standardization of the business concept (independent versus chain hotels).

The interviews were conducted according to an interview guide with open-ended thematic questions. The aim of the interviews was to gain rich descriptions of the hotel industry’s development over time from two viewpoints. First, different functions of each hotel’s “production process”, such as human resource management, supply, and marketing were touched upon. Second, the hotel managers’ views of the institutional context, such as the relationship between their hotels and the city government, were addressed.

In addition to interview data, a key data source was the collection of newspaper and journal articles from the Russian press between 1992 and 2005. These articles describe the development of the institutional context in the hotel industry in Russia in general and in St. Petersburg in particular. These data were utilized to triangulate and support the interview data. Finally, the two main data sources were complemented by reports from consulting companies and other industry observers.

In the empirical analysis, a temporal bracketing strategy was applied (Langley 1999) by separating the interview data into two successive periods (transition and post-transition) based on a discontinuity at their boundary (the 1998 finan-

cial crisis in Russia). The development of the institutional context and its implications for hotel enterprises' structures and practices were then studied within each phase. After retrieving all relevant information from the interviews, the narrative was complemented by additional information from the documentary data sources and "bracketed" into the two time periods.

*The empirical context: An overview of the St. Petersburg hotel industry*

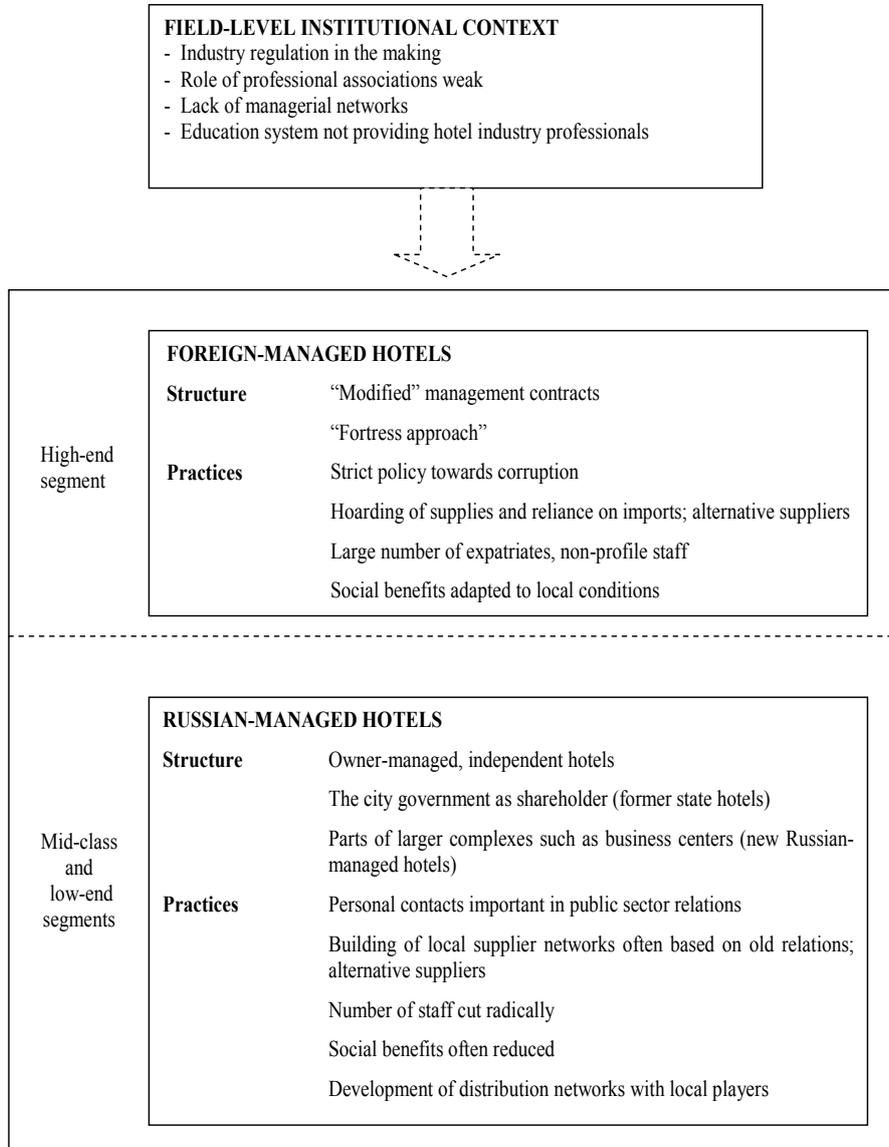
In the Soviet era, the hotel sector in St. Petersburg (then Leningrad) was administered through state tourism organizations. These were the state enterprise for international tourism 'Intourist', the bureau of international youth tourism 'Sputnik', and the Central Soviet for Tourism and Excursions, which organized domestic tourism (Gavrilov 1998:210). Each organization had its own hotel stock. In addition, there were municipal hotels and so-called *vedomstvennye* (corporate) hotels associated with state enterprises and political organizations (Kvartal'nov 1999).

When the Soviet Union collapsed, the ownership of the hotel properties was rearranged. Hotels previously managed by ministries and state enterprises either remained affiliated with these organizations or were privatized with their management and employees as the new shareholders. Most hotels, however, including those of Intourist, were allocated to local and regional authorities (Gudbergesen 1996). As a result, the local governments became major players in the industry, especially in Moscow and St. Petersburg.

The contemporary St. Petersburg hotel industry consists of several types of hotels, ranging from former state-owned hotels to high-level foreign-managed properties and mini-hotels. The majority of the hotel stock has been constructed in the Soviet period, in particular in the 1960s and the 1970s.

The construction of new hotels picked up only in the first half of the 2000s. In addition, the city's 300<sup>th</sup> anniversary in 2003 stimulated the opening of mini-hotels, which were often renovated from Soviet-time communal apartments in the city centre. Russian real estate developers have also increasingly started to invest in hotel construction. Some of these hotels are joint projects with international management companies.

After this brief overview of the empirical context, I now move on to analyzing the organizational practices in the St. Petersburg hotel sector more in detail. This is done by describing the field-level institutional context and enterprise strategies in the two time periods, transition (1991-1998 crisis) and post-transition (1998 crisis – 2005).

**Figure 2. Transition – period of divergence****Transition period – divergence between “us and them”**

This section illustrates the St. Petersburg hotel industry during the transition period, starting from the collapse of the Soviet Union in 1991 and ending with the

1998 financial crisis in Russia. Figure 2 summarizes the main aspects of this period.

The figure illustrates how the institutional context during the transition provided weak pressures toward homogeneity, resulting in strategic and structural divergence between foreign and Russian-managed hotels. As a result, the hotel market had foreign-managed properties in the high-end segment and Russian-managed ones in the mid- and low-end segments. The majority of the properties were old Soviet hotels, as new-start ups were still few.

*Institutional environment during transition: Field-level institutions in the making*

The institutional context faced by hotel enterprises during the transition was in flux, and because of that all three types of pressures for homogeneity (coercive, mimetic and normative) were weak. The *coercive* pressures exerted by the state weakened due to the dismantling of the state tourism organizations. At the same time, industry regulations meeting market conditions needed to be created. The legislation concerning the hotel industry was ambiguous. For example, licensing of hotel operations was required only in Moscow. Moreover, although a national rating system to control the quality of hotels was introduced already in 1994, certification was voluntary and any organization registered in the state standardization committee could grant stars. This eroded the credibility of the system.

The dissolution of the state tourism organizations with their coordination mechanisms and standards left a vacuum in the field as regards *mimetic* isomorphic forces, too. Industry associations started to emerge, but their influence in disseminating practices was limited. In addition, the presence of hotel management chains in the sector was limited to a handful of foreign-managed properties. On the one hand, there were no local chains that Russian-managed hotels could have joined and on the other hand their quality was not sufficient to become members of international chains. In addition, the attitudes of hotel owners were against giving up control to an outside hotel management company. Consequently, Russian-managed hotels largely operated each according to their own principles. Mimetic isomorphism leading to the dissemination of practices was also hindered by limited personnel transfer between hotels. On the one hand, foreign hotels did not want to hire personnel with experience from the Soviet service culture, and on the other hand, Russian hotels needed to rather reduce staff than hire new people.

Furthermore, *normative* isomorphic pressures were weakened by the low level of professionalization. Both key sources of professionalization, managerial networks and a shared educational base, were limited. Managerial networking took place mainly among foreign hoteliers, whereas there was little interaction among managers of former Soviet hotels. The Soviet practice of information hoarding

was prominent, as hotels did not want to share information for fear of revealing business secrets. Moreover, the educational base of hotel managers and staff was diverse. As there had been little specialized training for hotel managers in the Soviet Union, Russian hotel managers had different backgrounds. In addition, as the training institutes of state tourism structures were closed, the system of education for hotel industry professionals had to be created anew. In part, state-owned universities introduced degree programs for tourism, and new professional institutes were opened. However, the Soviet legacy was present in the curricula of these institutions, as their emphasis was on economic and technical subjects (Karpova 2003). As a result, universities and training institutes were not able to provide qualified personnel and management for the city's hotels.

All in all, these factors resulted in weak pressures for industry-level homogenization of organizational practices. In addition, hotel enterprises had to cope with market imperfections resulting from the systemic change. Here, foreign enterprises resorted to their global resource base, whereas Russian-managed hotels needed to build local linkages. This is illustrated in the following sections.

#### *Organizational practices of hotel enterprises during transition*

As regards structure, both old Soviet and foreign-managed hotels had to adapt their existing templates of organizing to the transitional context. As the state tourism organizations were dissolved, hotel directors had to take the responsibility for strategic planning and decision-making. Consequently, hotels introduced functions that had been performed by state tourism structures and opened corresponding departments. This included sales and marketing, and the provision of support services such as transportation. However, the operation mode as such did not change, as former state hotels continued to be owner-managed. In addition, private ownership was rare as the majority of former state hotels were owned by the city government. The city government was also heavily involved in foreign-managed operations. Basically the only option for foreign hotel management companies to enter the St. Petersburg market was to form a joint venture with the city government. In addition to requiring an investment in the property from the foreign partner, the city government also wanted to participate in the management resulting in "modified" management contracts.

New start-ups, which were still rare, were often parts of larger complexes such as business centres, which started to mushroom in the city. The demand for office space and other business infrastructure benefited also the old Soviet hotels, which compensated for the decrease in demand by transforming a part of their room capacity into office space. Furthermore, with a lack of quality apartments for rent, businesspeople even lived in hotels on a long-term basis. In high-class foreign-managed hotels this "fortress approach" included also a more extensive

in-house supply of leisure and shopping services than that needed in developed market economies.

In terms of relations with stakeholders, the transitional context was reflected in the way hotel enterprises were linked to the local operating environment. Foreign-managed hotels resorted to their global resource base and thereby minimized contacts with the local market, whereas local hotels built new business networks partly on the basis of their Soviet-era contacts. In relations with the public sector, Russian-managed hotels applied the template of close personal contacts, whereas foreign-managed hotels adopted their global policy of keeping “wheeling and dealing” to a minimum.

#### *Supplier relations – building networks and relying on own imports*

As the socialist planning system was dismantled, former state hotels had to take over the supply function themselves and build direct supplier relationships. The market for supplies started to develop; although there was still a shortage of quality supplies such as foodstuffs (Taylor 1994). Often, former Soviet enterprises or parts of them continued functioning in a new form. Hence, supplier relationships were often based on old personal contacts. Many suppliers were, however, not able to meet the requirements of a market economy regarding, for example, the quality of their products and delivery times. Hotels coped with this situation by keeping a reserve of alternative suppliers. This gave them security, as sometimes suppliers disappeared overnight or failed to deliver orders on time (Taylor 1994).

Foreign-managed hotels with high quality requirements needed to adapt their sourcing practices to keep up their quality. They relied on imported supplies such as foodstuffs, and even imported goods themselves, in the early years of the transition. They also maintained huge inventories of supplies. The reliance on imports was due to two factors. First, local products either did not exist or were of inferior quality, and second, foreign products were not yet available on the market.

#### *Customer relations: Global reservation systems vis-à-vis local partnerships*

The structure of the demand in the St Petersburg hotel market of the early transition had a polarized nature. All foreign-managed hotels of the city were positioned in the 5-star segment and almost exclusively served foreign customers. Soviet hotels represented lower price segments and their clientele mainly consisted of Russian and other former Soviet citizens. Foreign-managed hotels relied mainly on their own worldwide reservation networks, due to both the global nature of the business and to a lack of local demand.

The former state hotels faced a challenge, as the central Soviet tourism organs that had ensured occupancy were dissolved. The main way to cope was to establish internal sales and marketing departments, which contracted with newly emerging private travel agencies and tour operators. However, the majority of tourist firms served outbound tourism, limiting the number of potential sales and marketing partners of hotel enterprises. In addition, there were a number of tourist firms that had a “quick cash and disappear” approach. Finally, on-line reservation systems maintained by hotel chains and consortia were practically nonexistent during the early transition. On the one hand, the majority of the hotels were independent, and on the other hand, they did not have the computer technologies needed to use such systems.

#### *HRM strategies: Money the main motivator*

The transition forced hotels to adapt their HRM function as well. In the former state hotels, the number of staff was cut rather radically and increasing attention was paid to service quality. However, the level of service still lagged behind due to the lack of hospitality traditions. Foreign-managed hotels had large teams of expatriates, used to launch the operations and train the local staff. The Russian staff usually came from outside the industry, as foreign hoteliers did not want to hire staff accustomed to the Soviet type of service but preferred people with higher education and fluency in foreign languages. The motivation to work in the hotel industry was usually the relatively high salaries paid by foreign hotels, rather than a professional interest: “*People worked in customer service for money, not because they have a passion for it.*”

Furthermore, when the Soviet system collapsed, the provision of social benefits was transferred to the responsibility of the employer. Most hotels limited the benefits to statutory ones, such as compulsory medical insurance. Moreover, free meals, uniforms and transportation were often provided, as well as “*material*” (i.e. financial) help when needed. However, some of the hotels continued to provide “Soviet-time” benefits, such as recuperation in sanatoriums and children’s camps. Interestingly, some state hotels cut benefits to the bare minimum, whereas some foreign managed hotels (with the city as shareholder) kept up the Soviet-era social infrastructure.

#### *Relations with the public sector: Importance of personal contacts*

The legacy of the Soviet era was most visible in hotels’ relations with the public sector. Here, the gap between Russian and foreign-managed hotels was particularly wide. In addition to frequently changing legislation, ill-defined practices of public sector officials in enforcing the regulations were characteristic of the transition period. To be informed about legislative changes, Russian-managed hotels relied on personal contacts in the city administration – “*It’s better to be friends*

*with the tax inspectors, the tax police, everybody. [...] Not for closing their eyes to something, not at all, but to get information in time.*” Good relations with public sector officials were maintained through “gestures of attention”, such as hosting a dinner, or sending flowers or a box of chocolate on the official’s birthday.

In addition, inspection visits of various administrative bodies to hotels were frequent. Often, they were used as a means to collect payments that ended up in the official’s own pocket. In particular, foreign-managed hotels received attention: *“The local administration harassed us practically weekly; we were blamed for ridiculous things, and threatened with arrests and fines. We were often caught, because we don’t want to play games...”* As a rule, foreign-managed hotels took a strict standpoint towards corruption. Rather, the importance of acquiring all the necessary information beforehand when making new initiatives was stressed as means to fulfil all requirements and thereby avoid problems.

### **Post-transition period: The gap narrowing down**

This section illustrates how the institutional context in the St. Petersburg hotel industry evolved during post-transition following the 1998 financial crisis, and the respective changes in structures and practices of hotel enterprises. The main aspects of this period are summarized in Figure 3.

The figure illustrates how the institutional context in the St. Petersburg hotel industry became more established during post-transition, and pressures towards homogenization strengthened somewhat. However, imperfect state regulation still allowed hotel operations in the “grey zone”. Moreover, the division between upper-class foreign-managed and lower-class Russian-managed hotels became less strict. Foreign hoteliers started to eye the mid-class segment, and Russian-managed 5-star hotels began to appear. Instead, the legitimacy of operations became the major factor differentiating enterprises in the sector. The next section will illustrate this in more detail.

#### *Institutional environment during post-transition: Stabilization of market conditions*

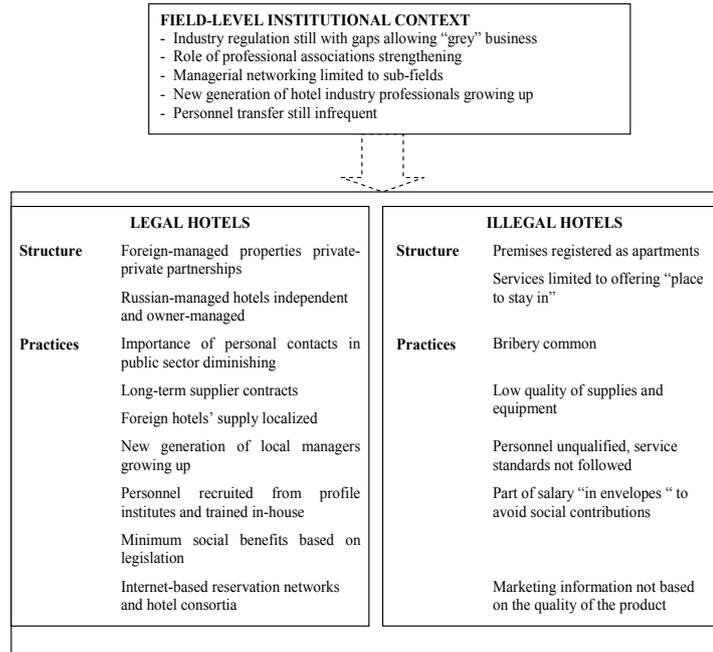
The 1998 financial crisis was a watershed in Russia, turning the political and economic turmoil of the 1990s into stability and rapid economic growth. President Vladimir Putin’s entry into power in 2000 further fostered institutional reforms, and market infrastructure was already functioning better.

The institutional context of the hotel industry and its sources for isomorphism changed as well, as market economy structures became more established and the involvement of the city government in the industry diminished. *Coercive* isomorphic pressures originating from state regulation were, however, still weak. In

### Figure 3. Post-transition: Narrowing the gap

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Figure 3. Post-transition: Narrowing the gap



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particular, the emergence of a new type of enterprises, mini-hotels, revealed gaps in the industry legislation, which did not recognize such a concept at all. Moreover, although attempts were made to create a single national rating system, the credibility of hotel certification as a regulative measure continued to be low, “*Stars can be bought for money – you apply for 3 stars because your hotel meets the 3-star criteria and they offer you 4 stars if you pay something extra.*”

In contrast, the role of professional associations as a source of *mimetic* isomorphic pressures strengthened somewhat, as new types of actors such as mini-hotels founded their own associations. There was, however, still no local industry association that could unite the city’s hotel enterprises. Moreover, there were common views among hotel managers that such associations were more marketing instruments for their participants instead of having a real effect on the dissemination of industry practices. Associations were also criticized for being out of touch with reality: “*The lecturers in their seminars are university people, who are fascinated with their theories – we should have experienced managers instead.*”

Moreover, personnel transfer as a vehicle for mimetic isomorphism started to occur more frequently. It took place, however, more between foreign-managed hotels and from Russian-managed to foreign-managed hotels. Russian-managed hotels were still not considered as attractive employers in comparison to foreign-managed properties. Interestingly, Russian managers still considered personnel transfer as something to be avoided, rather than a fact of life. “*Personnel turnover means that either a good hotel did not want to keep a bad specialist, or a bad hotel could not keep a good specialist.*”

Furthermore, professionalization as a source of *normative* isomorphism started to gain strength. In particular, the educational profile of managers and employees in the industry started to change towards a more professional direction as the efforts of newly created educational programs and hotels’ own training started to bear fruit. However, the local training system was still not developed enough to produce qualified managerial staff to meet the needs of new hotels. Thus, most managers of Russian-managed operations still came from outside the industry. In foreign-managed hotels the training efforts already started to show results, as mid-management positions previously held by expatriates could be filled with young Russians rising through the ranks in the company. In contrast to managers, the staff of Russian-managed hotels already had a predominately industry education, as most hotels recruited from professional institutes.

The second indicator of professionalization, managerial networking, was still not significant. Communication and information exchange between hotel managers in St. Petersburg was mainly limited to unofficial communication taking place between managers of hotels of the same category. Here, the foreign-managed hotels still formed a club of their own. There were signs, however, that

things were changing in this respect, as Russian managers with little industry experience were more open to share their experiences with others than the “red executives”. Moreover, as the supply of hotel services started to grow, hotels had to pay increasing attention to ensuring demand, particularly during the off-season. In addition, the city’s diminishing allocation of budget funds to tourism promotion (with the city’s 300-year anniversary in 2003 an exception) resulted in hotels joining forces to promote the city as a tourist destination. A joint initiative, “White Days”, was developed by the city’s 5-star hotels and other tourist industry actors such as museums and theatres to promote the city as a winter destination abroad. The city authorities welcomed the effort to the degree that it evoked a bitter comment from an expatriate manager “*After cutting the promotion budget to zero after 2003, the city now wants to piggyback the White Days program.*”

#### *Organizational practices of hotel enterprises during post-transition*

The strengthening of market economy institutions resulted in a decreasing need for strategic and structural adaptation for hotel enterprises. In terms of structure, hotels returned to their core service domain and private ownership started to prevail. In terms of practices, foreign and local hotels started to converge as the former started to integrate more tightly into the local operating environment. The main change in St. Petersburg hotels’ *structure* during the post-transition concerned ownership, as the city government was replaced with private owners. The city government’s relinquishment of hotel ownership in a series of auctions in 2004 and 2005 was the end result of a kind of “one step forward, two steps back” ownership and privatization policy that City Hall had implemented since 1999. The city shares in hotels were mainly acquired by Russian investors.

Private Russian investment into hotel construction picked up as well. Consequently, joint ventures between foreign hoteliers and the city government were replaced with conventional management contracts with Russian construction and real estate companies. Local hotel developers, who often lacked industry experience, began to understand the value of a foreign management company, whose reputation helped in negotiations to obtain financing for the project and whose expertise was valuable during the construction. In contrast, a major part of the city’s hotels continued to be owner-managed, as there were no local management chains yet, and many owners of existing properties were still reluctant to give control to outsiders.

A group of its own was formed by the illegal mini-hotels that operated beyond industry regulation, having been registered as apartments: “*You have your own apartment, you pay for it just rent as for an apartment, you don’t have a license for alcohol, don’t have a cash register, and work entirely gray without paying any taxes.*” These illegal mini-hotels restricted their services to providing a “bed

to sleep in”, in contrast to legally operating mini-hotels, which often position themselves into the upper price segment and provide extensive tourist services. Interestingly, the existence of the illegal segment became very clear in interviews with legally operating mini-hotels as a reference group they wanted to avoid belonging to. This was supported by secondary data on industry development. Hence, in terms of structure the industry had two competing templates: legal and illegal. The former was based on market-based exchange and a shared normative base, and the latter on ignorance about industry norms and regulation. This division was also visible in hotels’ stakeholder relations, as the following sections will illustrate.

#### *Supplier relations: Market conditions stabilize*

As the transition proceeded, the local market for foodstuffs and other consumer supplies developed to the stage where only some luxury items such as specific alcohol brands needed to be imported. Furthermore, tender-based long-term supplier contracts replaced keeping a reserve of suppliers on hold. Finding reliable suppliers became easier, as most one-day businesses had already disappeared as the result of a kind of “natural selection”. Regarding investment goods, such as furniture, hotels continued to prefer foreign materials because of quality guarantees. Russian production of goods with special requirements for, e.g., fire safety, such as hotel textiles, was still underdeveloped.

In general, respondents of this study stressed the quality of supplies and equipment. Many of them underlined the importance of, for example, bed linen to meet requirements concerning, e.g., fire safety and hygiene. Illegal mini-hotels were an exception here, as their disobedience of norms and requirements stretched also to this sector. *“In hotels it is not allowed to use textiles that are difficult to wash, that are ill-adapted to chemical cleaning. They have bedspreads filled with foam and with ruffles. Who is washing them, how they will look in the future?”*

#### *Customer relations: Joining hotel consortia*

During the post-transition, local hotel marketing consortia started to emerge, and Internet-based reservation systems were increasingly applied by Russian-managed hotels. This in part contributed to the increase in the number of foreign guests. As during the transition, foreign-managed hotels continued to rely on their global reservation systems, although the local demand for their services picked up as well.

A persisting problem in the city’s hotel sector continued to be the high seasonality of demand. During the “white nights” summer season the city were packed with tourists, whereas in winter occupancy rates were low. The situation was

made worse by the state institutions, which scheduled high-level political and other events to the high season. Here, hotels developed marketing strategies for the winter season, as was previously illustrated.

Legally operating mini-hotels were in a somewhat difficult position regarding their position in the market, as they did not want to associate with the illegal mini-hotels, which often used questionable marketing practices. *“They do not correctly advertise themselves, often embellish their services, which does not correspond to reality.”*

#### *HRM strategies: The importance of right service attitude*

The HRM practices between foreign- and Russian-managed hotels started to converge during the post-transition. A majority of hotel staff were students or young graduates of professional institutes, and the main criteria for hiring personnel was their having the right service attitude. As the educational institutions still failed to equip students with sufficient skills, the need for in-house training continued. Hotels in the legal segment provided training both in-house and by resorting to external experts. Illegal hotels, in contrast, put limited emphasis on training personnel in proper ways of working: *“The personnel are taken directly from the street, without figuring out how hotel work should be organized, as a matter of fact.”*

The range of social benefits provided continued to vary from basic benefits defined by the law to more comprehensive social packages. Interestingly, even some of the new Russian and foreign-managed hotels revived some Soviet era traditions, such as the “socialist competition”: *“At the end of the year we always organize a competition of the best employee of the department, reward the winner with a plaque of honour, a monetary prize, and people are motivated to work better and to compare themselves against others.”* Finally, operating transparently by paying full taxes and pension fund contributions was also considered a social benefit. The illegally operating hotels broke the norms in this sense as well, as paying “gray” salaries was a part of their tax evasion policy.

#### *Public sector relations: Need for personal contacts diminishing?*

The regulative environment was in general stabilizing, but there was still room for improvement: *“Our legislation changes so often that when you read about it, your hair rises: today one, tomorrow another, the day after tomorrow a third.”* Consequently, the need for personal contacts in public administration to gain information continued.

However, there were also signs that the tradition of having close contact with authorities was gradually disappearing. Instead, it was considered sufficient to operate transparently and fulfil all requirements. Comments, such as *“Giving small*

*gifts to civil servants... that has been gone for 10 years.*" and *"It makes no sense to patch up a hole with money – the hole will be there anyway."* illustrate this.

In addition, corruption was still viewed a problem, in particular related to important decisions such as the allocation of sites for hotel construction. In everyday operations, bribery was primarily associated with illegal hotels: *"If I have a hotel that has no chance of being approved by the fire inspection, or sanitary control, I have to pay bribes."* Finally, the partnerships with private Russian constructors brought new means for foreign management companies to cope with public sector demands: *"Whenever we face a challenge (I don't say a problem) with the public sector, we ask our partner to take care of it. It's up to him how he deals with it, I'm not asking."*

### **Discussion and conclusion**

This article examined how the institutional contexts and organizational practices of different types of hotel enterprises co-evolved in the St. Petersburg hotel industry as the post-socialist transition in Russia progressed from 1991 to 2005. Figure 4 summarizes the key findings.

The results of the empirical analysis contribute to a better understanding of enterprise adaptation to changing institutional contexts. First, I showed how under macro-level institutional upheaval, the existence of field-level pressures towards homogeneity and their impact on organizational practices are not evident. In particular, during the early years of the transition, when old industry structures are abolished and new ones are under construction, enterprises are practically "self-guided" as the institutional environment does not provide them with "templates of organizing". Here, institutional theory proposes that local incumbents would stick to the templates of the old system, and foreign entrants would apply imported templates. However, my empirical analysis suggests that in the case of the hotel industry, both old and foreign templates needed substantial adaptation during the transition. The key reason was the imperfect market environment, which made the foreign entrants isolate themselves from the local operating context by relying on their global resource base. Russian-managed enterprises (old Soviet hotels and the few new start-ups) in contrast needed to build local networks.

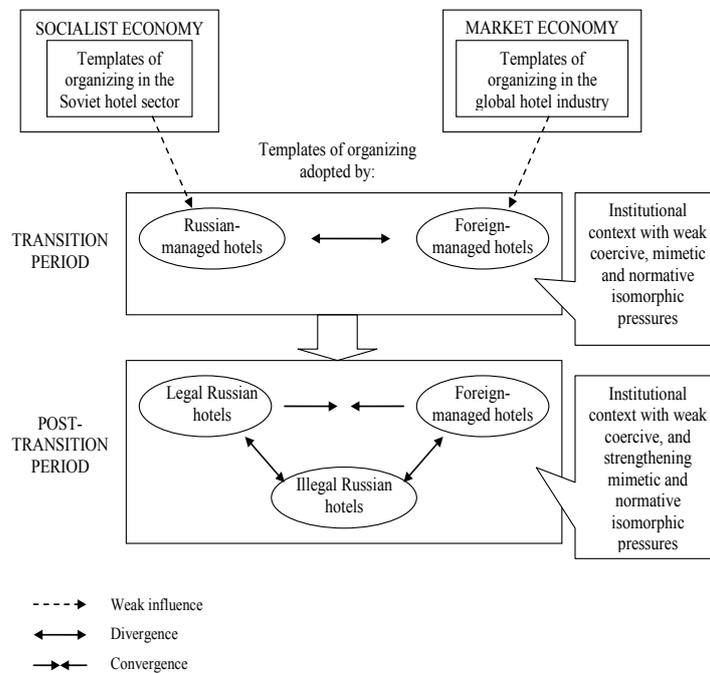
Moreover, I illustrated that institutional forces, such as state regulation, models for mimicry and professionalization evolve only gradually as the transition proceeds. However, I also showed that the continued lack of coercive pressure from the state results in the emergence of a new category of hotels: illegally operating ones, which ignore the institutional norms that most hotels already share. When mirroring against institutional theory, my contribution in this regard is that the logic explaining diversity in enterprise behaviour changes as the transition proceeds. During the transition, diversity is based on management – foreign versus

**Figure 4. Key findings of the study**

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Figure 4. Key findings of the study



local. Foreign-managed hotels are able to rely on their global resource base and organizational templates, and consequently behave differently from locally-managed hotels that do not have this opportunity. During the post-transition, however, this gap between “us and them” gradually narrows as the market economy gains a stronger foothold. Instead, the legitimacy of operations becomes the new basis for diversity. This illustrates that the market infrastructure has developed, but the institutional context still has gaps, which provide opportunities for grey business. My research thus concurs with Peng (2003) who proposed that the institutional pressures faced by the different types of enterprises converge as the transition proceeds, which narrows down the gap between their strategic behaviours.

Third, my study shows that although market economy practices have been disseminated rapidly in the St. Petersburg hotel sector, the legacy of state socialism is still visible in certain aspects. For example, some new hotel enterprises apply practices of socialist enterprises such as encouraging “socialist competition” between employees, and foreign-managed hotels may maintain extensive social infrastructure. In this sense, my study joins Kosonen (2004) who showed that in transition economies, both local incumbents and foreign entrants are likely to mix old and new thinking. However, the overall conclusion is that the St. Petersburg hotel sector “fundamentally operates in a market-oriented, competitive fashion” (Puffer/McCarthy 2007: 5). My study thereby supports the findings of Puffer/McCarthy (2007) on the prevalence of market capitalism in the Russian consumer sectors.

#### *Limitations of the study and suggestions for further research*

Like all research, this article has its limitations. First, the nature of the study was exploratory and aimed at describing the institutional change at the industry level. This limited the depth to which the strategic choices of individual enterprises were addressed. Further research would hence benefit from a more in-depth investigation of selected case companies on one hand, and from a survey-based examination of selected business practices among a wider population of enterprises on the other.

Second, due to its theoretical underpinnings, this study focused on the role of the institutional environment in the strategic action of enterprises. Therefore, enterprise preferences were addressed only to the extent that they are institutionally derived. However, it is recognized that strategic enterprise action is driven not only by institutional but also competitive pressures from the environment, which shape enterprise preferences. Hence, further analysis would benefit from the combined examination of the relative weights of these pressures. To gain a more comprehensive picture of industry dynamics, qualitative data would need to be combined with quantitative indicators describing industry characteristics.

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## Perceptions of MNC management: Local parent sensemaking in international joint venture process\*

Ed Clark, Anna Soulsby\*\*

*The article focuses on the way in which multinational corporations (MNCs) and local parent firms interact in the construction and operation of international joint ventures (IJVs). It seeks to contribute to the theory of IJV process in two ways. First, it constructs a preliminary integrative theoretical framework, which draws attention to the roles of initial venture conditions, of political, learning and relationship processes and parental perceptions of efficiency and equity. Second, it infers theoretical lessons from a case study of a German-Czech IJV. The empirical findings highlight the role of critical events that stimulate sensemaking processes, which in turn politicise the IJV and create different dynamic patterns.*

*Keywords: Czech Republic, international joint ventures, sensemaking, venture dynamics, process theory, multi-national corporation*

### Introduction

Research on international joint ventures (IJVs) has expanded in pace with their rapid proliferation (Yan, 1998) as organisational forms and their significance for multinational corporations (MNCs) as internationalising strategies (Parkhe 1996; Si/Bruton 1999; Guillén 2003). One consistent theme has concerned the IJV's apparent predisposition towards instability, under-performance and dissolution, though this influential view of their 'intrinsic vulnerability' (Das/Teng 2000) has been challenged both theoretically (Yan 1998) and empirically (Gomes-Casseres 1987). This debate has directed attention towards the relationships between the IJV's 'transitional' (Porter 1990) structural characteristics, internal processes (Yan/Gray 1994) and outcomes, which, according to some researchers, vary with contextual conditions and characteristics (Lecraw 1984; Beamish 1985; Meyer 2001; Child 2002; Uhlenbruck et al. 2003). Tied to this argument is the observation that, under certain conditions, head office management may treat IJVs as merely a stage in the structural expansion of the MNC, en route to the establishment of a fully owned and controlled subsidiary

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(Gomes-Casseres 1987; Blodgett 1992; Child 2002). How MNC and local parents negotiate and operate IJVs over time is therefore very much concerned with the theory of MNC management.

In this context, this article aims to review, evaluate and refine the theory of IJV process and dynamics and this involves two tasks. The first task is to examine the main concepts and theories that have contributed to the current state of knowledge, which involves evaluating contributions from two distinct theoretical and methodological standpoints. The dominant 'structural' approach seeks causal explanation by using multivariate methods to test empirical models that relate structural conditions with performance outcomes. Later IJV research has compensated for a critical omission in the structural view (Parkhe 1993; Inkpen 2001) by adopting inductive qualitative methods to study the role of internal processes in mediating structures and outcomes (Ring/Van de Ven 1994; Doz 1996; Ariño/de la Torre 1998). Our work contributes primarily to this latter 'processual' stream, but also brings together structural and processual factors in explaining dynamic IJV patterns.

The second task is to draw on an intensive case study of an IJV between a German multinational corporation (MNC) and a Czech former state-owned enterprise (SOE) to investigate in detail how interparental processes contribute to the internal dynamic. IJV processes are presented through the eyes of the Czech parent's managers, whose perceptions, interpretations and judgements influence their contributions to venture governance. Seeing the IJV through a local managerial lens is unusual within an international business literature mostly inclined towards the perspective of Western MNCs. From inductive analysis of this case, we introduce new concepts into the theoretical framework to improve its explanatory power. Among other points, we argue that the role of partners' expectations of the venture and their resultant sensemaking activities have special theoretical significance.

For the purposes of this article, we define a 'joint venture' as a legally separate organisational entity created by two or more independent (parent) firms, which aim to pursue a particular business project. It is international when the headquarters of at least one of the parent firms (usually an MNC) is based outside the joint venture organisation's country of operation (Geringer/Hebert 1989). This article follows conventions in the literature by considering the structure and process of IJVs through the interparental relationship between the MNC and the local firm.

The article continues as follows. In the next section, we critically review the IJV literature and deduce a preliminary theoretical framework to explain IJV process as interparental dynamics. The third section discusses the empirical research underlying the article, by explaining its background, methodological position, data collection and data analysis processes. Following that, we outline the case study

findings, which are the basis, in the next section, for analytical generalisation and extension of the theoretical framework already discussed. The article concludes by summarising contributions and implications for further research.

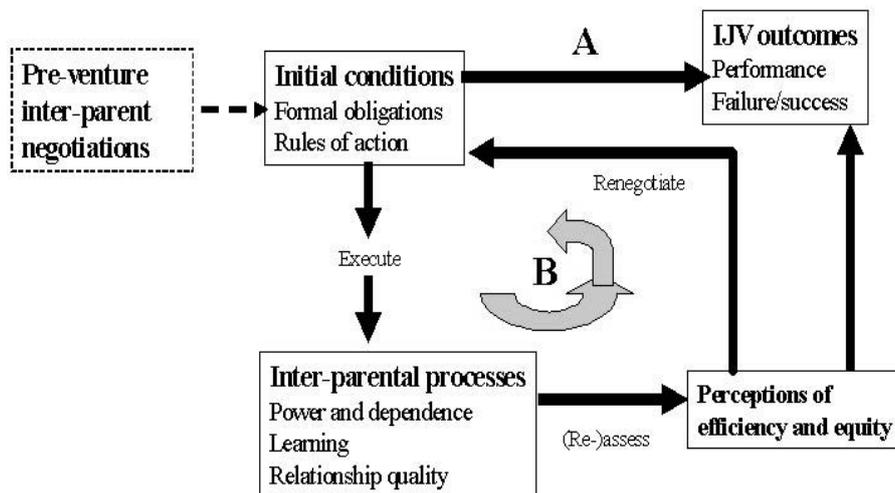
### Previous research and a preliminary framework

From a review of the structural and processual strands of IJV research, this section brings together key concepts within a preliminary theoretical framework (Figure 1) that summarises the current state of knowledge about IJV process and dynamics.

#### *Initial conditions and IJV outcomes*

IJVs are different from conventional organisational hierarchies. Their initial conditions are agreed through pre-venture negotiation between the multiple owners and reflect the balance of power, strategic interests and cultural diversity of the parents (Geringer/Hebert 1989; Fey/Beamish 2000). They have been treated as defining the IJV's structural features and rules of action, including equity share (Killing 1983; Lecraw 1984; Blodgett 1992; Child 2002), governance structures (Geringer/Hebert 1989; Yan 1998), management control structures (Lecraw 1984; Yan/Gray 1994; Child 2002) and mechanisms (Fryxell et al. 2002), resource dependencies (Yan/Gray 1994) and know-how contributions (Beamish/Banks 1987; Hamel 1991; Geringer 1991; Yan/Child 2002). The initial bargain (Inkpen/Beamish 1997: 183) is therefore a negotiated resolution of 'contradictions' (Yan 1998) or 'tensions' (Das/Teng 2000) arising from parents' competitive and cooperative needs (Hamel 1991; Fey/Beamish 2000).

**Figure 1. IJV structure, process and outcomes: A preliminary framework**



These same conditions arising from ‘multiple agency’ (Child/Rodrigues 2004) make it difficult to conceptualise and measure IJV performance. For example, the termination or longevity of an IJV might not signal ‘failure’ or ‘success’, but the realisation of the parents’ agreed goals (Gomes-Casseres 1987; Geringer/Hebert 1989/1991; Yan/Gray 2001) or high barriers to exiting the venture (Parkhe 1991). The argument in this article avoids such value judgements and focuses on observable venture ‘outcomes’ such as the dissolution or longevity of the legal arrangement.

The findings of predominantly large sample multivariate studies of the relationship between IJV initial conditions and outcomes have been inconsistent. Some studies have found for the superiority of those IJVs dominated by one parent, whether on the basis of dominant ownership (Killing 1983; Geringer/Hebert 1989; Child 2002) or control of strategic resources (Lecraw 1984; Geringer/Hebert 1989; Yan/Gray 2001). However, other researchers have discovered the opposite effect, that shared control has better outcomes, especially in developing countries (Beamish 1985; Beamish/Banks 1987; Blodgett 1992). The concentration on a direct causal relationship between initial conditions (e.g. control structures) and outcomes (often formulated as ‘success’ or ‘failure’) – see arrow A in Figure 1 – has been criticised for seeking over-simple answers to the ‘messy’ problems (Parkhe 1993) of ‘process dynamics’ (Doz 1996), which are left untheorised in a ‘black box’ (Salk/Shenkar 2001; Shenkar/Yan 2002; see circular arrow B, Figure 1).

#### *Interparental processes*

The desire to open the black box of IJV process has resulted in significant extensions to the mainstream way of thinking about IJV structure and outcomes. Process theorists argue that, to understand the effects of an IJV’s initial conditions, one must examine how parents execute them (Ring/Van de Ven 1994). The literature identifies three IJV processes that affect the way parents perceive and respond to the venture-in-action.

*Power and dependence.* The IJV literature has long recognised the importance of the structure of interparental control, but, for process researchers, explaining venture changes involves understanding shifts in the structure of ‘bargaining power’ from initial conditions (Yan /Gray 1994; Inkpen/Beamish 1997; Yan/Gray 2001; Shenkar/Yan 2002). From a bargaining power perspective, a competitive parent can create instability with its partners by changing the balance of power and dependence (Inkpen/Beamish 1997), thereby causing the initial conditions to degenerate through ‘micro bargains’ (Hamel 1991). In turn, such behaviour can be evaluated by managers of weaker parents as an inequitable altering of initially agreed rules of action (Child 2002).

*Learning.* Learning processes also mediate initial conditions and outcomes (Doz 1996). The IJV is both the product of the knowledge and skills brought by each parent and a vehicle for each parent to acquire knowledge, competences and resources that it hitherto lacked (Inkpen/Crossan 1995). Inkpen and Beamish (1997) examine the relationship between learning, bargaining power and venture stability, when one or more of the IJV parents is driven by the 'law of opportunism' (Yan/Gray 2001; Shenkar/Yan 2002). Not satisfied with simply 'gaining access' to a partner's knowledge and skills, a parent may aim to 'internalise' a partner's knowledge (Hamel 1991), acquiring it in ways or at a pace beyond the rules of action. Winning the 'race to learn' first challenges initial conditions but also shifts the balance of inter-parent power and dependence. However, the initial conditions can also be executed to promote an expansion in the knowledge and skills contributed by the partners. Doz (1996) thus sees the initial conditions as fostering an 'evolutionary' process of learning, comparable in principle to what Nonaka (1994) calls a spiral of organisational knowledge creation.

*Relationship quality.* The quality of the interparental relationship is reflected in the literature in many guises as a determinant of IJV performance: commitment (Fey/Beamish 2000), attachment (Inkpen/Beamish 1997), the balance of formality and informality (Ring/Van de Ven 1994; Fryxell et al. 2002), consensus and conflict (Yan/Gray 1994; Yan/Gray 2001; Fey/Beamish 2000; Peng/Shenkar 2002; Shenkar/Yan 2002), partner complementarity (Geringer 1991; Fey/Beamish 2001), working rapport (Ring/Van de Ven 1994; Beamish/Banks 1997; Yan/Gray 2001; Yan/Child 2002) and trust (Child/Faulkner 1998; Currall/Inkpen 2002; Fryxell et al. 2002).

In defining how parents should work together, these relationship qualities are inscribed in the venture's initial conditions, in terms of legal contracts and formal control structures (Ring/Van de Ven 1994). When the venture works as expected, these formal and legal obligations become embedded in personalised relationships or attachments (Inkpen/Beamish 1997). Fryxell et al. (2002) found that an interparental relationship based on 'affect-based trust' tends to lead to cooperation and positive perceptions of IJV performance. This cumulative effect can work in the other direction too, making relationship quality pivotal in the internal dynamics of the IJV. For example, sudden shifts in the balance of interparental power (Yan/Gray 1994) or knowledge (Doz 1996) can create initial doubts within a hitherto stable relationship. Moreover, excessive reliance on formal controls can lead parents, especially experienced ones, to feel mistrusted (Ring/Van de Ven 1994; Fryxell et al. 2002). Once doubt exists, further evidence of 'bad faith' can trigger an obsolescing dynamic leading to potential dissolution.

### *Perceptions of efficiency and equity*

This discussion shows that the execution of initial conditions can create shifts in the three processes described above, which in turn lead parents to reassess the value of the venture to them. Ring and Van de Ven (1994) argue that parents use criteria of 'efficiency' and 'equity' in monitoring the rules of action and making judgements about the functioning of the venture. Efficiency refers to the application of technical and economic criteria, including the expected profitability and costs of the business, while equity invokes social judgements of fairness, good faith and agreed mutuality. In perceiving and evaluating the venture in terms of efficiency and equity, parents make judgements based on their interpretation of the rules of action established in the initial conditions.

### *IJV dynamic patterns*

Perceptions of changes in bargaining power, learning and relationship get objectified in dynamic process patterns. From the processual literature, we can distinguish between three dynamic patterns of IJV process as inertial, accumulative and obsolescing. An inertial path (Doz 1996) is stable, but creates repeated, unprogressive iterations that reproduce the initial conditions over time (Yan/Gray 1994; Yan 1998). When the initial conditions or shifts in them are adjudged efficient and equitable, parents renegotiate the venture in an accumulative dynamic that amplifies learning and knowledge-sharing (Inkpen/Beamish 1997), utilises power and builds mutual trust and results in IJV longevity (Parkhe 1991; Yan 1998; Fryxell et al. 2002). An obsolescing spiral describes the opposite dynamic pattern, following perceptions by a parent that the initial conditions have been executed inefficiently or unfairly. For example, when local knowledge is illegitimately acquired (Hamel 1991), or the balance of bargaining power changed (Inkpen/Beamish 1997) or partner complementarity eroded (Geringer 1991; Parkhe 1991), negative re-assessment of the venture increases levels of instability (Yan 1998). The eventual outcome of this obsolescing dynamic over time is some form of venture dissolution.

Figure 1 summarises the contours of these arguments about IJV process and dynamics. In the remainder of the article, we use this conceptual model to examine the sequences of events within a German-Czech IJV, and, by identifying discrepancies, we seek to extend and refine the existing IJV process framework in terms of its explanatory power. Before that, we outline the methodology underlying our empirical work.

## **Research design and methods**

A number of IJV scholars have called for more qualitative case research to provide a richer picture of the 'unfolding of the... [IJV] process itself' (Doz 1996:56), and for inductive theory construction to make sense of the subject

matter (Parkhe 1993; Child 2002). The DeutschMotor-Autodil Joint Venture (DAJV) was one of the first examples of foreign direct investment (FDI) penetrating the provincial Czech regions and was quite unlike the better publicised cases such as Volkswagen's investment in Škoda. On the one hand, the establishment of DAJV is empirically interesting because it acted as a magnet for further Western capital in the region. But in the context of this article, it offers theoretically instructive case, because it provides a relevant setting for applying the preliminary framework to an archetypal dynamic pattern – dissolution through an obsolescing cycle and transformation into an MNC subsidiary.

### *Context*

DAJV was established in the Vysoký region<sup>1</sup>, which used to be a German 'island' in pre-World War Two Czechoslovakia. Although a legal act of retribution following the Nazi occupation of Bohemia and Moravia dispossessed 'German' citizens and sent them to Germany and Austria, many local Czechs with Germanic roots continued to have a grasp of the German language and an ease with German ways. Nonetheless, negative memories of wartime occupation sustain some ambivalence towards Germans, despite acknowledgement of their economic significance in post-socialist reconstruction.

Under the communist command economy, Autodil had been a large and successful automotive SOE, but since 1990 its former East European markets collapsed, state support was withdrawn and the directors have reluctantly made skilled workers redundant. When a government-funded enquiry concluded that SOEs in the Czech automotive industry could not survive without foreign capital, Autodil was omitted from the voucher privatisation schemes of 1991-1995 and finding a foreign strategic partner became the central principle of senior managers' corporate strategy.

In 1990, GEM, a large German engine manufacturer, was impressed by one of Autodil's new product designs but reluctant to make a commitment unless Autodil worked with one of its existing German suppliers, DeutschMotor, to assure quality. DeutschMotor is a huge MNC with 90 years of experience operating abroad in 16 different engineering sectors in more than 50 countries. It is both a direct competitor and a customer of Autodil, supplying varied automotive parts directly to motor manufacturers and indirectly to other parts suppliers, like GEM.

### *Data collection and in-field analysis*

We collected empirical materials during three two-week field visits to Vysoký from June 2001 to May 2002. The wider aim was to develop community and en-

enterprise-level materials on economic restructuring processes to complement embedded case study work (Yin, 2003) that we had conducted elsewhere (Clark/Soulsby 1995/1996/1998/1999a/1999b/2007; Soulsby 2001; Soulsby/Clark 1995/1996a/1996b/1998/2006/2007).

The project went through two major fieldwork phases. In the contextual phase, we made important local contacts and collected historical, economic and social information in the local archives. We conducted 'contextual interviews' with five leading political and business figures, visited enterprises and acquired documentary materials. In the second detailed phase (May 2002), we spent two weeks in Autodil, aiming to learn as much as possible about its internal restructuring experiences.

We combined our main research method, semi-structured interviewing, with collecting secondary materials and unsystematic observation. Using translators for language support and as cultural informants (Soulsby 2004), we conducted intensive interviews (lasting between 1.5 to 5 hours) with twenty-one respondents, comprising five directors, five other senior managers (including four former director), ten middle managers and the trade union official. The directors had on average worked 26 years within Autodil and were members of a powerful group of senior managers, known colloquially as the 'seven samurai'. Six of them had guided Autodil during the late 1980s, through the Velvet Revolution and had been responsible for negotiating the DAJV contract.

We adopted a mixed approach to interviewing, in part seeking 'factual' information (e.g. regarding dates, financial information, employment numbers) through structured questions. However, a major purpose was to examine managers' experiences of and involvement in the joint venture and the sequence of events that defined its evolution. Information was collected through an iterative process (Eisenhardt 1989), whereby themes and issues from one interview were followed up in later ones, serving, through repetition, to increase confidence in the details of the IJV process, as perceived in the field (Yin 2003). We continued interviewing until no new information or issue was forthcoming – i.e. saturation point had been reached (Eisenhardt 1989). We recorded almost verbatim notes of the translator's version of the replies, seeking clarification when the translators' answers were truncated or omitted reference to words that seemed important. These notes were written up at the earliest opportunity, in practice the same evening.

This procedure resulted in a series of 'first-order accounts' of DAJV, touching systematically on its establishment, internal changes, the path to dissolution and key events and processes that influenced these phases. Through iterative in-field analysis, our understanding of the IJV story settled down around certain narrative themes and patterns, which formed the basis of our embryonic second-order interpretations (Van Maanen 1979; Gabriel 2001).

### *Analysis of empirical materials*

In-field analysis was complemented by more systematic and detached analysis away from the field. Two main techniques were used to derive a chronology, re-examine the embryonic second order accounts developed in the field from Czech managers' narratives of German management, and induct an overarching narrative (Pentland 1999) of the IJV as a sequence of events over time.

We started by devising a data reduction table (Miles/Huberman, 1984), which extrapolated data about venture establishment, perceptions of operation, perceptions of crisis, and dissolution and post-dissolution from the 22 respondents. At this stage, 'factual' information (e.g. dates and sequence of events) was checked against other sources of information, such as internal and external documents and contextual respondents' statements. This unwieldy table was further simplified by identifying agreements and commonalities in narrative, expression, metaphors etc. and assembling an overarching processual and chronological account.

From the above, it was possible to identify four 'critical incidents' (Ring/Van de Ven 1994), which disrupted the respondents' routine perceptions of the venture (see next section). As Weick (1995) indicates, interruptions in the 'ongoing flow' force actors to reinterpret their situation to restore its meaningfulness in the light of the surprise episode. These qualitative-analytical techniques assured that our final interpretations were always traceable to the first-order accounts and primary materials.

### *Potential problems*

We have had to confront two major problems. First, it is not methodologically ideal to have only Autodil's managers' experiences of DAJV, and, for completeness, we have sought, unsuccessfully, DeutschMotor's version. The refusal of one party to cooperate is not unusual in dissolved IJVs (Shenkar/Yan 2002) and, even when researchers have evidence from both parties, there is a tendency to privilege just one side – usually the Western MNC (Lecraw 1984; Gomes-Casseres 1987; Parkhe 1991; Child/Rodrigues 2004). Despite its methodological desirability, this article's theoretical contributions do not rely on having both sides of the story. Wherever possible, we have been able to corroborate findings through inter-respondent reliability and independent sources (documents, contextual interviews). While it is unsafe to make inferences about DeutschMotor's actual motives from our materials, we collected substantial data about Autodil managers' own values and motives and of their perceptions and evaluations of DeutschMotor management behaviour. The application of interpretive skills to these data allowed us to construct an understanding of how and why Autodil's managers began to behave differently over time and an explanation of the dy-

namic processes that these differences engendered within the interparental relationship (Langley 1999).

Second, our research is affected by problems associated with a retrospective examination of IJV process. Practical circumstances made real-time longitudinal research impossible, but dealing with a 'complete case' means that we could assemble the whole story and the critical events within the process (Ariño/ de la Torre 1998; Shenkar /Yan 2002). We have followed Golden's (1992) advice to optimise the accuracy of the retrospective accounts and the validity of the case study findings. We acquired multiple perspectives by interviewing down and across organisational levels, used informed external disinterested respondents to monitor possible self-serving responses, and drew on published and unpublished evidence to corroborate 'factual' information (Leonard Barton 1990; Doz 1996).

### **The DeutschMotor – Autodil Joint Venture**

This section outlines the life of DAJV from its inception in 1990, through three years of operation (1992-1995) to its absorption as a wholly owned subsidiary into the DeutschMotor's multinational framework. The story is told as four overlapping critical incidents, as perceived by Autodil's managers. At each turn, these perceptions led them to re-assess the venture and engage with DeutschMotor management to clarify and reconfigure the initial conditions.

#### *The initial conditions: contributions and expectations*

Autodil directors entered pre-venture negotiations hoping to persuade DeutschMotor's directors to become a long term strategic partner for the whole business. The final joint-venture agreement (see Table I) offered both companies something:

We wanted employment for our employees and the development of Autodil [which was crucial]... because of the loss of [traditional] customers... For DeutschMotor... the workforces [and labour costs] in Germany and the Czech Republic are very different... [but] transport costs are comparable... [and our] employees are qualified and experienced... (Autodil director).

DeutschMotor insisted on a controlling ownership share

you need 34% of shares to have power, according to Czech law. Autodil first wanted to put in 34%, but DeutschMotor turned this down. Then Autodil wanted to put in... [as little as] 12%... [but] DeutschMotor insisted that we invest more. So the [final deal of] 24% was a compromise. (Autodil director)

Through this ownership structure, DeutschMotor could appoint its own staff to senior management positions, including the General Director and Financial Director. It recruited a Czech Deputy Director from outside Autodil, which nominated only the Technical Director to represent its interests in DAJV.

**Table 1. Initial contributions to DAJV**

<i>Autodil</i>	<i>DeutschMotor</i>
140 million Kč (plant, land, buildings)	443 million Kč (capital)
Technically skilled workers	New technologies
Cheap production costs	Management know-how
Good location	Quality standards and systems
Supply parts to be assembled	Access to client networks
Product blueprints and patent	Access to supplier networks
Local networks	International reputation
Technical Director	General and Financial Directors

Autodil's capital share took the form of land, buildings and the original design for its work with GEM. It supplied components for assembly and selected a small number of employees for the start-up. The directors saw DAJV as an opportunity to acquire modern technology, secure jobs for some employees and learn about modern management practices, especially quality assurance. At the same time, strategic cooperation with DeutschMotor would connect Autodil into global industrial networks and allow the company to learn about MNC clients' expectations. Most of all, the efficiency of DAJV would generate profits to reinvest in Autodil's remaining independent businesses. On the other hand, DeutschMotor constructed a state-of-the-art assembly plant in a strategic location for eastern markets and gained access to a highly skilled workforce and the patent component design.

Autodil's managers assessed the initial bargain very positively. They had partially realised their priority to find a 'strategic partner' and the initial conditions set up clear expectations about the venture and the relationship with DeutschMotor. Their 'catastrophic situation' (Autodil director) offered little choice but to accept DAJV's unfavorable structural conditions, but since DeutschMotor remained dependent on Autodil managers for local knowledge, local resources and contacts, especially in relation to the labour market and political support, their new relationship augured well. DAJV was seen as the first step towards long-term cooperation with DeutschMotor and Czech managers expected the Germans to reciprocate. In the medium term, the joint venture would transfer critical management knowledge and generate profits to plan for and invest in Autodil's future.

With these formal structures and informal expectations, the IJV started operating in 1992. As a former General Director argued, "...it was very good at the beginning, like someone moving into the family as a friend". But there were unforeseen problems. To continue the quotation and anticipate the story: "...then you

discover that he [the new family friend] is looking at your wife and you have trouble”.

### *Critical incidents, internal processes and dynamics*

Analysis of the first-order accounts reveals four critical incidents: the venture’s unplanned acquisition of labour; its loss making habits; DeutschMotor’s unilateral plans to expand in the region; its unilateral plans to expand DAJV. Each incident affected the Czech managers’ perceptions of MNC management and the inter-parent balance of bargaining power, learning and relationship quality; each challenged their understanding of DAJV and prompted responses that created an internal momentum and dynamic.

#### *Critical incident 1: poaching labour*

The initial agreement gave Autodil control of the transfer of workers to DAJV, but, soon after operations began, there were some unexpected incidents.

We expected a transfer of employees... [There] were only supposed to be 250 jobs [in DAJV] – only a few per cent of our employees... They were [to be] chosen by [Autodil] supervisors and managers, and the criteria were: could Autodil work without him? And could he complete the tasks needed by DAJV? ... Usually they were younger [employees]... (Autodil director)

However, within months of opening, the movement of labour from Autodil to DAJV, according to another director, had become an ‘uncoordinated transfer... It was poaching’.

DAJV’s personnel manager knew many of the workers at the Autodil plant and offered higher wages to attract the most skilled and experienced employees, thereby disrupting Autodil’s capacity to run its own businesses efficiently. During these ‘terrible years’, key employees began to demand wages to match those of their former co-workers and rising labour costs and labour power created an internal crisis of production quantity and quality in Autodil.

In making sense of this unexpected turn of events, some Autodil managers felt that they were being treated unfairly and that the venture was affecting the efficiency of Autodil’s operations. Though the seeds of doubt were sown for some, senior managers continued to have faith in DeutschMotor’s original commitments.

#### *Critical incident 2: making losses*

As one Autodil director explained, “...we expected a profit, [and] we needed the money for investment [in Autodil]”. Yet, after its first full year of operation, DAJV not only failed to post a profit, it actually declared a large loss. On inves-

tigation, Autodil's directors discovered that the German parent had adopted a transfer pricing strategy, selling DAJV's products at a loss to DeutschMotor, which sold them on to its customers at a profit that was realised in Germany. According to another director, "DAJV was showing a perpetual loss – it was debt management". A senior manager agreed: "for every Deutschmark that Autodil gave DAJV, DeutschMotor took two".

This use of DeutschMotor's structural control in this way was entirely unanticipated by Autodil's managers, who saw the 'one-sided' decision as being quite contrary to the mutually beneficial venture that they thought they had established. Czech senior management was forced for a second time into sensemaking overdrive and their re-evaluation of DAJV led to some stark conclusions. Absorbing the losses from the unilateral transfer pricing methodology was a great blow to Autodil's strategic reinvestment plans. Nonetheless, this formative experience of international business practices undermined their hitherto unquestioned belief in DeutschMotor's cooperation and goodwill.

'Change of philosophy': In the light of their initial expectations, Autodil's management interpreted the two incidents as indicative of an emergent pattern, suggesting, in fact, that DeutschMotor had undergone a 'change of philosophy'. This realisation was epiphanic. Some believed it to be a genuine change in strategic commitment arising from a change in DeutschMotor's circumstances. Others were more cynical, feeling that the critical incidents had revealed the MNC's real strategic values and intentions.

Whatever DeutschMotor's 'real' motives, Autodil senior management from this time on attributed its actions towards DAJV to a more predatory strategic orientation, reflecting exploitative, short-termist, ethnocentric and competitive values. In making sense of DAJV, Czech managers reached for various metaphors, many located in local historical and national identities, such as 'colonialism', 'occupation', 'master-servant relationship', 'national fate', and 'comedy'. These sensemaking devices in turn screened out other possible explanations of the MNC's behaviour.

The attribution of a definitive change in DeutschMotor's values marked a point from which return to earlier expectations would be immensely difficult. Autodil managers' new understandings affected not only their explanation of past critical incidents, but also the prediction of future ones and their actions towards the German parent. Short of something unusual happening, the internal dynamic of the venture would now be built on these expectations of power, learning and trust in the interparental relationship, creating pressures towards obsolescence and dissolution.

*Critical incident 3: expansion outside the JV*

In the spirit of cooperation, Autodil's directors had used their networks to put DAJV's General Director in contact with influential local politicians and officials. In time, the municipal and regional authorities granted DeutschMotor both land and tax exemptions to subsidise the building of new factories. Rumours spread in the community that the MNC intended to employ 11,000 people in the region.

In the light of DeutschMotor's 'change of philosophy', the Czech managers reassessed the motives behind DeutschMotor's plans to expand outside the DAJV framework. In a small local economy like Vysoký, DeutschMotor's aggressive competitiveness in labour and product markets threatened Autodil's future. This interpretation served to reinforce not only the image of DeutschMotor as a strategically expedient rather than cooperative partner, but also a new discourse of colonialism and betrayal that, mid-way through DAJV's life, was permeating Czech management thinking.

*Critical incident 4: new capital injection into JV*

Twelve months before final dissolution, DeutschMotor announced its next strategic step – a fourfold increase in its capital investment in DAJV aimed at developing new product lines. This issue served as a catalyst in the IJV process.

We sold our shares to DeutschMotor, because [their] very expensive plans... were not acceptable... Without injecting capital, we would have atomised our share of the joint venture... we would have had no power and just have to stand and watch. (Autodil director)

Another director commented bluntly referred to DeutschMotor's behaviour as 'colonial'. DeutschMotor's plans reinforced the perceived inequity of the political process within the IJV. DAJV's expansion was also opposed on efficiency grounds viz. Autodil would be unable to recruit and retain its skilled workforce and mainstream production would be affected. One director described Autodil's position as "powerless and passive".

By 1995, external sources reporting similar patterns in other DeutschMotor joint ventures served to confirm their understanding of the Germans' motives. The director responsible for negotiating withdrawal perceived 'an efficient philosophy': '...establish a joint venture, stabilise it, acquire local labour, buy the venture out... and konec [the end]'. Another director stated quite simply that by 1995 'DeutschMotor no longer needed Autodil'.

The continuous task of making sense of the venture-in-action led Autodil's managers to their understanding of MNC management. Their initial expectations of mutual trust, exploratory knowledge sharing, long-term cooperation and interde-

pendence gave way to expectations of breached trust, competitive learning, short-term expedience and dependence. The accumulating bargain they had anticipated in the establishment of DAJV was transformed into an inefficient and inequitable relationship, in which they felt controlled, 'out-learned' and weakened. The joint venture had evolved into an obsolescing bargain leading to eventual dissolution and the direct acquisition of the joint venture organisation to be owned and managed as a subsidiary plant.

### **Discussion: Strategic sensemaking and the IJV dynamic**

The DAJV case confirms the overall contours of the preliminary theoretical framework deduced from the existing literature (Figure 1). In general, the internal processes conventionally locked up in a 'black box' mediated the relationship between IJV initial conditions and outcomes. More specifically, the findings underscore the important role of the local parent's perceptions of MNC management in responding to and enacting shifts in interparental bargaining power, learning and relationship quality. Through these perceptions, the Czech parent reconsidered its views of MNC management and re-evaluated the efficiency and equity of the venture, with subsequent renegotiations moving it through an obsolescing cycle towards dissolution, one of the three generic dynamic patterns.

We argue that our understanding of IJV process can be extended by capturing these insights theoretically. We enhance the theoretical role of sensemaking activities in a number of theoretical refinements that revise the existing theoretical framework.

#### *1. Initial conditions*

The processual conception of IJVs needs to move beyond a narrow view of the venture's initial conditions, its structure of ownership and control as formal 'rules of action' to include the informal norms and expectations that parents hold of the venture in action. These initial expectations of the venture are theoretically central to processes of perception, interpretation and evaluation that permeate processual theory (see 3, below).

#### *2. Venture expectations*

Autodil's management had strategic and operational expectations of how DAJV should operate. These expectations partly reflected their pre-venture priorities – i.e. their 'prior strategic orientation' – that linked Autodil's survival to a long-term strategic partnership based on interdependency, knowledge sharing and a co-operative working relationship. They also emerged from the negotiation process and were embodied in the structural arrangements that (they thought) were agreed with DeutschMotor. Thus, initially, they trusted the MNC partner to exe-

cute the venture's conditions 'equitably' – in conformity with 'agreed' conditions – and 'efficiently', to allow improvements in their mainstream businesses. However, venture expectations were not fixed, but rather adjusted in relation to parents' judgements of fairness and performance.

We propose that the preliminary theoretical framework be extended to include the concepts of prior strategic orientation and venture expectations. These reflect the well-understood ideas that partners vary in their 'complementarity' (Geringer 1991), their climate and values (Parkhe 1991; Johnson et al. 1996; Fey/Beamish 2000; Pothukuchi et al. 2002) and in particular values such as temporal orientation (Das/Teng 2000:89), knowledge exploitation or exploration (March 1991; Koza/Lewin 1998), intent to internalise or access knowledge (Beamish/Banks 1987; Hamel 1991) and ethnocentrism or polycentrism (Perlmutter 1969; Inkpen/Crossan 1995). The concepts perform an important theoretical role in the framework, explaining how the stages of the dynamic interrelate and unfold.

### *3. Critical incidents and the process of sensemaking*

The initial conditions define the rules and norms of the venture-in-action, against which parent managers perceive and interpret the goings-on of the venture. As long as the initial conditions are realised, the IJV sustains an inertial path (Doz 1996). Critical incidents are theoretically significant occasions, when actors are confronted with unforeseen contraventions of the rules and norms of action and have to work hard to give meaning to these experiences.

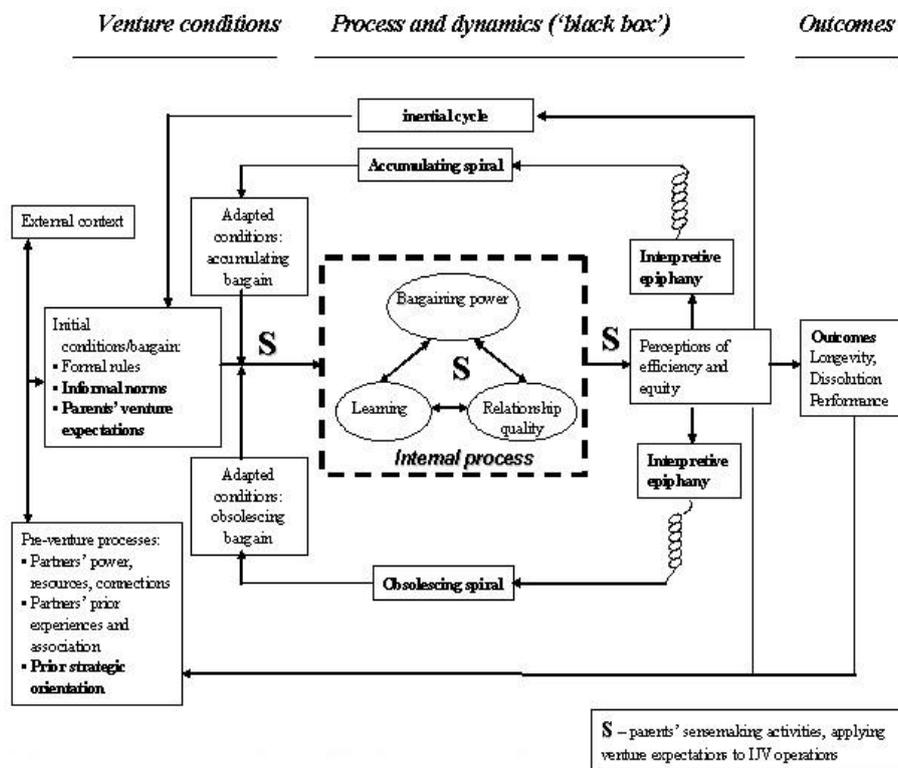
The empirical arguments support the dynamic role of these sensemaking processes. Rather than the venture's initial formal conditions being associated with venture instability and dissolution, this dynamic and its momentum ensued from the unanticipated divergence of 'reality' from expectations and the subsequent engagement in re-evaluation and renegotiation of conditions. In our case, the Czech managers drew on existing local and national discourses and meaningful metaphors to make sense of DeutschMotor's conduct. They likened DeutschMotor to a 'strong and big dictator', a 'colonialist' and a war victor and saw their enterprise as 'incubators for DeutschMotor', 'new servants' with their own 'sad fate'. Such discourses politicised their perceptions of the MNC by attributing strategic motives to the German managers; these political sensemaking, sense-giving and enactment activities fed back into the interparental relationship and contributed to the unfolding IJV process.

### *4. Interpretive epiphany*

From our empirical materials, we can infer one further theoretical mechanism in the internal dynamic process. When Autodil managers suddenly 'realised' that

DeutschMotor was behaving according to different norms of action and applying different philosophical principles to those they had expected, they underwent an interpretive epiphany, which was a watershed in the IJV process. This in turn led to a radical re-evaluation of their own venture expectations, tipping the balance towards suspicion rather than trust. This interpretive epiphany is politically central to the dynamic that changes the direction of an unfolding process, because this realisation tinged all future perceptions and evaluations, creating a stronger momentum for the downward spiral and dissolution. In adding this theoretical mechanism to the revised framework, we suggest that it is worth further theoretical and empirical exploration.

Figure 2. Revised theoretical framework



5. The revised theoretical framework

By combining theoretical deduction from the existing literature and theoretical induction from the empirical case, we now provide the contours of a revised theoretical framework. Figure 2 shows the relationships between initial conditions, internal processes and venture outcomes, but the key revisions (in bold font) fur-

ther prise open the 'black box' of internal process. The framework demonstrates the importance of venture expectations and sensemaking (S) in producing and promoting IJV dynamics.

The framework starts logically from the pre-venture negotiation of initial conditions, in which potential parents' prior strategic orientations, their resources, bargaining power and previous experiences are played out within the particular business-contextual conditions. The resulting initial conditions define both the formal rules and informal norms of action, which in turn are reflected in the parents' respective expectations of the venture. The execution of the initial conditions is reflected in the processes of bargaining power, learning and relationship quality, which are perceived by parents through the lens of their expectations of the venture, and evaluated in terms of norms of equity and efficiency.

At this stage, if the parents are satisfied with the venture's operations (e.g. the balance of power or learning remains in line with expectations), they will reproduce the initial conditions via the inertial cycle loop. If they experience sharp and repeated discrepancies between venture expectations and venture operations, one or both parents may, via an epiphanic shift in expectations, enact either accumulating or obsolescing spirals that lead to an adaptive renegotiation of initial conditions. An accumulating spiral reinforces and improves the venture conditions, increasing the likelihood of longevity as an outcome, as in the case of evolutionary learning (Doz 1996). An obsolescing spiral, as in the DAJV case (Shenkar/Yan 2002), creates a tendency to venture deterioration and, other things being equal, to venture dissolution.

## Conclusions

In seeking to develop the theory of IJV process and dynamics, this article builds from and integrates existing knowledge of and research into interparental IJV processes. Our empirical findings in part support the importance of the initial structural conditions in understanding IJV outcomes, but also underscore the need to open up the 'black box' of internal processes. In this latter respect, our arguments affirm the significance of processual research, which has examined the dynamic effects of changes in the balance of interparental bargaining power, learning and relationship quality. These processes not only change as the initial conditions are put into practice, but they are also crucial in understanding how and why an IJV's structural conditions change over time.

Our arguments add to the existing state of IJV theory by explicitly conceptualising the role of interpretive processes, parallel to Vaara's (2003) recent contribution to the theory of post-acquisition integration. When venture conditions are agreed, they establish not only formal structures or rules of action, but also informal expectations about the venture-in-action. The parents' expectations of the venture are crucial in explaining why and how they perceive, interpret and re-

spond to each other and therefore to the venture-in-action. When venture expectations are contravened, a parent's ensuing sensemaking activities lead to re-assessment of the venture's meaning, for instance, in terms of efficiency and equity. The attribution of new meanings to the venture affects the way in which managers interpret and enact – and give objectivity to – its initial conditions.

Where there are repeated disjunctures between expectation and perceived reality, a parent may experience a mindset-changing epiphany and create an obsolescing or accumulating dynamic. Not only does this draw attention to the theoretical mechanism that precedes and prompts a directional turn – hence moving our understanding of IJV process beyond evolutionary cycles; it also adds the notion of an accelerating processual spiral. As in DAJV, an unchecked obsolescing spiral will eventuate in some form of dissolution, while an accumulating spiral is likely to prolong the life of the venture, possibly leading to new partnership activities (Doz 1996).

These arguments have a number of implications for MNC and international management theory. First, they direct research towards developing a more refined understanding of the role of diverse prior strategic values and venture expectations in MNC-local enterprise collaborations. Explicit studies of strategic orientations and commitments would put scholars (and practitioners) in a better position to explain or predict patterns of cooperation and breakdown in partnerships. Second, instead of the existing fragmented interest in IJV sub-processes, researchers are encouraged to focus more systematically on the interrelationships between politics, learning and relationship quality and on sensemaking as a central theoretical process.

Third, the particular findings of DAJV raise important questions about the aftermath of dissolved IJVs, following up the ways in which former parents build on their experiences. While it is known that MNCs generally use their prior IJV experiences to inform their later cross-border ventures, more qualitative data from case studies would enhance this stock of knowledge. In contrast, little is known about how local parents build on experiences of IJVs with large MNCs. In our own research, we know, for example, that Autodil's senior managers resented what, in the end, they saw as DeutschMotor's manipulation of the joint venture, were frustrated by their inability to realise their strategic preferences, and embarrassed by their international business naiveté. Nonetheless, they appreciated the hard lessons of working with a successful MNC and, tongue in cheek, looked forward to taking on the powerful parental role in their plans to expand eastwards into the former Soviet bloc.

At a more practitioner level, this research draws the attention of local managers of 'weaker' parents within an IJV agreement to the possible ways in which MNC management can use the IJV as an organisational experiment in the evolution of new subsidiaries. Local managers, especially in emerging economies, can

be quite naïve about the more expedient motives in international business and how 'real motives' can be dressed up in a politically softer language. Studies of MNC managers within IJVs can further give local managers preliminary insights into how MNC management might subsequently seek to integrate and operate their subsidiaries. In acknowledging the significance of strategic orientations and sensemaking processes in transnational settings, we therefore echo the call for more qualitative case studies to explore the complexities and nuances of international relationships.

## Notes

All names used in reporting this research have been changed in order to preserve the confidentiality of our respondents.

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## The connection between trust and leadership styles in Slovene organizations\*

Jure Kovač, Manca Jesenko\*\*

*In leadership, trust between superiors and subordinates plays a very important role. This article presents the results of empirical research covering the connection between the level of trust within an organization and leadership styles, which were defined in a dichotomous way (democratic vs. non-democratic). In order to understand the mutual connection between trust and leadership on a deeper level, we selected delegation, communication and control as important elements in the leadership process. The results obtained in the analyses indicate the connection between the level of democracy in leadership styles and the level of formalisation in delegation, communication and the control of the tasks of one's subordinates, as well as the democracy in leadership and the level of trust.*

*Key words: trust, organisation, leadership, leadership styles, communication, delegating, control*

### 1. Introduction

In the previous decade, there has been a considerable increase in researching trust at the organizational level. There are several reasons for this. Zeffane and Connell wrote "that researchers and practitioners continue to recognise trust as an important factor in determining organizational success, organizational stability and the well-being of employees" (Zeffane/Connell 2003:1). In addition, trust within an organisation is gaining in importance due to new organisational forms such as network organisations and knowledge organisations. Thus, an author like Bleicher, who developed the concept of the "organization of trust" (Vertrauensorganistaion) (Bleicher 1991:72), defines the "organization of trust" in his latest observations as the foundation stone of a modern organisation. Bleicher considers "an intelligent company" where trust is "the glue that holds organizations together" to be the organisational form of the future (Bleicher 2009:73).

Research into the role and significance of trust in organisations is not a recent innovation. In its function within an organisation, trust is related through elements such as power, control and other limitations, including intimidation as well as statutory and hierarchical authority. Studies in this field provide the following forms of trust established (between members of organisation) within an

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organisation: trust based on intimidation (this produces very fragile relations); trust based on expertise; and trust emerging from the overlapping of interests. The types of trust between members of an organisation certainly depend on individual situational factors (Robbins/DeCenzo 2001:368; Schweer/Thies 2003).

One will look in vain trying to find a uniform view in the expert literature of the role and importance of trust in an organization. Individual representatives of the different “schools” have vastly differing views on the role and importance of trust. The author of the theory on transaction costs, Oliver Williamson, highlighted the role and importance of trust in individual transactions in his early works (1975). In his subsequent work (Williamson 1985/1993), the significance of trust in organizations was downgraded to the level of personal opportunism. Hill (1990), on the other hand, made the opposite claim: organizations with a high level of trust have lower transaction costs and are therefore more effective in the long run. Kramer and Cook (2004:2) have noted that research on organizational trust addresses three main issues. The first theme has been the constructive effect of trust with respect to reducing transaction costs within organizations. Secondly, the role trust plays in spontaneous sociability among organizational members has been explored. Thirdly, there has been an appreciation of how trust facilitates appropriate forms of deference to organizational authorities.

In recent times, researching the role and importance of trust has been given fresh impetus (Nooteboom 2002:2). Authors such Barney and Hansen (1994), Fukuyama (1995), Zeffane and Connell (2003), as well Bijlsam-Frankema et al. (2008) define the role of trust in much broader terms. They believe that trust can be a source of competitive advantage for a particular organization. Trust can therefore be placed among factors that affect the success and efficiency of an organization. In doing so, they emphasise that a higher level of trust within an organisation can contribute to:

- Open forms of communication
- Lower levels of formality
- Simplified forms of coordination
- Lower transaction costs
- More stable interpersonal and inter-organizational connections (Staehele 1999:409; Zeffane/Connell, 2003:3; Schweer/Thies 2003:59; Bijlsam-Frankema et al. 2008:22; Bleicher 2009).

As we can see, the field of studying trust within an organisation is very extensive, and understanding the role of trust between superiors and subordinates has a special place in this research. Therefore, we will hereinafter focus on studying trust within an organisation, paying special attention to the field of trust between superiors and the subordinates. Further, the notion of trust shall be used here with a broad meaning, as a positive expectation that our partners will not act opportunistically – in a self-interested way – through their words, actions or deci-

sions, regardless of the possibilities and opportunities. This is not to say that trust is unconditional and unlimited. There are certain restrictions or limitations that the environment sets to organizations and individuals in their perception and interpretation of trust.

## 2. Trust between leaders and their subordinates

Bleicher writes that the relationship between superiors and subordinates may be based on trust or on fear (Bleicher 2009). To be more precise, Bleicher believes that "in addition to fear, trust is one of the ways of keeping the social system together" (Bleicher 2009:72). Ghilic-Micu and Stoica write that "fear is the opposite of trust in the workplace" (2003:16) and emphasise the negative consequences of fear taking over at the workplace. The negative influences of fear on the efficiency of performing work tasks have been confirmed by numerous researchers. Thus, Schein (1995) confirmed the negative influences an atmosphere of fear has on learning processes within an organisation (Kramer/Cook 2004:264). Bibb and Kourdi are even more forthright when they write that "low trust cultures are characterised by fear of the boss and fear of making a mistake because of the repercussions. The sort of behaviour that you see in such cultures is caution, lack of risk taking as well as passive acceptance and lack of challenge to authority" (Bibb/Kourdi 2007). In contrast, a high level of trust leads to "synergy and performance" (Ghilic-Micu/Stoica 2003:17; Bibb/Kourdi 2007:23). Therefore, it is in the interest of each leader to develop a high level of trust in relation to his or her subordinates. We will hereinafter focus predominantly on exploring the scope and importance of trust between superiors and subordinates.

The role of trust between leaders and their subordinates has been the subject of research from numerous different disciplines, including organizational psychology, management, and public administration. Transformational and charismatic leaders trust their followers (Kirpatrick/Locke 1996; Podsakoff et al. 1990). Trust is an important element of effective behaviour (Fleishman/Harris 1962) and leader-member exchange behaviour (Schriesheim et al. 1999). Other studies show that promoting trust can be important for leader effectiveness (Bass 1990; Hogan et al. 1994).

Most of the existing studies state that the process of building trust between leaders and subordinates lies in the hands of leaders. Hence, in their research Dirks and Ferrin (2002) have discerned "substantial relationships between perceptions of leadership actions, including transformational leadership ( $r=.72$ ), interactional justice ( $r=.65$ ), participative decision making ( $r=.46$ ), and failure to meet expectations of subordinates ( $r=.40$ ), as well as others. In short, trust in leadership appears to be associated with a well-established set of leadership actions and behaviours" (Dirks/Skarlicki 2004:33).

On the basis of their research, Dirks and Skarlicki (2004:33) conclude: "Trust in leadership appears to be associated with a well-established set of leadership actions and behaviours." Andersen (2005:402) came to similar conclusions. In his article, he exposes the connection between the activity of superiors and the trust of their subordinates. From his findings, it results that superiors gain the trust of their subordinates with their activity, and the level of trust between superiors and their subordinates differs with regard to hierarchical level in an organization. Researchers have shown that the leader's efforts to build trust are key mechanisms for enhancing organizational effectiveness (Barney/Hansen 1994).

From the ideas represented above, it can be concluded that trust in superiors has many advantages for individuals as well as organizations. Building trust between superiors and subordinates is extremely important for a successful and effective operation of an organization.

### **3. Research**

#### *3.1. Theoretical basis and methodology*

In the research into trust within organizations that we have performed, we found that different levels of trust exist within organizations, according to the individual hierarchical levels. (Kovač/Jesenko 2004). The findings obtained in the research from 2006 are of particular importance; we found that an increased level of trust within an organization contributes to a reduced level of formalization within an organization (Kovač/Jesenko 2006).

In 2008, we carried out new research with the desire of deepening the understanding of the impact and significance of trust within the organization, with a special emphasis on the connection between the level of trust and the leadership styles within an organization. We decided to explore the connection between leadership styles and trust because of findings that leadership actions and behaviours are the greatest contributors to increasing trust between superiors and subordinates. A leader's work is best manifested in his or her leadership style (Whitener et al. 1998; Dirks/Skarlicki 2004; Andersen 2005).

We chose Bleicher's concept of the "organization of trust" (Vertauensorganisation) (1991) as the basic theoretical model. Bleicher believes that the development of organisations in the second half of the 20th century moved from a rigid bureaucratic form, with distrust on the part of superiors towards the subordinates as a key feature, towards a more adaptable informal organisation based on a high level of trust between the members (1991:70-75). The author presented an integrated view, i.e. the characteristics of the "organization of trust" in comparison with the "organisation of distrust." From his model, we took the basic finding that relationships between superiors and subordinates within the "organization of trust" are based on less formal mutual relations or cooperation (Bleicher

1991:76). This finding represented the starting point for conceiving our research model.

The basic relationship between superiors and subordinates within an organisation is formed through the leadership process. The basic form of the leadership process within an organisation is manifested in the so-called leadership style, which can be defined as a relatively permanent pattern of influence on the subordinates with the goal of mutually achieving set objectives (Staeble 1999:334). In theory, leadership styles are shown for the most part as dichotomous models (autocratic vs. democratic, directive vs. participatory, etc.) (Bass 1990:415).

For our research, we adopted the leadership styles definitions from the questionnaire that was prepared within the framework of the INTERKULT research project on intercultural comparison from 1994 (Lang et al. 1996). The behaviour of leaders thus comprises coherent, "to be" notions that are realised with the aid of leadership instruments (Lindert 1996:91). The manner and form of using influential mechanisms for directing co-workers towards achieving objectives have been defined in the four possible varieties of leadership styles; they are marked as L1, L2, L3 and L4. Thus, they represent:

- L1: Capable of making immediate decisions. Communicates his decisions to co-workers in a clear and assertive manner. Expects co-workers to be loyal and not to cause problems when implementing and executing his decisions.
- L2: Capable of making immediate decisions. Prior to their implementation, he tries to explain his decisions in detail to the co-workers. He justifies his decisions and answers all questions from the co-workers.
- L3: Usually, he discusses the issue with his co-workers first and takes their suggestions into consideration when making a decision. However, he expects everyone to participate in the realization of his decision, even though it may not be in line with what they had suggested.
- L4: When an important decision has to be made, he usually organises a meeting. He explains the problem to co-workers and encourages discussion. The head makes a decision based on the majority opinion.

With a more in-depth understanding of the scope of trust between superiors and subordinates, exploring the connection between the leadership style and the level of trust can be seen as too superficial. In order to understand the mutual connection between trust and leadership on a deeper level, we selected delegation, communication and control as important elements in the leadership process (Bass 1990:402). The manner and form of the implementation of control, communication and delegation is, to a great extent, related to leadership style (Bass 1990:27).

We decided to select communication, delegation and control as elements of the leadership process because they occur most frequently in the research related to trust between superiors and subordinates within an organization. Based on the

research by Whitner et al. (1998:513), the following factors contribute the most to increasing trust between leaders and subordinates:

- behavioural consistency
- behavioural integrity
- delegation and control
- communication
- demonstration of concern

It can be shown that delegating, controlling and communicating as important elements in the leadership process (Bass 1990). This is why we focused especially on the stated factors within the leadership process for the continuation of our research.

In order to understand the connection between the selected elements of the leadership process (delegation, control and communication), we examined the research findings obtained thus far. Authors like Das/Teng 1998 and Schweer/Thies 2003 found that a certain level of control is necessary in most organisations. Although trust can simplify the controlling process (Neubauer/Rosemann 2006:134), it cannot completely eradicate or substitute it. Trust can only decrease the controlling process's complexity.

In the field of communications, authors such as Zand (1977) and Korsgaard/Roberson (1995) emphasise that trust is one of the central elements in the communication process within an organisation (Schweer/Thies 2003:78). The level of trust influences the quality of the communication process itself and increases its openness and intensity. Research carried out by Willemyns et al. (2003) in the field of communication between superiors and subordinates showed that the more the superiors in the communication process (communication style) emphasise their position within an organisational structure, the lower the level of trust between the superior and the subordinates (Neubauer/Rosemann 2006:137).

We understand delegation as a process of empowerment by ones' subordinates, who can take responsibility for certain activities. Bass writes that "the degree of delegation is associated with the trust the superior has for the subordinate" (Bass 1990:312). The form of delegation depends on the trust between the superiors and the subordinates (Whitner et al. 1998:517). Therefore, in an organisation with a lower level of trust, we find a higher level of complexity in the delegation process (Bijlsam-Frankema et al. 2008:22). A higher level of formalisation and excessive regulation is a reflection of this higher level of complexity in the delegation process (Bleicher 1991:74).

We defined the forms and manners of implementing communication, delegation and the control of tasks from the perspective of a greater or lesser level of formalisation. Thus, we determined that leaders within the leadership process may

use both formal (written) and informal (oral) forms when communicating, delegating and controlling tasks.

### *3.2. Hypotheses and the sample structure*

This research stemmed from the basic premise that leaders enjoy different levels of trust within an organisation due to their leadership style. Leaders apply a greater or a lesser degree of formalisation according to the leadership style that individual leaders implement. Based on these starting points, we created two working hypotheses that served as the basis for data analysis:

- H1: The higher the level of formalization in the processes of task delegation, communication and control, the lower the perception of the leader's democratic approach in the eyes of his subordinates.
- H2: The more democratic leaders enjoy a higher level of trust than the less democratic leaders do.

When measuring the perception of the leader's "democratic" approach, we used the four previously defined leadership styles. We can therefore observe that the democratic approach increases as we progress from the type L1 leader to the type L4 leader.

Since we found in our previous research that such a definition is relatively rigid, we decided to measure the individual elements that define the types of leaders presented above for this research. The individual elements present typical characteristics of theoretically defined leaders, as described above. In this research, we measured these elements in the form of statements, i.e. we asked the surveyed respondents to grade the extent they believe the statements apply to their superiors using a scale from 1 (I don't agree at all) to 5 (I fully agree). All the statements are presented in the section "Defining the types of leaders from the democratic leadership styles." Since certain elements connect content-wise based on the level of democracy in leadership styles, we hereinafter determined the different types of leaders on the basis of cluster analysis. Based on the perception of individual elements, we later defined different groups of leaders that differ according to their level of democracy in leadership styles.

Other elements studied (trust, the delegation of tasks, the level of communication and control) have a multi-dimensional nature; therefore, they were measured in the research questionnaire indirectly. We determined individual factors (in order to best define an individual element) on the basis of the organization's practical operation.

We measured the trust in different levels of organization, because we wanted to obtain an integrated picture of the trust within the organization as a whole. Consequently, the respondents evaluated trust within an organization in a general sense, among the top leaders, their superiors and subordinates, and among the

organizational units. The other three dimensions (the delegation of tasks, communication and control) were defined in the research questionnaire from the formal and informal points of view.

#### *About the sample*

In performing this research, we wanted to obtain an insight into the connection between a democratic leadership style and the formal and informal elements of the leadership process. We obtained the data with the help of employees and part-time students from our faculty. The selection of the sample was random from the perspective of the active population in Slovenia. Out of 300 questionnaires distributed, we received 104 completed ones, or 34.6%. With this research, we wanted to ascertain whether indications exist of the expected connections between the phenomena studied. Therefore, it is essential to ensure the representativeness of the studied phenomena with the sample (Coenders et al. 2003).

Although the sample is not representative from the perspective of the Slovene population of active companies, the following description of the sample shows a satisfying variety of data that can offer information on the desired connections between the phenomena studied. The results demonstrate the appropriate representativeness of the phenomena studied. The data was obtained using a questionnaire of 18 questions and divided into five chapters (general information, employment information, leadership style, trust, leadership process and organization elements).

As can be seen in Table 1, 8% of the sample are directors, nearly 20% are heads of sectors, 40% are the heads of departments or groups and around 34% are professional employees without a leadership role.

The sample includes approximately the same number of men and women; in terms of age, respondents between 35 and 50 prevail. The sample shows a relatively high educational level as 54% of respondents have a university degree or completed specialization, while 46% have a Masters' degree. The structure of the organisations that the respondents come from is highly heterogeneous. Industrial companies are represented with the largest share of 18%, closely followed by state administration with 17%. Organisations and the educational sector have a share of 14%, while the trade sector has 13%. The banking sector follows with 9%, other service sectors have a share of 8%, information technology has a share of 6% and other fields of activity a share of 6%. Irrespective of the fact that the structure of the organisations that the respondents come from is markedly heterogeneous and that the structure includes the industrial and the service sectors, as well as state administration, we cannot consider the sample to be representative in terms of the distribution of the active population in Slovenia.

**Table 1. Sample structure**

Position within an organization	Director	8%	Gender	Men	54%
	Head of the sector	18%		Women	46%
	Head of the department	31%	Age	Less than 35	22%
	Head of a group	9%		35 to 50 years	61%
	Professional employee	34%		More than 50	17%
	Clerk	1%	Education	University degree or specialization	54%
		Master's degree		46%	
Number of employees in your company	< 50	20%	The activity of the organization in which you are employed:	Trade	13%
	50 - 99	13%		Banking and financial services	9%
	100 - 499	26%		Information technology services	6%
	500 - 999	18%		Other	8%
	1000 - 5000	18%		Industry	18%
	> 5000	5%		Education	14%
		The health sector		11%	
		State / municipalities		17%	
		Other		6%	

### 3.3. Results of the research

#### *Defining the types of leaders from the democratic leadership styles*

Since our previous experience shows that this differentiation of the types of leaders is relatively rigid, we decided for this research to separately measure the elements of democracy or non-democracy that determine the types of leaders described above. Therefore, we asked the respondents the extent to which they agree that individual elements hold true for their superiors. Later, we classified the types of leaders using cluster analysis. We decided on hierarchical clustering, in which we took the Squared Euclidean Distance as a measure of difference, whereas the similarity or difference between clusters was measured using the Ward method, which maximises the homogeneity within clusters.

Classifying the units into clusters showed four sensible groups of leader types. Their features are expressed by the averages of the individual elements.

We can observe a clear line of separation between the first and third groups, which provisionally reflect the extremes of the previously defined four types of leaders. Therefore, the first group was marked as type L1, which represents the least democratic type of a leader. The third group, type L4, represents the most democratic type of leader. The second group is positioned between the two extremes, as it shows elements from both the first and the fourth group. The last group is different from the other types of leaders. The only element that defines

**Table 2. The average values of the evaluated elements of leadership styles**

	L1	L23	L4	L0
Immediately makes decisions	<b>3.8</b>	<b>3.7</b>	2.7	1.9
Informs co-workers of his decisions in a clear and assertive manner	3.4	<b>4.5</b>	3.0	1.8
Expects co-workers to be loyal and not to cause problems when implementing and executing his decisions.	<b>4.4</b>	<b>4.8</b>	3.4	2.9
Prior to their implementation, he tries to explain his decisions in detail to co-workers	2.4	<b>4.0</b>	<b>4.0</b>	2.0
Justifies his decisions and answers all questions from the co-workers.	2.3	<b>4.0</b>	<b>4.1</b>	1.9
Usually discusses the issue with his co-workers before making a decision.	2.3	<b>3.6</b>	<b>4.1</b>	2.6
When making a decision, takes their suggestions into consideration.	2.6	<b>4.0</b>	<b>4.1</b>	2.5
Expects everyone to participate in the realization of his decision, even though it may not be in line with what they had suggested.	<b>4.2</b>	<b>4.6</b>	<b>3.6</b>	<b>3.6</b>
When an important decision has to be made, usually organises a meeting.	2.8	<b>4.0</b>	<b>4.0</b>	2.4
Explains the problem to them and encourages discussion.	2.3	<b>4.0</b>	<b>3.9</b>	2.5
Makes a decision based on the majority opinion.	2.4	2.9	<b>3.5</b>	2.0

this group, is that a leader “expects everyone to participate in the realization of his decision, even though it may not be in line with what they had suggested.” We could say that the employees cannot classify such a leader as authoritative or as democratic. It seems that the behaviour of such a leader is perceived as feeble, indecisive and uncooperative. This group was marked as type L0.

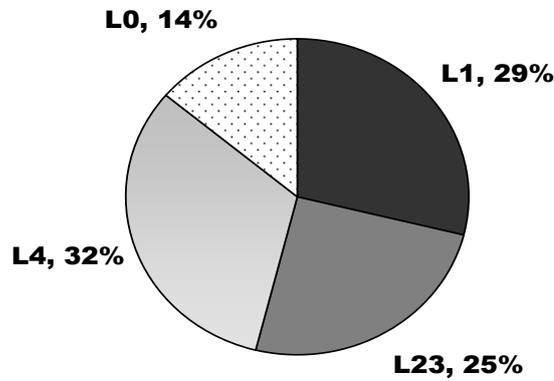
Figure 1 shows the presence of the group leaders formed in the sample. While the first three groups show nearly equal presence, the last group (L0) represents over 10% of the sample. The connection between the various types of leader and the manner of task delegation, communication and control.

In further analyses, we wanted to first check whether statistically significant differences exist between the various types of leaders in the individual factors of the delegation of tasks, the types of communication and performing control. For this purpose, we used the One-Way ANOVA to compare the average values of the four independent samples. We found that statistically significant differences occur on all three elements of the leadership process.

### *The delegation of tasks*

With the delegation of tasks, we offered the respondents four choices to which they said how often they were used within their organization. They replied on a

Figure 1. The structure of the types of leaders



five-level scale (1- Never,... 5 – Always) on how often tasks are delegated in written form, through co-workers, orally or in combination of the three.

Figure 2 shows that, within the organizations surveyed, on average, tasks are most frequently delegated orally and least frequently through co-workers.

Figure 2. The average frequency of the delegation of tasks

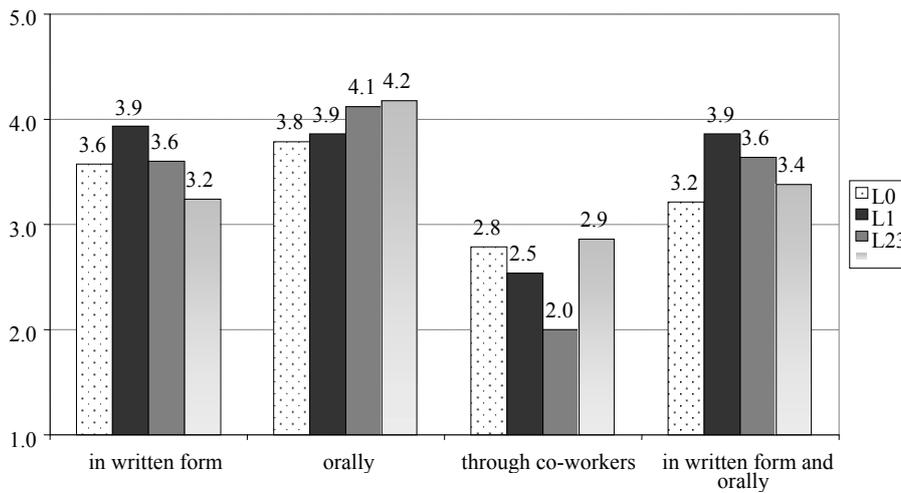


Table 3 shows that significant differences occur between the four types of leaders in the frequency of the written delegation of tasks ( $p=0.055$ ) and in the frequency of the delegation of tasks through co-workers ( $p=0.028$ ).

**Table 3. ANOVA for Equality of Means between the different types of leaders for the ways of delegating tasks**

		Sum of Squares	df	Mean Square	F	Sig.
Written	Between Groups	6.737	3	2.246	2.629	0.055
	Within Groups	78.596	92	0.854		
	Total	85.333	95			
Oral	Between Groups	2.426	3	0.809	1.315	0.274
	Within Groups	56.564	92	0.615		
	Total	58.990	95			
Through co-workers	Between Groups	10.654	3	3.551	3.172	0.028
	Within Groups	100.750	90	1.119		
	Total	111.404	93			
Written and oral	Between Groups	5.252	3	1.751	2.225	0.090
	Within Groups	72.373	92	0.787		
	Total	77.625	95			

By using even comparisons between the average values of groups, we found that, in comparison with other types of leaders, type L1 leaders delegate tasks in writing more frequently. Statistically significant differences occur when compared with type L4 leaders ( $p=0.006$ ). Similarly, the delegation of tasks both orally and in writing is more frequent in type L1 leaders than with other types of leaders. Statistically significant differences occur when compared with type L0 leaders ( $p=0.029$ ) and type L4 leaders ( $p=0.045$ ).

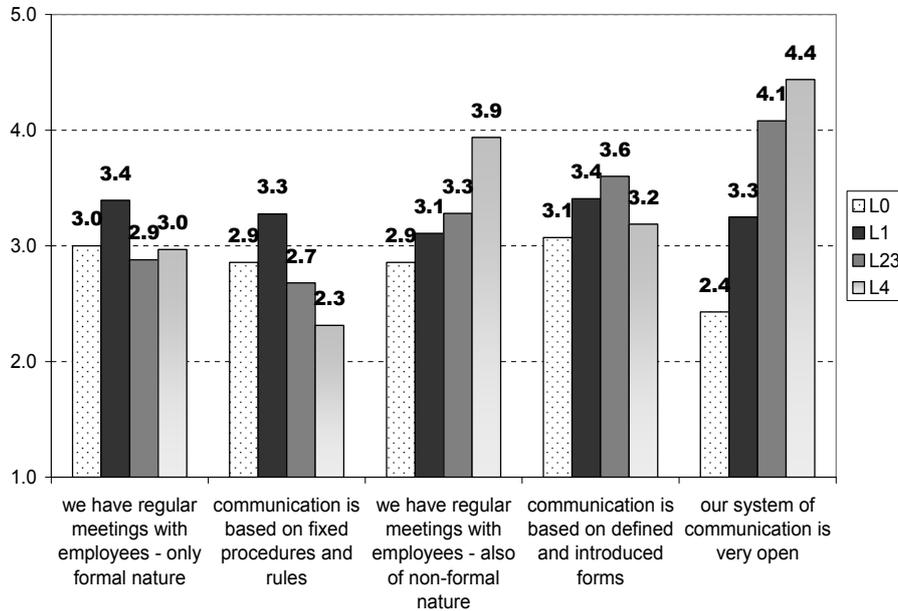
Type L0 and type L4 leaders delegate tasks through co-workers more frequently than other types of leaders. Statistically significant differences occur when compared with type L23 leader ( $p_{L0-L23}=0.030$ ,  $p_{L4-L23}=0.005$ ).

### *Communication*

Communication within organizations was measured on a five-level scale (1 – I don't agree at all, ..., 5 – I fully agree), based on the following statements: we have regular meetings with employees – only of a formal nature; communication is based on fixed procedures and rules; we have regular meetings with employees – including those of an informal nature; communication is based on defined and introduced forms, our system of communication is very open.

The frequency of individual communication styles is shown in Figure 3, which demonstrates that, on average, the respondents most agree with the claim that their system of communication is open. They agree least with the claim that communication is based on fixed procedures and rules.

**Figure 3. The average agreement with the claims on the system of communication within organizations**



With analysis of variance (results are shown in Table 4), we can ascertain that statistically significant differences exist in the styles of communication defined as “communication is based on fixed procedures and rules,” “we have regular meetings with employees – including those of an informal nature” and “our system of communication is very open.”

With even comparisons between average group values, we established that the type L1 and L4 leaders differ with statistical significance ( $p=0.002$ ) with regard to the implementation of fixed procedures and rules of communication, this being more typical of type L1 leaders. Type L4 leaders organise meetings more frequently and discuss informal themes as well; this is statistically significant in comparison with other types ( $p_{L4-L0}=0.004$ ,  $p_{L4-L1}=0.006$ ,  $p_{L4-L23}=0.033$ ). The openness of the system of communication showed statistically significant differences between nearly all pairs of leader types. No statistically significant differences were observed between the L23 and L4 pair of leaders ( $p_{L0-L1}=0.021$ ,  $p_{L0-L23}<0.001$ ,  $p_{L0-L4}<0.001$ ,  $p_{L1-L23}=0.006$ ,  $p_{L1-L4}<0.001$ ).

### *Control*

Control in organizations was measured on the basis of the frequency of performing the five different types of controlling. We asked the respondents to mark on

a five-level scale (1- Never,... 5 – Always) how frequently control is performed in their organization using oral reports, working meetings, co-workers, written reports and personal checking.

**Table 4. ANOVA for Equality of Means between different types of leaders for different ways of communication**

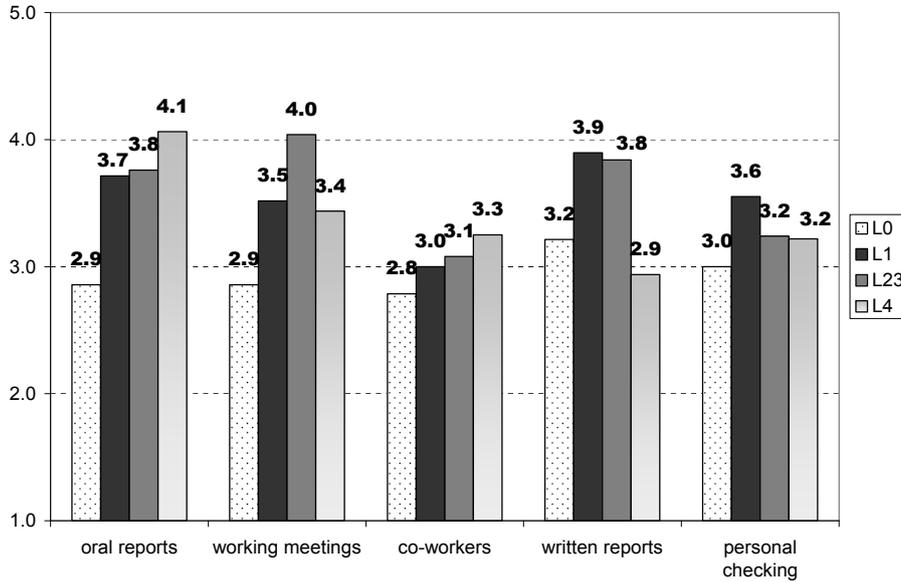
		Sum of Squares	df	Mean Square	F	Sig.
We have regular meetings with employees – only of a formal nature	Between groups	4.218	3	1.406	0.952	0.419
	Within groups	140.287	95	1.477		
	Total	144.505	98			
Communication is based on fixed procedures and rules	Between groups	14.418	3	4.806	3.448	0.020
	Within groups	133.822	96	1.394		
	Total	148.240	99			
We have regular meetings with employees – including those of an informal nature	Between groups	16.106	3	5.369	4.136	0.008
	Within groups	123.308	95	1.298		
	Total	139.414	98			
Communication is based on defined and introduced forms	Between groups	3.566	3	1.189	0.913	0.438
	Within groups	122.322	94	1.301		
	Total	125.888	97			
Our system of communication is very open	Between groups	49.243	3	16.414	14.386	0.000
		108.394	95	1.141		
		157.636	98			

Figure 4 shows that, on average, control is most frequently performed using oral reports and least frequently through co-workers.

Analysis of variance showed (Table 5) that statistically significant differences occur when control is performed using oral and written reports and at working meetings.

Based on the paired tests performed between the group average values, we can establish that control through oral reports is statistically less frequent with type L0 leaders than with other types of leaders L0 ( $p_{L0-L1}=0.009$ ,  $p_{L0-L23}=0.007$ ,  $p_{L0-L4}<0.001$ ). Moreover, controlling through working meetings is statistically the least significant for type L0 leaders ( $p_{L0-L1}=0.027$ ,  $p_{L0-L23}<0.001$ ,  $p_{L0-L4}=0.047$ ). This type of control was statistically more frequent than the two other types of controlling with type L23 leaders ( $p_{L23-L1}=0.036$ ,  $p_{L23-L4}=0.014$ ). With control through written reports, statistically significant differences occur between type L1 and L4 leaders ( $p=0.001$ ) and type L23 and L4 leaders ( $p=0.003$ ). It is more frequent in type L1 and type L23 leaders.

Figure 4. The average frequency of individual types of control



The above analyses showed that, with individual elements of the leadership process, statistically significant differences occur between the various types of leaders from the perspective of the levels studied (the delegation of tasks, communication and control). How the individual types of leaders differ from the perspective of formal and informal approaches to the delegation of tasks, communication and control was studied with the aid of discriminant analysis. With discriminant analysis, we wished to establish whether the groups studied in a multi-dimensional space, determined by two or more (discriminant) variables, differ. The technique of discriminant analysis is based on the definition of a minimal number of new variables (discriminant functions), which are determined as a linear combination of discriminant variables in such a manner that the groups studied – with regard to the values of the discriminant functions – show the biggest differences.

**Table 5. ANOVA for Equality of Means between the different types of leaders for control implementation**

		Sum of Squares	df	Mean Square	F	Sig.
Oral reports	Between groups	14.217	3	4.739	4.901	0.003
	Within groups	91.864	95	0.967		
	Total	106.081	98			
Working meetings	Between groups	13.119	3	4.373	5.397	0.002
	Within groups	77.791	96	0.810		
	Total	90.910	99			
Co-workers	Between groups	2.313	3	0.771	0.672	0.572
	Within groups	110.197	96	1.148		
	Total	112.510	99			
Written reports	Between groups	18.678	3	6.226	4.969	0.003
	Within groups	120.282	96	1.253		
	Total	138.960	99			
Personal checking	Between groups	3.389	3	1.130	1.335	0.267
		81.201	96	0.846		
		84.590	99			

In the case of  $k$  groups, we have  $\min(G-1, p)$  discriminant functions (where  $G$  is the number of groups and  $p$  is the number of discriminant variables). We obtain them by building the matrix

$$\mathbf{H} = \sum_{i=1}^k n_i (\bar{\xi}_{i\cdot} - \bar{\xi}_{\cdot\cdot})(\bar{\xi}_{i\cdot} - \bar{\xi}_{\cdot\cdot})^T \text{ and}$$

$$\mathbf{\Xi} = \sum_{i=1}^k \sum_{j=1}^n (\xi_{ij} - \bar{\xi}_{i\cdot})(\xi_{ij} - \bar{\xi}_{i\cdot})^T$$

where  $\xi_{ij}$  is the vector of variables for the  $i$ -th unit of the  $j$ -th group,  $\bar{\xi}_{i\cdot}$  is the vector of the arithmetic middle of the  $i$ -th group and  $\bar{\xi}_{\cdot\cdot}$  is the vector of arithmetic middle for all groups. Discriminant functions are built by taking vectors of the  $\mathbf{a}_i$  matrix  $\mathbf{\Xi}^{-1}\mathbf{H}$ , which belong among the non-null Eigenvalues, for coefficients of discriminant functions. If their number equals  $s$ , we have the same number of discriminant functions:

$$z_1 = \mathbf{a}_1^T \boldsymbol{\xi}, z_2 = \mathbf{a}_2^T \boldsymbol{\xi}, \dots, z_s = \mathbf{a}_s^T \boldsymbol{\xi}$$

The discriminant function that separates the groups to the greatest extent is the one that belongs to the biggest Eigenvalue.

The delegation of tasks, communication and control were treated as multi-dimensional phenomena that can be performed in more formal and informal forms. The formal and informal approach perspective was considered in the elements with which we described the leadership processes studied. Discriminant variables used in the discriminant analysis were determined as the average level of the formal or informal elements of an individual level, which provided us with six new variables (the formal and informal delegation of tasks, formal and informal communication and formal and informal control). The elements included in an individual new variable are shown in Table 6.

**Table 6. Defining the formal and informal levels of individual levels of the leadership process**

	FORMAL APPROACH	INFORMAL APPROACH
<b>DELEGATION OF TASKS</b>	<ul style="list-style-type: none"> <li>■ Written</li> <li>■ Written and oral</li> </ul>	<ul style="list-style-type: none"> <li>■ Oral</li> <li>■ Through co-workers</li> </ul>
<b>COMMUNICATION</b>	<ul style="list-style-type: none"> <li>■ We have regular meetings with employees – only of a formal nature</li> <li>■ Communication is based on fixed procedures and rules</li> <li>■ Communication is based on defined and introduced forms</li> </ul>	<ul style="list-style-type: none"> <li>■ We have regular meetings with employees – including those of an informal nature</li> <li>■ Our system of communication is very open</li> </ul>
<b>CONTROL</b>	<ul style="list-style-type: none"> <li>■ Working meetings</li> <li>■ Written reports</li> </ul>	<ul style="list-style-type: none"> <li>■ Oral reports</li> <li>■ Co-workers</li> <li>■ Personal checking</li> </ul>

Table 7 shows the Eigenvalues, variance percentage and canonical correlation for each of the three possible discriminant functions. We can observe that we can explain 95% of the differences between the groups with the first two discriminant functions, 62% with the first and 33% with the second discriminant function.

With the help of Wilk's lambda, we can establish that the groups differ in a statistically significant manner with regard to the average of the first and second discriminant function (Table 8). Moreover, we can ascertain that the four groups of leader types are best differentiated – and in a statistically significant manner – by two discriminant functions.

**Table 7. Eigenvalue, % of variance, cumulative % of variance and canonical correlation coefficient**

Function	Eigenvalue	% of Variance	Cumulative %	Canonical correlation
1	0.453(a)	62.0	62.0	0.558
2	0.242(a)	33.1	95.1	0.441
3	0.035(a)	4.9	100.0	0.185

The first three canonical discriminant functions were used in the analysis.

**Table 8. Wilk's lambda**

Test of function(s)	Wilk's lambda	Chi-square	df	Sig.
1 through 3	0.535	53.775	18	0.000
2 through 3	0.778	21.637	10	0.017
3	0.966	2.995	4	0.559

How the selected discriminant functions are connected with the independent variables is shown in Table 9, which shows correlations between the discriminant variables included in the analysis and the selected discriminant function. We can observe that the first discriminant function is best explained by informal communication and informal control, both being positively connected with it, while the second function is positively connected with the formal elements of the leadership process. We also can observe a rather high negative connection with the informal delegation of tasks.

**Table 9. Pooled within-group correlations between the discriminating variables and standardised canonical discriminant functions**

	Function	
	1	2
Informal communication	0.799(*)	-0.299
Informal control	0.444(*)	-0.124
Formal control	0.146	0.760(*)
Formal delegation of tasks	-0.084	0.513(*)
Informal delegation of tasks	0.072	-0.468(*)
Formal communication	-0.085	0.284(*)

Variables ordered by the absolute size of correlation within function.

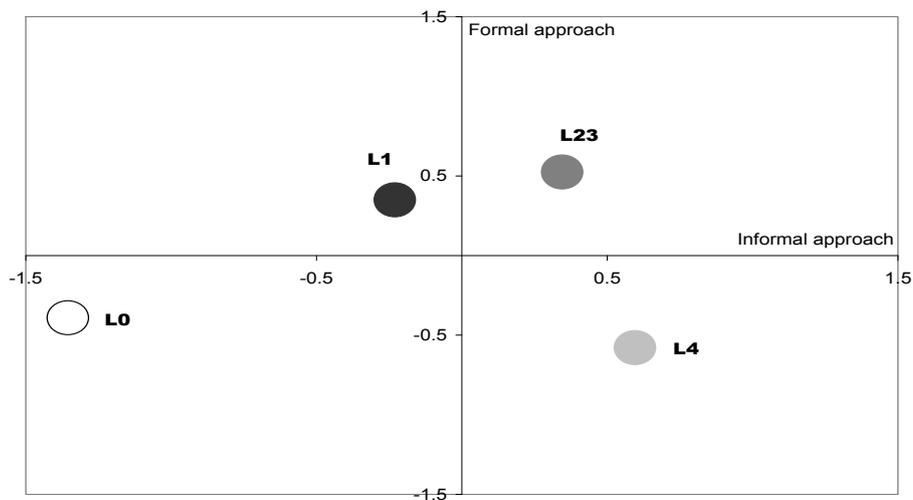
\* Largest absolute correlation between each variable and any discriminant function.

Therefore, we can ascertain that the first discriminant function, which explains the greatest number of differences between the groups, presents an informal approach to leadership, whereas the second discriminant function presents a more formal approach to leadership processes.

Figure 5 shows group centroids for the first (informal approach) and the second discriminant function (formal approach). When comparing a type L1 leader with a type L23 leader and a type L4 leader, we can observe that it is typical for the type L1 leader to use more formal leadership elements and fewer informal leadership elements in a leadership process. When a type L23 leader is compared with other types, we notice his typical usage of both formal and informal leadership elements, whereas a type L4 leader uses mainly informal leadership elements and formal leadership elements to a lesser degree. The type L0 leader uses a significantly different approach than the other leaders. When compared with other types of leader, we notice that he uses fewer informal leadership elements, as well as fewer formal leadership elements. If viewed from the three levels of the leadership process discussed, this can lead us to believe that his cooperation with subordinates is small.

We have demonstrated that various types of leaders differ with regard to their use of formal and informal leadership approaches with regards to the three levels of the leadership process; in doing so, we concluded that democratic leaders use more informal leadership elements in their leadership styles (and/or fewer formal leadership elements), which proves our first working hypothesis.

**Figure 5. A visual presentation of group centroids for the first (informal approach) and the second discriminant function (formal approach)**



*The connection between the different types of leaders and the level of trust in an organization*

In the article (Kovač/Jesenko 2006), we found that an increased use of formal elements of leadership decreases trust within organizations, whereas the use of informal elements of leadership increases it. If we take the above analyses into consideration, which establishes that the types of leaders differ with regard to their use of formal and informal approaches to leadership, we can conclude that the level of trust received by these leaders from their subordinates also differs.

The research questionnaire measured the level of trust at various levels (within an organization, the top leaders, the superiors and subordinates and the organizational units). The trust between respondent and superior, who was evaluated from the democratic leadership point of view, thus best describes the level of trust between the superiors and the subordinates; the respondents evaluated trust on a five-level scale (1 – very low level of trust,... 5 – very high level of trust). In order to find out whether individual types of leaders differ with regard to the established level of trust of the subordinates, we performed one-way analysis of variance (ANOVA), so that we could reject the null hypothesis that claims that the four types of leaders are equal with regard to the average value of trust (Table 10).

**Table 10. ANOVA for Equality of Means between the different types of leader for trust between superiors and their subordinates**

	Sum of squares	df	Mean square	F	Sig.
Between groups	27.655	3	9.218	9.905	0.000
Within groups	89.345	96	0.931		
Total	117.000	99			

The paired comparisons between the average group values (table 11) show that, with regard to trust, leaders of type L0 and L1, and of type L23 and L4 do not differ statistically; however, we noted statistically significant differences between the leaders of types L0, L23 and L4, as well as between leaders of types L1, L23 and L4.

**Table 11. Multiple comparisons**

(I) Type of leader	(J) Type of leader	Mean Difference ( $\bar{x}_I - \bar{x}_J$ )	Std. Error	Sig.
L0	L1	-0.335	0.314	0.289
	L23	-1.154(*)	0.322	0.001
	L4	-1.339(*)	0.309	0.000
L1	L0	0.335	0.314	0.289
	L23	-0.819(*)	0.263	0.002
	L4	-1.004(*)	0.247	0.000
L23	L0	1.154(*)	0.322	0.001
	L1	0.819(*)	0.263	0.002
	L4	-0.185	0.258	0.474
L4	L0	1.339(*)	0.309	0.000
	L1	1.004(*)	0.247	0.000
	L23	0.185	0.258	0.474

\*The mean difference is significant at the .05 level.

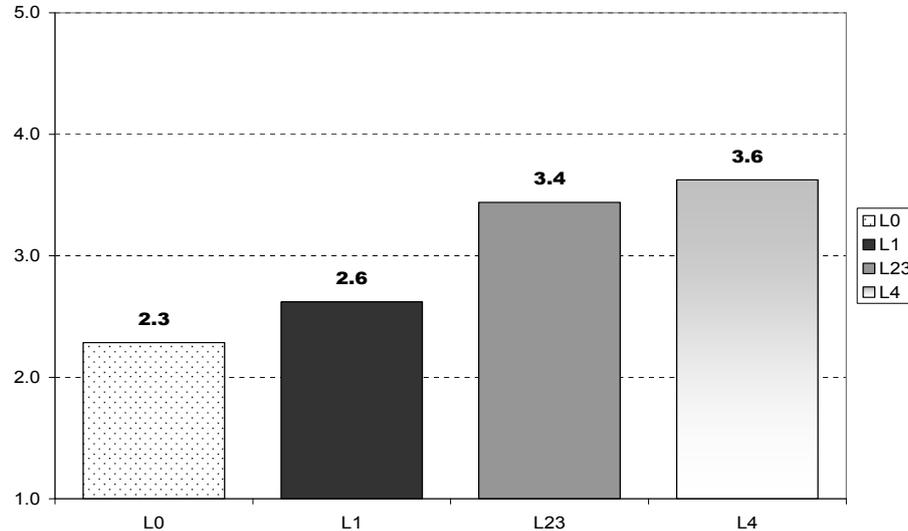
Figure 6 shows the average values of trust among the four types of leaders, from which we can deduce that the more democratic approach to leadership brings about an increased feeling of trust among the superiors and subordinates; the differences are statistically significant. Therefore, we found that democratic leaders enjoy a higher level of trust among their subordinates, which confirms our second working hypothesis.

#### 4. Conclusions and future research

With our research, we wanted to discover whether statistically significant connections exist between the level of democracy in leadership styles and the level of the inclusion of formal and informal elements into the processes of task delegation, communication and control, as well as between the level of trust among the subordinates and the superiors.

The definitions of the democratic leadership approaches were based on the four previously defined leadership styles; however, the elements of the individual types of leaders that determine a democratic or non-democratic approach were measured separately. By using cluster analysis, we were able to define four new groups of leaders; three groups (marked as L1, L23 and L4) coincide provisionally with a theoretically defined group of leaders and thus reflect their level of democracy. The fourth group is of a new type of leader, whom his subordinates cannot define as either an authoritative or a democratic leader; his behaviour is perceived as feeble, indecisive and uncooperative (we marked him as type L0).

**Figure 6. The average level of trust among the superiors and the subordinates, as observed in the four types of leaders**



With discriminant analysis, we discovered that the four groups of leaders studied differ in their use of formal and informal elements in the processes of task delegation, communication and control. Informal elements of communication and control showed greater distinguishing power. Furthermore, we found that an increased level of democracy in leadership brings about an increased use of informal leadership elements and a decreased use of formal leadership elements (and vice versa). It is interesting that type L0 leaders – when compared with other types of leaders – use both formal and informal elements studied to a lesser degree in the examined leadership processes; this indicates a lower level of cooperation and connection with the employees.

A comparison of trust between the four groups of leaders studied showed that by increasing the level of democracy in leadership, an increased level of trust occurs between the superiors and the subordinates. Type L0 leaders – who cannot be defined as non-democratic due to their behaviour – enjoy the lowest level of trust and do not differ in a statistically significant manner from the least democratic leaders of type L1. This shows how important personal strength and determination are for top leaders when establishing the trust of their subordinates.

The results obtained in the analyses indicate the connection between the level of democracy in leadership and the level of formalisation in delegating tasks, communication and controlling the tasks of one's subordinates, as well as the democracy in leadership and the level of trust. In this respect, it should also be taken into account that the results do not show cause and effect connections, on-

ly connections between the observed phenomena. Therefore, further research should pay greater attention to the reliability and validity of the measured constructs. In other words, it would be necessary to define the formalisation or non-formalisation of the studied constructs in greater detail and to determine their validity through ongoing research. Therefore, we can only view the results of the research presented as a preliminary study that shows theoretically predicted connections between the observed phenomena and, as such, presents the basis for more in-depth research into the connection between democracy in leadership and the level of formalisation in the leadership processes of leaders, as well as the connection between democracy in leadership and trust within an organisation. In our further research, we plan to focus on the cause and effect connections between the observed constructs; however, this will require a more detailed definition of the constructs and a larger sample of units studied.

In the area of developing trust theories, we can establish the confirmation of individual theoretical concepts on the positive impact of the level of trust on the leadership process within an organization. At the same time, the established results represent a motivation for further research of the correlation between the level of trust within the entire process and leadership style, and organizational dimensions.

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## Local development in the rural regions of Eastern Europe: Post-socialist paradoxes of economic and social entrepreneurship\*

Bruno Grancelli\*\*

*This paper aims to highlight some paradoxes of the agrarian transformation in Hungary and Poland and the ways they impinge on the working of private and cooperative farming. The first section reassesses the debate on the specificities of cooperative management in the light of the de-collectivization of agriculture. The second addresses continuities and changes in the symbiotic relationship between big coops and rural households within the two ongoing processes of Europeanization and economic globalization. The final section discusses the 'cooperative difference' and concludes with some analytical insights on who makes it both in coops and households.*

*Key words: Cooperatives conversion, family farms, subsistence agriculture, rural development in CEE*

### 1. Introduction

A good deal of research on private and cooperative farming is framed by the paradigm of rural (or 'post-rural') development which is often presented as an outcome of the theoretical exhaustion of the paradigm of agricultural modernization. However, the continuities and changes of the agrarian transformation in CEE and CIS countries seem to challenge this way of thinking. This exploratory paper aims to discuss some paradoxes of economic and social entrepreneurship that emerge in the modernization of post-socialist agriculture through a comparative look at cases studies in the rural areas of Hungary and Poland.

The first section of the paper provides examples of the paradoxes that impinge on the working of the former collective farms and that may be found at three levels. The first one lies in the fact that the industrialization of agriculture went along with a backward transition of sorts to a subsistence-type agriculture which largely recalls that of the 1940s. The second originates from the contradictions between the speed of the process of institution building and the slowness in the de-institutionalization of old structures. The third paradox becomes evident in the working of big cooperatives both in the local markets and the process of local/rural development.

Generally speaking, the 'cooperative difference' is thought to be made by the following factors: (a) coops contribution to bringing local monopolistic markets

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closer to competition; (b) their capacity to deal with externalities by keeping a presence in markets seen as unprofitable by investment oriented firms (IOFs) and, (c) their involvement in the formation of 'capital for social innovation' and community development through networking and learning processes (Novkovic 2007). The literature on the role of cooperatives in the post-socialist transformation highlights a set of contradictions in each of these functions. First, ex-socialist coops show some difficulties to act as competitive yardstick thanks to the significant amount of land of which they kept the property after the restitution laws (Hungary/Bulgaria). Given that households usually transferred their quotas to a cooperative, and the difficulties to set up a new private firm, the paradoxical result is that those coops are in monopsonic condition in the local market because they can pay low prices for the land they buy or lease (Meurs 2004).

On the other two functions coops are also lagging behind. There seem to be a lack of 'social cooperatives' or 'community-based enterprises,' that is, of organizations which try to combine the production of collective goods with an efficient management (Sikor 2002). There are little signs of an evolution towards associational forms based on a multi-stakeholder ownership whereby the distinction between production coop and consumption coop becomes blurred. More precisely, such multi-stakeholder ownership characterizes the big restructured coops which often operate within the food chains brought about by the 'supermarket revolution' of the last decade. There also seem to be few attempts to create reciprocity networks based on voluntary work, self-help and forms of cooperation within the process of sustainable rural development (Kelemen et al. 2007). The reasons of all that has something to do with the two other paradoxes of the agrarian transformation recalled above. On the one hand, the main trend is the reproduction of a subsistence-type agriculture and not the spread of small, efficient and labour-intensive firms; on the other, the programs of institution building need old (informal) institutions to get somewhat implemented through 'institutional corridors' defined by traditional local elites (Sehring 2008).

The second section of the paper put forward a rethinking of the debate on the cooperative difference in light of evidence on the agrarian transformation in Hungary, Poland and other CEE-CIS countries: a debate which revolves around some basic research issues. What kind of relation does exist between practice and theory of cooperation? May the contradictions of cooperative management be a source of innovation and organizational flexibility? Or, on the contrary, such contradictions will accelerate the conversion process from coops to investment-oriented firms?

The paper concludes with some insights for a comparative analysis of (a) forms of economic and social entrepreneurship that are developing at the intersection between market, community and the informal economy and, (b) the key actors that are straddling the divide between the speed of institution building and the

evolutionary character of change in all those institutions that persist at the informal level and originate in the pre-socialist and socialist history.

## **2. The 'cooperative difference': rethinking the debate in light of the post-socialist agrarian transformation**

The debate on the peculiarities of cooperative enterprises has revolved around two crucial issues: the efficiency of their management and their impact on the socioeconomic environment in which they are embedded (Sen 1966; Porter/Scully 1987; Furubotn/Pejovic 1970; Milgrom/Roberts 1992; Dow 2003; Gorton/Davidovna 2004; Merret/Walzer 2004; Mooney/Gray 2002; Novkovic 2007; Zeuli/Deller 2007). Among the classic problems of cooperative management in the market economy one may find free riding in that individual members do not have to bear the whole cost of their collective decisions (Sen 1966). Another problem lies in the propensity to underinvestment stemming from the limited horizon of individuals who can gain from the productive use of a resource only for a limited amount of time (Furubotn/Pejovic 1970; Porter/Scully 1987). Still another problem lies in the divergent interests of 'principals' and 'agents' which generally stems from the separation of property and control and thus may also touch big cooperative firms (Milgrom/Roberts 1992).

However, despite the governance problems quoted above, coops tend to reproduce themselves both in mature market economies and in catching up economies. If one looks specifically to CEE countries, one may notice that processes of demutualization go along with a certain persistence of production coops and the spread of purchasing and marketing associations, especially in the rural regions of Hungary, the former Czechoslovakia, Bulgaria and Romania (Borzaga/Sparks 2004; Gatzweiler 2003; Gorton/Davidovna 2004; Meurs 2004; Thesfeld/Boevsky 2005; Bateman 2006).

The guiding principles of cooperation have been established by the International Cooperative Alliance (ICA): association on voluntary bases, democratic control on strategies and daily management, common property of all or part of the enterprise assets, autonomy from the public or private organizations with which the coops interact, training of the members and spread of information, cooperation among coops and, finally, participation in activities for the sustainable development of the local community approved by the membership ([www.wisch.edu](http://www.wisch.edu)). The implementation of these principles is to be verified in three functional domains in which coops are involved. First, the capacity to act as competitive yardstick by rendering the market less monopolistic and more competitive. Second, the capacity to cope with externalities, that is, to mitigate market failures by keeping a presence in sectors seen as unprofitable by IOFs. Third, the capacity to generate 'capital for social innovation' through the creation of networks for the production of public and private goods that imply self-organized processes

of social learning backed by adequate forms of institutional support (Merret/Walzer 2004).

The issue, though, is how to evaluate these three basic functions of the cooperative firm in the transitional societies and catching up economies of Eastern Europe. What should we check, and how, as far as the socioeconomic impact of cooperation is concerned? One stream of research has been reassessed by Gorton and Davidovna (2004) in their east-west comparison of the factors that impinge on the efficiency of private and cooperative farming. The two authors review a number of approaches focused on the balance between the efficiency gains brought about by specialization and the costs of monitoring the workers in coops and in IOFs. Yet, Gorton and Davidovna point to the fact that in CEE countries cooperative members are very often 'residual claimant' in that they contribute not just with their work, but with parcels of land they acquired with the laws on restitution. Their conclusion then is that one cannot single out an optimal firm that is bound to prevail once the reform of the agricultural sector is being completed. It is indeed difficult to generalize on the relative efficiency of coop and IOFs because of the complex interplay between structural factors (soil, climate, etc.) and subjective factors such as individual and household strategies. Besides, the merger of firms may have an impact in terms of technical and allocative efficiency, but small family farms may also be efficient if an adequate set of services is available to them (Gorton/Davidovna 2004:11).

The lesson here is that economic and social entrepreneurship emerging in rural regions of CEE are to be analyzed in two stages of the transformation process: (a) the Nineties, with the laws on restitution, privatization and restructuring of state and cooperative farms and, (b) the last decade with the *Acquis communautaire*, the national policies of 'rural regeneration,' the 'supermarket revolution,' the modernization of commercial agriculture, the persistence of subsistence farming, and the slow growth of second generation cooperatives.

### **3. Transformation of collective farming: continuities and changes in the symbiotic relationships between coops and rural households**

At the outset of systemic transformation in CEECs, a general consensus existed on the necessity to modernize the agricultural sector. Yet in Western Europe, where agriculture has been modernized, the modernization paradigm has been widely criticized (van der Ploeg et al. 2000; Sotte 2003; Gatzweiler 2003; Cavazzani 2006; Csurg et al. 2008; Juska et al. 2005; Fonte 2008). Such criticism may be summarized in two points. First, the industrialization of agriculture led to an unsustainable production model due to the high dependence of the sector from exogenous factors that 'squeezed' it and brought about a constant reduction of the ratio between earnings and production costs. Second, firms restructuring resulted in a decoupling of agricultural production from the local en-

vironment and in standardization processes linked – among other things – to the “regulatory treadmill” at national and EU level (Cavazzani 2006).

### *3.1. National legacies of socialist agriculture: similarities and differences*

The criticism of the modernization paradigm is not unfounded. Yet indicators such as, for instance, the one million horses on active duty in Polish agriculture (Chloupova 2004) should warn us against the risk of proposing ideas ahead of times. The comparative study of agrarian transformation in CEECs cannot neglect the legacies of collectivization and the socialist industrialization of rural areas. Hence, some basic outcomes of the socialist agrarian policies and their impact in different national contexts must be recalled here. First, these countries were under-urbanized as all the others in Eastern Europe for socialist industrialization had been extensive and shared many features with those of latecomer countries. Second, planning priorities brought about a stratification of sectors, enterprises and places so that infrastructures and services were at the lowest levels for a rural population made of workers-peasants. Third, big collective enterprises – mainly state farms in Poland and cooperatives in Hungary, Bulgaria or Czechoslovakia – began to dominate the economic landscape in rural areas from the Seventies on (Swain 2000).

Some cross-national differences are also to be highlighted for Hungary (along with Bulgaria) and Poland may be roughly taken as the best and the worst environment for the development of cooperative enterprises. In Poland small family farms did not disappear under socialism. Rather what would change were their links to big state firms at the outset and to more market oriented enterprises later on. In Hungary, on the contrary, the starting point of socialist agriculture was the “Neo-Stalinist Model” of the Fifties which meant a rise in the state prices, a reduction of mandatory consigns, a narrowing of the salary gap with industry, an improvement in welfare provisions, and encouragement to differentiation of activities. In the successive decade, all this was followed by the New Economic Mechanism which would bring about a couple of welcomed changes. First, rural households were allowed to use the socialist distribution channels and, second, coops began to enjoy more economic freedom within a ‘quasi-market’ environment whereby individual members used to work both for their coop and their household (Swain 2000).

A case whereby the legacies of collectivization are quite different from the Hungarian and Polish ones is Russia due to culture, and political, social and economic institutions. In Russia it turned out to be particularly difficult to break the old industrial empires. This applied to the big kolkhozes as well for reasons that were only partly related to the scale and type of production. Indeed, collective farms were a component of: (a) an unreformed command economy in which agriculture was –much more than in other socialist countries- subsidized and de-

pendent on industrial inputs; (b) a vertically integrated food processing industry and, (c) a state welfare system whose insufficiencies used to be partially compensated by the concession of family plots to the rural workers of the 'industrialized villages' (Harrod-Menzies 2006; Oswald 2007)

### *3.2. Two domains of change in the Nineties and the mother of all paradoxes*

The first domain of change lies in the symbiotic relationships between coops and IOFs, on the one hand, and the new small farms that began to spread as an outcome of the closing up or restructuring of collective farms. The second one refers to the behavioural patterns of actors who play a key role in the agrarian transformation and the implementation of policies for 'rural regeneration'.

In every country of Eastern Europe, the socialist economic elite has been able to reproduce its social position mainly through its control on the implementation of the privatization processes. What happened everywhere was that those officials who had control over the means of production under socialism were also those who acquired property rights in state owned enterprises by asset stripping and the spinning off of subsidiaries (Windolf 1998:343). This indeed was the main outcome both where privatization has been a top-down or a bottom-up process. The difference, however, lies in the ensuing possibilities for enterprise restructuring according to the market principles. This point may be illustrated by contrasting the transformation of the institutional environment in Hungary and in Russia.

The process that has been unfolding in Hungary was that of an integrated ownership pattern in that it frequently integrated different kinds of owners within the firm with foreign investors often playing a prominent role. This pattern of 'recombinant property' (Stark 1996:1019) was a risk-spreading device of sort. Yet, risk-sharing implies a social and institutional context in which risk-taking is accepted and the production system is open to the global economy. The framework of privatization processes in Russia lies in stark contrast with the Hungarian one.

A basic aspect of the Russian difference is apparent in the way reforms were implemented. The problem here does not lie in a top-down approach which was indeed common to the countries of Eastern Europe. Rather, it lies in what had been happening in the social organization of the former Soviet state. In Poland, for instance, one may speak of a state "partially appropriated" by informal networks and groups. In Russia, however, what took shape was 'clan state' in which cliques of officials have been able to privatize sectors of the state for which they are responsible (Verdery 1998). The top-down implementation of reforms did not prompt economic actors to shift from a reliance on networks to a reliance on law. As Stephan Hedlund (2001:216) puts it, the institutional changes of the early 1990s "would have required successful introduction of a system of secure

property rights into a social system where the very notion of 'rights' as such was seriously underdeveloped."

In Russia, a process had been unfolding which led to both the privatization of the state and the dominance of that state over big business. According to Andrey Yakovlev (2006:1048) the bulk of the Russian big business that chose the strategy of a close integration with the state gets subordinated to an administrative model of economic regulation in which "the game around the rules" is being played now as it was in the previous stages of reform. A game which was also played in the Soviet era when it was almost impossible not to break some of the many directives and regulations and being penalized if the higher authorities could not be convinced to close one or both eyes (Grancelli 1988).

What is worth adding here is that the way big business is forced into a condition of state-dependency is cascading down to the level of the relations between former big kolkhozes and rural households. The latter indeed survive on their small plots of land thanks to the resources they get, in a way or another, from the former kolkhoz (see boxes 5 and 6).

These new farming organizations are managed by ex-directors of state and cooperative farms but also by people with previous experience in the 'second economy' of socialism. Thus, the actors one may find in different combination in the rural regions of CEE and CIS are now the following: (a) small farmers of the subsistence agriculture whose subsistence is also due to some extra incomes (pensions, subsidies, etc.) that form the bulk of the rural population, especially in the lagging regions and the 'Eastern peripheries'; (b) small and medium family farms that try to live on agriculture whose owner come from state and cooperative enterprises; (c) big firms in the agrifood chain managed by former socialist directors and, (d) big and middle restructured coops heading towards privatization (Swain 2000; Bateman 2006). The first and second types of actors include a variety of autonomous work as an alternative to unemployment. In fact, many of the 'rural entrepreneurs' are former industrial workers who have become self-employed out of necessity and do not think of investments or core business insofar as they see their activity as a substitute source of income. Also worth mentioning is the fact that a significant increase of new job opportunities is only apparent in regions bordering with western Europe, and that very few of the new entrepreneurial opportunities stems from national and EU support policies. The problem though lies not just in the unintended effects of policy implementation: it also has something to do with an anti-business attitude quite common within a rural population still overwhelmingly made of workers-peasants (Buzalka 2008).

On the policies for rural development, the emerging trend seems to be that local authorities are usually powerless both for lack of funds and administrative inexperience in front of a growing responsibility for local development policies on which the pressure of economic interests has began to grow. A slow change in

the composition of the local elites is nonetheless taking place in Poland, Hungary, and also in Bulgaria, even if the “post-socialist growth machine” is often managed by people who used to manage that of late socialism (Kulcsar/Domokos 2005; Oswald 2007).

To sum up, the comparative investigations of these fields of change shows evidence of a macro-level paradox emerging in the early stages of the agrarian transformation, namely that reform policies brought about not only a modernization of commercial agriculture. As a matter of fact, these policies and the opening up to the global economy also favoured the extensive growth of a subsistence agriculture with some resemblance to that of the 1940s, that is, modernization went along with a process of re-traditionalization in the rural economy and society (Brown/Kulcsar 1999; Gutkowska 2003; Small 2003; Fadaeva et al. 2004).

The post-socialist machine is bringing about much less growth in the Russian countryside (especially in the northern regions) whereby the reform of local government seems to have yielded too little and too late. In this case, the agrarian structure keeps being based both on mass production and family plots despite the legal changes in the ownership of farms. In Russia an ‘institutional deficit’ is still apparent in the lack of organizations that could help SMEs and farms to solve their problems. Actually, in front of powerless local governments, Russian farmers usually were not able to organize themselves also due to the absence or weakness of support from the government and NGOs. Consequently, the symbiotic relationship between the ex-kolkhozes and rural households is still strong, even if there appears to be an increasing divergence in the pathways of change in different localities (Kalantaridis et al. 2007). What emerges from the case studies in Russia has been aptly summarized by Leo Granberg (2007:59) in these terms: “... private plot holders are not in a great hurry to change their modus operandi and become fermery. They will, however, engage in more non agricultural activities either as registered companies or in the grey economy.”

Nevertheless, the opening up of the agrifood sector to FDI and the process of accession to the EU will foster further changes in the relationship between big cooperatives and small family farms.

#### **4. The cooperative difference in CEE management: If it is there, who is going to make it?**

Research on the first stage of the agrarian transformation has been mainly focused on the supply side of change, that is, on economic reforms, restructuring of enterprises or the reconstruction of the financial systems. It is only recently that the process has been tackled from the demand side, that is, from the changes in the distribution sector. In other words, a new stream of research began to emerge on the ‘supermarket revolution’ currently unfolding in CEE countries

within the processes of Europeanization and economic globalisation. The evidence provided by this literature is still scattered, but it yields useful accounts on the relations between big distribution chains and local producers, on joint ventures in the agrifood sector, and on the ongoing processes of 'Regoverning markets' in the region (Reardon/Swinnen 2004; Dries et al. 2004; Milczarek-Andrewska 2008). The changes of the last decade had an economic impact, but their socio-cultural consequences are also noticeable both on consumers and the actors of interest here, that is, agricultural producers. The impact of the supermarket revolution is thus taken here as the background for an assessment of the cooperative difference in addressing market failures and in building capital for social innovation.

#### *4.1. Cooperatives, small farms and market competition*

The supermarket revolution was set in motion in CEECs by the same determinants which triggered the process elsewhere in the world such as: rising per capita incomes, urbanisation, liberalisation of investments in the distribution system, and technical and organizational changes in the procurement systems of supermarkets. The sector especially affected by these changes is the dairy sector whose capacity to attract foreign investments was second only to that of the automotive industry. The impact of EU accession has been significant as well insofar as supermarket chains have been providing assistance to farmers to comply with EU norms, especially on the quality of products (Reardon/Swinnen 2004).

Multinational companies have played an increasingly important role in the modernization of Polish and Hungarian agriculture. Yet their impact has been differentiated due to the relative weight of structural and cultural legacies of the previous regime, the capacity of implementing reforms, the degree of integration of national economies in the globalisation processes, the costs of labour and the structure of the agrifood sector. First, household farms usually do not have enough investment capacity to insert themselves into the new value chains. Second, they find it difficult to reach the scale of production and the quality standards to compete in the market. Third, agrifood industries prefer not to deal with a myriad of small producers because of the negative implications in terms of transaction costs. Finally, it is worth noting that employment in commercial agriculture has been decreasing dramatically due to the restructuring of enterprises (Dries et al. 2004).

However, a set of shock absorbers are more or less effectively working in the three domains referred to above. In the economic sphere forms of assistance to small farmers are put in place in matters such as investments in human capital, management techniques, quality inputs and machinery. Moreover, a good deal of former coops and state farms are now included in the agrifood chains so that they may act as buffers between the changes in the distribution channels and the

small family farms. Also important is the modernization of the dairy sector with its potential implications in terms of local/rural development (LRD) for it favours the spread of off-farm activities such as packaging, quality control and services to enterprises and others. As for small producers who cannot specialize and rely on traditional distribution channels, they do not remain passive but look for alternative sources of income. It is not by chance that some experts also suggest support policies for these farmers such as, for instance, the conservation of environment (Milczarek-Andrewska 2008).

The conclusion Reardon and Swinnen draw from their investigations is that there are clear signs of distributive sector assistance to small producers which help compensating, up to a certain extent, their market failures. This positive outcome might be even greater if there were a higher degree of development of associational forms among agricultural producers. Some evidence on this may be found, especially in Hungary whereby a new generation of agricultural associations is gaining ground as a brief sketch of two successful purchasing and service coops may demonstrate.

In Poland, on the contrary, cooperation among small producers seems to remain quite rare because of an entrenched mindset and a lack of reciprocal trust outside the interfamily network (Brown/Kulcsar 1999; Small 2003). Be it as it may, there seem to be a slow spread of purchase and marketing cooperatives that may increase the bargaining power of small producers in front of big distribution (Wilkin et al. 2006). Four typical cases in Hungary and Poland are sketched below (see Boxes 1, 2, 3 and 4). These cases may also be taken as empirical references for the discourse on the third function which make up the cooperative difference: the creation of capital for social innovation (Box 4).

**Box 1. Three cases of new cooperatives in Hungary**

The first coop (Kapostai) was founded in 1994 by 35 small owners as a non profit organization for the purchase of seeds and fertilizers. Success is noteworthy so that initial membership grows up to 2000 people in the next five years. In 1995 a similar society is founded for the collective selling of fruit and vegetables, which gets closer to 300 members in 2002. The coop organizes the buying of material inputs and a number of selling outlets. In order to improve competitiveness and better product quality, the coop may also work on the basis of production contracts with individual producers and makes efforts to purchase inputs of the same type. The annual surplus is redistributed among members proportionally to their turnover with the coop, after a deduction for deposits and costs.

The second case is a coop which already existed in the pre-socialist period and started anew in 1993 as Haidú Gazdák Agricultural Association and three years later as Farmers' Club, and finally, in 1999, as Purchasing and marketing coop of Gazdák (PMCHG). The new association focused on: gathering and spreading technical and commercial information, joint purchase of inputs and marketing of products. Also important was the function of accessing additional government support. The first coop retained its original form until 2000 despite the possibility, according to the law of 1992, of becoming a joint stock company. This choice seems to be related to the initial composition of membership: almost two thirds is made of retired people. Yet membership changes increasingly over the period up to 1999 when the number of external actors overcomes that of initial members and the coop turns into a joint stock company. The stated reasons of the changeover were to secure more sound foundations to property rights, more efficient management of production, easier access to investment capitals, better image of the firm and to increase the returns of shareholders.

*Sources: Szabo/Kiss 2004; Forgacs 2008*

**Box 2. A limited liability company for the buying and selling of fruit in Grojec**

The town of Grojec (50 km from Warsaw) is part of the main area of fruit production in Poland. The SUN-SAD is a company for the commercialization of apples founded by ten partners linked together by a long, common experience.

The partnership, founded in 1997, began its activity under the slogan "Ten vitamins from a sunny Polish orchard"

A year later the partnership turns into a limited liability company and a program of investments is devised by the owners-shareholders. Production and storage are modernized through credit on easy terms. Forty types of apples are sold to supermarket chains, wholesalers and retailers. A significant quota goes to export. Management and marketing policies are decided collectively during the weekly meetings. The members may also sell individually, but it is agreed that selling through the society has the priority.

The co-owners are also involved in associations of interest representation at local and regional level. They also cooperate with the foundation for the development of rural cooperatives. In relation to this, the intention is to seek the collaboration of the British Know How Fund, as happened initially with a Dutch consultancy firm. The strategy is to expand the business and to produce according to EU standards.

*Source: Metera 2001*

**Box 3: A group of producers in organic farming in Brodnica**

Groups of organic farmers began to spread in the area back in the early 1990s also thanks to training initiatives by German and Swiss specialists. The first representative organization of these farmers in Poland was founded in 1989 under the label of Ekoland which, in a short amount of time, promotes the establishment of 58 farms.

As in the previous case, the Association takes shape from a set of personal and institutional links among members who participated in courses, instruction trips and various kinds of common activities. In this case, however, the common activity of members is limited to professional training, and the promotion of organic farming in fairs and the media. Shortly afterwards, the new law on the associations of buying and selling allows a number of more market-oriented members to set up an informal group (Brodnica) that involves 20 small producers of wheat and fruit. In 1993, a group of three people set up a cooperative for the organic farming of fruit and vegetables which, a few years later, turns into a limited liability company supported by both the regional project managed by Ekoland, and the Heinrich Boll Foundation. With the aim of extending the production mix, the coop members arrange an agreement with a bakery in Torun. In the meantime, new sources of funding are sought after at the national level and abroad to enlarge and modernize the warehouse.

Production is checked by the Ministry of Agriculture and also by a Dutch agency, and it is sold to wholesalers, supermarkets and retailers all over the country. Due to the scarcity of financial resources, the farmers devise forms of mutual support in the commercialization of production, and regulate their terms of trade also in terms of barter. The main problems at the beginning stem from the unsatisfactory level of prices and the incapacity to secure a continuous flow of deliveries, especially for vegetables, due to the unresolved logistic problems. In their marketing activities, the members are assisted by three part-time employees and an expert in organic farming. Despite its problems, the organic farm and the plant for the production of whole-wheat pasta have been able to hire 12-14 full time employees and 40 seasonal workers. The big prospective problem remains undercapitalisation.

*Source: Metera 2001*

**Box 4. Social capital and leadership in two Hungarian coops in the commercial agriculture**

Trust and reciprocity. Both components of social capital are seen as important for the development of the cooperative model. Yet, members of the traditional coop (Beke) mainly trusted national and EU institutions while in the second generation coop (PMCHG) members trusted their partners first and foremost.

Communication and information. Beke members are more inclined to seek information from the organizational leadership and national media. PMCHG members more inclined to gathering information from community leaders. In both cases, a good flow of information is pointed out, even though the flow shrinks on investments issues. A shared view: information management is a prerogative of organizational leadership and communication with external actors is the best way to improve the chances of getting institutional support.

Community, social networks and informal institutions. The motivation to help the community remains strong in both coops, even if help is conceived of in terms of time, not money. Shared view on the mediation of internal conflicts: involvement of the leadership and/or discussion of controversial issues at the general meeting. The presence of internal cliques was mentioned only by two of the ten people who gave in-depth interviews. Institutional environment and the cooperative model. The attitude of members towards the mutuality principle began to change with the introduction of radical reforms. On this, the shared view seems to be that the law of restitution of 1992 was ill conceived and badly implemented. The level of trust among coop members dropped steadily since then, and people became more reserved and less inclined to engage in cooperative activity. Almost all the 10 interviewees stated the lessening of their trust in the government in charge, especially in the traditional coop. A disappointment was also apparent concerning the policies adopted in the process of accession to the EU.

*Source: Forgacs 2008*

However, successful big coops within the transformation of a commercial agriculture wide open to FDI and subject to EU Common Agricultural Policies are just one side of the agrarian transformation in Eastern Europe. The other is the side which includes the bulk of rural population, namely the subsistence agriculture and rural households still largely dependent for their livelihood from former collective farms turned into IOFs or new coops. It is comparative research on continuities and changes in that symbiotic relationship that may help rethinking the debate on the cooperative difference in the catching-up economies of CEE and CIS (Box 5 and 6).

*4.2. Kolkhoz legacies, rural livelihood and the agony of a symbiotic relationship*

The focus of the comparative research must also be directed to another context of the relationship, that is, to the actors of a less advanced agrarian transformation in local communities largely out of the reach of exogenous factors of change.

It is in the lagging rural regions and the 'Eastern peripheries' that negative socio-demographic changes are dramatically evident in terms of ageing of the population, mortality, emigration, growing poverty (Brown/Kulcsar 1999; Small

2003). These are indeed the places whereby the social costs of economic transformation are especially acute in terms of unemployment and reduction of welfare provisions (Shubin 2007). It is there that rural livelihood is largely based on a set of non market economic activities of households in a grey area between legality and illegality (Kalantaridis et al. 2007). Granted, the activities in the informal economy are not a new phenomenon: they emerge both from the traditional peasant society and the real working of Soviet enterprises, especially in low priority sectors (Grancelli 1988). They are embedded in the rural society of today, even if for different reasons than in the past: they have to do with the survival strategies of household usually within the agony of a relationship established in another era (Neef 2004; Wallace/Haerpfer 2004; Heinonen et al. 2007).

**Box 5 A former collective farm and a stanitsa in Kuban**

The former kolkhoz turned in 1992 into a limited shareholding company. This big breeding factory was one of the best in the region of Krasnodar. It still keeps a good level of economic viability, mainly due, however, to the low cost of labour. On the other hand, the salary level is not the main incentive for people working in this organization. Today (as in the past), the real incentive for rural households is to access the resources of the farming enterprise and use them as inputs for their individual farm. Besides food products, shareholders receive a small dividend from the piece of land they rented to the new enterprise. The point though, is that they get only about 15% of the claimed land profitability. Thus, if they decide to sell their share, they would do this at the rate of exchange established by the former kolkhoz.

By the late Nineties the management became the real master of the enterprise and began to impose new production standards under which workers get a certain salary, plus some resources for household farming with the aim of bringing the old tactics of stealing to an end. However, the problem is that salaries remain low and the legally allotted fodder is both scarce and distributed according to the degree of 'closeness' to the bosses. Hence, the only alternative way to access to the common pie is to participate in the 'voluntary-compulsory work' in weeding and harvesting vegetables.

The reduction in the possibilities of informal acquisition of resources from the ex-kolkhoz may be partially compensated by the development of exchanges based on kindred relations and business ties which, as a rule, involve someone working in the big farm. An interesting outcome is that such exchanges usually lead to the formation of family cooperatives of a sort that put in common a set of resources and opportunities (money, materials, time) of several families.

*Source: Fadaeva et al. 2002*

The question emerging here relates to two possible evolutionary paths. A first possibility is that survival household strategies turn out to be part of a re-traditionalization of rural communities that may threaten the reconstruction of civil society. A second possibility is, instead, that they may have a potential in terms of local development and societal modernization. In any case, the first step to tackle this issue is to gather preliminary evidence on what kind of outcomes are brought about by the strategies of households within the agony of the symbiotic relationship with the former Soviet-type cooperative.

**Box 7. Production coops and rural households in Saratov**

In the village of Povolgie the main employer has always been the kolkhoz. In 1991 the management tries to implement a strategy of radical restructuring which meets with the strong opposition of the majority of the labour force. The management and a group of the most qualified workers then leave and take with them the best machinery and their property shares and form a new production association which is able to keep a good level of economic viability. In successive years, a process of apportionment of small farms from the ex-kolkhoz keeps going, even if only about two thirds of the new small firms are really working.

To the extent that the influence of the ex-kolkhoz decreases, elements of rural self-organization began to emerge in the management of the commons. For instance, when the kolkhoz practically ceased to keep up the water supply system, at a meeting of the village inhabitants, it was decided to raise funds to be earmarked for that purpose. On this, the most successful farmers exerted a leadership role.

Even in this case, a new stage of adaptation of households began to appear as a consequence of the breakage of the "symbiotic mechanism of family-farm coexistence." Families tried first to siphon off from the kolkhoz as many resources as they could. At the same time, they also began to try to restructure the homestead according to criteria of profitability. Yet the problem was the lack of financial resources. For instance, a steady salary was earned only by a small minority of women who worked in the public sector, and for half of the 17 families of the sample, monetary income was only half of overall family revenue. Hence, there exists some nostalgia for the good old days of the Eighties when life was secure, and the house replete in the kolkhoz and its little company town.

Nonetheless, the household interest for private agriculture is growing. It is, however, a very traditional agriculture where, in recent years, "a slow but unmistakable return to the times of individual peasant farmsteads of the beginning of the last century was taking place."

*Source: Fadaeva et al. (2002)*

**6. Lessons learned and generalizations**

Four generalizations may be cautiously drawn from the case studies on coops in the modernization of commercial agriculture in CEE countries. First, most members of production coops which remained as such seem to long for the good old days of the quasi-market conditions of a partially reformed socialist economy: they state their support for the mutuality principle and recall the high levels of social capital that existed in the past. However, in a growing number of cases, the majority of coop members decide that the conversion into an IOF may be the best way to secure their rights as residual claimants to economic returns.

Second, the members of the not many marketing and service coops explain their choice to associate with their difficulties, as individual farmers, due to the rising production and transaction costs of their relationships with supplier and customers. Third, the cases clearly show the presence of path-breakers both in big coops and small household farms. Indeed, organizational leadership seems to play a crucial role either in keeping production coops alive or convincing people to join new types of associations or to turn a coop into a joint stock (or limited liability) company. Fourth, a reservoir of economic and social entrepreneurship

is also noticeable in the subsistence agriculture, and it may take an organizational shape with the help of pull factors such as, for instance, commercial opportunities and availability of new resources. In those cases, households' strategies may go beyond the horizon of a networked poverty to build forms of interfamily cooperation that may be conceived of as precursor of the cooperative or private enterprise.

How to explain this explanandum?

The construction of the cooperative difference in CEE management as research object teaches three methodological lessons. The first one is that:

To understand the cooperative difference one needs to retrieve variables that are often missing in economic approaches, namely those related to the production of capital for social innovation. Yet, retrieving extra-economic variables should not lead us to neglect a clear evidence, namely that path breakers, both in private and cooperative farming, are striving for a consolidation of their property rights

In other words, what should be done is the operationalization of human and social capital for these concepts becomes crucial if the efficiency of farming is framed within the general issue of local-rural development.

However, to elaborate further on this issue, a second lesson is to be learned:

The production of capital for social innovation is to be located in time and space, and framed within the changing relationships between former collective farms and rural households in a set of local contexts differentiated by: type of agriculture, weight of path dependency, implementation of reform policies, and patterns of socioeconomic change.

The differentiation of local contexts is also due to exogenous factors related to the degree of openness to the global economy and the impact of programs for the modernization of agriculture and rural development. Thus, the third lesson is that:

The weight of path dependency and the ways innovators break the path also depends on external pull factors whose combination is different in CEE and CIS.

A comparative analytical framework should then theorize the cooperative difference within the processes of rural development in CEE countries without separating the economic dimension from those of institution building and de-institutionalization of existing structures. The case studies reviewed here also provide theoretical insights for this endeavour.

A remarkable step ahead in this direction is the cross-national comparison carried out by Mieke Meurs (2004) within the framework of transaction cost economics. Drawing from evidence in Hungary and Bulgaria, Meurs tackles two interrelated questions: Why the development of private farming has been so slow?

Why such a persistence of production coops and the transformation of many former kolkhozy into holding coops that integrate many small family farms? The reason is that the economic returns of private farming remain low in comparison to those of big coops which operate in imperfect markets and are managed in ways that have little correspondence to the classic principles of cooperative governance. In such conditions, transaction costs to be considered are not just those of monitoring labour: such costs are high for private farming mainly due to the imperfections of input and output markets. On the contrary, production and transaction costs of big coops may be kept relatively low because of the reserve of production factors and social capital inherited from the previous regime.

The explanation Meurs provides is framed by a transaction cost approach in which extra-economic variables are also included to explain the cultural barriers initiators face while trying to create a new business. Yet, these variables play a residual role for the research question is whether or not the persistence of former collective farms is, on the whole, hampering the efficiency of farming in the catching up economies of CEE.

That comparison is focused upon the first aspect of the cooperative difference. For example, a paradox Meurs notes in the explanandum is that the big amount of land inherited by former-socialist coops in Hungary and, even more, in Bulgaria has put them in a monopolistic condition in the local market. Nonetheless, this concentration of ownership has also favoured a reduction in transaction costs of buying and renting land. The point then is: Big cooperatives may have not performed well as competitive yardsticks, but they had somewhat favoured the consolidation of private property rights on land after the fragmentation of property brought about by the laws on restitution. Changes may occur though, both in the management of big coops as in small family farms even in a condition of imperfect markets. Thus, the consolidation of property rights may act as a pull factor for the expansion of private farming if a small group of farmers succeeds in expanding its control on the arable land (Meurs 2004).

This example is theoretically relevant insofar as it allows thinking about the applicability of the property rights approach to this research object: an approach seldom applied even to cooperatives in developed market economies. In general, property rights have been used to address the problems of resource allocation in the firm: Who are the decision makers? Who are the residual claimants on economic returns? Merret and Walzer (2004), in their study on coops and local development, start from the classic question of what determines the choice of an organizational form by the enterprise. According to them, this perspective may also be applied to coops to understand the way they align the incentives of their members and stakeholders and the possible consequences of this in terms of demutualization. In other words, when the membership becomes too heterogeneous, the principal-agent problems applies to big coops as well unless a strong

governance and an effective representation of interests are in place (Merret/Walzer 2004:58).

The holding coops, successors of collective farms, are also cases in point for they have a highly heterogeneous membership which includes external shareholder-investors. Can we apply to them the same approach? The idea put forward here is that we can insofar as the property right approach has acquired a more processual character than it originally had, and this allow further thoughts on the principal-agent model in contexts in which many agents are also residual claimants. On the comparative analysis of these changing contexts, some concluding remarks.

There is today enough evidence that the rebuilding of market institutions in post-socialist countries cannot be seen as a process of unfreezing of an institutional arrangement to refreeze it in a new configuration (Boudreaux/Aligica 2007). A processual approach is needed which goes beyond the insertion of cultural factors into the transaction costs approach to the evolution of post-socialist agrarian institutions. In other words, a comparative approach should also account for the different transition paths that are going to change same basic structural elements of the previous economic regime. The point on this has been clearly made by Ingrid Oswald (2007:225) who proposes the concept of 'industrialized village' for explaining the social and cultural outcomes of the Soviet-type industrialization of the countryside. In Russia, much more than in Hungary and Poland, the consequences of that process are: (a) a lack of economic basis for the running of private and competitive firms; (b) the absence of social actors willing to transfer administrative functions from the former kolkhozes to municipalities and, (c) the overwhelming presence of people accustomed to having a waged job, that is, a rural population without farming skills.

Many analytical insights may be drawn from a processual approach in which both structural and cultural legacies are given due consideration. For instance, Jane Harding (2004), in her case study on the local governance in Wroclaw, takes the concept of path dependency into account for it is important to understanding the existing legacies. Yet, she does not conclude that new institutions should be allowed to emerge in a path-dependent and incremental way. Rather she emphasizes the role of local path-shapers and the way they are forging new structures in a context in which the capacity of governance is shaped by fractured interests, power relations, and the intervention of external player.

Two lessons emerge from these studies. First, informal institutions such as, for instance, those which give some groups a disproportionate access to the decision making process are positing a quite different scenario from that of freely contracting individuals. Second, the role of exogenous players may have a highly variable importance in the development and governance of localities. Thus, a basic feature of a processual approach to the changes in property relations is its fo-

cus on strategic behaviour of path shapers in different social and institutional contexts. Examples may be the nomenklatura who have converted their social capital into economic capital; the workers that may have turned their collective 'blockade capital' into individual social capital or the importers of intellectual capital from western market economies (Hardy:313-316). Examples may also be the villagers of the lagging rural regions that rely on mutual help that sometimes may lead to the creation of 'family cooperatives' (Fadaeva et al. 2002; Shubin 2007; Oswald 2007).

The problem in general, especially in CIS, is the lack of an adequate governance structure to implement the new legal norms which also is a problem of de-institutionalization of old structures. Thus the challenge here is how to explain the behaviour of path-shapers in this process, only partially intentional, of institutional change in which local administration is the meeting place of formal and informal structures. If this 'messy middle' is brought into the picture we may see the usefulness of the concept 'institutional bricolage' to understanding how local development brokers recombine traditional and Soviet ways of resource distribution with "post-Soviet [pseudo-]participatory processes as rules demanded by donors institutions" (Sehring 2008:19).

This implies that in the local polity-economy we may have different combinations of forms of self-help along with the political decision making. Hence the theoretical challenge for the application of property right approach to the cooperative difference in CEE management is that of a conjoint analysis of two processes. First, the interrelations between economic development and the consolidation of property rights of innovators and path-shapers. Second, the way government and donors' institutions favour the growth of public entrepreneurship for the creation of new a polycentric governance of local development.

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## From the chaos of transition economy to “normalized” managerial practices: The role of group interaction in creating meaning in managerial work\*

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*The purpose in this paper is to explore the interplay between managerial sensemaking, representations and identity in the context of a transition economy. Using the approach of theory of social representations (Moscovici, 1961), a thirteen year long observation of a group of twelve owners/managers was adopted. The research concluded that managerial practices emerged in social interaction. These practices existed in relations of co-production and were embedded in the social construct. During the transition period, the content of managerial actions, narratives and identity changed in the same way under the influence of shared culture, ideologies and day-to-day social practices. This is one of the rare longitudinal studies of transition economies where the process of emergence of a small social group was observed and the pattern of evolution identified.*

*Key-words: transition, ideology, identity, longitudinal, Kazakhstan*

### Introduction

Despite a number of research studies conducted on the transition process (Lavigne 1995), there is limited literature devoted to company leaders and managers as a social group involved in social processes and not enough consideration has been given to the role of human subjectivity in this context (Fotaki 2009). Very often content, process and context were studied separately by organizational scholars (Pettigrew 1987; 1990; 1992) and much richness was overlooked concerning the relationship between these elements. The purpose in this paper is to explore the process of interaction between managerial sensemaking and identity during transition. How do company managers make sense of their environment and their-own actions? How do they constitute their representations of a changing world and of themselves? How do they express these representations in their discourse? How does ‘what they say’ relate to ‘what they do’? These questions focus on key elements of the process, which are interrelated and mutually constitutive.

This paper is the result of an empirical longitudinal study, focused on the development in private company manager practices during the transition from a planned to a market economy in Kazakhstan, one of the 15 former republics of

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the Soviet Union, which became independent in 1991. It aimed to investigate how the changes which occurred in society after the break down of the Soviet Union were perceived and enacted by entrepreneurs, identified as key-figures in this transformation process.

This paper argues that during the transition period in the post-Soviet countries new managerial practices and discourse that did not exist before perestroika were constructed by practitioners involved in this process. In ten years the old soviet-type administration was transformed into a more modern management system. This process started with the most dynamic part of the population realizing that “the economy was not working any more” and that “the world had changed”. They tried to understand the change, to make sense of what had happened, to ascribe meaning to unusual events happening in society in order to take appropriate action. Such action can be taken when individuals form their representations about the environment and themselves. For them, these representations are the “true knowledge”, natural logic, beliefs and guiding patterns for behavior and action (Cossette/Audet 1992; Eden 1992; Fiol/Huff, 1992). In this paper, the term “social representation” is used to enhance the collective process of their construction. Representations are deeply rooted in national culture and history, influenced by the dominant ideology and embedded in the day-to-day social practices of individuals.

The following section elucidates the concepts of sensemaking and social representation and their relationship with the other concepts of the theoretical framework of this study. Thereafter the design and the results of the empirical study will be presented. The paper will conclude with a discussion of its contribution in relation to managerial practices literature.

### **From sensemaking to social representation**

This paper explores the relationship between managerial discourse/practices and social structures producing and reproducing these practices and discourse. It stresses the importance of the ideological and cultural elements involved in the social construction of reality (Berger/Luckmann 1967) and its verbal expression. These taken-for-granted, self-evident assumptions of knowledge (Huff, 1990) will be questioned in this paper by examining the processes and mechanisms of their production.

A growing stream of research has suggested that cognitive sensemaking processes are important in conducting strategic changes (Fiss/Zajac 2006) and that the company managers play a key role in this process by providing meaningful interpretations to their organizations (Thomas et al. 1993). Therefore, this paper tries to link managerial thinking, speaking and acting by using the concepts of sensemaking, representations, and strategic actions. In this research, sensemaking is understood as a process of meaning building. The sensemaking perspec-

tive (Weick et al. 2005; Gioia/ Mehra 1996; Weick, 1995; Gioia et al. 1994; Thomas et al. 1993) is appropriate because sensemaking starts “*with chaos*” (Weick et al. 2005), when previous understanding, representations and schemas no longer match current events and cannot be used to take appropriate action. This statement truly describes the situation in Kazakhstan as well as in all the other former republics of the Soviet Union in the early nineties. However, sense-making theory lacks instruments to explore how current meaning is embedded in the past; how existing frameworks, beliefs and practices influence the constitution of new knowledge. Social Representations Theory fills some conceptual gaps in the sensemaking theory and offers some methodological solutions to study the process of meaning building.

According to the Social Representations Theory (Moscovici 1961; Jodelet 1989; 1984), rooted in French social psychology, *representation* can be viewed as a *process* similar to sensemaking and as a *product* of this process expressed in the form of images, schemas or cognitive frameworks organizing our thinking and action (Laroche 1995). According to Jodelet (1989), social representation is a form of socially developed and shared knowledge, with practical implications, which contributes to the construction of a common reality for a social group. It is important to mention three interdependent features of representations: 1/ they are developed in and through communication, 2/ they help to construct reality and 3/ they shape the surrounding environment through their organization. It is accepted that social representations constitute a system of values, ideas and practices with a twofold function; first to establish an order which will enable individuals to orient themselves in their material and social world and to master it; and secondly to enable communication to take place among the members of a community by providing them with a code for social exchange (Moscovici 1984).

Social representations are anchored in collective memory or otherwise in the historical and *cultural* construct shared by a social group; in the *ideology* which is dominant in the society at that period of time; and in the day-to-day social *practices* of individuals and social groups. (Grize et al. 1987). Therefore, different social groups can share the same representations, and yet vary from other groups which are involved in different practices and exposed to alternative ideological or cultural influences. The theory of representation anchoring (Grize et al. 1987) provides a major insight into the origin and imagination process within a context of transition.

### **The role of group interaction and identity in the creation of managerial practices**

Managerial practices are investigated in this research through the process of social representation and appear as a product of the social interaction and sense-

making process. Within the process of sensemaking, top-managers create not only representations about their business and practices but also about themselves. The self-representation together with the sense of belongingness to the social group call for the concept of individual and social identities. Identity has been conceptualized at several levels of analysis, including individual, group, organization, and society. However, almost no research has attempted to establish multilevel linkages, although the identity construct holds the possibility of integrating multiple levels of analysis (Foreman/Whetten 2002), particularly in sociology and psychology, where scholars have depicted multiple identities as being the norm for individuals (Mead 1934; Beyer and Hannah 2002).

Identity is essentially the set of beliefs or meanings that answer the question “Who am I?” (Mead 1934). It is a general concept that refers to various types of mental representations about the self and encompasses not only personal characteristics but also attributes relevant to individuals’ work, profession and position within an organization. Individual identity is constructed through cyclical, episodic exchanges with others (Mead 1934). An individual’s sensemaking process is guided by a search for the coherence or the compromise between the exterior meanings, his or her self-identity, representations, past and future actions (Dutton /Jackson 1987; Gioia/Mehra, 1996).

Establishing social connections through different groups meets individuals’ needs for approval and self-esteem (Murray/Holmes and Collins 2006). It refers to the definition of self vis-à-vis some group as an occupation or organization (Ashforth/Mael, 1989). Social identities are based on the belongingness to a meaningful social group (Baumeister/Leary 1995). Individuals identify themselves with a specific group by desire to transfer this group attributes and characteristics into their own self-image (Turner 1985). An individual may have as many social identities as he or she has group memberships. Each respondent’s membership in different organizations and networks, having particular rules, values and codes requires a certain type of behavior. A person’s identity is arranged as a hierarchy of different identities co-existing at the same time (Feldman 1979). An individual’s identities are at least partially composed of the roles he or she plays (Pratt/Foreman 2000). The various social roles may be in contradiction with each other. Goffman (1959) suggested that individual’s behaviors, similar of those of actors on a stage, are largely conducted for others in order to convey impressions that serve the actors’ self-interests. At the same time, these performances have implications for a person’s understanding of self in that the role represents the self the person wants to be.

### **Empirical study**

The empirical study observes a group of private company owners and managers during the transition from a Soviet planned economy to a market economy. The

group, named “New Generation” by the mass media, is composed of 12 entrepreneurs who started their businesses in the early nineties and became part of the business elite in early 2000. The creation of this group constituted an outstanding and complex phenomenon in the social and economic life of Kazakhstan. Observing this group was a major opportunity to follow the process of the constitution of new managerial practices during this period. The empirical study aims to observe the process of emergence and evolution towards the “normalization” of managerial practices in the transition economy through longitudinal analysis of verbal accounts or narratives of a group of company managers and owners. This analysis allowed the reconstruction of the content of social representations created and shared by the group about their business, practices and roles as well as about themselves. This study was guided by a threefold question:

1. How does a group of top managers give meaning to their job in the changing environment of a transition economy?
2. How does change in the group identity relate to the change in the building of meaning?
3. How do social structure and ideologies influence these managers’ narratives and practices?

This research did not follow a linear process. Moving backwards and forwards between theory and the empirical data ensured the relevance of the data collected and the validity of the explanations.

### **Research methodology and design**

Narrative methodology was mainly used in order to access to the content of managerial representations. The meaning built within the process of sensemaking as well as managerial representations could be expressed either through actions or through stories, narratives, verbal accounts or discourses. Managers’ narratives are a source of rich data not only about their practices, strategies and projects, but also about themselves. Narrative methodology also enables one to grasp the collective and social aspect of their production, which is one of the key-dimensions of this study. But it does not mean that managers say exactly what they think and do what they say. Interviews are contextually situated, which constitutes a major limitation of this method. Narratives are much more complex constructions, which certainly produce rich data, but need to be thoroughly analyzed in conjunction with other data sources.

Longitudinal in-depth case studies were conducted for each of the twelve top managers and for the group “New Generation” as a whole over a seventeen year period, 1991 to 2008 inclusive, eight years of retrospective and nine years of real time data collection. Once a year, the members of “New Generation” were interviewed during a two week visit to Kazakhstan. The interviewing process

was centered on the following questions: *"What is the essence of managerial work for you? What were the most important actions you took last year? Why? What will be your future actions? Why?"* The following year more specific questions were asked about reported strategic action taken during the past year. The interviewing was structured in exactly the same way each year and covered the same questions with each respondent.

The research was designed in three distinctive stages, the preliminary stage being used to justify the sample choice and to describe the chosen group and the transition context. "New Generation" was selected for this research because of the intensity of the dynamic change in its activity and identity as well as because of its significant exposure in Kazakh society and its influence on business and management practices in the country. According to the local press articles in 1993-1996, this group reflects and symbolizes the overall transitional process in all former Soviet republics.

The preliminary stage led to the identification of the 12 founding members of "New Generation", mutually accepted and identified as the core of the group. Many other businessmen also identified themselves as members of this prestigious group, but were not accepted by the "core", so they were not included in the study group. The list of 23 names, built from local press articles about "New Generation", was shown to the most often cited members and they eliminated those who did not belong to the group. Only 12 members mutually identified themselves as being part of this group.

The first stage of the research involved the collection of interviews, of internal and external documents concerning the members of "New Generation" and the direct observation. The data was collected annually and interpreted, analyzed and compared period by period. For both retrospective and real-time studies, five different sources of information were used (interviews with three different types of informants, internal documents and local press articles) and several methods of empirical data collection and analysis were adopted. The data was mainly collected by carrying out a series of semi-directive interviews once each year with: 1) "New Generation" members, in order to study the content of their managerial practices and the meaning they attributed to their work and to the context of this work; 2) their colleagues, in order to determine the strategic actions taken by the members of the group and to cross-check the information, received from other sources; 3) local researchers in the field of social and political science, in order to get an outside view on the social, economic and political context for each period of study. Moreover, local press articles devoted to the "New Generation" group and to its members were collected for the whole period, as well as the organizational documents of the twelve respective companies and of different associations and committees in which the group members participated over the period of study. In total, 62 semi-directive interviews with mem-

bers of the group, 88 interviews with their colleagues and 9 interviews with local researchers were held during the period of study, which represented more than seven hundred pages of interview transcriptions. More than 280 internal documents and 81 press articles were collected and analyzed.

Transcripts of the interviews were analyzed using open coding procedures (Usinier and al. 1993) to develop conceptual labels for categories of interest. A second stage focused on data interpreting, period by period, in order to identify the content of respondents' representations and its inscription in the social context. By the end of this stage an analytical framework was elaborated to make connections between the categories identified in the narratives and the social context. The third stage represented a transversal content analysis of all collected data through the whole observation period (1991-2008): interview summaries, company documents, mass media articles about the group and its members individually. Conversation analysis (Drew /Heritage 1994), content and documentary analysis methods were used to complement each other (Isenberg 1986). Using the framework elaborated in the previous stage made it possible to elucidate the meaning production process used by the group members in relation with their strategic actions and the social context.

### **Group “New Generation”**

The “New Generation” is a group of young company directors and owners who started up their businesses in the early 90s in the commercial sector. The members of this group all are men and native Kazakhs<sup>1</sup>, all belong to the same generation: they were 24 to 30 years old when their careers as entrepreneurs began. Later on they organized a movement in opposition to the old political administration, the so-called “red directors”, civil servants and politicians inherited from the time of the Soviet Union. The consolidating idea of this group was motivating and powerful: “To contribute to the prosperity of Kazakhstan by promoting democracy and the market economy”<sup>2</sup>. Officially this movement did not exist for a long time, crushed under the weight of criticism from the “old elite” and contradictions inside the group. The lack of political experience and organization, the picture of “climbers” and “sharks” in Kazakh society as well as their illegitimate position in the eyes of the old elite contributed to the defeat of this movement. On the other hand, the core of this group has continuously changed until 1997. Other young businessmen and entrepreneurs have identified themselves as part of a new generation of managers or leaders without being a part of the “New Generation” group. They gather in professional clubs and associations of people sharing the same profession, the same ideas on the future of their

1 In the early nineties, 39% of Kazakhstan population was ethnic Kazakhs, 41% ethnic Russians and 20% other ethnic groups (Ukrainians, Tatars, Chechens, etc.).

2 Here and further in this section, quotes from local newspapers translated by author from Russian.

country, on business methods and objectives without pursuing any political or economic goal. In 1998, the general tone of the press about “New Generation” changed completely, because, on one hand, the group abandoned the political claims, and on the other hand, the government needed to show a progress in developing entrepreneurship and local business. The picture of young and ambitious managers greedy for power and money was replaced by the image of “young patriots, willing to serve their country”, and that of “highly professional, well educated, very efficient managers – the future of the nation”.

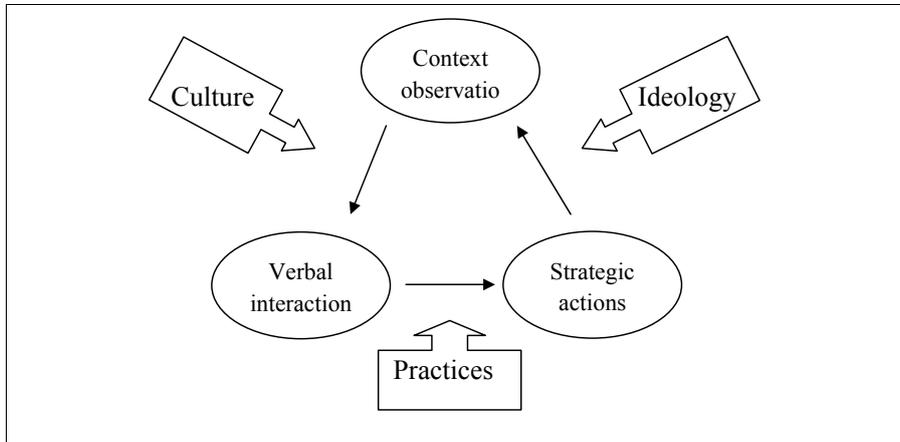
Within a period of only ten years, the group members had developed their firms into large holdings<sup>3</sup>, following the massive privatization which took place from 1992 to 1996. Some of the members of this group held office as ministers, deputy-ministers, political party leaders and heads of influential associations. In 2003, the most politically active members of “New Generation” launched into political action by organizing a new anti-presidential political party called the DVK (Democratic Choice of Kazakhstan). All the members of “New Generation” supported them either explicitly or implicitly. This attempt was no more successful than the first one. The party folded up for insignificant reasons and another one was organized whose agenda was more moderate. After this incident, all the other members of “New Generation” focused on their businesses and limited their outside activities to the participation in professional associations, charity and cultural events.

### Empirical findings

The findings reported in this paper are *second-order* analysis results (Gioia/Chitipeddi 1991) produced on the third stage of the research and based on a transversal analysis of all the data using the framework elaborated in the previous stages of analysis. This transversal analysis process was operated in the following manner:

1. The narratives collected from the group within a year and processed through category analysis produced first order analysis data. Internal documents and local press articles went independently through the same process.
2. The identification of homogeneous content and the patterns of change of that content resulted in the detection of five periods in managerial discourse evolution.
3. The comparison, period by period, of categorized content coming from group members’ narratives with, on the one hand, categorized content of internal documents, and, on the other hand, that of media articles.

3 In Kazakhstan, which has a population of 15 million inhabitants, small firms have 5 to 50 employees, medium firms 50 to 100 employees, and large companies are taken to be those with more than 100 employees. The holdings mentioned here had more than 1000 employees in 1997.

**Figure: Second order data transversal analysis process**

Thus, in this paper only the last stage, second order transversal analysis results will be reported. This analysis provided evidence that in their everyday lives, company managers developed and used a whole range of specific clichés, micro-models and convictions which were both acquired in their interaction and used in order to take action. The meanings attributed by the members of “New Generation” to various situations and activities proved to be a key to understanding their managerial practices.

### Five periods in the group history

The analysis of the “New Generation” members’ interviews revealed an apparent change in the meaning they gave to their businesses, to their roles and functions inside and outside their companies. The table 1 in Appendix A shows the changes in content of the respondents’ representations of their roles, functions, identities, proclaimed objectives as well as the implicit objectives visible through the content analysis of their interviews. The interview content analysis revealed that the overall period of observation could be divided into five periods within which the respondents’ ideas were homogeneous. Although the content of self-representation varies from one period to another, some elements remain stable and evolve in a cyclical way.

**Appendix A: Evolution of the “New Generation” members’ representations of the company manager’s job. Summary of interviews content in five periods**

Periods	1991-1995	1996-1998	1999-2002	2003-2005	2006-2008
<b>Categories</b>					
<b>Expressed Objectives</b>	To create a company, to catch any opportunity, to find new markets, new products, new methods, to procure finance, to negotiate with all kinds of partners, staffing.	To optimize the Company structure, planning	To create favorable conditions for company development	To improve the economic conditions in the country	To assure the sustainability of the company
<b>Hidden objectives</b>	Not determined	To legitimize his new position of “company owner”	To project a positive self-image in society, to find his own identity and style of management	To influence different decision making processes at the State level to his advantage and to gain power	To preserve his private property, to reinforce his social status
<b>Functions</b>	day-to-day management key accounts management solve any kind of problems, etc.	strategic decision making control day-to-day management	restructuring company promotion company development	(vague definitions by respondents) lobbying	assuring group cohesion searching for synergies
<b>Roles</b>	Entrepreneur “Engine” of the business	Interface between the company and the outside world	Company “protector”	“promoter” of ideas	The company’s “face”
<b>Competences</b>	On the personal, psychological level “smart”	On the intellectual level	On the communication level	On the political level	On the social level

Periods	1991-1995	1996-1998	1999-2002	2003-2005	2006-2008
<b>Categories</b>					
<b>Self-image</b>	“new generation” manager	“brain” of his company	“strong leader”	“responsible citizen”	“balanced person” “respectful businessman”
<b>Place</b>	Everywhere in the company	At the center of his company	On top of his company	Outside his company, and in lobbies	Within his company and within his networks

### Period 1: 1991-1995

During the first period, they assigned themselves the roles of “pioneers”, “creators” and “challengers”. They were not clear about their actions, but all of them wanted “to take quick actions”, “to catch all opportunities”, “to take advantage of the absence or irrelevance of certain laws and rules”, “to create new possibilities for business development”. Having neither knowledge nor experience in management and business, these entrepreneurs had to create their managerial practices and leadership style from scratch. In this first period, the entrepreneurs’ approach to business was very simple and opportunistic:

*“Just after the perestroika, the shortage of all kinds of goods was so severe, that everything brought in Kazakhstan was sold immediately. No marketing was needed, no advertising, nothing. We all [“New Generation” members] were involved in any business, providing it was profitable” (“NG” member interview quotes, June 1996).*

Not surprisingly, company managers had an opportunistic approach and similar strategies not only within the group but allegedly in all post-soviet and Eastern European countries. This mechanism is described in a similar manner by many researchers from different countries in transition.

*“By 1993, there were 25 employees in my company and we were involved in seven different businesses from importing computers from Moscow to Kazakhstan and chocolate bars from Germany, to real estate and travel agency businesses. N...n [name of another group member] sold [laughing] Toyota cars and chicken and eggs at that time!” (“NG” member interview quotes, June 1996).*

### Period 2: 1996-1998

During the second period, “New Generation” members decided to change their strategy with regard to their respective businesses. So, the most important decision of this period was to restructure the companies, which became highly diversified businesses, with no synergy between them and were more and more in competition with the businesses of other members of “New Generation”. By that

time the privatisation process had come to an end and the opportunistic approach to acquiring new firms was replaced by restructuring and optimizing strategies. During this period, the main data collected were internal documents such as “business plans”, “restructuring memos” and acquisition documents. Most transactions (85%) concluded between members of “New Generation” themselves, and few businesses were bought from or sold to outside owners. This period was also characterized by the group members’ active learning. All of them reported having followed at least 5 weekly business seminars organized by newly emerged business schools and consulting companies. They had also sent their middle managers on different training programs.

*“Not only me, but my colleagues too, we move forward by trial and errors. We’ve never done before, what we are doing now. And we never learnt how to do business. I have a biology diploma, ... [name of another respondent] is an engineer, and ... [name of another respondent] is a journalist. And we all have to manage huge, diversified businesses.” (“NG” member interview quotes, October 1997).*

Moreover, they had to legitimize their actions in society, where the majority of the population still believed in the old soviet values and was hostile to newly emerging capitalistic relationships. This is the reason for speaking not only about sensemaking but also about sensegiving.

During this period the membership in “New Generation” was considered a valuable resource and an undeniable force against political uncertainty, economic chaos, and institutional insufficiency. It was a possibility for them to co-create meaning and managerial practices. The data reported in this study describes the process of sensemaking in a very practical manner: each member of “New Generation” contributing to the construction of the common meaning of a changing environment and of the relevant response to these changes. Practically, when one member of the group discovered a useful tool, innovative method or found interesting information, he brought it to the attention of the group for discussion, evaluation or testing. Thus, some ideas, tools or techniques were rejected; others evolved and strengthened through discussion and were kept for practice by the members of the group.

### *Period 3: 1999-2002*

In the next period, the vulnerability of new businesses, their dependence and unstable character, as well as the absence of guarantees securing private property pushed new business elites to penetrate legislative and government structures. Two of the respondents became members of Parliament, 2 took Ministerial posts, 1 became Vice-Minister, 3 of them were appointed as Executive Directors of huge public companies, whereas the others remained at the head of their own companies.

*“Two reasons pushed me to enter the government. First of all, I had acquired so much experience in managing my companies that I felt I was able to manage a Ministry, which was poorly managed by old Soviet apparatchiks. It couldn’t be worse. And secondly, it was a personal challenge for me. You remember, I told you once, my slogan is ‘the sky is the limit’ and decided to prove to myself that I was capable of becoming a minister at 36.” (“NG” member interview quotes, September 2001).*

Their employment in these posts did not last long and was not always successful, but as our respondents recognized themselves, this management experience was worthwhile in terms of understanding power distribution at the State level.

*“For me the reason [for becoming a Member of Parliament] was very simple and pragmatic: you cannot be totally secure in this country unless you are close to the power structures.” (“NG” member interview quotes, September 2001).*

#### *Period 4: 2003-2005*

This period was similar to the previous one, with the difference that some of “New Generation” members confronted the presidential power by creating a new opposition party. This period’s data suggested that the change in the meaning of their managerial work was not necessarily a result of the new social status or new functions of individual members of “New Generation”. Curiously, when only a few of them got involved in a new activity and therefore changed the content of their discourse on their practices, other members, who did not have the same experience, delivered a similar discourse. The following example clearly explains this mechanism. When, in 2003, two members of the “New Generation” organized a political party and three more expressed publicly their support for this initiative, the remaining five members were skeptical about the usefulness of this action. Nonetheless, in the interviews at the end of 2004, they identified themselves as a *“new political force in Kazakhstan”*, and their self-perception changed in the same way as that of their co-members involved in politics. The interviews of this period contained a large number of sentences referring to political topics (bearing in mind that questions asked remained the same and focused on managerial practices and respondents’ strategic actions): *“lack of transparency”, “dictatorship”, “tribalism and nepotism”, “incompetence of government and administration”, “corruption”,* etc. Surprisingly, in 2004, after their political party was defeated, such expressions completely disappeared from the last series of interviews. New vocabulary invaded the narratives of all the group members: *“effectiveness and efficiency”, “managerial excellence”, “strategic and international development of the company”, “competitive advantage”;* or otherwise *“humanism”, “charity actions”, “ethical business”, “Kazakh culture promotion”* and so on.

### *Period 5: 2006-2008*

The last period of observation showed the group members concentrated on the development of their private businesses and participation in different business and professional associations, like the Congress of Entrepreneurs of Kazakhstan, the Forum of Employers of Kazakhstan, etc.

*“We should not fight on their ground [politics], since we are going against their interests [power incumbents in Kazakhstan] and we will always lose. We should develop business practices, professional management, the competitiveness of Kazakh companies and their integration in the world economy. And through these practices we can win, I mean, we can steadily establish a normalized market economy from the bottom even though the top remains corrupt and unprofessional.” (“NG” member interview quotes, July 2004).*

By the end of the observation period, the respondents’ narratives were more and more influenced by the ideological framework, either coming from the dominant Kazakh ideology or from Western management theory and practices. During the last series of interviews, respondents described their activities in terms of “*gaining competitive advantage*”, “*creating shareholder value*”, etc., whereas at the beginning of the study in 1997, they spoke about “*surviving*”, “*finding their way in the chaotic landscape*”, “*adopting an appropriate management style*”, “*securing their businesses*”, and so on.

### **Discussion**

The empirical findings, briefly introduced in the previous section, will be now discussed more in detail. In the literature on countries in transition (Matonyte 1998; Nutti, 1996; Mink/ Szurek 1992) researchers often argue that during the transition period the new managerial discourse completely replaces the old one based on Soviet management and plan economy. This section will explain by which channels and in which forms, management practices appear and evolve in transition economies.

This study endeavored to understand how a group of managers/owners having emerged in the chaotic environment of a transition period could construct coherent managerial narratives reflecting “normalized” managerial practices. In the post-Soviet countries of the early nineties Western managerial knowledge was not yet available; local business schools, training centers and consulting companies had not yet emerged and ignorance of the English language prevented young businessmen from studying abroad. How did these new managers of private companies in general and “New Generation” members in particular develop their practices and make sense of their job and of the hectic environment of a transition period?

Based on the theories of sensemaking and social representation, this paper conceptualizes the mechanism of creating meaning in the form of small scale loops between context observation, verbal interactions and actions, occurring within a

framework provided by the social construct: culture, ideology, and social practices.

In post-Soviet countries, new managerial practices emerged through an active process of sense-seeking and sensemaking within social interactions. In different periods of this study the influence of national culture, dominant ideology and social practices varied. At the beginning, the process of meaning building was mostly driven by social practices, by the need to understand the transitional context and to take appropriate action. In the later stages of this process the weight of ideology grew increasingly. First of all, the Kazakh dominant ideology and official discourse supplied key directions, ideas and vocabulary; later on, Western managerial discourse invaded the ground and almost replaced sensemaking.

### **Mechanism of creating meaning in managerial work**

The empirical results show that the group studied in this research constructed *common* and *shared* meaning around their managerial activities, the context and themselves. These representations find their expression in the different forms of communication as well as in the strategic actions of the group members. The role of interaction within the group is not limited to “making sense” of past actions and events, but it also drives future actions, which, in turn, have an impact on members’ representations.

When this group emerged, in this most uncertain and turbulent period, their practical experience and group interaction had great impact on their practices. Indeed, they did not have any official references enabling them to understand the context. The old soviet ideology had already been rejected, whereas the new one had not yet been established. Western management theory, explaining the essence of managerial practices, was not yet accessible. The previous common knowledge contained in the collective memory of the Kazakh society could not give a relevant explanation of “What was happening at that period” and “What to do” in this new situation.

For each new ‘socially significant’ object, the group consensus produced a ‘referential representation’ integrated in the common cognitive system. The representation of an object can be acquired or espoused by a group, when it already exists, or needs to be constructed if the object is completely new. This ‘referential representation’ provides an internal source of coherence for the group members and, at the same time, constrains their social behavior. The ‘referential representation’ provides a kind of grid for making sense of ambiguous situations reflected by the individual’s mental images and consequently makes adequate action possible.

The study shows that meaning was built by the group in a contingent and singular context, which included the country’s authorities, cultural and ideological artifacts as well as the actions and meanings of the other social actors. Cultural el-

ements are recognized as being of high importance in strategic change processes (Johnson 1990; 1992). This study suggests that the *central elements* of meaning remained stable during the whole period of the study.

Anchorage in the dominant ideology endows the representations with legitimacy and social acceptability at a given moment. The official ideological discourse triggers the development of peripheral elements of representation which act as a link between deep seated central elements and the ongoing discourse. These elements provide flexibility to individual representations and adapt them to the prevailing beliefs.

The role of social practices is to keep individuals' representations in line with the reality of the context and therefore to ensure the relevance of their actions. At the same time, practitioners produce new social objects, meanings and common knowledge (Samra-Fredericks 2003). They shape the world at the same time as it shapes them, speaking in Giddens's (1984) and Bourdieu's (1994) terms.

The content analysis of top managers' narratives revealed a significant instability in the meaning of the managerial job that was deeply embedded in the social context. The more hectic and uncertain the environment was, the more unstable managers' representations about their work. This observation probably makes sense only in a transitional background, where rapid changes in the environment require quick cognitive adaptation and therefore constantly evolving representations.

### **Self-representation and group identity in the meaning creation process**

This study suggests that company CEO's identity cannot be categorized as a construct with rigid boundaries, especially during periods of rapid change and social instability. The observation of “New Generation” members revealed the importance of their self-image and belongingness to the group in constructing the meaning of their managerial practices. In describing their experiences and future plans, respondents repeatedly talked about how their self-conceptions were related to their steadily changing practices and roles. Clearly, such self-conceptions played a major role in the process of sensemaking of their environment and their own actions. “Managers tend to view the world through categories relevant to their present situation. (Isabella 1988: 356)”

The need for internal coherence encourages individuals to adopt the strategies compatible with overall group beliefs. This finding, coupled with the other conclusions, suggests that the meaning of the managerial practices is closely related to the self-representation of the group members. In the particular case of the “New Generation”, business strategies are tightly linked with personal strategies and vice versa; self-representation is closely related to representations of man-

agerial practices, functions and roles: they follow each other, influence each other and reshape each other in the small scale loops process.

The findings of the empirical study show that the self-representation of the “New Generation” members evolves in the same direction and with the same pattern as their representation of their managerial practices, roles and functions. It is important to mention that separate analysis of self-identity, expressed in the interviews of the group members and analysis of their image in the society and identified through articles and documentary screening, show only some insignificant differences between them. This conformity between self-identity and social image can be explained by the fact that the entire group communicated effectively about themselves and their company in the media, in order to gain a positive image and strengthening their social position.

To conclude this section, sensemaking processes organize group relationships around common meanings, reducing the complexity and uncertainty of the business context, and providing assertions, beliefs and practical knowledge for use in the managers’ respective activities. Uncertainty reduction is a core human motivation. Certainty renders existence meaningful and confers confidence in how to behave and what to expect from the physical and social environment (Hogg/Terry 2000; 1992). At the same time, individuals’ representations and practices are dependent on their position in the society, which seems to organize their various social roles and to provide, if not impose, the framework for sense-making (Fiske/Taylor 1991).

## **Conclusion**

The purpose in this paper was to explore the process of interaction between managerial, practices, representations, identity, and discourse. In particular, the author wished to explore this relationship in the context of a transition economy where all these elements were unstable due to fast changing conditions of the transformation process.

The final narratives of “New Generation” members give accounts of “normalized” managerial practices. In the conversations they all use the generally accepted vocabulary of Western management discourse. But does it mean that they really constructed Western type managerial practices or they have just learnt to use the discourse? Strategic actions analysis revealed that managerial practices of “New Generation” managers are still very different from those of leaders in western countries. But the last interviews and written documents showed their ability to use management concepts, often in appropriate way. Transversal analysis showed also that “New Generation” strategic actions were more efficient at the beginning of their career. Individually and collectively they made more bad decisions during the later periods of the study than at its beginning. This paper argues that wrong actions were made on the basis of erroneous meaning attribut-

ed by the group to the situation. This meaning arose from initial sensemaking process which meant that an official discourse becomes institutionalized. The group almost stopped reflecting on the discourse and ideological anchorage became dominant.

The theoretical contribution stemming from this conclusion is that managers involved in an active process of sensemaking, in which anchorage in the cultural, ideological and practical constructs is well balanced, are more likely to build the most fitting meanings and consequently to take appropriate actions, i.e. actions resulting in desired outcomes in a specific contextual setting. Those who only rely on management discourse, who do not ask themselves the right questions, are more likely to come up with inappropriate answers, leading to managerial practices that do not meet their expectations in terms of results.

Thus a key implication to be drawn from these results is that studies on managers should not be restricted to examining their occupational roles and functions only at the firms where they work. Another contribution of this research consists in the study of company top managers as socially competent players (Rouleau 2005), whose sensemaking activities are not bounded by the frontiers of the organization and their managerial roles and functions. Strategists are above all active social players with their own personal ambitions. They have their own subjective views about the ethics, the feasibility and scope of their actions. Indeed, the strategies and representations, formed in the interaction between a manager and his/her environment, only exist because of the consistency of the internal processes orienting and constraining his/her social conduct and actions.

Secondly, the managerial practices, the discourse and the representations of a social group are in a relation of *co-production*. The tight interactions between the members of the group, their identification to “New Generation”, mutual trust as well as the convergence of their interests participate in the construction of *group cohesion*, *well orchestrated strategic actions*, *shared representations and common practices*. Meaning is built by the group in a contingent and singular context, and includes the country’s authorities, cultural and ideological factors as well as the actions and meanings of the other social actors.

Thus, this study contributes to understanding the role of the group in interpreting ambiguous information and ascribing it a relevant meaning, especially within a transitional context. It offers an innovative approach for the study of the development of managerial practices as a process of talk-based interaction relating managerial representations, rooted in social context and managerial discourse as a function of situation based expressed identity.

The majority of the research on managerial cognition is carried out on a snapshot basis. This kind of research does not take into account the long-range pro-

cess of the evolution of managers' representations and cannot observe its implications for their strategic actions. One of the contributions of this study consists in the introduction of the temporal aspect and the follow-up of the evolution of the group of managers over a long period of time. Exploring the stability or instability of managers' representations in Western society may be a fruitful avenue for future research.

Although this study provides significant empirical and theoretical insights, there are several limitations worth addressing here. Despite an attempt to show the subtleness of the change process in managerial practices in a particular context, not all the elements have received sufficient attention to create a comprehensive description of this process. This process is rather more complex, fragile and dynamic than this paper reveals. In everyday managerial practices, company managers deal with complexities and ambiguities which demand a great deal of improvisation, of micro-decisions and choices. Despite an attempt to show the subtleness of the process of emergency and change in managerial practices in a particular context, not all the elements of this process have received sufficient attention in the process of creating a comprehensive and dynamic narrative.

The results of this study have several implications for organizational theory and practices. Our understanding of the process of managerial practice development is incomplete until we better understand how tacit knowledge or practical wisdom gained from social interactions between individuals and groups translates into managerial discourse. The intersection between sensemaking and social representation theories has great but yet largely unexplored potential for our understanding of manager thinking and acting. This paper has tried to energize this potential by describing various speculations, based on empirical research, and some propositions that can act as a framework for future research.

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## The moderating effects of national culture on the development of organisational learning culture: A multilevel study across seven countries\*

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*This study examines the moderating effects of national culture dimensions (Hofstede 1980) on three key elements in the development of organisational learning culture: information acquisition, information interpretation and behavioral and cognitive changes. Data were collected from 1333 companies in three CEE countries (Slovenia, Croatia, Macedonia) and other regions. The results showed that four national cultural dimensions (power distance, individualism, masculinity, and uncertainty avoidance) had no significant moderating effects on the relationship between information acquisition and information interpretation. However, the relationship between information interpretation and behavioral and cognitive changes was positively moderated by power distance, and negatively moderated by individualism, masculinity and uncertainty avoidance.*

*Keywords: organisational learning; national culture; information acquisition; information interpretation; behavioral and cognitive changes.*

### Introduction

Organisational learning was found to be a critical source of sustainable competitive advantage (de Geus 1988), a driving force for corporate performance (Sorenson 2003; Stata 1989; Tucker/Nembhard/Edmondson 2007), a catalyst for innovation (Bates/Khasawneh 2005), and an influential factor on organisational outcomes such as job satisfaction and turnover intention (Egan/Yang/Barlett 2004). Meanwhile, increasing globalization in the past few decades has driven more organisations to operate across national boundaries and establish a culturally diversified workforce (Kirkman/Shapiro 1997). While the literature on organisational learning is vast and growing (Arthur/Huntley 2005; Easterby-Smith/Lyles 2004; Schwab/Miner 2008; Zellmer-Bruhn/Gibson 2006), little is known about how organisational members' learning process is influenced by their national cultural backgrounds. While research on a related concept of cross-border knowledge transfer in MNC is vast (e.g. Chen/Sun/McQueen 2010; Gupta/Govindarajan 2000; Hocking/Brown/Harzing 2007), this is less so for or-

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organisational learning across various national cultures (Michailova/Hutchings 2006; Tsang 1999, 2002; Walczak 2008).

In this paper we focus on organisational learning culture. Škerlavaj (2007) defined organisational learning culture as a set of norms and values about the functioning of an organisation that put high emphasis and value on elements of organisational learning process (information acquisition, information interpretation, and behavioral and cognitive changes). It is a combination of different culture types within the competing values framework (Denison/Spreitzer 1991). While there has been few studies studying organisational learning culture related to organisational performance and to innovations in different countries, the actual mechanisms of how specific dimensions of a national culture could affect organisational learning culture have yet to be discovered (Dimovski/Škerlavaj/Kimman/Hernaus 2008; Hong/Easterby-Smith/Snell 2006).

Broadly speaking, organisational learning is a multilevel process (Holmquist 2004; Ibarra/Kilduff/Tsai 2005; Sanchez 2001). Scholars have advocated for the importance of using a multilevel approach to examine organisational culture and climate (Yammarino/Dansereau 2010), as well as organisational learning across the individual, group and organisational level (Crossan/Lane/White 1999). Individual members not only work within a specific group and organisational context, but also within a specific national culture at large ((Hofstede 1983)). Therefore it is crucial to use a multilevel approach to uncover the potential cross-level interaction between national cultural characteristics and organisational learning culture as well.

The goal of this study is to develop a multilevel model to explain how national culture could influence the development of organisational learning culture. The focus of this study is to examine how the interrelationships among these three learning elements could be moderated by different dimensions of a national culture (Hofstede 1980, 2001; Hofstede/Hofstede 2005). This approach is theoretically important because it provides an extended and comprehensive perspective in conceptualizing organisational learning above and beyond the traditional organisational boundary.

More importantly, this study seeks to empirically test the multilevel models by analyzing data collected from organizations in Central and East European countries (Slovenia, Croatia, and Macedonia) and other regions (Turkey, Spain, Malaysia, and South Korea). Existing research has highlighted the importance of examining national contextual factors (such as national institutional development) on organizational development in CEE countries (Soulsby/Clark 2011). Other research has studied the relationship between organizational culture and knowledge management in a particular industry of a particular CEE country (Omerzel/Biloslavo/Trnavcevic 2011). However, to date, there exists scant research that focuses on the co-evolution of national culture and organisational

learning culture across different industries and CEE countries. Thus, in the context of increasing globalization and transformation of national and organizational cultures in CEE countries (Clark/Soulsby 2009), there is a pressing need to study management issues not only within, but also across the organizational, industrial, and national levels. Therefore, this study contributes to CEE management scholarship by unraveling the effects of national cultural characteristics on organisational learning across a diverse array of industries in both CEE and non-CEE countries.

This paper is organized as follows. First, we begin by presenting the concept of organisational learning culture and dimensions of national culture. Next, we develop two sets of hypotheses about the moderating effects of national culture on the development of organisational learning culture. Specifically, the first set of hypotheses concerns the relationship between information acquisition and information interpretation, as well as the moderating roles of national cultural dimensions on this relationship. The second set of hypotheses investigates the influence of information interpretation on behavioral and cognitive changes, and how national cultural dimensions could moderate such relationship. Then we use hierarchical linear modeling (HLM) analysis to test the multilevel models with survey data from seven countries across Europe and Asia. Finally, we discuss the findings and their implications, as well as the limitations and future directions of this study.

## Theories and hypotheses

### *Organisational learning culture*

There is a wealth of literature dedicated to defining and conceptualizing organisational learning. It is a “process of improving actions through better knowledge and understanding” (Fiol/Lyles 1985: 803), and “a continuous testing of experience and its transformation into knowledge available to whole organisation and relevant to their mission” (Senge 1990, p. 6). Tsang (1997) contrasts organisational learning with learning organisation in terms of its descriptive and theoretical nature vis-à-vis normative and practical nature of learning organisation. Huber (1991) conceives organisational learning as an integrated process of information acquisition, information distribution, information interpretation and organisational memory. Argyris and Schön (1996) state that organisational learning emerges when organisations acquire information (understandings, know-how, techniques and procedures) of any kind by any means. What these perspectives share in common is that organisational learning is a sequential and dynamic process in which organisational members acquire new information, develop new knowledge, and modify their behaviors accordingly (Huber 1991; Levitt/March 1988; Murray/Donagan 2003; Slater/Narver 1995).

A crucial aspect of organisational learning is the development of organisational learning culture, which is defined as a set of organisational norms and values that support systematic and in-depth approaches to achieve higher-level organisational learning (Škerlavaj et al. 2007). Centering around the functioning of an organisation (Schein 1992), these organisational norms and values aim to support various forms of higher-level organisational learning, such as double-loop (Argyris/Schön 1996), strategic (Bhattacharya 1985), or generative learning (Witrock 1974, 1992). The conceptualization of organisational learning culture is proposed based on the integration of key organisational learning processes (Huber 1991) and competing values frameworks of organisational culture and development (Denison/Spreitzer 1991).

The development of organisational learning culture is achieved through consecutive phases of (1) information acquisition, (2) information interpretation, and (3) behavioral and cognitive changes (Garvin 1993; Huber 1991). Organisations ascribing high importance to organisational learning culture must first acquire information, and then interpret it to fully understand its meaning and implications. Based on the interpretation and sense-making of acquired information, organisational members would make behavioral and cognitive changes accordingly (Garvin 1993; Huber 1991). These three sequential phases are required to complete the transition from “knowledge in words” to “knowledge in action” in organisational learning (Škerlavaj et al. 2007). Therefore, organisations that have developed a strong learning culture are effective in acquiring and transferring knowledge. Employees working in a strong learning culture are also likely to modify behaviors and perceptions as a result of learning and interpreting newly acquired information. When a learning culture is developed in an organisation, an integrated sequential process of information acquisition, interpretation and behavioral changes is written in the organisation’s “DNA” and becomes an integral part of the organisational culture. Within such learning culture, aspirations to learn new information, interpretation of existing information, and action based on acquired information are well rooted among organisational members. This is the reason why this study focuses on how national culture could influence the development of organisational learning culture, rather than organisational learning processes in general.

Previous research has suggested and supported the connections among the above three key elements in the development of organisational learning culture. Several single-country studies (Hernaus/Škerlavaj/Dimovski 2008; Mok Kim Man/Dimovski/Škerlavaj 2007; Škerlavaj et al. 2007; Zagoršek/Dimovski/Škerlavaj 2009) and a two-country (Škerlavaj/Dimovski 2009) research have provided empirical support to a strong positive effect of information acquisition on information interpretation, and an even stronger positive effect of information interpretation on behavioral and cognitive changes. However, none of these studies found a direct relationship between information acquisition and behavioral and cogni-

tive changes. Such finding suggests that information interpretation is a vital phase that mediates information acquisition and cognitive and behavioral changes. After the employees in the organisations acquire information in the initial phase, they must interpret and make sense of such information before they make any behavioral or cognitive changes. As an extension to aforementioned studies, this study proposes to test these two fundamental relationships again with larger and more diversified samples (organisations from seven countries), so as to further assess the external generalizability of these three core elements in the development of organisational learning culture. Further, these two hypotheses, which are proposed at the organisational level, will be incorporated as the ground-level processes into the development of multilevel model in the following sections.

*Hypothesis 1a: Organisations' emphasis on the importance of information acquisition is positively related to their emphasis on the importance of information interpretation.*

*Hypothesis 1b: Organisations' emphasis on the importance of information interpretation is positively related to their behavioral and cognitive changes.*

#### *Dimensions of national culture*

Organisations are nested within nations, and tend to develop and evolve in ways that are compatible with the surrounding national culture (Sagiv/Schwartz/Arieli 2010). To function effectively, organisations must gain and maintain some public legitimacy (Kostova/Roth 2002), and adapt to the cultural characteristics in the home or host nation. The same principle is true for the development of organisational learning culture, which is driven and constrained by not only the demographics of employees (Wang/Yang/McLean 2007), but also its organisational, social, and national contexts (Škerlavaj et al. 2007). Thus it is imperative to contextualize organisational learning by investigating how specific national cultural characteristics could influence organisational learning processes (Meyer 2007). To address this research question, this study focuses on four key dimensions of Hofstede's national culture models (1980; 1984, 1991; 2001): individualism-collectivism, power distance, uncertainty avoidance, and masculinity-femininity. Notwithstanding being subject to various criticism (Holden 2002; Wilkesmann et al. 2009; Williamson 2002), Hofstede's models have been widely accepted and credited as a leading theoretical framework to study national cultures and cross-cultural differences (Chandy/Williams 1994; Kogut/Singh 1988; Michailova/Hutchings 2006). In addition, the validity of Hofstede's national cultural dimensions has been tested in various settings over time (Mouritzen/Svara 2002; Shane/Venkatraman 1996).

Despite the popularity in using Hofstede's models to understand the similarity and variance in national cultures, few studies have applied his models to examine the effects of national cultural dimensions on organisational learning. To bridge this research gap, this study seeks to explore the moderating effects of each of the four key national cultural dimensions on the development of organisational learning culture, specifically on the sequential relationships among information acquisition, information interpretation, and behavioral and cognitive changes. Our model does not include the fifth national cultural dimension of Hofstede's models, long-term orientation, because it was not included in the original 4 primary cultural dimensions by Hofstede. Moreover, the data in this dimension was not available for the countries we investigated in this study.

#### *Power distance*

Power distance is defined as the extent to which a society accepts the fact that power in its institutions and organisations is distributed unequally (Hofstede 2001). The characteristics of a national culture with high power distance include low accessibility of supervisors to their subordinates, less trust, and more stringent hierarchical structure within organisations. Organisational members influenced by high power distance national culture are more likely to accept hierarchical differences and abide by the authoritarian leadership, because they believe that the supervisors are more knowledgeable and should have decision-making power (Sagie/Mainiero/Koslowsky 2000). In contrast, the low power distance national culture is characterized by a decentralized distribution of decision-making power, support for individual thinking, and smooth supervisor-subordinate communication and cooperation (Hofstede 1991). Therefore, national cultures with different levels of power distance could exert distinct influence on how organisational members acquire and interpret information, as well as how they modify their behaviors after learning.

Previous research has applied the power distance cultural dimension to studying how students seek feedback in the class learning environment (Hwang/Francesco 2010). The authors argue that students with high power distance would feel more comfortable learning from their fellow students rather than from the superiors – professors. Other studies have extended the research on power distance from individual to the organisational learning settings. Couto and Vieira (2004) found that high power distance was negatively related to research and development activities in organisations, and that the low power distance would facilitate intra-organisational cooperation and problem solving. These findings are consistent with Nakata and Sivakumar's work (1996), which showed that the low power distance culture would promote cooperation and exert positive influence on R&D research and innovation within organisations. In their qualitative comparative study of German and Hong Kong organisations,

Wilkesmann, et al. (2009) claim that a high power distance culture would negatively affect knowledge transfer because it helps preserve a strict and omnipresent hierarchical organisational structure which would hinder vertical knowledge sharing within organisations. Taken together, previous studies have provided empirical support to Hofstede's (1991) assertion that a high power distance national culture would impede innovation of organisations nested in such culture.

Applying the power distance cultural dimension to the development of organisational learning culture, we speculate that organisations in a high power distance culture would have greater difficulties in the development of an effective organisational learning culture. First, since individual employees in a high power distance culture tend to give up the decision-making power to their supervisors and refrain from active learning, they are less likely to make dedicated efforts on interpreting the information they have acquired. Organisational members are more hesitant to take ownership of the information they have, as well as to make sense of the information they have obtained. Second, employees in a high power distance culture are less likely to modify their behaviors or change their perceptions as a result of information interpretation, because they believe their behaviors and cognition should conform to superior expectations and managerial control. Therefore, given the voluntary nature of knowledge transfer and organisational learning (Osterloh/Frey 2000), organisational members in a high power distance culture are less motivated to engage in quality information interpretation and deliberate behavioral and cognitive modifications. Consequently, it is more challenging to develop an effective organisational learning culture in a high power distance cultural context. Hence, we propose the following hypotheses:

*Hypothesis 2 a: The impact of information acquisition on information interpretation within organisations is weaker in national cultures with high power distance than with low power distance.*

*Hypothesis 2 b: The impact of information interpretation on behavioral and cognitive changes within organisations is weaker in national cultures with high power distance than with low power distance.*

#### *Individualism-collectivism*

Central to Hofstede's national culture models is the development of the individualism-collectivism construct (Michailova/Hutchings 2006: 389). Hofstede's proposition of this national cultural dimension is based on previous work in organisational theory on self- and collectivity-orientation (Parsons/Shils 1951), as well as cooperation and competition in the human society (Mead 1967). The individualism-collectivism construct consists of two opposite cultural dimensions that focus on the relative importance of individual versus group interests

(Hwang/Francesco 2010). The contrast between individualism and collectivism has been extensively studied to explain a variety of organisational phenomena (Adler 2002), such as creativity and innovation (Eisenberg 1999), student learning (Hwang/Francesco 2010; Wagner 1995) and technology mediated learning (Arbaugh/Benbunan-Fich 2006; Hornik/Tupchiy 2006). This paper takes a further step to examine the moderating effects of individualism-collectivism on the development of organisational learning culture.

According to Hofstede, an individualistic culture is characterized by loose ties between individual members (Hofstede 1980), individuals being the smallest unit of the society, and the superiority of independence and personal achievement to collective interests (Hofstede 2001). In an individualist culture, people emphasize on task achievement and the realization of personal values, even at the expense of interpersonal relationships (Kim/Triandis/Kagitcibasi/ Choi/Yoon 1994). On the contrary, a collectivist national culture is composed of strong and cohesive groups of people (Hofstede 1980). In such cultural context, the smallest unit of the society is the family, and collective interests take precedence over individual benefits and values (Hofstede 2001). In addition, a collectivist culture accentuates interdependence and building a harmonious relationship between individuals, sometimes even at the expense of task achievement (Kim et al. 1994).

The individualism-collectivism cultural dimension has been found to influence various organisational processes and outcomes. A recent meta analysis of field studies (Bell 2007) shows that collectivism has emerged to be one of the strongest predictors of team performance. For example, organisational members tend to behave more cooperatively when their business unit emphasizes on collectivistic rather than individualistic cultural values (Chatman/Spataro 2005). Further, Iliés, Wagner, and Morgeson (2007) found that affective linkages between group members were higher where groups had collectivistic tendencies. Scholars have also explained the influence of collectivism on group and organisational behaviors through five facets of psychological development: preference for in-groups, reliance on in-groups, concern for in-groups, acceptance of in-group norms, and prioritization of in-group goals (Jackson/Colquitt/Wesson/Zapata-Phelan 2006). Therefore, groups and organisations within a collectivistic cultural context tend to demonstrate a greater level of interpersonal reliance and acceptance for collective actions.

More specifically, individualism-collectivism is viewed as the major distinctive influence on how various groups of people process and deal with information (Bhagat/Kedia/Harveston/Triandis 2002; Earley/Gibson 1998; Hofstede 1980; Hofstede 1991; Triandis 1995, 1998). Bhagat et al. (2002) claim that people in individualistic societies perceive information to be independent of its context, while collectivistic cultures stress the context in which information is conceived, interpreted and shared. When studying cultural influences on knowledge sharing

in China and Russia, Michailova and Hutchings (2006) propose that collectivism leads to solidarity and frequent information exchanges among organisational members, which in turn would lead to intensive knowledge sharing (especially within groups). Therefore, the supremacy and frequency of interpersonal interactions in a collectivist culture not only facilitate information sharing among organisational members, but also motivate them to interpret the information based on specific organisational contexts and social cues. In contrast, organisational members in an individualistic culture are less likely to engage in collective information exchange, clarify with other members to reach a shared understanding of information, or interpret acquired information based on its organisational, social and cultural contexts. Hence, we expect that organisations situated in nations with a stronger individualistic national culture will exhibit a weaker positive relationship from information acquisition to information interpretation in the development of organisational learning culture. We propose the following hypothesis:

*Hypothesis 3a: The impact of information acquisition on information interpretation within organisations is weaker in individualistic than in collectivist national cultures.*

The differences between individualistic and collectivist national cultures also influence the process of converting interpreted information into actionable knowledge (i.e. to implement behavioral and cognitive changes based on the interpretation of acquired information). Organisational members in a collectivist culture are more sensitive to the context in which information is processed (Nisbett 2003), and tend to pay more attention to the tacit dimension of organisational knowledge (Bhagat et al. 2002). Previous research has suggested that intensive interpersonal relationships facilitate the transfer of tacit knowledge in organisations (Nonaka/Takeuchi 1995). Thus we speculate that a collectivistic culture would support and enhance individuals' tendency to make behavioral and cognitive changes based on their interpretations of information acquired from the organisational context. Further, Brickson (2007) found that the individualistic-collectivist orientation engendered distinct patterns of relations amongst internal stakeholders and provided unique potential to advance certain forms of social value. As such, the relationships formed among employees in a more collectivistic organisation are more likely to be based on preference and concerns for in-group actions, thereby increasing the likelihood of employees' behavioral and cognitive changes based on social influences and collective values. In contrast, organisational members in an individualistic culture tend to pay less attention to the shared context of information interpretation, and are less motivated and capable of converting knowledge (especially tacit knowledge) into behavioral and cognitive changes. Even if they do modify their cognitive and behavioral tendencies, such changes tend to be driven by their individual preferences and personal values, rather than by the meaning they derive from the information inter-

pretation process. Therefore, when organisations place strong emphasis on information interpretation, such value is more likely to be observed, shared, and practiced by members in collectivist rather than individualist cultures. Thus we expect that organisations nested within a stronger individualistic national culture will demonstrate a weaker positive relationship from information interpretation to behavioral and cognitive changes.

*Hypothesis 3 b: The impact of information interpretation on behavioral and cognitive changes within organisations is weaker in individualistic than in collectivist national cultures.*

### *Masculinity*

The third national cultural dimension to be examined in this study is masculinity, which refers to the extent to which the dominant values in a society are “masculine” rather than “feminine.” Hofstede (1980: 47) elucidated that the defining characteristics of a masculine culture include competitiveness and assertiveness, whereas a feminine national culture values people and relationships. Individuals in a masculine culture are more ambitious and voracious for wealth and material possessions. In the organisational settings, employees with a masculine cultural background are more performance-oriented, and pay less attention to building interpersonal relationships in the work place.

Although existing research on the effects of masculine culture on organisational learning is scarce, a few studies have shed light on how the masculinity dimension of a national culture could influence organisational knowledge transfer and collaboration. Ford and Chan (2003: 15) suggest that the masculinity level of a national culture is negatively related to knowledge sharing between organisational members. Further, Couto and Vieira (2004) found that cultures of low masculinity provided more support to collaboration, which led to a greater level of research and development activities within organisations. These studies suggest that as a high masculine culture places a greater emphasis on individual achievement and competition over interpersonal collaboration and relationship building, it would hinder individual’s learning process that entails peer-to-peer information seeking and knowledge sharing. Therefore, organisational members in a masculine culture are less likely to engage in collaborative information seeking and quality information interpretation. Consequently, they are less likely to make behavioral and cognitive changes based on the information they have learned and interpreted. Hence, we propose the following hypotheses:

*Hypothesis 4 a: The impact of information acquisition on information interpretation within organisations is weaker in national cultures with high masculinity than with low masculinity.*

*Hypothesis 4 b: The impact of information interpretation on behavioral and cognitive changes within organisations is weaker in national cultures with high masculinity than with low masculinity.*

#### *Uncertainty avoidance*

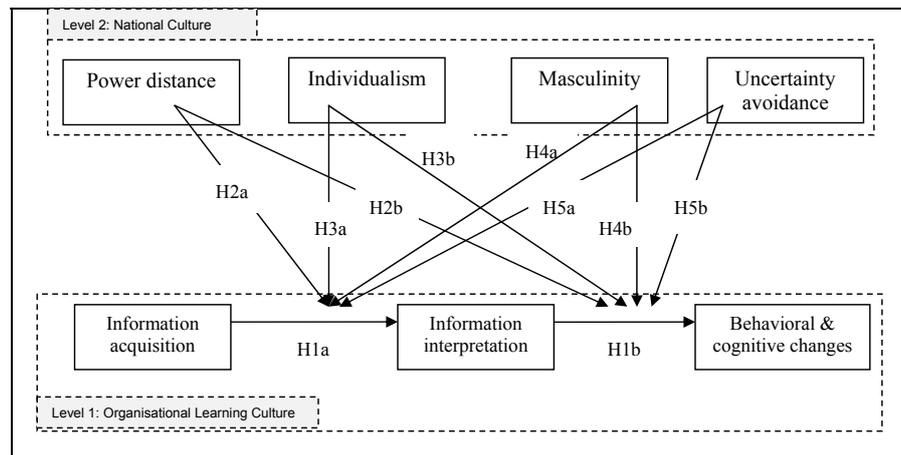
Uncertainty avoidance is defined as the extent to which a society feels threatened by ambiguous situations and tries to avoid uncertainty by providing greater career stability, establishing more formal rules, circumventing deviant ideas and behaviors, and upholding absolute truths and the attainment of expertise (Hofstede 1980: 45). With regard to the effects of uncertainty avoidance on the development of organisational learning culture, one can expect two conflicting agendas. On the one hand, a high uncertainty avoidance culture provides well-defined responsibilities for information processing and makes effective decisions on what information to be acquired, who is responsible for information interpretation, and how to make cognitive and behavioral changes based on information learned. On the other hand, a high uncertainty avoidance culture diminishes the flexibility, creativity and innovation in information learning. In effect, the learning process in a low uncertainty avoidance national culture is developed in a more efficient and flexible fashion (Wilkesmann et al. 2009).

In light of today's global competition that values innovations and changes, we speculate that a high uncertainty avoidance culture would bring adverse influence on the development of organisational learning culture. When organisations and their employees are hesitant to embrace uncertainty and ambiguity, they are less motivated to acquire new information and seek unconventional ways to interpret such information. They are inclined to follow pre-existing rules and protocols to process information. Further, they are less likely to make behavioral and cognitive changes to avoid risks and maintain stability. In contrast, organisational members from a low uncertainty avoidance culture are more flexible and active in seeking new information, engage in experimental learning, and even learning from failure (Madsen/Desai 2010). They have greater propensity to change their perceptions and behaviors to adapt to the constantly changing environment. Therefore, given the increasing level of uncertainty and ambiguity in the information environment surrounding today's organisations (Brown/Duguid 2000), a high uncertainty avoidance culture would diminish the development of organisational learning culture. Thus we propose the following hypotheses (a summary of all hypotheses is provided in Figure 1):

*Hypothesis 5 a: The impact of information acquisition on information interpretation within organisations is weaker in national cultures with high uncertainty avoidance than with low uncertainty avoidance.*

*Hypothesis 5b: The impact of information interpretation on behavioral and cognitive changes within organisations is weaker in national cultures with high uncertainty avoidance than with low uncertainty avoidance.*

**Figure 1: A multilevel model of organisational learning**



## Methods

### Sample and procedures

Empirical data were collected through surveys from 1333 companies with a size of 50 employees and larger. These companies were located in 7 countries across Europe and Asia: Slovenia, Croatia, Malaysia, Macedonia, South Korea, Spain, and Turkey, which all exhibit great variability in each of the four national cultural dimensions. We selected participating organisations from a diversified industrial background in order to enhance the external generalizability of this study. Surveys were distributed to managers at different levels and who were knowledgeable of the organisational culture and practices within their companies. In each company, only one participant answered our survey questions about the development of organisational learning culture in his/her company.

Adapted from the OLIMP (Organisational Learning and Information Management Processes) questionnaire developed in previous research on organisational learning culture (Dimovski/Škerlavaj 2008; Škerlavaj et al. 2007), the original version of our survey was created in English. Then the survey was translated into seven official languages (Slovenian, Croatian, Korean, Spanish, Macedonian, Turkish, and English for Malaysia) prior to be distributed. We administered the data collection by collaborating with local research teams in each of the seven counties. All team members were familiar with the goals of this study, and were

proficient in both English and their local official language. The overall response rate was 31.4% across all countries. Table 1 summarizes the major demographic characteristics of participating companies.

**Table 1: Demographics of survey respondents and their companies**

Country	Slove- nia	Croat- ia	Malay sia	Mace- donia	South Korea	Spain	Turkey
Number of respondents	203	202	300	200	207	107	112
<i>Distribution of respondents</i>							
Organisational position							
Top management	31.5%	22.4%	68.3%	35.6%	63.3%	9.3%	40.2%
Middle management	31.5%	55.7%	28.9%	27.2%	21.3%	7.5%	33.9%
Lower management	12.8%	13.0%	2.7%	17.9%	13.0%	24.3%	5.4%
Not specified	24.2%	8.9%	-	19.3%	2.4%	58.9%	20.5%
<i>Distribution of companies</i>							
Size (Number of employees)							
50-249	38.7%	38.8%	37.0%	73.8%	62.8%	74.6%	92.0%
250-499	33.7%	32.8%	9.0%	13.6%	4.5%	5.3%	2.7%
500+	24.1%	22.4%	54.0%	12.5%	32.7%	20.0%	5.3%
Not specified	3.5%	6.0%	-	-	-	-	-
Annual revenue in 2004 (mil. €)							
Under 7	37.4%	51.0%	35.3%	39.5%	53.8%	17.6%	2.7%
7-27	42.8%	34.3%	54.3%	40.0%	10.1%	50.0%	23.2%
Higher than 27	19.8%	14.6%	10.3%	20.5%	36.2%	32.4%	74.1%
Industry							
Agriculture	2.5%	2.5%	2.0%	2.5%	0.1%	1.8%	0.9%
Fishing	0%	0%	2.7%	-	-	0.4%	0.9%
Mining	1.0%	1.5%	5.0%	-	-	0.4%	0.9%
Manufacturing	46.8%	31.7%	15.0%	30.0%	36.7%	10.8%	40.2%
Electricity & water supply	1.5%	5.0%	2.7%	2.0%	-	0.7%	1.8%
Construction	10.3%	15.8%	4.7%	6.0%	5.3%	3.9%	8.9%
Wholesale & retail trade	10.3%	13.4%	11.7%	21.0%	12.6%	2.9%	9.8%
Hotels & restaurants	3.4%	6.4%	5.0%	2.0%	0.1%	0.4%	11.6%
Transportation	6.4%	5.4%	16.3%	4.0%	7.2%	1.8%	7.1%
Financial intermediation	3.4%	3.0%	7.3%	10.0%	17.4%	0.4%	6.3%
Real estate	1.0%	0%	3.7%	4.0%	10.1%	-	0.9%
Other community, social & personal services	9.9%	12.4%	24.0%	8.0%	6.3%	2.5%	2.7%
Not specified	3.4%	2.5%	-	10.5%	4.3%	0.8%	8.1%

### *Measures*

The data of this study comes from two sources. The data for testing the development of organisational learning culture were collected in the surveys mentioned above. The measures of the three key variables of organisational learning (information acquisition, information interpretation, and behavioral and cognitive changes) were adapted from previous research on organisational learning culture (Dimovski/Škerlavaj 2008; Škerlavaj et al. 2007). The second set of data concerns 4 national cultural dimensions, which was retrieved from Hofstede's models of national cultures and cross-cultural differences (Hofstede 2001; Hofstede/Hofstede 2005).

While there are heated debates about the common method variance (Spector 2006; Vandenberg 2006), majority of researchers agree that common method variance (i.e., variance that is attributable to the measurement method rather than to the constructs the measures represent) is a potential problem in behavioral research (e.g. Chang/van Witteloostuijn/Eden 2010; Colquitt/Ireland 2009; Podsakoff/MacKenzie/Lee/Podsakoff 2003). While it varies for different disciplines, approximately one quarter of the variance (Cote/Buckley 1987) can be contributed to the influence of prior pattern of responses on the responses to certain survey item (Colquitt/Ireland 2009). While this is a major concern for most authors, reviewers and editor of journals publishing empirical contributions in management, psychology, sociology, business and education, there are also some remedies to it. Various authors (Burton-Jones 2009; Chang et al. 2010; Podsakoff et al. 2003) suggest both statistical and procedural methods of control in order to minimize effect of the common method variance to the overall quality of data gathered.

In order to avoid problems with common method bias we used several approaches. First, we have used data from two different sets of sources: 1) OLIMP questionnaire (Škerlavaj et al. 2007) and 2) Hofstede's research on national culture (Hofstede 2001). Therefore, none of the hypotheses related to moderating effects of national cultures should be affected by this source of variance. Second, following suggestions and applications in the literature (e.g. Murray/Kotabe/Zhou 2005) we used some reverse coded items for the organisational learning constructs (information acquisition, information interpretation, and behavioral and cognitive changes). Third, we employed Harman's one factor test on three organisational learning constructs to post-hoc address the common method variance issue. If that was a severe difficulty in our study, one would expect a single factor to emerge for exploratory factor analysis or one factor to account for most of the covariance in the independent and criterion variables (Murray et al. 2005; Podsakoff/Organ 1986). Our exploratory factor analysis on organisational learning culture items results showed no general factor was evident in the unrotated factor structure, with Factor 1 accounting only for 21.0% of the variance. Thus,

both preemptive procedural (data collection design) as well as post-hoc statistical measures suggest that common method variance is not a problem.

#### *Information acquisition*

A set of 15 items was used to measure information acquisition based on a 5-point Likert-type scale ranging from 1 = "strongly disagree" to 5 = "strongly agree." These items assessed the degree to which the organisation supports and values the provision of quality information, active seeking of advice and new business methods, and acquisition of knowledge related to the operation of the company. Examples of the items include "In our organisation we explicitly reward employees who are a source of quality information" and "Expertise regarding the industry, products, and services is an extremely important criterion for hiring a new employee." The full description of the survey instrument is available from the first author of this paper.

#### *Information interpretation*

The measurement of information interpretation consisted of 11 items. The first nine items asked participants to rate the importance of information interpretation through a selection of communication means (e.g. personal contacts, team meetings, committees as decision-makers, telephone calls, special reports, e-mails, intranets, and electronic forums) within the company. The last two items asked participants to rate the importance of information sharing between the management and subordinates, and the simplicity and conciseness of such information. An example of the item is "For information interpretation and the recognition of business opportunities the following things are important: team meetings." The measurement of each item was based on a 5-point scale ranging from 1= "not important at all" to 5= "very important."

#### *Behavioral and cognitive changes*

This variable was measured by a set of 14 items in the survey. Each participant was asked to report the degree of changes that took place in 14 different areas of organisational practices in the company within the last three years. These areas included the quality of products/services, number of products/services offered, speed of operations, introduction of new marketing approaches, efficiency of information systems within the company, level of understanding of major problems in the company, and level of understanding of company's strategic orientation. Each item was measured on a 5-point scale ranging from 1= "substantial decline/decrease" to 5 = "substantial improvement/increase."

### National culture

We acquired the data of the four national cultural dimensions from three external sources. The national culture data for Croatia, Malaysia, South Korea, Spain, and Turkey were directly retrieved from Hofstede's research (Hofstede 2001; Hofstede/Hofstede 2005). Hofstede reported scores of each national cultural dimension for over 70 countries and regions based on his initial research on IBM employees from 40 countries and subsequent replications and extensions on other international populations all over the world. Since Hofstede's works focused on former Yugoslavia, we retrieved the national culture scores from more recent research for Slovenia (Jazbec 2007) and Macedonia (Avramaska 2007). Both studies utilized the same criteria Hofstede used in evaluating the national cultural dimensions. Based on empirical research, they provided more accurate and precise cultural scores for these two countries. Across all seven countries, the range of the scores in each of the four national cultural dimensions was: power distance (ranging from 27 to 104), individualism (ranging from 18 to 107), masculinity (ranging from 20 to 86), and uncertainty avoidance (ranging from 8 to 42).

## Results

### Descriptive statistics

Table 2 provides descriptive statistics of all variables analyzed in this study, including the means, standard deviations, and inter-correlations. The inter-item reliability coefficients are reported on the diagonal of the correlation matrix in Table 2.

**Table 2: Descriptive statistics and correlations for company- and country-level variables**

	<i>N</i>	<i>M</i>	<i>SD</i>	1	2	3	4	5	6
1. Information acquisition	1333	3.65	.48	.725					
2. Information interpretation	1333	3.72	.56	.492**	.794				
3. Behavioral & cognitive Changes	1333	3.66	.69	.301**	.627**	.931			
4. Power distance	7	59.14	26.56	.116**	-.093**	-.121**	-		
5. Individualism	7	49.14	31.06	-.142**	.018	.056*	-.783**	-	
6. Masculinity	7	61.86	28.63	.095**	.075**	.034	-.233**	-.317**	-
7. Uncertainty avoidance	7	54.43	15.63	.123**	-.017	.081**	-.200**	.447**	-.706**

*Notes.* Values on the diagonal are inter-item reliability levels (Cronbach's alpha). Significant coefficients are flagged, \*  $p < .05$ , \*\*  $p < .01$

### *Multilevel models and component evaluation*

The dataset consisted of two hierarchically nested levels: 1333 organisations (level-1) nested within 7 countries (level-2). In each of the 1333 organisations, one participant provided data on the information acquisition, information interpretation, and behavioral and cognitive changes in his/her company. These data constituted the lower-level unit of analysis in this study. The second-level data included the four national culture scores for each of the seven countries. Therefore, we used Hierarchical Linear Modeling (HLM 6.0, Raudenbush/Bryk 2002) to test the following aspects of our multilevel model of organisational learning: 1) the existence of a multilevel structure, 2) the moderating effects of each cultural dimension on the relationship between information acquisition and information interpretation, and 3) the moderating effects of each cultural dimension on the relationship between information interpretation and behavioral and cognitive changes.

### *Testing the existence of a multilevel structure*

As suggested by Raudenbush and Bryk (2002), this study first tested the existence of a multilevel structure in the model we proposed. In the intercept-only model with information interpretation as the dependent variable, the ICC (intra-class correlation) at the national level (level-2) was .085, which indicates a high degree of association on information interpretation behaviors between different organisations within the same nation. In other words, organisations from the same country in our study perceived a similar level of importance in information interpretation within the organisation. Following Hayes' (2006) recommendation to use multilevel modeling in situations where intraclass correlations exceed 0.05, the ICC results of the intercept-only model justified our use of a multilevel analysis as an appropriate strategy for analyzing the effects of information acquisition on information interpretation. In the intercept-only model with behavioral and cognitive changes as the dependent variable, the ICC at the national level (level-2) was .033, indicating a relatively low degree of association on behavioral and cognitive changes between organisations within each country. However, as Hox (2002) suggests, the low intraclass correlations at higher levels could be offset by the large cluster sizes at those levels. As our study examined a large number of organisations (190 companies on average) in each country, the multilevel analysis procedure is still an appropriate method for testing the influence of information interpretation on behavioral and cognitive changes.

### *Incremental model building: Information interpretation as the dependent variable*

To test our hypotheses, we developed two sets of multilevel models based on the theoretical predictions using the incremental improvement procedure outlined by

Hox (2002: 49-71). In the construction of these models, all variables were grand-mean centered. The estimated coefficients and standard errors for all models are presented in Table 3 and Table 4.

First, to test the influence of information acquisition on information interpretation (H1 a) and the moderating effects of each cultural dimension on such relationship (H2 a, H3 a, H4 a, and H5 a), we started with the intercept-only model with *information interpretation* as the dependent variable (see Model 1 in Table 3). Then we added *information acquisition* as a level-1 explanatory variable (Model 2), and found Model 2 significantly improved on the intercept-only model. Finally, we added each of the four national cultural dimensions to Model 2 separately (Model 3 a, 3 b, 3 c, and 3 d). The results showed that, compared to Model 2, the overall model fit for each of the four incremental models (with the national-level variables added) significantly deteriorated ( $\Delta$  Deviance = 353.80, -13.74, -13.56, -13.12, -11.92 respectively,  $p < .01$ , see Table 3). The results suggested that none of the interaction effects between each national cultural dimension and information acquisition contributed to explaining information interpretation above and beyond information acquisition.

**Table 3 Summary of HLM analysis results (Information interpretation as the dependent variable)**

Predictor	Model 1	Model 2	Model 3 a	Model 3 b	Model 3 c	Model 3 d
Intercept	3.699**	3.708**	3.708**	3.709**	3.709**	3.709**
Information acquisition		.579**	.579**	.581**	.574**	.579**
Information acquisition x power distance			.00006			
Information acquisition x individualism				.001		
Information acquisition x masculinity					-.001	
Information acquisition x uncertainty avoidance						.001
<i>Variance of random components</i>						
Company-level variance component	.300	.230	.230	.230	.230	.230
Country-level variance component	.028**	.015**	.015**	.015**	.016**	.016**
$\Delta$ Deviance <sup>a</sup>	-	353.796 (1)**	-13.737 (1)**	-13.565 (1)**	-13.119 (1)**	-11.920 (1)**

Notes. <sup>^</sup>  $p < .10$ , \*  $p < .05$ , \*\*  $p < .01$ . All explanatory variables were grand mean centered.

<sup>a</sup> The change in deviance ( $\Delta$  Deviance) is distributed as a  $\chi^2$  with degrees of freedom equal to the difference in the parameters between models (indicated in parenthesis).

To directly test the effects of information acquisition on information interpretation (H1 a) and how this relationship could be moderated by each of the four national cultural dimensions: power distance (H2 a), individualism (H3 a), masculinity (H4 a), and uncertainty avoidance (H5 a), we examined the coefficients of the corresponding parameters estimated in the models mentioned above. First, as shown in Table 3, at the organisational-level (level-1), information acquisition was found to be positively related to information interpretation (Model 2,  $\gamma = .58$ ,  $SE = .03$ ,  $p < .01$ ). Thus H1 a was supported. However, at the national level (level-2), none of the four national cultural dimensions (Model 3a-3 d) had a significant effect on the relationship between information acquisition and information interpretation, thus H2 a, H3 a, H4 a, and H5 a were not supported. Taken together, these results suggest that while ascribing greater importance to information acquisition would lead to a greater perception of the importance in information interpretation overall, such influence was not affected by a specific national cultural dimension in each of the seven countries.

*Incremental model building: Behavioral and cognitive changes as the dependent variable*

To test the second set of hypotheses (H1 b, H2 b, H3 b, H4 b, and H5 b), we began with an intercept-only model in which *behavioral and cognitive changes* was the dependent variable (see Model 4 in Table 4). Then we added *information interpretation* as a level-1 explanatory variable (Model 5), and found the new model significantly improved on the intercept-only model. Finally, we added each of the four national-level variables to Model 5 separately (Model 6 a, 6 b, 6 c, and 6 d). The results showed that each of these incremental models significantly improved over Model 5 ( $\Delta$  Deviance = 657.23, 177.63, 77.73, 35.19, 6.04 respectively,  $p < .01$ , see Table 4).

As the model-fit increased with adding the cross-level interaction effects, we examined the coefficients of the corresponding parameters to assess the direct effects of information interpretation on behavior and cognitive changes (H1 b), as well as how this relationship could be moderated by power distance (H2 b), individualism (H3 b), masculinity (H4 b), and uncertainty avoidance (H5 b). As shown in Table 4, at the organisational-level (level-1), information interpretation was found to be positively related to behavioral and cognitive changes (Model 5,  $\gamma = .78$ ,  $SE = .03$ ,  $p < .01$ ). Thus H1 b was supported.

Further, at the national level (level-2), each of the four national cultural dimensions had a significant effect on the relationship between information acquisition and information interpretation. However, contrary to H2 b, the power distance dimension had a positive effect on the relationship between information interpretation and behavioral and cognitive changes (Model 6 a,  $\gamma = .01$ ,  $SE = .001$ ,  $p < .01$ ). In addition, individualism was found to have a negative impact on the re-

relationship between information interpretation and behavioral and cognitive changes (Model 6 b,  $\gamma = -.01$ ,  $SE = .001$ ,  $p < .01$ ), which supported H3 b. Similarly, consistent with H4 b and H5 b, the masculinity and uncertainty avoidance dimensions had a significant negative effect on the relationship between information interpretation on behavioral and cognitive changes (Models 6 c and 6 d,  $\gamma = -.01$ ,  $SE = .001$ ,  $p < .01$ ). These results suggest that in the presence of the positive influence of information interpretation on behavioral and cognitive changes within organisations, such influence is weakened by the level of individualism, masculinity and uncertainty avoidance, and strengthened by the level of power distance in the national culture.

**Table 4: Summary of HLM analysis Results (behavioral and cognitive changes as the dependent variable)**

Predictor	Model 4	Model 5	Model 6 a	Model 6 b	Model 6 c	Model 6 d
Intercept	3.653**	3.665**	3.678**	3.666**	3.668**	3.665**
Information interpretation		.776**	.634**	.721**	.724**	.770**
Information interpretation x power distance			.012**			
Information interpretation x individualism				-.010**		
Information interpretation x masculinity					-.007**	
Information interpretation x uncertainty avoidance						-.009**
<i>Variance of random components</i>						
Company-level variance component	.465	.284	.246	.265	.274	.280
Country-level variance component	.016**	.008**	.008**	.007**	.007**	.008**
$\Delta$ Deviance <sup>a</sup>	-	657.231 (1)**	177.632 (1)**	77.729 (1)**	35.188 (1)**	6.036 (1)*

Notes. <sup>^</sup>  $p < .10$ , \*  $p < .05$ , \*\*  $p < .01$ . All explanatory variables were grand mean centered.

<sup>a</sup>The change in deviance ( $\Delta$  Deviance) is distributed as a  $\chi^2$  with degrees of freedom equal to the difference in the parameters between models (indicated in parenthesis).

## Discussion

The goal of this study was to theorize and empirically test a multilevel model of the moderating effects of national cultural dimensions on the development of organisational learning culture. Specifically, we developed two sets of multilevel hypotheses to examine the degree to which each of the four primary national

cultural dimensions would enhance or weaken the previously established positive relationships between information acquisition, information interpretation, and behavioral and cognitive changes (e.g. Škerlavaj et al. 2007). By using hierarchical linear modeling analysis of empirical data collected from 1333 organisations across seven countries, we found support for cross-level interaction effects between national cultural dimensions and the positive influence of information interpretation on behavioral and cognitive changes. In the models where behavioral and cognitive changes were the dependent variable models, the improvement of model-fit after the inclusion of national-level variables has demonstrated the viability and importance of using a multilevel approach to studying the development of organisational learning culture. The findings from this study provide further support to the conceptualization of organisational learning as a multilevel and context-based process (Holmquist 2004; Huber 1991; Ibarra et al. 2005; Quigley/Tesluk/Locke/Bartol 2007). Thus it is imperative to examine organisational learning processes not only within the organisational boundary, but within a specific national cultural context and even cross-cultural settings as well.

The foundation of this study is built upon the sequential relationships between three key elements in the development of organisational learning culture: perceived importance of information acquisition leads to greater perceived importance in information interpretation, and consequently a greater level of behavioral and cognitive changes. A number of research studies have provided theoretical and empirical support to the establishment of these fundamental linkages in organisational learning (see Hernaus et al. 2008; Mok Kim Man et al. 2007; Škerlavaj/Dimovski 2009; Škerlavaj et al. 2007; Zagoršek et al. 2009). By analyzing data from organisations located in 7 geographically and culturally distinct countries, this study replicated and generalized previous research findings to a broader international population. Overall, organisations that place greater emphasis on information acquisition tend to emphasize more on the importance of information interpretation, which leads to greater behavioral and cognitive changes.

The major contribution of this study is to investigate a higher-level contextual influence on organisational learning: how national cultural dimensions moderate the positive influence of information acquisition on information interpretation, and that of information interpretation on behavioral and cognitive changes. Contrary to what this study hypothesized, there was no significant moderating effect of any of the four national cultural dimensions on the relationship between information acquisition and information interpretation. Such findings suggest that national cultures play an insignificant role in moderating the initial development of organisational learning culture. In other words, organisations' emphasis on the importance of information interpretation is universally influenced by their perceptions of the importance in information acquisition. Such effects would not be

strengthened or weakened by the level of power distance, individualism, masculinity, or uncertainty avoidance in a specific national culture. However, the lack of moderating effects of these four cultural dimensions in this phase does not exclude the existence of other moderators at the national or organisational level. At the national culture level, the fifth cultural dimension developed by Hofstede, long term orientation, might exert a moderating effect on the positive influence of information acquisition on information interpretation. One can speculate that organisations in a long-term oriented culture are more likely to emphasize on the importance of information interpretation, whereas organisations in a short-term oriented culture tend to focus more on the acquisition of large quantity of information rather than an in-depth and enduring interpretation of such information. At the organisational level, the relationship between information acquisition and interpretation could be moderated by contextual factors such as organisational structures (Rulke/Galaskiewicz 2000), absorptive capacity of employees (Tsai 2001), and the intrinsic characteristics of organisational knowledge to be learned (Zander/Kogut 1995).

The key finding of this study is the interaction effects of national culture dimensions on the positive relationship between information interpretation and behavioral and cognitive changes. A crucial outcome of the development of organisational learning culture is the modification of behaviors (Madsen/Desai 2010) and cognitive beliefs (Crossan et al. 1999) based on the interpretation of information acquired. Our study found that each of the four national cultural dimensions played a significant role in moderating how information interpretation led to greater behavioral and cognitive changes. In particular, the positive influence of information interpretation on behavioral and cognitive changes was strengthened by power distance and weakened by individualism, masculinity, and uncertainty avoidance in a specific national culture. These findings suggest that while the perceived importance of information interpretation as a result of information acquisition is unaffected by the national cultural context in general, the process of converting interpreted information into action could be facilitated or hindered by a specific national cultural dimension.

It is worth noting that while the moderating effect of the power distance dimension was found to be significant, it worked in the opposite direction as to what we hypothesized (H2 b). It suggests that the greater acceptance of the inequality of power distribution within organisations, the greater influence information interpretation would have on employees' behavioral and cognitive changes. In other words, organisational members in a high power distance culture are more likely to modify their behaviors and perceptions when they perceive a greater level of importance in information interpretation. We speculate that such tendency is related to the increasing emphasis on knowledge transfer and information utilization in today's knowledge-based economy. In those cultures where members are more likely to accept and expect the power to be distributed unequally,

they are also willing to conform to managerial control and modify their behaviors according to corporate values. As more companies incorporate intra-organisational knowledge sharing and learning into formal corporate procedures and rules, those members who are more acceptable to power distance are more likely to make behavioral and cognitive changes so that they can adapt to the organisational learning culture. In contrast, for those members who are less tolerant of the managerial control, they would be more likely to act independently and differently from the organisational learning culture. Thus in organisations situated in a high power distance culture, employees are even more likely to transform their interpretations of information into behavioral and cognitive modifications, because such changes might be required by the management or conform to organisational culture and values.

Consistent with our predictions, the positive effect of information interpretation on behavioral and cognitive changes was negatively affected by the level of individualism, masculinity, and uncertainty avoidance in a specific national culture. A defining characteristic of an individualistic culture is its predominant preference of individual goals and interests over collective goals and interests. Given the social nature of organisational learning rendered by social learning theory (Bandura 1969), it is not surprising to find the hampering effect of individualism on organisational members' behavioral and cognitive changes as a result of information interpretation. In addition, according to theories of mutual interest and collective action (Coleman 1973, 1990), organisational learning is a coordinated process that produces outcomes unattainable through individual actions alone (Monge/Contractor 2003). Therefore, it is reasonable to expect that a national culture that stresses the importance of individual values and actions would weaken the positive impact of information interpretation on behavioral and cognitive changes.

Masculinity is another dimension of national culture that negatively affects the development of organisational learning culture. The inherent values of a masculine culture emphasize on the achievement of short-term material goals while caring less for interpersonal relationships and long-term development. As such, members of a masculine culture are more likely to make behavioral and cognitive changes for purposes such as profit generation and self-promotion, rather than relationship building and cultivating a learning culture. Given the well-established connection between organisational learning and organisational performance, our study suggests that organisations of a masculine culture may be able to attain satisfactory performance and profits in the short term, but would encounter greater challenges and difficulties in developing a positive organisational learning culture which is required for their sustainable growth. Similarly, as the uncertainty avoidance dimension would weaken the influence of information interpretation on behavioral and cognitive changes, the organisational learning culture is more likely to be cultivated in an organisation that embraces changes

and uncertainty. In low uncertainty avoidance cultures, organisational members are willing to modify their behaviors and perceptions to reflect what they have learned from the information environment. The pursuit of new information and openness for changes in such cultural contexts would ultimately lead to more innovative learning processes and a healthy organisational learning culture.

#### *Theoretical contributions*

This study contributes to existing research on organisational learning in the following aspects. First, we develop a multilevel theoretical model of organisational learning that examines the moderating effects of national cultural dimensions on the sequential relationships of information acquisition, information interpretation, and behavioral and cognitive changes. Our study advances previous research on organisational learning culture by not only finding support for the direct effects of organisational-level explanatory variables, but more importantly, by capturing the moderating effects of national-level contextual variables. The results of this study confirm the viability and importance in including the national cultural dimensions in the theoretical development of organisational learning. Second, unlike previous research on related topics that relied solely on case studies or conceptual reasoning, we tested our theoretical models of organisational learning with empirical data. This approach resonates a recent call for more rigorous empirical testing of theories in organisational culture research (Yammarino/Dansereau 2010). Given the nesting structure of our theoretical models, a multilevel analysis is most appropriate for testing cross-level interaction effects in organisational learning research. To the best of our knowledge, this is the first study that utilizes the multilevel analytic procedure to study how national cultural dimensions influence the organisational learning culture. The multilevel approach helps provide an enriched understanding of the contextual influences of national cultures on organisational learning culture, which has been traditionally examined at the organisational level only. Third, this study examines data from seven countries across Asia and Europe, and each of these nations represents a distinct national and cultural background. Moreover, our participating organisations come from a wide range of industries. The number and diversity of organisations we examined in this study enable us to generalize the findings of this research to a broader organisational and national context.

#### *Practical implications*

The findings of this study encourage managers to how to remain competitive in a globalized economy by leveraging cultural diversity in the development of organisational learning culture. An important message for organisational managers is that they should seek to balance the strengths and weaknesses of cultural di-

versity in order to better facilitate knowledge transfer and organisational learning to support productive work on a global stage.

Another key practical implication of our study is that managers should be mindful of the potential negative impact of certain cultural dimensions on organisational learning. For example, for organisations saturated in individualistic cultures, managers should cultivate a working environment that values peer-to-peer information sharing and knowledge transfer. They should establish organisational procedures and rules to prevent individuals from holding information to serve their own interests, and should implement organisational incentives to reward collective learning and information sharing. For employees working in a high uncertainty avoidance culture, organisations should design appropriate knowledge transfer systems to facilitate their efforts in information seeking and problem-solving. Examples of such systems include digital information databases and search engines on corporate intranets, which could simplify employees' information acquisition processes and consequently enhance their willingness to cope with organisational uncertainty by learning new information.

#### *Limitations and future research*

Although this study did not find a significant moderating effect of national cultural dimensions on the relationship between information acquisition and information interpretation, it by no means suggests that such a relationship is independent from other contextual variables at the organisational and national level. Actually, as mentioned in the results section of this paper, the high intra-class correlation (ICC) in modeling the effects of information acquisition on information interpretation (Model 1) implies that employees tend to interpret information in similar fashions within the same nation. Such results suggest that besides the four primary national cultural dimensions examined in this study, there may be other national and cultural variables that would contribute to the variation in information interpretation across different countries and the similarity of such behaviors within the same country. Future research should investigate additional contextual factors from internal and external environment to further understand the contextual influences on the development of organisational learning culture.

Additionally, there have been increasing debates about the validity and reliability of Hofstede's national culture scores (Holden 2002; McSweeney 2002; Wilkesmann et al. 2009; Williamson 2002). We developed our multilevel models based on Hofstede's cultural dimensions for two reasons. First, Hofstede's work is one of the most widely cited researches on cross-cultural differences (Chandy/Williams 1994; Kogut/Singh 1988; Michailova/Hutchings 2006), and his national cultural scores for over 70 countries and regions are publicly available. Second, few other research that reports national cultural scores is able to sustain validity over time and across different settings (Mouritzen/Svara 2002; Shane/

Venkatraman 1996). Nonetheless, future research should explore national cultural dimensions established in other national culture models, such as the GLOBE project (House/Hanges/Javidan/Dorfman/Gupta 2004), Schwartz theory of cultural values (Sagiv et al. 2010; Schwartz 1999, 2004, 2009), and Trompenaars and Hampden-Turner's cultural dimensions (1998). Such endeavors would help uncover the cross-level interactions between organisational learning and other cultural variables not included in Hofstede's works. Finally, to further enhance the external generalizability of our study, additional research should be conducted to expand the scope of participating countries to include a broader range of national cultures from continents other than Europe and Asia.

## Conclusions

This study develops a set of hypotheses to test the moderating effects of four national cultural dimensions on the development of organisational learning culture. Specifically, we seek to discover the cross-level interaction between national cultural dimensions and two key sequential relationships influencing organisational learning processes: the linkage from information acquisition to information interpretation, and the linkage from information interpretation to behavioral and cognitive changes. The results suggest that while national culture plays an insignificant role in influencing organisational employees' interpretation of information they have acquired, each of the four key cultural dimensions significantly strengthens or weakens the effects of information interpretation on behavioral and cognitive changes. Thus there is evidence that national culture plays a different role at different phases of the development of organisational learning culture. Furthermore, different cultural dimensions would influence organisational learning processes in different directions. Specifically, a high power distance culture would enhance the positive effects of information interpretation on behavioral and cognitive changes, whereas a high individualistic, masculine, and uncertainty avoidant culture would weaken and hinder such process.

Unlike majority of previous studies that examine national culture and organisational learning culture at separate levels, this study proposes an integrated theoretical framework to further understand how organisational learning culture develops within the national cultural context at large. This study demonstrates that the development of organisational learning culture is indeed a multilevel and context-based process. As all organisations operate within a specific national culture that is characterized by distinct cultural traits, organisational learning culture is inevitably influenced by these cultural dimensions. The multilevel model developed in this study contributes to existing literature by considering and incorporating the contextual influences of national culture on organisational learning.

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## Blockholding and organisational diversity: the case of a transition economy\*

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*We approached the issue of blockholding effectiveness and behaviour by studying some exemplary organisational transformations in the Republic of Srpska. We found two distinct clusters of blockholdings. The first cluster is worker-entrenched blockholdings, where most workers are unionised. The second cluster constitutes worker-liberal blockholdings, where most workers are not unionised. There are two distinct subgroups in this cluster. The vast majority of blockholdings in the first subgroup developed a prevailing role of the capital owner, heavy-weight management and a less trained workforce. The second subgroup nurtures reciprocity of management and core workers' cognitive assets, and is also the most productive.*

*Key words: corporate governance, organisational transformation, developing countries, blockholding, worker empowerment (JEL: J54, P20)*

### 1. Introduction

Blockholding, or concentrated ownership in the hands of one single owner or a few large owners, has been in the focus of corporate governance research (Holderness 2003).<sup>1</sup> Studies have shown mixed results about the role of blockholdings in corporate governance subject to organisational development. Is it a substitute for legal protection in institutionally poor environments (Shleifer/Vishny 1997; La Porta et al. 2008), or is it a foundation for strategic coordination between different stakeholders (Black 1990; Cronqvist/Fahlenbrach 2009)? Most research

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<sup>1</sup> The term blockholding (and blockholders) is commonly used in economic literature, dealing primarily with the problems arising from more/less concentrated ownership and agency problems (see Holderness 2003). Blockholding refers to a situation of having large owners present, whereby the limits to what is large are set differently. For example, Demsetz/Lehn (1985) suggest using largest 5 to 20 shareholders, while Schleifer/Vishny (1986) suggest a 5% limit (in Earle et al. 2005). The notion of a block refers primarily to the "power to impact" therefore the definition can differ by country (institutional characteristics) or industry. Type, size and number of blockholders matters for firm structure, strategy and long-run performance (see Tribo et al. 2007; Sanchez-Ballesta/Garcia-Meca 2007; Henrekson/Jakobsson 2012).

so far has come to the conclusion that concentrated ownership affects firm performance positively (Tribo et al. 2007) due to easier long-term goal orientation agreements (Hoskisson et al. 2002) and more intense monitoring of managers' actions, consequently decreasing managerial discretion and inhibiting self-serving behaviour (Finkelstein/Boyd 1998; Tosi et al. 1997). However, there are also studies showing negative effects of blockholding on firm performance due to decreased liquidity of equity (Maug 1998), misguided corporate strategic alignment (Thomsen/Pedersen 2000) or deriving benefits from the control function only for the largest blockholder (Johnson et al. 2000; Dyck/Zingales 2004). So a question arises: What differentiates the effectiveness of block-owned firms? We approach this issue by studying the affect of labour market institutions.

While there is convincing evidence about the influence of labour institutions in Western Europe on the effectiveness of a blockholding (Henrekson/Jakobsson 2012; Van Essen et al. 2012), there is much less evidence from transitional countries. In particular, there is almost no information from countries of the former Yugoslavia, where peculiar labour relations, including worker participation, played an important role in the past.<sup>2</sup> After Yugoslavia fell apart in the last decade of the 20th century, new countries have emerged in its place. Among them, Bosnia and Herzegovina has had the most dramatic history.

Our research is based on a questionnaire study that was conducted in autumn 2011 in the Republic of Srpska, one of the entities constituting Bosnia and Herzegovina. In the recent decade the country has been strongly influenced by economic reforms on account of privatisation, liberalisation, and a changing global environment (globalisation). Mass privatisation was introduced in the years 2000 and 2001 with the intention of making ownership dispersed in most privatised companies. The country preserved Yugoslav labour relation institutions for a long time and in the year 2000 adopted a liberal Labour Law to ease some of the labour market rigidity.

In our case, we are dealing with a unique database of companies where top managers were asked specific questions about relations between corporate stakeholders (owners, managers, and workers) and corporate governance. Our study has two main findings: First, in the period of ten years after the liberal reforms were launched, blockholding became the prevailing ownership structure in the Republic of Srpska. Second, significant differences in the behaviour of blockholdings based on the empowerment of workers are observed. We identified two distinct clusters of firms. In the first cluster most workers are institutionally em-

2 Damijan et al. (2004) revealed raising ownership structure concentration in Slovenia as a result of the battle for control between blockholders, which is negatively influencing corporate performance. Koman et al. (2015) describe the appearance of blockholdings in Montenegro in relation to stripping assets in the privatisation processes where interdependency between economic actions and political positions of individuals did not lead to establishing rules which would promote value building.

powered (unionised), therefore we call these firms ‘Worker–Entrenched block–holdings’. Although cooperative behaviour between the blockholders and unions is evident in few cases, there are also signs of rent–seeking behaviour of unions, who use their monopoly position in order to expropriate a part of value added. This is particularly evident in some state–owned firms.

The second cluster of firms shows a different pattern of development. We named these firms ‘Worker–Liberal blockholdings’, since most workers in this cluster are not institutionally empowered, but rather present an unconstrained work force in the labour market. There are two distinct subgroups in this cluster of firms identified as well. A vast majority of blockholdings in the first subgroup correspond to a profit maximising Core–Periphery mode of firm with a prevailing role of the capital owner, heavyweight management and a less trained workforce. The second subgroup strongly reflects the Reciprocal–Essentials (hereafter RE) mode of firms (Aoki 2010), where the main ingredient of such mode is the growing importance of human cognitive assets, not limited only to those of management but also including those of core workers. Hence, the blockholding diversity appears as the result of different labour relations in firms and various types of corporate governance could be found.

Our contributions are threefold. First, we contribute to the literature on blockholdings by analysing blockholdings’ corporate behaviour and organisational architecture in the framework of different labour institutional arrangements (Wright et al. 1996; Holderness 2003; Sanchez–Ballesta/Garcia–Meca 2007; Edmans 2009). Second, by studying firm behaviour in one ex–Yugoslavian country, we are able to shed light on the transformation of labour capital relations and corporate governance after the abandonment of social ownership and worker’s self–management. Thus, our analysis of blockholdings in the Republic of Srpska also portrays well the development of corporate governance in other parts of former Yugoslavia. On this ground we contribute to the emerging comparative view of corporate governance, which seeks to explain corporate governance both in terms of agent relations and path (national) dependency (Hall/Soskice 2001; Aguilera/Jackson 2003; Hopner 2005; Aguilera et al. 2008; Aoki/Jackson 2008; Aoki 2010). Third, we made methodological innovations in the approaches to surveying organisations.

In the following section we present the development of blockholdings in the Republic of Srpska as well as describe the labour market to embed the evolution of blockholding into context. In the third section, we present the hypotheses of our research. This is followed by methodology along with the survey design and questionnaire structure. In the fifth section we convey our results. In the last section we draw conclusions.

## 2. Development of blockholdings and specific labour institutions in the Republic of Srpska

### 2.1 *Economy of the Republic of Srpska*

The disintegration of Yugoslavia in the 1990s had a strong effect on the Bosnian economy. The armed conflict that followed on its territory destroyed a substantial part of its physical and human capital. In 1995, the Dayton Accord split the state of Bosnia and Herzegovina into separate entities: the Federation of Bosnia and Herzegovina (Federation), the Republic of Srpska, and Brčko District.

In the period from 2000 to 2008, Bosnia and Herzegovina witnessed robust growth, in particular a double-digit GDP nominal growth rate and a real growth rate between 6% and 7%. The growth was stimulated by international assistance, increased foreign and domestic investments, a credit boom funded by foreign banks and booming domestic demand financed from abroad. While residents in all Balkan countries spent more than they earned from domestic sources, the Republic of Srpska boasted some of the highest ratios of domestic absorption over GDP. This was possible mainly by large remittances from family members working abroad. According to the estimations, those transfers generate between 15% and 18% of GDP every year (EBRD 2011).

After several years of growth, the economy experienced a sharp decline in the late 2008, similar to the case of other countries in the region. The output also fell significantly in 2009 by approximately 3% (EBRD 2010). This economic downturn settled slightly in 2010. However, in 2011 the economy of Bosnia and Herzegovina stagnated and remains in deep recession. The trend of negative developments persisted in 2011 in the field of foreign direct investments, budget deficit, increased cost of living, rising inflation and a constant increase in unemployment. In 2011, the number of employed people in Bosnia and Herzegovina amounted to 693,359, while the number of unemployed people was 529,994 (in 2010 there were 517,004 unemployed). In the Federation of Bosnia and Herzegovina, the number of employed people was 441,115, while 367,512 were unemployed. In the Republic of Srpska, there were 239,998 employed and 150,971 unemployed. The employment rate in Bosnia and Herzegovina was 31.9% (29.8% in the Federation of BiH, 36.1% in the Republic of Srpska, and 22.9% in the Brčko District), and the unemployment rate was 27.6% (29.2% in the Federation of BiH, 24.5% in the Republic of Srpska and 39% in the Brčko District). According to the ILO methodology, the unemployment rate in Bosnia and Herzegovina was 27.6% in 2011, compared to 2010 when it was 27.2% (Stanković 2012).

## 2.2 Ownership concentration

A proper legal protection of investors, including minority investors (shareholders and creditors), ownership disclosure and transparency, and capital market transactions are determined within the legal framework of each entity. With assistance from the international community, the Federation of BiH and the Republic of Srpska adopted commercial legislation and the Company Act. The Federation of BiH adopted the Company Act in 1998, and the Republic of Srpska in 1999.

Discussions about the best privatisation model followed the overall debate on corporate governance in Bosnia and Herzegovina, especially on how to find the most efficient way of transmitting the interests of owners to the company. The entities adopted mass privatisation as the prevailing privatisation programme in hope that ownership in most companies would end up dispersed.<sup>3</sup> There were three approaches used: privatisation of small companies – small privatisation, the privatisation of large companies – large privatisation, and the privatisation of strategically important companies. The assets of companies undergoing privatisation could be purchased with cash, vouchers or coupons.<sup>4</sup>

The privatisation started with a pilot programme of hard currency auctions in 18 small companies (coupons were treated as hard currency) in July 1999. By March 2001, 98 of 276 small companies had been sold for a total value of KM 20.6 million (approximately 10 million Euros), of which about 80% was paid in coupons.

Approximately 600 companies in the Republic of Srpska that hold around one-quarter of the total assets of state-owned enterprises were subject to privatisation under the voucher privatisation scheme from the year 2000 to 2001 (IMF 2005). The first official trade in Bosnia and Herzegovina took place on March 14, 2002 on the Banja Luka Stock Exchange in the Republic of Srpska. Even though there were some successful examples of privatisation, the general effect of voucher privatisation was minor, accompanied by few new investments and a notable lack of skills of leading managers (OHR 2004).

Out of the 135 strategic companies, 52 of them were selected for the privatisation in the framework of international tenders. However, in the first years only a small number of strategically important companies was sold through auctions and international tenders. Therefore, after 2003 there was more focus on the pri-

3 This was a prevailing view in most transitional countries. As argued by Hansmann and Kraakman (2001), the best form of an organisation is the shareholder-oriented model, and practice and law are convergent on this model.

4 Each citizen in the Republic of Srpska was entitled to vouchers, while coupons were issued on the basis of frozen foreign account deposits. Vouchers could only be used in privatisation through the voucher offer, and were valid for two years after they had been deposited into a special Privatisation Account.

atisation of strategically important companies. The Republic of Srpska sold some of its most attractive assets to foreigners between 2004 and 2007. In the period from 2005 to 2006, the manufacturing and banking sectors attracted most of the foreign bidders. The main telecommunications company was sold in 2007. This was by far the largest foreign investment in the Republic of Srpska in the last decade. In the period from 2008 to 2010, the most important sector was the retail sector

Consequently, since the beginning of privatisation the share of the Republic of Srpska's state ownership has greatly diminished. However, some companies remain in direct state ownership. The state also holds a prevailing share in some joint corporations. A number of firms were privatised to foreigners. The remaining forms of corporations are privately owned corporations, which arose from the voucher privatisation programme. Today, most of the voucher-privatised firms exhibit enormous difficulties in corporate governance and are, in many cases, captured by influential groups or individuals (Hoff/Stiglitz 2004; Koman et al. 2015). Taking also into account newly established firms by private entrepreneurs, blockholding is currently considered to be the dominant corporate governance mode in the Republic of Srpska (Mikerević 2012).<sup>5</sup>

### 2.3 Industrial relations

The labour legislation in Bosnia and Herzegovina, social dialogue and collective bargaining are displayed at the level of entities. Even though laws have been designed and passed in Parliaments of the entities after the war, they retained rigid clauses and inflexibility within the labour market remained. Under pressure from the international community, both entity governments have amended labour laws. The Labour Law in the Republic of Srpska, which was amended in November 2000 (Službeni Glasnik, RS 38/00, 40/00, 41/00), eased some of the labour market rigidities. The notice period and the size of severance paid by employers were both significantly reduced. In this sense, labour legislation in the Republic of Srpska is relatively liberal.

Any worker that is employed can become a member of the labour union, whereby he/she accepts the rights and obligations arising from the Statute and other acts of the labour union. There is currently no official data that could accurately indicate the actual share of employees as union members. According to some estimates, approximately one-half of employees in BiH are members of labour unions (Dedić 2013). There is higher labour union presence in the public sector. In the private sector, labour unions are most frequently present in those com-

<sup>5</sup> Data on the exact share of private domestically-owned firms vs. private foreign-owned firms vs. state-owned firms in the Republic of Srpska is impossible to obtain due to the constantly changing number of firms (bankruptcies, liquidations, mergers, new entry) and a prevailing number of small firms with less than 20 employees.

panies that had labour unions organised before they had been privatised, while it is seldom the case in newly established private companies that employers would allow their workers to engage in union activities (Stanković 2012).

The Association of Unions of the Republic of Srpska<sup>6</sup> is a representative and the carrier of collective bargaining in the Republic of Srpska, together with the government of the Republic of Srpska and Union of Employers of the Republic of Srpska (Unija udruženja poslodavaca Republike Srpske) (Službeni Glasnik, 2007).<sup>7</sup> In May 2010, they jointly signed an ‘umbrella’ General collective agreement, which set the rules for determining basic wages. Basic wages are determined by multiplying the initial wage for the simplest work task with the so-called coefficients, each representing particular weight for more demanding work tasks. The minimum wage in the Republic of Srpska is set forth by the General collective agreement as well. The General collective agreement is supplemented by industry-specific agreements or special agreements that are uniting a few industries, which effectively convert the concept of basic wage on the level of industries or groups of industries. Four industry agreements and six special agreements are currently in effect in the Republic of Srpska. In addition to sizes of coefficients for different occupations, they also differ in the context they cover. For example, the collective agreement for the energy sector has (along with the finance sector) the highest minimum wage and coefficients for classifying wages based on specific tasks. The General collective agreement applies to all workers and employers. No collective agreement concluded at the branch or company level may grant lesser rights than those stipulated in the General Collective Agreements. The differences between the public and private sector are especially evident in the area of implementing the existing collective agreements, where provisions of agreements are more frequently violated in the private sector (Stanković 2012).

The Labour Law completely excludes the participation of employees in corporate governance, i.e. it does not propose or prohibit workers’ participation. The employer is only obligated to inform employees about their rights and obligations, wages, the state of the company, and future development. As for employ-

6 In 1992, the Association of Unions of the Republic of Srpska (Savez sindikata Republike Srpske) was founded. The Association was formed from the organisation “Zveza sindikatov Jugoslavije” (Association of Unions of Yugoslavia). In addition to union organisations, which operate under the auspices of the Association, there are also enterprise unions in some companies, which are not members of the Association. They emerge spontaneously, in the event that employees are dissatisfied with the operation of the official Association, which is particularly the case in bankrupted companies. Currently, they have no great significance.

7 In addition to collective bargaining, a tripartite social dialogue is organised through of the Economic and Social Council which involves the representatives of the Government of the Republic of Srpska, Association of Unions of the Republic of Srpska and Union of Employers of the Republic of Srpska.

ees' councils or workers' councils, the entity laws regulate their organisation. In order for the workers' council to be formed, the employer must have at least 15 workers in permanent employment position. In the Republic of Srpska the decision on the establishment of a workers' council can be made by no less than one-third of the total number of workers at a single employer (Stanković 2012).

### 3. Related literature and hypotheses

The paper refers to the literature on *corporate governance*. In the leading agency–theoretical explanation of corporate governance (Jensen/Meckling 1976; Fama 1980; Fama/Jensen 1985), ownership and control are dispersed and stock markets are liquid, generating higher returns, providing higher possibilities of diversification for investors and facilitating financing to managerial entrepreneurs (the outsider system). On the other hand, the blockholding system (the insider system) is a system of large shareholders (blockholders). It ensures more vigilant shareholders' monitoring over management and longer shareholders' time horizon. Capital markets are thinner than in the outsider system and the liquidity of stocks is rather low (Bratton/McCahery 2002; Holderness 2003). While the advocates of the outsider systems see blockholdings as a substitute for legal protection in a poor environment (Schleifer/Vishny 1997; La Porta et al. 2008), the opponents claim that blockholders are common all over the world and seem to be relatively stable in time (Holderness et al. 1999, Holderness 2003). Moreover, there is an emerging view on corporate governance (Hall/Soskice 2001; Aguilera/Jackson 2003; Aguilera et al. 2008; Aoki/Jackson 2008; Hopner 2005) that seeks to explain corporate governance both in terms of agent relations and path (national) dependency.

The paper also refers to the literature on *labour unions and bargaining*. The more recent models, taking into account the bargaining process between management and unions, replaced traditional perceptions of unions as a monopolist on the supply side of the labour market. The notion of bargaining assumes that unions have control over employment as well as wages. Different strategies are then possible. Monopoly unions could maximise a wage bill and choose a level of employment where marginal wage equals zero, or they maximise the mark-up of wages over the market (alternative) wage. The equilibrium wage is higher in the latter case (maximisation of rents) than under wage bill maximisation (Ehrenberg/Smith 2011). The monopoly union model presupposes that bargaining between managers and unions is sequential, with unions setting and then the firm choosing the level of employment. However, if the values of those variables are chosen simultaneously, this results in a situation of efficient bargaining (Estrin et al. 2008). The formal models of efficient bargaining take a game theoretical approach and search for a solution on the contract curve, the locus of points on the firm's labour demand curve and the union's indifference curve. The precise point on the contract curve chosen by the two sides depends upon their rela-

tive bargaining power. As the bargaining power could be an exogenously determined force, the outcome depends not only on endogenous, but also on exogenous factors (Svejnar 1986). In particular, European countries feature rather specific institutions in regard to the role of labour in the economy and corporate governance (Ferner/Hyman 1998). Van Essen et al. (2012) investigated if European labour institutions can function as a countervailing power to blockholdings and even increase the cooperative capabilities of shareholders and their willingness to cooperate with workers to increase profit. They identified the following influences of labour institutions on blockholding: 1) the employment protection laws constrain the ability of blockholders to pursue value-enhancing adjustments of the scale operations in their firms; 2) collective labour action laws negatively affect blockholder effectiveness; 3) employee involvement in firm decision-making has a positive effect on blockholder effectiveness, and 4) no significant effect of the level of unionisation on blockholder effectiveness exists.

Whereas the negative effects of employment protection and collective labour action laws on blockholder effectiveness support the competitive perspective between stakeholders, the positive effect of labour laws mandating employee voice in firm decision-making is more in line with the cooperative view of corporate governance. This means we made reference to the literature on *worker participation* as well. The cooperative view of corporate governance could namely be explained by the fact that employee involvement in decision-making may foster the elimination of post-contractual information asymmetry (Freeman/Lazear 1995), increase investments in human capital (Furubotn 1988; Furubotn/Wiggins 1984) and enable the controlling owners to pursue value-enhancing quality management and innovative strategies (Kraft et al. 2011). In addition, with the globalisation of markets and the information revolution, which is a new phenomenon, Aoki (2010) proposes a RE mode of organisational architecture (reciprocal essentialities of management and workers cognitive assets). The growing importance of human cognitive assets, not limited only to those of management but also including those of the core workers, is the main ingredient of such a mode.

Two working hypotheses were made based on the literature review and description of the development of blockholdings and industrial relations in the Republic of Srpska. The first takes in the account the diversity of blockholdings based on different ownership arrangements and the divergent role of unions in organisations. Hence, corporate governance diversity should be an important feature of the corporate landscape in the Republic of Srpska. In view of the relationship between bargaining among corporate constituents and corporate governance, the working hypothesis is as follows:

*Hypothesis 1: Blockholding behaviour differs in relation to the bargaining power dissimilarity found in corporate constituents.*

However, this competitive approach among corporate constituents is often challenged by a more cooperative view, claiming that corporate constituents do not merely compete for the largest possible slice of the corporate pie, but also coordinate and cooperate strategically to increase the size of the pie which is to be distributed (Aoki 1984; Hall/Soskice 2001). In particular, organised workers in labour unions might positively affect blockholder effectiveness owing to decreased transaction costs and collective action problems, that burden dispersed employees to effectively pursue their interests in competition with other corporate constituents (Traxler 2003; Schnabel et al. 2006). The concentrated representation of labour interests can thus increase the likelihood of cooperation, producing benefits that dominate the costs to shareholders resulting from the empowering effects of unionisation. Likewise, value-enhancing cooperation between blockholders and labour may provide joint strategies that require firm-specific investments in human capital, worker empowerment and higher worker loyalty defining a firm's genetic material helping to achieve competitive advantage (Prašnikar et al. 2017; Van Essen et al. 2012). In addition, efficient bargaining between unions (workers) and the firm on employment and wages might better serve interests of both the firm and unions (workers). Such outcomes should be difficult to achieve if a monopoly union of workers pursues rent-seeking behaviour (maximisation of wages). This leads to the following working hypothesis presented in the form of two sub-hypotheses on the role of unions (workers) in blockholding relations in the Republic of Srpska:

*Hypothesis 2a: Effectiveness of blockholdings is higher if unions (workers) are involved in strategic cooperation between employees and blockholders.*

*Hypothesis 2b: Effectiveness of blockholdings is lower if unions (workers) are seeking rent-motivated behaviour.*

## **4. Sample selection and questionnaire**

### *4.1 Research design*

To test our working hypotheses we rely on questions posed to top managers in the firm. Managers were chosen as respondents because they possess comprehensive operational and strategic knowledge about the firm, as was required by the questionnaire. We were not in a position to obtain balance sheet data without the permission of companies. The primary data was acquired through a unique psychometric type of questionnaire associated with firm productivity, which was primarily developed and tested by Bloom and Van Reenen (2007).<sup>8</sup>

<sup>8</sup> Psychometric questionnaires are most commonly used in psychology to conduct research in human psychological behaviour (i.g. Sixteen Personality Factor Questionnaire by Cattell 1946), frequently with the help of factor analysis in order to find latent behavioural traits (i.e. finding social value structures). For further reference see Musek (1993).

The survey was conducted in autumn 2011. We pilot tested the questionnaire on a few firms and selected 60 companies to compose a stratified sample on the basis of their size, industry and location which we believed were good representatives of companies with over 50 employees in the real sector of the economy. With the help of a research team from the University of Banja Luka, we appealed to the CEO of each company for collaboration, sent them the questionnaire, and received positive answers from 58 companies. We also collected data about individual characteristics of the surveyed firms, such as export orientation (share of revenues made abroad), ownership type (state or private, domestic or foreign, and dispersed or concentrated/blockholding), industry (service or manufacturing), and legal form (limited liability company or joint stock company). Firms were also asked to provide specific internal accounting information, from which we were able to calculate the added value per employee to use as a measure of their performance.

Manufacturing firms constitute 61.4% of the sample, 22.4% are state-owned firms, 15.5% are owned by foreigners, and 94.8% are block-owned. In 2011, they generated 8.7% of total income and employed 5.4% of employees among all firms registered in the Republic of Srpska. In terms of the industries from which the surveyed firms were selected (mining, energy, manufacturing, construction, trade and other services) these blockholdings generated 20.9% of total income of these industries.

#### 4.2 Questionnaire structure

The questionnaire consists of the following question sets: 1) *decision-making*, 2) *adjusting employment*, 3) *wage setting*, 4) *the role of labour unions*, 5) *participation of workers in risk sharing*, 6) *participation of workers in decision-making*, 7) *internal training*, and 8) *on-job training*. Since we are interested in the labour issues in blockholdings, each question set is related to a particular item from our literature review. The first is directly related to the role of workers in corporate governance, the next three deal with labour unions and bargaining, and the last four deal with the position of workers in building comparative advantages of firms. Thus, they are indirectly related to the role of workers in corporate governance as well. Each question set contains three consecutive statements to which managers responded positively ('yes') or negatively ('no'). Each following statement in a question set represents a greater degree of complexity, building into a cascading structure.<sup>9</sup>

We start the first question set from the premise that a fundamental division between owners and managers is the division between the right to control (control

<sup>9</sup> A combination of closed questions directs respondents to a systematic way of thinking about the actual situation in the organisation without being biased or thinking too broadly about it. See Bloom and Van Reenen (2010 b) for an alternative view.

rights), the right to bear risk and returns for taking risk (residual rights), and the right to *decision-making* (decision rights). The first two rights are in the domain of the owners of the firms whereas the last right regarding decisions on the use of existing resources belongs to managers. The choice about the separation of strategic function (given usually to top management) and day-to-day decisions (which are usually in the hands of middle and lower management) is in the hands of company owners (Wheelen/Hunger 2010), and they are responsible for addressing the agency problem which in turn leads to the (de)solution of consolidating owners' and managers' interests. Owners have the highest influence on (non-)cooperative behaviour of main corporate constituencies: owners, managers and workers (Aoki 1984; Van Essen et al. 2012).

In order to capture the *employment adjustments* (the second question set) of firms when they are confronted by external shocks, it is useful to start with a profit maximising model of a firm subject to capital and labour accumulation constraints. The derived static factor demand functions can be perceived as desired long-run equilibrium levels of labour and capital. In the absence of adjustment costs, firms constantly adapt employment to a desired level according to changes in market parameters (in particular, changes in output and wages) (Domadenik et al. 2008). Realistically, firm behaviour is dynamic rather than static and there are substantial adjustment costs. In constructing the questionnaire, this distinction was taken into consideration. Firms utilise different ways to restructure employment in the short term (using overtime, hiring part-time workers, employing through agencies, hiring students etc.), known as defensive labour re-structuring. In the long term they adjust desired employment by adjusting the number of full-time employees, noted as strategic restructuring of employment. In addition, we considered firms that based their competitive advantages on human capital to be building on the concept of core employees. The higher the share of core employees, the more is invested in a firm's human capital and the higher the firm's comparative advantage (Lepak et al. 2003; Aoki 2010; Zupan et al. 2010).

Deciding on *wages* (the third question set) is another important element in bargaining. In a mixed economy, such as the Republic of Srpska, which is marked by liberal relations toward employment and founding new companies on one side, and preserving institutions of collective bargaining in the labour market from the former Yugoslavia on the other side (path dependency), the size of wages (if they are higher than reservation wages<sup>10</sup>) is associated with collective bargaining processes at different levels. A negative answer to the first question in the question set relating to wages leads to the conclusion that workers are paid at the reservation wage. Furthermore, answering positively to the second

10 The reservation wage is defined as the wage limit below which employees would be unwilling to work.

question implies a positive deviation from the earnings assured by collective agreement. This either means higher bargaining power of unions, if they exist, or that the firm is building its compensation policies on the efficiency wage philosophy. When wages are among the highest in the country, either the first or second strategy is escalated.

To achieve greater bargaining power, employees organise themselves into *labour unions* (the fourth question set). Our first question was whether unions existed in the firm. We then tested the collaborative behaviour of unions. In the case of more competitive unions, the collaborative character of unions could diminish due to the competition between unions for membership, which is found especially in European states (Ferner/Hyman 1998). The final question relates to unions' concerns with the firm's success.

The fifth question set, entitled "*Workers' Participation in Risk Sharing*", first tests the willingness of employees to do 'something more' for the firm, which is a broad concept that can be understood in different ways. The key issue here is that workers are voluntarily prepared to spend their own time (outside working time) and energy in the benefit of the company, without any pressure or coercion from the employer. After testing workers' compliance, we focused on workers' long-term planning and loyalty to the firm by asking about their willingness to stay with the firm even if they had been offered better (paid) employment elsewhere. Lastly, we questioned workers on their propensity to financially participate in the firm and take financial risks.

In order to study the effect of *workers' participation in the decision-making process* on firm performance, we could categorise participation into levels or degrees. Clarke et al. (1972) distinguishes between participation concentrated on work tasks (work-centred participation) and participation concentrated on the distribution of power (power-centred participation). We have modelled our question set by Bernstein (1982), who distinguishes between four degrees of workers' control: 1) employee consultation represents the lowest degree of participation, where workers merely provide written or oral suggestions to management, which can choose to ignore or act on them, 2) employee co-influence involves discussions between workers and management, where workers have the right to be informed, discuss their interests, protest, and offer suggestions, but management still makes the final decision, 3) joint management, or co-determination, where both parties have the right to veto decisions and form joint decision committees, and 4) self-management, as the most advanced, enables full participation of all members of the firm, with workers having total control over decision-making process. Since the Republic of Srpska normative framework does not support workers' participation, this questions set is comprised of questions which include the first three degrees of employee participation in the decision-making process. The first question, "Are workers informed about key deci-

sions for the firm?” reflects employee consultation. The second question, “Is there an established open dialogue with the workers about key decisions for the firm?” expresses employee co-influence. The last question about workers being members of governing bodies includes joint management or codetermination.

Based on the notion that cooperative blockholdings also invest more in human capital, we chose to include this scope in our analysis. Investments in firm-specific human capital have been a long debatable issue in the economic profession. Following the resource-based view of firms, human capital was recognised as an important source of competitive advantage and a firm’s ability to adapt in volatile environments (Barney 1991; Judge et al. 2009). Many researchers later identified firm-specific human and structural resources as the largest subcategory of businesses’ intangible investment (Corrado et al. 2009, for the US and UK; Fukao et al. 2009, for Japan; Bloom/Van Reenen 2010 a).

The seventh question set analyses *internal training* as a part of human capital practices in the firm. First we identified the company’s intention to make collaborative efforts by asking about the provision of organised training based on identified needs of the company. Next, we determine the proportion of employees in training and establish the firm’s dedication to measuring the effects of training. Firms that also measure training effectiveness with other methods, rather than solely by conducting a survey at the end of a training programme, are considered more dedicated.

By studying *on-the-job training*, we identified whether the company actually provides regular on-the-job training (e.g. apprenticeship, mentorship, job rotation etc.) and if it actively promotes spreading knowledge among its employees. If a firm considers on-the-job training as an important factor in the promotion of key employees, it will foster successors for most of its key employees, allowing for quick and efficient replacements.

## **5. Diversity and behaviour of blockholdings in the Republic of Srpska**

To identify the nature of corporate governance in the Republic of Srpska, we performed an agglomerative hierarchical cluster analysis in Stata SE 11. We adapted the simple Matching metric for calculating distances as one of the more suitable and most commonly applied metrics for clustering binary variables. To find the most suitable number of clusters, we chose as the most appropriate Ward’s error sum of squares agglomeration method, which minimises variation within clusters (homogeneity) and maximises variation between clusters (hetero-

geneity) (Sharma 1996).<sup>11</sup> We applied the second question in each question set as the clustering variable because they possess the most variability and are, therefore, the most suitable for clustering.<sup>12</sup> We also used Pearson's Chi-square test to find differences between all three groups. The results are presented in Table 1.

The cluster analysis identified two broad clusters that behave as Worker-Entrenched blockholdings and Worker-Liberal blockholdings based on the level and type of worker empowerment, with the latter further divided into two subgroups (sub-clusters) of predominantly manufacturing Core-Periphery firms and service RE firms to capture any further heterogeneity within the initial group. This confirms Hypothesis 1, which says that firm behaviour differs dependent on bargaining power dissimilarity. In the following subsections, we describe each type of blockholding in further detail.

### 5.1 Cluster of worker-entrenched blockholdings

In our discussion about the organisational architecture of firms in the Republic of Srpska, we particularly examined the group (first homogenous cluster) of 24 mostly unionised firms presented in the first two columns of the body of Table 1. Ninety-two percent of firms in this cluster have workers organised in unions, which institutionally empower (entrench) workers and represent their interests in the bargaining processes. Only one union organisation exists in 88% of firms. Compared to the second cluster, these proportions are high. In the first subgroup of the second cluster, unions only exist in approximately 11% of firms, while in the second subgroup unions are not present in any of the observed blockholdings.

11 To test the validity of results, we applied different distance measures and agglomerative techniques. By using Jaccard, Dice and Russel/Rao measures (Finch 2005), we got similar results as with simple Matching, but simple Matching produced the most significantly different clusters tested with Pearson's Chi-square. We also tried other agglomerative methods, such as single, average and complete linkage, but we encountered a problem with chaining, which is a common occurrence when clustering dichotomous variables. Performing clustering on subsamples provided reliability testing. This was inconclusive in some cases due to sample size limitation.

12 We also performed clustering by using all variables in the question sets and found similar results with less significant differences between clusters because of lost variability. The first questions have significantly more positive answers than negative answers, while vice versa is true for the third questions (a consequence of cascading). Therefore, the first and third questions have too low variability, making clustering problematic.

Table 1: Blockholding types in the Republic of Srpska

	Worker-en-trenched firms (n=24)		Worker-liberal firms				Chi-square	Sign.
			Core-periphery mode (n=18)		RE mode (n=16)			
	% yes	sd	% yes	sd	% yes	sd		
<b>1. THE DECISION-MAKING</b>								
Operation/strategic management separated	70.8	46.4	72.2	46.1	100	0.0	5.776	0.056
Managers and owners act unanimously	70.8	46.4	55.6	51.1	100	0.0	8.960	0.011
Owners, managers and workers coordinate decisions	58.3	50.4	38.9	50.2	68.8	47.9	3.219	0.200
<b>2. DECISIONS ON EMPLOYMENT</b>								
Short-term adjustments to shocks are appropriate	83.3	38.1	94.4	23.6	87.5	34.2	1.200	0.549
Achieving desired level of employment	54.2	50.9	83.3	38.3	62.5	50.0	3.962	0.138
Existence of core group of employees as a comparative advantage	37.5	49.5	55.6	51.1	56.3	51.2	1.906	0.386
<b>3. DECISIONS ON WAGES</b>								
Higher than alternative wages	75.0	44.2	22.2	42.8	100	0.0	24.310	0.000
Wages higher than collective agreement	41.7	50.4	11.1	32.3	68.8	47.9	11.829	0.003
Wages among the highest in the country	37.5	49.5	5.6	23.6	56.3	51.2	10.300	0.006
<b>4. THE UNION ROLE</b>								
Workers organised in unions	91.7	28.2	11.1	32.3	0.0	0.0	43.113	0.000
One union organisation exists	87.5	33.8	11.1	32.3	0.0	0.0	39.601	0.000
Unions concerned with a firm's success	37.5	49.5	5.6	23.6	0.0	0.0	11.959	0.003

	Worker-en- trenched firms (n=24)	Worker-liberal firms				Chi- square	Sign.	
		Core-periphery mode (n=18)		RE mode (n=16)				
		% yes	sd	% yes	sd			
<b>5. WORKERS INCLINATION TOWARDS RISK</b>								
Workers are prepared to do "more" for the firm	83.3	38.1	72.2	46.1	100	0.0	5.027	0.081
Workers would stay with the firm in bad times	62.5	49.5	33.3	48.5	75.0	44.7	6.521	0.038
Workers are willing to make fin. invest. in a firm	37.5	49.5	11.1	32.3	43.8	51.2	5.016	0.081
<b>6. WORKERS PARTICIPATION</b>								
Workers are informed about key decisions	66.7	48.2	50.0	51.4	100	0.0	10.540	0.005
Workers have an open dialogue with managers	62.5	49.5	44.4	51.1	100	0.0	12.286	0.002
Workers are members of governing bodies	45.8	50.9	5.6	23.6	43.8	51.2	8.787	0.012
<b>7. INTERNAL TRAINING</b>								
Existence of organised forms in the firm	100	0.0	66.7	48.5	81.3	40.3	8.894	0.012
More than 50% of workers participate	41.7	50.4	33.3	48.5	50.0	51.6	0.971	0.615
Other methods of evaluation than survey exist	29.2	46.4	5.6	23.6	18.8	40.3	3.732	0.155
<b>8. ON-THE-JOB TRAINING</b>								
Existence of organised forms in the firm	91.7	28.2	55.6	51.1	100	0.0	14.003	0.001
Systematic knowledge transfer among employees exists	87.5	33.8	55.6	51.1	100	0.0	12.000	0.002
Successors for most of key employees exists	79.2	41.5	44.4	51.1	62.5	50.0	5.385	0.068

	Worker-en- trenched firms (n=24)		Worker-liberal firms				Chi- square	Sign.
			Core-periphery mode (n=18)		RE mode (n=16)			
			% yes	sd	% yes	sd		
<b>ADDITIONAL INFORMATION</b>								
Productivity higher than median firm	45.8	50.9	33.3	48.5	75.0	44.7	6.167	0.046
Service industry	26.1 <sup>a</sup>	44.9	22.2	42.8	75.0	44.7	12.501	0.002
Limited Liability companies	37.5	49.5	55.6	51.1	87.5	34.2	9.805	0.007
More than 100 employees	70.8	46.4	16.7	38.3	12.5	34.2	18.887	0.000
More than 0% of export	54.2	50.9	55.6	51.1	50.0	51.6	0.114	0.945
More than 25% of export	41.7	50.4	38.9	50.2	18.8	40.3	2.456	0.293
More than 50% of export	20.8	41.5	22.2	42.8	12.5	34.2	0.614	0.736
Foreign ownership	16.7	38.1	11.1	32.3	18.8	40.3	0.418	0.811
State ownership	37.5	49.5	16.7	38.3	6.3	25.0	5.887	0.053
Block ownership: more than 50% share	91.7	28.2	100	0.0	93.8	25.0	1.509	0.470

<sup>a</sup> n=23

On average, the blockholdings in this cluster are larger, coming mainly from the manufacturing sector. The prevailing legal status is the joint stock company (although 38% of firms are limited liability companies). The firms do not deviate positively or negatively in productivity<sup>13</sup> since 46% of companies in the cluster show higher productivity than the median productive firm in the sample. Moreover, 38% of firms in this cluster are state-owned companies. The proportion of state-owned companies is much higher than in the second cluster. Almost one-fifth of firms in the cluster are foreign-owned companies; others are voucher-privatised and de-novo companies.

Data in Table 1 shows that operations and strategic management decisions in these firms are separated in approximately 71% of firms. In the same share of firms, managers and owners act unanimously and there is very high coordination of basic strategic decisions between owners, managers and workers (in 58% of firms). Eighty-three percent of firms claim that short-term adjustments to shocks are appropriate and use flexible employment arrangements to achieve these adjustments. The most widely applied forms of flexible employment arrangements are part-time employments, hiring students and using overtime work.<sup>14</sup>

This group of firms achieved the lowest level of desired employment and has the lowest assertion of the core group of employees concept among all three clusters of firms. Wages are higher than alternative wages in 75% of all companies, higher than those set by collective agreements in 42% of firms and among the highest in the country in 38% of cases. As mentioned earlier, there is one union organisation operating in most of the firms and 38% of companies claim that unions are concerned with the firm's success. With regard to loyalty, more than 80% perceive their employees as willing to do something more for the firm. About 60% of companies believe that employee loyalty level is high and that employees would remain with the firm even if they were offered a slightly better employment opportunity (e.g. better paid job). In almost 40% of all cases, workers would even be willing to make financial investments in a firm. Two-thirds of firms claim to use a participative style of leadership with employees having the right to voice their opinions, which are taken into account when making managerial decisions. One aspect of participative leadership is the presence of work-

13 Productivity was measured by added value per employee, which was used to make a dummy variable. Firms with added value per employee less than or equal to the sample median were given the value 0, and firms with added value per employee more than the sample median were given the value 1.

14 Based on managers' ranking of adjustment methods to short-term demand fluctuations, hiring part-time workers is by far the most often applied method (on a scale from 1="most used" to 5="least used," Friedman rank is 2.42). It is followed by hiring students (3.84), using overtime work (4.00), employing through agencies (4.06), using reduced working time (4.62) and using work on hold (4.74).

ers in government bodies, which exists in almost one-half of the companies. With regard to human capital investment, all companies reported training organised in line with company requirements. Moreover, the training participation levels exceed one-half of employees in 40% of the companies. Only one-third of firms show the presence of other methods of evaluation rather than a survey. More than 90% also reported having formal programmes of on-the-job training, and only a few less claim to support a formal transfer of knowledge, mostly through mentorships, instructions and teamwork. Seventy-nine percent of firms believe to have competent successors for the key positions in the company, which is achieved through the internal transfer of knowledge.

However, this highly positive image of the collaborative effects between unions and blockholders, which would confirm Hypothesis 2 a, becomes less convincing if we make an internal comparison of firms in this cluster of mostly unionised companies. Although the total number of firms is low, a more in-depth analysis shows that firms differentiate to a certain degree. Let us consider, for example, state-owned firms (nine) and foreign-owned firms (four). Wages in state-owned firms are higher than those set by collective agreements and are among the highest in the country in almost 80% of cases. All of these firms claim that workers are prepared to do 'something more' for the firm and would stay with the firm also in harsh economic times. In two-thirds of state-owned firms, workers are willing to make financial investments in the firm. However, only three state-owned firms claim to have achieved a desired level of employment. On the contrary, all foreign-owned firms have a desired level of employment. Wages are higher than those set by the collective agreement only in one case. Workers in foreign-owned firms are also more prone to leaving the firm in bad times and are not willing to make financial investments in the firm. On the other hand, foreign firms involve more than one-half of workers in internal training relatively more often than state firms. In relative terms, they also outnumber the state-owned firms in using other methods of evaluation rather than mere surveys.<sup>15</sup>

On the basis of our data, it seems that state-owned firms might resemble the behavioural characteristics of Yugoslav firms (companies managed by workers, managers and the government), where unions played an important role in defending workers' employment and wages in centralised collective bargaining processes (Prašnikar/Svejnar 1991). Good examples of such governance arrangement are the prevailing state-owned companies in the energy sector. The collective agreement in the energy sector includes a list of different compensations, including a tenure premium that puts younger workers in a disadvantaged position compared to older workers. The agreement also includes collective health insurance, new year packages for children, payment for every newborn

15 A more detailed analysis is available upon request.

child, payment for international labour day, payment for different sorts of benefits for retirees and families of the deceased workers etc., which is not included in most other collective agreements.

Due to possibility of rent-seeking behaviour emerging in the state-owned firms, a possible explanation of the highest self evaluation of internal training and on-the-job training, among all firms in the sample, might be that some of these firms do not differentiate between investments in firm-specific human capital that is expected to be value-enhancing from investments in firm-specific human capital for which this is not the case (Micco/Pages 2004; Van Essen et al. 2012). These results suggest that Hypothesis 2 b could be confirmed in the case of state-owned unionised firms.

## *5.2 Cluster of worker-liberal blockholdings*

The second studied broad cluster consists of 34 Worker-Liberal (mainly non-unionised) blockholdings with a union organisation present only in two cases. These firms are, on average, smaller than those in the first cluster. The cluster is further divided into two subgroups, i.e. in 18 Core-Periphery firms mostly from the manufacturing sector (almost 80% of firms in the first subgroup fall into this category) and 16 RE mode firms mainly from the service sector (three-quarters of firms in the second subgroup fall into service industries). Columns 3 to 6 in the body of Table 1 show different behavioural patterns of the two subgroups, which are further described in the following two subsections.

### *5.2.1 Worker-liberal manufacturing-oriented blockholdings*

These manufacturing blockholdings are smaller compared to the first cluster (see columns 3 and 4 in the body of Table 1). Limited liability companies prevail in terms of legal status (56%) and there are fewer firms having state ownership (17%). A check of the ownership structures shows that a number of blockholdings in this group belongs to privatised, formerly socially-owned firms. They are among the least productive (only one-third of firms in the group show higher productivity than the median firm).

As it is evident from the results in Table 1, the decisions in this subgroup are made with the lowest level of consensus between the owners and managers. Decisions are coordinated among owners, managers and workers in less than two-fifths of firms, and the decision-making power is highly concentrated in the hands of managers (or owners). Short-term labour adjustments to shocks were

executed in 95% of cases,<sup>16</sup> and firms adjusted employment to a desired level in more than 80% of cases. The concept of core employment is observed in 55% of firms. In most cases the wages are close to the alternative wage. The study revealed that these workers are paid the lowest wage and also have the lowest risk propensity. They are willing to stay with a firm in only one-third of cases at times of economic distress (crisis). Since the economic situation of many firms is currently aggravated, most workers would probably leave the firm if an opportunity arose. The share of firms in which workers participate, as well as the share of firms having investment in human capital, is low compared to other groups of firms. In a series of these firms they do not provide employees with even basic information about company operations. The relationship with workers is mostly transactional.

Core–Periphery employment relationships are more evident in this cluster than in the cluster of Worker–Entrenched firms. This phenomenon is similar to the description of Deakin and Reberiouxa (2009), where many companies in France are reducing the proportion of core employees in favour of agency labour and subcontracting peripheral jobs owing to pressure from financial markets. This type of firm is often found in regions of the former Yugoslavia due to one further reason: a non-transparent lengthy privatisation of former socialist firms which is, in some cases, still not completed and is characterised by frequently changing privatisation methods.<sup>17</sup> Both tendencies are also evident from our data. Firms studied in this segment operate on the verge of economic efficiency as they are more extensively involved in foreign trade, where they are faced with a higher level of competition (see additional information in Table 1). Moreover, non-transparency and corruption of fast ownership concentration in the hands of new owners are often cited as the main reasons for dissatisfaction in certain firms where managers (owners) exercised high controlling power.<sup>18</sup> Consequently, these firms are, in most cases, domestically owned.

### 5.2.2 Worker–liberal service–oriented blockholdings

This subgroup comprises mainly of limited liability companies. Their productivity is higher than in the median firm in 77% of cases, which makes this group of firms the most productive of all three clusters. What would be the driver of

16 Based on managers' ranking of adjustment methods to short-term demand fluctuations, hiring part-time workers is most commonly applied (Friedman rank: 2.53). It is followed by using overtime work (3.61), using reduced working time (3.78), employing through agencies (4.36), using work on hold (4.56) and hiring students (4.58).

17 In a study of Montenegrin firm behaviour in the period from 1998 to 2009, Koman et al. (2015) found that too many Montenegrin firms have been lost in the privatisation process due to badly designed and non-transparent rules. Stripping assets was a more lucrative strategy than building value.

18 See for example World Bank (2000).

above average efficiency of this subgroup of firms? Our data could certainly point to one fact. Namely, this group of firms is characterised by cooperative behaviour between the main stakeholders (managers, workers and owners), which might be value enhancing. This is already evident from the answers received to the first set of questions. The results about the level of cooperation in decision-making under the 5<sup>th</sup> and 6<sup>th</sup> column of Table 1 body show a high level of consensus between owners and managers, and coordination of decisions with workers as well. Firms adjust well to short-term employment, economic shocks<sup>19</sup> and to a desired level of employment. Firms also highly address the concept of a core group of employees. Workers have higher wages than those set by collective agreements in almost 70% of firms. It was claimed by 57% of firms that they are among the highest in the country.

Workers' participation in decision-making is observed in almost all firms. Workers are well informed, have an open dialogue with managers, are members of governing bodies in 45% of firms, and their risk propensity is high. They are willing to make financial investments in the firm in 43% of cases. Investments in human capital, in the form of investments in internal training as well as on-the-job training, are present in the majority of firms. Yet, workers in these firms are not organised in unions. Collaboration with managers (owners) is voluntary and developed as a result of mutual recognition that management's capabilities and workers' capabilities are necessary for value-enhancing activities. Their cooperation is an important factor of company success.

This group of firms resembles the RE model developed by Aoki (2010) in which the cognitive assets of management (MCA) and those of workers (WCA) are reciprocally essential. Without joint cooperation, neither of them can increase marginal product simply by substituting the use-control of non-human, physical assets (PHA) to the other. The results also support Hypothesis 2 a. Such internal environment evolved especially in the service sector (three-quarters of cases), which presented one of the major shortcomings of the former Yugoslavia along with the absence of small and medium-sized enterprises (Petrin/Vahčić 1990), and was, thus, able to attract a young, educated labour force.

## 6. Conclusion, limitations and future directions

The Republic of Srpska is one of the entities constituting Bosnia and Herzegovina and a representative case of a transitional economy where we were able to study corporate governance and productivity differentiation through the development of labour market institutions. There is almost no information on this is-

19 Managers ranking of adjustment methods to short-term fluctuations in demand gave priority to hiring part-time workers (Friedman rank: 2.66). It is followed by employing people through agencies (3.63), using overtime work (3.63), hiring students (3.91), using reduced working time (4.59) and work on hold (4.56).

sue available from countries of the former Yugoslavia, where peculiar labour relations played an important role in the past. The Republic of Srpska preserved Yugoslav labour institutions long after the disintegration of Yugoslavia occurred in 1991. However, the situation has been strongly influenced by economic reforms on account of privatisation, liberalisation, and globalisation in the past decade. One of the purposes of privatisation was to reform corporate governance and increase firm efficiency. The shareholder-oriented model was perceived as becoming the prevailing mode of a firm's corporate governance. However, our results indicate that voucher-privatised firms in the Republic of Srpska are a temporary phenomenon. As mass privatisation was introduced along with the launch of liberal reforms, a convergence to concentrated ownership and diversity of blockholdings is a prevalent tendency under these circumstances.

By studying blockholdings in the Republic of Srpska, we identified various types of corporate behaviour and organisational architecture transformations in the framework of different labour institutional arrangements. Significant differences in blockholdings' behaviour, based on the level and type of (institutional) empowerment of workers, can be observed. Our analysis identified two broad clusters that behave as Worker-Entrenched blockholdings and Worker-Liberal blockholdings, with the latter further divided into two subgroups of predominantly manufacturing Core-Periphery mode firms and service Reciprocal-Essentials (RE) mode firms. In Worker-Entrenched blockholdings most workers are members of (mainly one) labour unions, and achieved fairly good results in terms of collaborative efforts of blockholders and unions. But, some unions (particularly in state-owned firms) might evolve rent-seeking behaviour.

Most workers in the cluster of Worker-Liberal blockholdings are not associated with unions. The owners and/or managers are the dominant decision makers in the first subgroup of profit-maximising, Core-Periphery firms, which are the least productive. The Core-Periphery model is likely to be the outcome in many cases of privatised firms. The second subgroup of blockholdings with Reciprocal-Essentials (RE) mode of organisational architecture has developed under the influence of technological changes. It represents an important segment of business that emphasises reciprocity of management and core workers' cognitive assets, and is the most productive of all groups.

Different labour relations in firms and various types of corporate governance resulted in blockholding diversity that might promote the selection of corporate governance modes in favour of those that utilise new technologies better and increasingly on the global scene. The RE model is a very good example of such type of firms. Diversity also makes an economic system more adaptable to environmental change, as well as more robust to economic shocks.

The case of the Republic of Srpska clearly shows that a design toward a unified group of firms was a difficult endeavour and that it failed for different reasons.<sup>20</sup> This endeavour also brought along some lessons that are important in a broader context. Collaborative effort on the side of blockholders and unions (workers) could be value enhancing and might increase the company efficiency. However, a monopoly-oriented union could present an obstacle for further development of this collaborative approach. This means that institutional similarities to the Yugoslav system, cooperative behaviour of constituents on the one side and high impact of the state and politically influenced unions on outcomes of central bargaining on the other side, are still present and they affect the way companies behave.

Groups of firms in this study were obtained through the analysis of a unique dataset. The data was gathered through a psychometric questionnaire asking managers about different characteristics of decision-making in the firm. We applied a technique of cascading closed questions. In some cases, open questions might have been better, but enterprises in the Republic of Srpska do not have experience with (such) research, so managers were suspicious about their rationale and, therefore, reluctant to cooperate.

The limited sample size is a limitation of this study. However, we are satisfied with the number of responses considering the circumstances. This research gives hope that even more companies will be prepared to cooperate in the future and make research in the respective region.

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## An integrative view on managerial discretion: A study of a Russian firm in transition\*

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*What are the forces that influence strategic managerial decisions in the context of economic transition? In this paper, we analyse how strategic and governance forces influence the degree of discretion perceived by managers operating in the context of the transition economy of Russia. An exploratory case study provides insights about the managerial decision-making process in a transition economy through the exploration of context-specific factors that shape the perceived degree of managerial discretion. The findings of the paper redefine the concept, indicating the existence of a relationship between strategic and governance forces and their joint influence on managerial discretion. Our results provide a number of practical and theoretical implications for the managerial decision-making process in Eastern Europe.*

*Key words: managerial discretion, strategic management, corporate governance, transition economies, case study, Russia (JEL: L11, P20)*

### 1. Introduction

The concept of managerial discretion can be defined as a manager's latitude of actions and the latitude of objectives which influence the ability of an organization to adapt to the forces of its external environment (Shen/Cho 2005; Ponomareva 2013). The latitude of actions refers to the number of strategic options available for managers, while the latitude of objectives refers to the extent to which managerial objectives are aligned with the firm's objectives. The twofold definition reflects the presence of two largely independent streams of research on managerial discretion that are taking place within the fields of strategy and governance research.

Although strategy researchers associate the increase of managerial discretion with a higher influence of managers on strategic outcomes for both the good and the bad of their firms (Carpenter/Golden 1997), governance researchers are more concerned with preventing managers from misusing their discretion in organizations (Shleifer/Vishny 1997). These different agendas have led to some-

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what conflicting perspectives as to how managerial discretion affects organizational functioning.

Yan, Chong and Mak (2010:521), representing the strategy side, define managerial discretion as 'coherent, rational, unified decisions executed by managers to achieve organizational development'. Results of their study performed in an international joint venture in China suggest that a greater degree of managerial discretion is associated with a larger range of developmental opportunities for a firm. An opposite view on discretion presented by Mayers and Smith (1994) provides evidence that a higher degree of managerial discretion will be associated with higher agency costs for the firm. These two perspectives, evolving independently in the literature, indeed can be seen as complementary to each other. The strategy perspective analysing the concept of managerial discretion in terms of agency benefits such as strategic flexibility may be complemented by the governance view on discretion, which focuses on the transaction costs, recognizing the double-edged sword of the concept of managerial discretion.

In this paper, we attempt to answer the calls of previous researchers to address this discrepancy of perspectives (Shen/Cho 2005; Caza 2012) by providing a theoretical framework as well as an empirical illustration (within the distinct institutional environment of Russian economy) of the concept of managerial discretion. Our theoretical contribution lies in integrating the two previously isolated perspectives by building a conceptual model of managerial discretion. The empirical contribution of the present study lies in an empirical illustration of strategic and governance forces that define the boundaries of managerial discretion in the context of economic transition. As opposed to analysing managerial discretion through a prism of objective proxy-measures, we focus on understanding how managers themselves perceive the factors that shape their discretion.

The structure of the paper is as follows. First, we present a theoretical model of our research. Subsequently follows a review of the literature on managerial discretion within the strategic management and governance perspectives, respectively. Then, an illustrative empirical case is presented, followed by the description and analysis of the main findings, where we elaborate on the integration of the two perspectives and their role in shaping managerial discretion. Conclusions, limitations, and directions for future research complete the paper.

## **2. Theoretical and conceptual framework**

The conceptual model is grounded within an integrative view on the concept of managerial discretion which combines strategic management and corporate governance research perspectives. The strategic management view, which depicts discretion as the latitude of managerial actions is grounded within the upper echelon perspective (Hambrick/Mason 1984). Within this perspective, managerial

discretion has been argued to moderate the relationship between top management team (TMT) characteristics and organizational outcomes (Filkenstein/Hambrick 1990; Hambrick 2007), with a primary, positively inclined argument that increasing managerial discretion will strengthen the influence of TMT characteristics on the organizational outcomes.

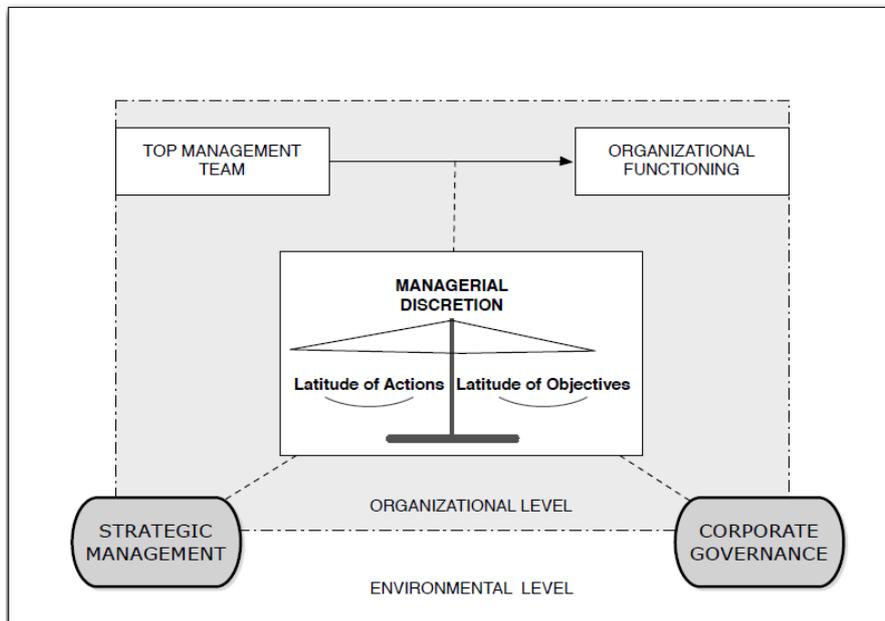
The corporate governance perspective, grounded within the agency theory of a firm, views managerial discretion through a disciplinary lens (Shleifer/Vishny 1997), referring to it as a latitude of objectives. The agency theory focuses on the potential conflict between owners and managers within a corporation, viewing managerial discretion as a grey area where managers may maximize their own benefits at the expense of shareholders' capital and profit (Jensen/Meckling 1976). A divergence of managerial interests from the interests of a firm may have a bearing on the agency costs for a firm (Lang et al. 1995); thus, an increased degree of managerial discretion is assumed to require closer monitoring (Miller 2011).

Viewing managerial discretion from only one viewpoint may considerably limit its conceptualization. In particular, the strategy perspective does not address the agency costs arising from the misuse of discretion by managers, whereas the governance literature overlooks the strategic opportunities associated with managerial discretion. Through the integration of the two perspectives, we present a more comprehensive view underlining the multifaceted nature of the concept.

### *2.1 Strategic perspective on managerial discretion*

The main assumption of strategic management research states that managers are responsible for the strategic development of a firm, that is, for adapting an organization to the forces of the external environment (Chandler 1962). The upper echelons perspective (Hambrick/Mason 1984) has provided a further rationale for why managers matter for the organization, asserting that decisions in a firm are usually made by the top management team rather than by the CEO alone, and the decisions made would reflect the bounds of the team's rationality. The empirical investigation of links between TMT composition and organizational outcomes has revealed largely mixed results, associated with the existing complexity of the relationship (Umans 2013).

An opposing perspective on managers' influence on organizational outcomes is presented by the environmentally deterministic view on organizations, in particular organizational ecology and neo-institutional theory perspectives. The organizational ecology perspective argues that organizations unable to change from within die because of the existence of organizational inertia (Hannan/Freeman 1977). Neo-institutional theorists support that notion, claiming that institutional forces have a profound impact on shaping organizational outcomes (DiMaggio/Powell 1983).

**Figure 1: Managerial discretion: framework of analysis**

In response to the conflicting arguments in the field, Hambrick and Finkelstein (1987) have suggested the concept of managerial discretion as a theoretical lever to explain the influence of the executive team on a firm's strategic choices. The authors assert that executive influence on organizational outcomes may vary depending on the level of managerial discretion. Their seminal work has laid a foundation for a subsequent body of research exploring managerial influence on organizational outcomes, using managerial discretion as a moderating variable.

## 2.2 Strategic factors defining managerial discretion

Within the framework of strategic management research, managerial discretion is viewed as an aggregate concept, comprised of multiple determinants at environmental, organizational, and individual levels of analysis (Hambrick/Finkelstein 1987). The task environment level of discretion refers to the macro environment in which the organization is operating. The model proposed by Hambrick and Finkelstein (1987) depicts the environmental factors through the analysis of product differentiability, market growth, industry structure, quasi-legal constraints, and powerful outside forces.

The general assumption is that high rates of product differentiability will provide more opportunities for managers to act upon, thus positively influencing the de-

gree of managerial discretion. A second presumption is that high growth rates of a market may be associated with the increased number of resources and opportunities available within a market as well as an entrepreneurial mode of action. Oligopolistic structures characterized by several main competitors may decrease the degree of managerial discretion in comparison to more competitive industries, where the competition has not consolidated. Subsequently, it is assumed that the heavier the burden of legal requirements, the fewer options managers have in their discretion. Further, the existence of powerful outside forces such as suppliers and buyers may decrease the latitude of actions available for managers.

The organizational level of managerial discretion may be characterized by three main factors: organizational inertia, resource availability, and powerful inside forces. According to Hambrick and Finkelstein (1987), the more inertial forces that exist within an organization, the less is the scope of discretionary power available to managers in that organization. Inertial forces may be represented by hierarchical structure and a strong corporate culture.

The availability of a firm's resources can have a positive influence on the degree of managerial discretion. The literature on organizational slack shows the importance of uncommitted resources for managers to initiate strategic change and development (Bourgeois 1981). Furthermore, Hambrick and Finkelstein (1987) refer to internal political conditions as powerful inside forces shaping the degree of managerial discretion. In support of this, Finkelstein and Hambrick (1990) found that organizations characterized by a high level of managerial discretion show a stronger relationship between TMT tenure and a firm's strategic persistence. This indicates that through time, managerial teams characterized by a high level of discretionary power may have a stronger influence on a firm's strategic development.

### *2.3 Corporate governance view on managerial discretion*

The governance view on managerial discretion focuses on problems arising from the utility maximization motive of individual behaviour in the presence of a separation of management and risk-bearing functions (Fama 1980). Studies focusing on managerial discretion from a governance perspective have largely relied on transaction cost economics (Williamson 1981) and the agency theory of a firm (Jensen/Meckling 1976), emphasising how to align managerial objectives with the objectives of the principal of the firm.

Miller (2011) found that, firms with a strong system of governance are more likely to be present in environments that require a higher degree of managerial discretion. These results suggest that a high degree of managerial discretion needs to be controlled through effectively enforcing a system of governance mechanisms. In support of this argument, Morellec (2004) used the concept of managerial discretion to explain observed financial leverage ratios across firms,

showing that low levels of debt financing are due to high levels of managerial discretionary power. This leads to the presumption that managers may use their discretion in order to pursue their private interests of 'empire-building' activities at the expense of shareholders' interests, resulting in agency costs for the firm.

### *2.3.1 Governance mechanisms*

The agency costs due to self-interested behaviour of managers can be mediated effectively by a set of corporate governance mechanisms. These mechanisms are designed to protect investors and to assure that they receive the returns on their profits, simultaneously allowing managers to perform their tasks of running the company in a way that maximizes shareholders' value (Shleifer/Vishny 1997).

According to Shleifer and Vishny (1997), the mechanisms of corporate governance include ownership structure, executive compensation, financial capital structure, and the managerial labour market. Previous research has discussed the roles of the market for corporate control (Manne 1965) and the role of the board of directors (Fama 1980) as monitoring mechanisms of managerial behaviour. Previous research has also shown that ownership structure has a significant influence on a firm's strategic choices (Thomsen/Pedersen 2000). Large block holders are assumed to possess more power that is significant and more opportunities to influence the management team (Moerland 1995). Concentrated ownership structure is seen as a mechanism to limit managerial discretion through increased monitoring of the top managers. On the other hand, the presence of CEO duality, when a single individual serves both as CEO and chair of the board (Rechner/Dalton 1991), can substantially increase managerial discretion, through the consolidation of CEO power (Harrison et al. 1988).

According to the assumption in the managerial labour market, if the manager is no longer performing well, he or she will be replaced by better candidates for the position (Moerland 1995). Consequently, high competition in the market for managerial labour will have a negative effect on managerial discretion because of the constraints associated with future employment opportunities for managers.

According to pecking order theory, the information asymmetry between a firm's investors and managers creates incentives for managers to prefer internal to external financing (Myers/Majluf 1984). Morellec (2004) asserts that managers tend to prefer equity financing to debt financing because of the decreased discretion associated with debt capital structure. According to the agency perspective, debt financing is expected to significantly decrease managerial discretion through limiting free cash flow within the firm (Jensen 1986; Maug 1997).

According to the classic work by Manne (1965), the market for corporate control refers to the competition over control of resources. Well-functioning markets

for corporate control are assumed to decrease the degree of managerial discretion because of the threat of seizure of control over a firm's assets by other control groups (Fama 1980; Shleifer/Vishny 1997).

According to Fama (1980), the board of directors represents an institution created to monitor the set of contracts representing a firm. Maug (1997) emphasises the role of independent directors not affiliated with the management of the firm as a mechanism for limiting managerial discretion through the negotiation of contracts. Thus, an active board and the presence of independent directors are assumed to limit the amount of managerial discretion through greater control over managerial decisions.

#### *2.4 Managerial discretion in the context of transition economies*

While recent studies indicate a rising interest in and the increasing need for research conducted in novel institutional environments (Barkema/Baum/Mannix 2002; Kirkman/Law 2005), the majority of studies on managerial discretion have been set within the context of stable institutional environments of Western economies (Hambrick 2007). Simultaneously, relatively few researchers have focused on companies operating in more dynamic environments such as emerging markets (Yan et al. 2010). Even less research has been conducted within the sub-category of emerging markets–transition economies.

Transition economies refer to economies undergoing a process of economic transition from a state-planned to an open market economy (Peng 2000). These economies are usually characterized by an ongoing process of institutional change (Hoskisson et al. 2000) as well as by the presence of a high level of institutional uncertainty (Khanna et al. 2005). Institutional changes, in the context of rapid conversion from planned to market economy and as a consequence the institutional uncertainty, often make flexibility and the adaptive capacity of the firm operating in these environments an important characteristic for their survival. On the other hand, such context implies a specific selection of governance mechanisms that exist in transition economies. Consequently, the exploration of the adaptive capacity of the firms and the governance mechanisms in context of economies of transition presents a worthy endeavour of developing management theories and understanding the specificity of the managerial decision-making process within this unique institutional context (Hoskisson et al. 2000).

Previous research has argued that the institutional environment affects the freedom that managers face when undertaking strategic decisions (North 1990; Peng 2003). On one hand, strategic constraints in the forms of market imperfections, institutional voids, lack of capital and managerial expertise impose significant limitations on managerial actions in transition economies. Another important obstacle is the poorly functioning institution of property rights, particularly in the case of the Russian economy (Gans-Morse 2012). The presence of a wide spec-

trum of political risks highlights the necessity of a better strategic fit of an organization to the context of its external environment, signifying the importance of the strategic flexibility of the firm (Iankova/Katz 2003). On the other hand, the fast pace of economic growth has brought opportunities for firms to capitalize upon what could not be found in developed markets. Increasing participation in the global economy through joining trade organizations along with growing domestic markets has opened new possibilities, challenging firms to compete in a global arena (Hoskisson et al. 2000).

The absence of functioning formal institutions is replaced by a mix of informal institutions (Peng 2003). Despite substantial improvement, problems associated with corporate governance in transition economies remain present, including weak protection of minority shareholder rights and inefficient board structure (Tipuric et al. 2012). The governance system of transition economies can be characterized as relationship-oriented (Babic 2003), where firms rely largely on informal personal contracts, business groups, and networks. Another important characteristic of these economies is the presence of a concentrated ownership structure and relatively small and underdeveloped stock markets (Weimer/Pape 1999).

As argued earlier in this paper, both strategic flexibility and corporate governance are important in the context of transition, therefore the notion of forces that shape managerial discretion can more clearly emerge from this type of environment. Furthermore, the exploration of the concept of managerial discretion in the context of transition economy can bring new insights about the factors influencing the managerial decision-making process relevant for this particular type of environment.

### **3. Methods**

A theory of managerial discretion is currently in its adolescent stage (Caza 2002), lacking a unified definition of the concept. Thus, a qualitative research strategy may be more applicable because it allows for the elaboration of a description and definition of a concept. The qualitative research strategy also gives researchers an opportunity to examine how managers perceive the factors that shape their discretion and compare those observations against the theoretical framework as well as against the objective measures used in previous research. According to Hambrick and Finkelstein (1987), managerial discretion only refers to the spectrum of actions that executives are aware of. Thus, to develop a unified set of objective measures of discretion, it is crucial to acquire an in-depth understanding of the managerial perceptions of factors that determine it. Consequently, it is argued that a single case study could be an applicable research strategy when an investigation concerns highly complex topics with a rudimentary theoretical basis (Eisenhardt 1989; Yin 1994; Dul/Hak 2007).

### 3.1 Data collection

While the majority of studies in the fields of strategy and governance research focus on large listed corporations, it is the non-listed small and medium-sized enterprises that represent the prevailing majority of business entities in most of the world economies, including those in transition (Cunningham 2011). According to Hofer and Schendel (1978), small firms present a valuable context for studying fundamental managerial tasks. Moreover, governance issues are of immediate concern for smaller firms, since the information asymmetry may be considered as higher, and the roles of the owners and managers may overlap, thus making the separation between ownership and control less clear (Cowling 2003; Brunninge et al. 2007). Bearing this in mind, one may infer that the decision-making process can differ substantially in smaller firms compared to larger ones. Thus, examining how managers make strategic decisions in small companies can contribute not only to knowledge about managerial decision making in organizations but also shed some light on the governance and strategy processes within small-sized enterprises in particular. Furthermore, smaller firms may offer a more dynamic context for studying managerial discretion. They are assumed to possess higher flexibility and ability to adapt faster to market changes such as downsizing due to economic fluctuations (Cowling 2003).

The present case study of Company Alpha was designed according to the procedure described by Yin (1994): first creating the case-study protocol and subsequently conducting semi-structured interviews. Interviewing was chosen as the method for collecting data because it enables greater openness to the object of study (Alvesson/Deetz 2000). Eight semi-structured interviews were conducted with a duration between 30 minutes and 1.5 hours. The interviews took place at the main office of the company within the period of a week. Interviews were conducted with the owner-CEO and top managers of the firm. Prior to the interviews, the participants were approached by e-mails providing details about the research project, assured confidentiality, and offered interview guides upon request. With the consent of study participants, all interviews were audio-recorded and subsequently transcribed.

Other data were collected from several sources, including interviews with managers, internal documents (financial reports, corporate structure, descriptions of the main processes, production norms, etc.). Separate pilot interviews were conducted with two retired executive managers prior to the main interviews with the purpose of testing and redefining the interview guide. After minor modifications, an updated version of the guide was used for each interview (see Appendix A).

### 3.2 Case description: company alpha

Company Alpha is a closely-held, private, small-sized enterprise situated in Saint Petersburg, Russia. It was established in 1998 by the current owner-CEO. Since 2007, it has been oriented towards rapid expansion through diversification. During 2012, the number of employees more than doubled, reaching a total of 60. The current development of Alpha is directed towards transferring control of the enterprise from the owner to professional managers operating in highly diversified business units. Due to the existing uncertainty of private property rights in Russia, the owner-CEO of the company is not considering selling ownership stakes in Alpha; however, his aim is to reduce his involvement in the management of the company by delegating this role to the top managers.

Alpha has three strategic business units (SBUs): (1) wholesale lighting (55% of sales), (2) retail sales of lighting (10% of sales), and (3) metal construction (35% of sales). The firm is also involved sporadically in independent projects in the construction and real estate industries. The top management team includes three top managers responsible for the SBUs, two managers responsible for planning, an HR manager, a business development manager, a logistics manager, and the owner-CEO. All top managers report directly to the owner-CEO.

## 4. Findings

The findings of this study are presented here according to the themes that emerged through the study. Each theme is divided into sub-themes as described below. Citations from interviews, translated from Russian to English by the authors, are used to illustrate each of the themes.

### 4.1 Theme 1: strategic task environment

This theme reveals itself through the driving forces of strategic change. During the last five years, Alpha's top managers have actively monitored its external environment, seeking to capitalize on arising strategic opportunities. Managerial discretion becomes of the highest importance during the process of initiation and execution of strategic change; it is an essential condition for managerial ability to adapt the company to the forces of its external environment (Hambrick/Finkelstein 1987).

Adoption of a highly diversified business model supports the notion of experimentation and exploration of opportunities (Porter 1979). While the lighting and metal construction (MC) SBUs are the main sources of the firm's growth, further diversification prospects are explored on a project-related basis. The process of diversification helps the owner-CEO to mitigate the risks of strategic failures; however, it does not affect the risk of top managers directly responsible for each of the units. Interviews with the TMT revealed that not all projects undertaken succeeded. One example given was an attempt to produce lighting in-

dependently which had been closed down because of low returns, indicating that top managers possess sufficient discretion to initiate strategic changes in the firm. The following sub-themes exemplify the role that managerial discretion plays in the process of strategic change.

#### *4.1.1 Product differentiability*

Product differentiability in the lighting industry is perceived to be high because of the comparatively fast rotation of the products. The main rotation is made every six months, while minor changes in the product slate are made every quarter. The changes in the product portfolio indicate the ability of managers to execute strategic choices. Managers make changes independently, based on information from customers and suppliers and on personal judgment. According to Hambrick and Finkelstein (1987), high rates of product differentiability will provide more opportunities for managers to act upon, thus positively influencing the degree of managerial discretion.

#### *4.1.2 Market growth*

Top managers perceive market growth in the lighting industry as being overall positive but not significant. They attribute the fast growth of the firm's sales primarily to the increase of its market share and penetration of upper market segments, indicating that they see their products and services as highly competitive.

The recent decline in construction business closely linked to the MC segment is not perceived by managers as a strategic constraint because they see opportunities in widening their market share through offering clients a more attractive product portfolio. Apart from that, managers have also indicated that their firm undertakes large investments in facilities and equipment, which serves as an indication that the company is exploiting existing strategic opportunities and exploring new ones.

Market growth have been traditionally associated with the enhancement of managerial discretion Hambrick and Finkelstein (1987) due to the increasing number of resources and opportunities available within a market as well as with an entrepreneurial mode of action (Mintzberg 1973). The present case might indicate that even in the absence of high market growth, the opportunity to increase the firm's share of the market widens the scope of strategic choices, positively influencing the degree of perceived managerial discretion, while the comparatively narrow market size serves as a significant limitation of perceived managerial discretion.

#### 4.1.3 Demand instability

The demand for Alpha's products is perceived by top managers as stable with strong seasonality trends present in both lighting and MC segments. The seasonality trends are opposite in the two segments, mitigating the risks by allowing the company to sustain its performance throughout the year. Strong seasonal demand also indicates a high dynamism of the market, thereby creating strategic opportunities. The increased scope of strategic opportunities, in turn, signifies existing managerial discretion (Hambrick/Finkelstein 1987).

#### 4.1.4 Industry structure

Top managers perceive the lighting industry overall as highly competitive, referring to product rotation, a wide product portfolio, and the quality of products as their main competitive advantages. They indicate that they are aware of the competition and are constantly working on improving their operations, looking for new opportunities on the market. Hambrick and Finkelstein (1987) observe that more competitive industries are expected to be more open to innovative moves and non-standard strategic decisions. Operating in a highly competitive milieu and being aware of existing competition signal the presence of managerial discretion in Alpha's TMT.

#### 4.1.5 Quasi-legal constraints

The state bureaucracy is also been identified by managers as an unwanted constraint to the implementation of strategic decisions. In addition, the very idea of being involved in legal cases is perceived as a long-lasting process that may require both time and financial resources. On the other hand, the company has developed its own way to avoid it to a large extent:

*Planning department manager: 'We have such a bureaucracy thing; the bureaucracy [is] easily avoidable... If you pay ten times more, you're not going to the committees; other people will do it for you'.*

The presence of middle agents that deal with governmental authorities allows the company to minimize the time spent on obtaining necessary permits. This comes at a cost, however: the heavier the burden of legal requirements, the more limited the scope of managerial actions. The effect of such limitations is mitigated by managers through contracting with third parties to overcome the bureaucratic burden.

#### 4.1.6 Powerful outside forces

The main challenge, according to the interviews with managers and as indicated by the owner-CEO of the firm, is associated with the relationships of the firm

with its business partners. In particular, the strict terms of the contract with the main customer in the lighting segment (a retail chain) is a concern for managers.

The credit term offered by the wholesaler to Alpha is 60 days. In addition to that, the retail chain has a fixed purchase price. Sometimes changes in the supplier's conditions such as an increase in purchase price may be included in the contract with the retail chain only three months after the change is implemented. Such restrictions constrict the company to the condition of the retail chain, increasing the risks associated with breaking the contract. Maintaining the contract with the retail chain even during periods of loss is a priority for the managers.

A different dynamic can be observed in the relationship between Alpha and its main supplier. A long-term contract and developed mutual trust allow Alpha to base its competitive advantage on the close relationship with its supplier. Alpha views the supplier more as a business partner and is engaged actively in promoting the supplier's brand within the region. This, in turn, provides a larger number of strategic options and therefore has a positive influence on the degree of perceived managerial discretion.

Hambrick and Finkelstein (1987) hypothesize that the influence of powerful outside forces limits the degree of managerial discretion. In particular, the Alpha case demonstrates the influence of the main buyer as a significant limitation of managerial discretionary power, whereas the long-term contract with the supplier serves as a positive enhancement of it.

#### *4.1.7 Experiencing transition*

The interviews revealed the experience of the managers' task environment to be closely related to the context of economic transition. The specificity of transition economies was associated with poorly functioning formal institutions. Unclear jurisdiction and the need for extensive paperwork for obtaining necessary permits were seen as important elements of the context in which managers make their decisions.

Alpha's contracts with the main supplier and retail chain are complex and must be followed precisely. In order to sustain existing contracts, however, they need to be supported by interpersonal trust. Trust appeared to be important aspect for the interviewees. In particular, the word 'trust' was mentioned in relation to discretion and delegation. Trust was seen mainly as a consequence of the formal relationship and not vice versa. Managers indicated that in the relationship with their business partners, they relied primarily on the formal contracts, but trust was an important part that developed through time. Despite the formal agreement, engagement in a legal dispute could be rather costly for the company and therefore the developed trust serves as a guarantee against the unplanned costs of breaking the legal contracts.

The appearance of the concept of trust during the interviews with the top managers may be attributed to the role of trust as a complementary mechanism to enforce formal contracts (Poppo/Zenger 2002). Countries undergoing the transition process rely on both formal and informal institutions in their transactions (Peng 2003). The change of institutional settings is associated with a great degree of uncertainty, both creating opportunities but also hindering strategic development. Managers have a larger variety of choices when it comes to the enforcement of their contracts with business partners. This may indicate the enhancement of their discretion. On the other hand, reliance on informal institutions such as personal contracts undermined high initial costs (Peng 2003). Thus, managerial discretion can be enhanced by the use of personal relations, but the associated costs create a considerable hindrance to it.

#### *4.2 Theme 2: internal organizational environment*

This theme reveals itself through the managers' and owner's perceptions of the internal environment of a firm. Similar to Theme 1, the growth process has an important impact on perceived managerial discretion at the organizational level of analysis. The three central sub-themes present strategic forces that shape the degree of managerial discretion at the organizational level of analysis, including inertial forces, the availability of resources, and powerful inside forces.

##### *4.2.1 Inertial forces*

From the interviews it appeared that the final formulation of strategic goals is the sole responsibility of the owner-CEO. However, the TMT has a substantial influence on the execution of the firm's strategy, and top managers are encouraged to provide suggestions regarding strategic decisions. Before the final approval, all strategic decisions are discussed at TMT meetings:

*From an interview with the owner: 'When the team gets together, I'm saying to all my [employees] that we [are] like-minded, we are a team, we have to think in the same direction. Well, it's not just a matter of "all repeat after me..."'*

This quotation indicates the peculiarities of the decision-making process within the firm. The decision-making process appears to be team-based. Instead of separating the SBUs and managers responsible for strategy execution based on the business divisions, the strategic decisions are made in a team, which in turn may facilitate information flow, increase the participation of managers in the firm's decisions, and positively influence the degree of managerial discretion. On the other hand, this may indicate a strong socialization process, which leads to the creation of an increasingly homogeneous TMT. During the interviews, all managers and the owner-CEO were asked questions about the firm's external environment. A consensus among top managers regarding the perceived discretion deriving from the firm's external environment indicates the presence of a strong

culture and team cohesiveness. Managers are expected to act within the norms; acting against them may significantly limit the degree of perceived managerial discretion.

The culture of the company is perceived as being open to change. Indeed, change at Alpha is perceived as an ongoing process rather than a temporary event. Thus, the embeddedness of change in organizational functioning outlines the opportunities for managers to execute their discretionary power.

Simultaneously, the rapid process of organizational growth makes it more difficult to monitor the current state of the company; therefore, increasing the formalization of the main processes and the development of the internal control system are discussed in the TMT meetings. This draws attention to two processes: increasing managerial discretion because of a larger scope of activities of top managers and increasing control over managerial behaviour. Although the scope of opportunities available for managers is increasing, the formalization of processes may have a negative impact on managerial discretion. Currently, the planning department is developing a system of performance indicators according to which top managers will be evaluated for the performance of their department. This implies that the firm's fast growth is positively influencing managerial discretion, through providing more strategic opportunities. On the other hand, the increasing discretion is coming at the cost of a higher level of monitoring of managerial performance.

#### *4.2.2 Resource availability*

All of the interviewees indicated that resources can be relatively easily obtained by managers if they are oriented to the strategic development of the firm. The resources include mainly human (the company is actively hiring new employees) as well as some financial (loans for purchases of new equipment). The use of the resources is closely linked to the agenda of growth. If top managers show evidence that resources will be efficiently used to enhance the firm's growth, it becomes very likely that they will obtain them. Simultaneously, the owner-CEO has a cash-free policy; thus all monetary transactions are credited. This indicates the presence of strong control over the use of financial resources. This is in line with previous studies stating that the availability of resources increases the scope of decision-making opportunities for managers (Adner/Helfat 2003; Hambrick/Finkelstein 1987). In the case of Alpha, it may be inferred that the firm's growth positively influences the degree of managerial discretion in relation to the allocation of resources.

### *4.2.3 Powerful inside forces*

It appears from the interviews that several power coalitions are present within the company. In particular, the planning department creates an impression of being more informed about corporate strategic objectives than the managers of the three SBUs were. Their reflections about corporate strategy are more long-term oriented, whereas the SBU managers are more focused on the daily operations of their departments. The planning department managers also work closely with monitoring Alpha's financial situation, whereas department managers do not have detailed information about the financial situation and investment decisions within the firm.

This observation falls in line with the planning school of strategy (Shuman et al. 1985), which argues that the planning department has an increased influence on the firm's strategic decisions during the stage of active growth. Knowledge about the firm's processes and financial standing can be interpreted as one of the sources of managerial discretion. This, in turn, provides indications of differences arising in the degree of perceived discretion among the departments within the firm.

## *4.3 Theme 3: influence of governance*

This third theme reveals how managers and the owner define the boundaries of managerial discretion as well as the costs of exceeding it. Because of the specificity of the Russian context, attributed mainly to the presence of institutional voids (McCarthy/Puffer 2013), not all of the governance mechanisms were revealed during the interviews as important factors influencing managerial decision making and discretionary limits. In particular, the influence of the board of directors, the external audit, and the market for corporate control were not perceived by the interviewees as important factors influencing the scope of managerial discretion. Because of its relatively small size and high concentration of ownership, Alpha does not have a board of directors. The firm outsources its accounting and its audit; thus, top managers could not provide any information regarding them. The poorly functioning formal institutions of corporate governance in Russia have hindered the development of an effective market for corporate control. No indications of the potential influence of this mechanism were revealed during the interviews.

### *4.3.1 Ownership concentration*

The governance of Alpha is context-specific. Insider ownership constitutes the prevailing ownership structure among Russian firms (Wright et al. 2003). The duality of the owner-CEO position at Alpha may be associated with the unity of command, on the one hand, leading to the enhancement of managerial discretion

of the owner-CEO, but may also lead to a decrease in the discretion of top managers. In the context of the poorly functioning institutions of private property, ownership concentration becomes of increasing importance as a control mechanism monitoring the disciplining of managerial behaviour (La Porta et al. 1998):

*From the interview with the owner-CEO: 'I define the scope of competence, and within [this] competence a person has the right to undertake decisions. Accordingly, when it is within his [her] competence, the person shares responsibility with me equally. I delegate it to him [her]. If a person exceeds it when undertaking decisions and thereby some costs are obtained, these costs he [she] should cover himself [herself]'.*

This quotation indicates that the owner-CEO perceives himself as the key shaper of managerial discretion. He is also aware of the limits of discretion that he assigns to the managers. The increase of managerial discretion needed to execute strategic change within the company comes together with an increasing cost of higher responsibility for managers. In addition to that, business risks assumed by managers are shared between the owner-CEO and the responsible top manager.

#### 4.3.2 Market for managerial labour

Several interviewees mentioned that reputation plays an important role for managers. All of the interviewed top managers were 'headhunted' by the company from their competitors or business partners (suppliers, retail chains).

The context of economic transition implies certain specificities. First, a very limited number of professionals have the necessary skills and education to manage companies effectively. The majority of current managers received their education and work experience during the planned economy and thus lack the experience of working in a market economy. Second, the current number of professional executives cannot be absorbed by the market because of high salary demands. This context may serve as a strong inducement for managers to perform because 'headhunting' by another company often implies a substantial raise in compensation. Looking for employment independently may compromise the salary demands for the managers. On the other hand, 'headhunting' may serve as an indication of governance, through selecting highly competent professionals within a business sector. Consequently, it can be assumed that the asymmetry of the managerial labour market may have a negative influence on the perceived degree of managerial discretion.

#### 4.3.3 Capital structure

Alpha uses different sources for financing its business development. The initial capital investment was made from the owner's personal capital, while later the company increased its share of borrowed capital. According to Devyataeva (2013), a collateral loan for small- and medium-sized enterprises in Russia can be obtained at a 20–25% interest rate. Yet most of Alpha's capital investments

are financed by bank loans. The decision to borrow capital was made by the owner mainly because of the favourable conditions negotiated with the bank and, second, as an indirect attempt to discipline managerial behaviour. According to the owner, the use of credit disciplines managers, making them more conscious and transparent about the use of the capital. Consequently, the preference towards the use of the borrowed capital indicates the negative influence on the scope of perceived discretion by the top managers.

#### 4.3.4 Managerial compensation

The top managers claimed that their salaries are higher than market salary. This may serve as an indication of increased discretion because they are expected to make more decisions in the company during the growth process. Higher level of compensation can be a leverage of risk undertaken throughout the decision-making process. Prior studies have shown that executive compensation in lower-discretion industries tends to be lower, whereas a higher level of executive compensation is attributed to higher-discretion industries attributing it to the ability of managers to influence firm outcomes (Finkelstein/Boyd 1998). The small size of the company implies that managers may have a less defined task spectrum and a wide array of responsibilities; a higher level of compensation thus may serve as a mediator of the increased risks.

#### 4.3.5 Emerged differences in perceived managerial discretion

When it comes to the perception of factors that may limit the degree of managerial discretion, striking differences were observed in the perceptions of environmental influences between the managers and the owner-CEO. In particular, management perceived factors such as quasi-legal constraints and the firm's relationship with its main client as being constraints to the firm's strategic flexibility:

*From an interview with the planning department manager: 'The agreement [with the main retail chain] is very serious and not flexible, and, well, it was signed [a] long time ago and for any changes of the conditions, sometimes it takes almost half a year... In this regard, we are very vulnerable ... seriously'.*

In contrast, the owner-CEO perceived it as an opportunity to improve the internal efficiency of the firm.

*From an interview with the owner: 'It organizes, it makes you think, it makes you move, and we are doing this. So I do not see the problem here'.*

The strict conditions of agreement with the main retail customer force the company to improve the efficiency of its internal processes. The high interest rate makes managers more conscious about how they use available resources. This may be interpreted as a balancing act. With the uncertain external environment, increased control and discipline are needed for the firm to sustain these chal-

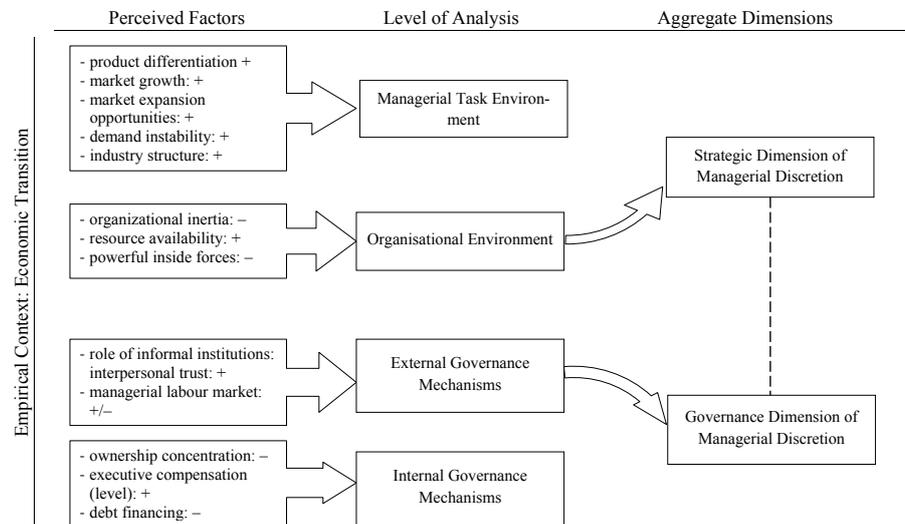
lenges. The external challenges are hard to manage for a small-sized company like Alpha. However, it is comparatively easy to implement internal changes that help the firm adapt. This can be considered as a factor limiting managerial discretion and increasing the transparency and control available to the owner of the firm. While realizing the challenges coming from the external task environment, the owner views these as an advantages in aligning these interests with those of the firm's managers.

## 5. Summary of empirical findings

The model in Figure 2 summarizes the key findings of the study. It depicts factors that shape the degree of discretion perceived by the managers at Alpha; the factors are grouped into two levels of analysis: external environmental and internal organizational levels and subsequently congregated into strategic and governance dimensions of managerial discretion. It is important to highlight that factors appear to be context-specific.

Strategic forces derive from the managers' task environment as well as from the organizational environment. At the task environment level of analysis, factors including product differentiation, market growth, market expansion opportunities, demand instability, and industry competition were seen as positively influencing the degree of perceived managerial discretion. The present study aimed at exploring managerial perception of factors that determine their discretion. While the majority of earlier suggested factors were perceived as being important in the decision-making process by managers, some new factors appeared as important. Managerial perceptions largely depend on the context of the firm. Transition economies, characterized by the presence of both formal and informal institutions present an environment where informal ties of the manager constitute an important factor determining their discretionary power.

When it comes to the forces within the managerial task environment, it is important to note that while market growth was considered to be relatively low, market expansion opportunities were seen as an important factor that considerably enhanced the scope of strategic managerial choices. On the other hand, quasi-legal constraints and powerful inside forces, manifested primarily by suppliers and main customers of Alpha, were viewed as negative influences on the degree of discretion perceived by managers. At the organizational level, managers perceived organizational inertia and powerful inside forces as negatively influencing the degree of managerial discretion, while access to resources was viewed as an important factor enhancing it.

**Figure 2: Forces shaping the degree of perceived managerial discretion at Alpha**

External governance factors were closely related to the institutional environment of transition. In particular, the role of informal institutions such as interpersonal trust was seen as an important factor positively influencing the degree of managerial discretion. The managerial labour market was perceived as having both positive and negative influence on the level of discretion by managers. On one hand, the shortage of qualified managers was a positive influence, while high salary demands that could not be met by firms were viewed as a negative influence on the level of perceived discretion. The internal mechanisms of corporate governance included the level of managerial compensation, ownership concentration and the choice of capital financing. The level of managerial compensation was also viewed as an influential factor enhancing managerial discretion. In particular, higher level of salary was associated with greater discretion as a compensation for the risk undertaken in decision making. On the other hand, the presence of a strong owner as well as debt financing were perceived as factors that discipline managerial behaviour through limiting the scope of their actions.

## 6. Discussion and conclusions

This study provided insights about factors that shape managerial discretion in the context of economic transition. The study identified several factors that may affect the scope of perceived managerial discretion among the top managers of a small-sized firm operating in the Russian economy. At the environmental level, it was revealed that factors including product differentiation, market growth, demand instability, industry structure, quasi-legal constraints, and the power of

suppliers and buyers might affect the scope of strategic opportunities recognized by managers. In addition, context-specific environmental factors such as the role of informal institutions, and trust in particular, were identified as additional factors influencing the degree of managerial discretion. Internal organizational factors such as the perceived degree of organizational inertia, resource availability, and perceived differences in discretion among organizational groups were seen as important determinants of the perceived level of managerial discretion. The role of governance structure appeared also as an important determinant of the perceived degree of managerial discretion. In particular, governance mechanisms including ownership concentration, the managerial labour market, the level of executive compensation, and the firm's financial capital structure were revealed as important determinants of the perceived degree of managerial discretion.

This paper contributes to the development of the literature on managerial discretion in several ways. First, the study contributes to the advancement of a theory of managerial discretion by providing an integrative perspective on the concept. In contrast to previous research, where the majority of studies used the concept to study other organizational outcomes (Finkelstein/Hambrick 1990; Li/Tang 2010) and based on the objective quantitative measurements of managerial discretion, this research focused on exploring the multifaceted nature of the concept of managerial discretion through examining individual perceptions of managers. Our results indicate that managerial discretion can be revealed as a combination of forces of strategic flexibility and governance forces directed towards the disciplining of managerial behaviour. This case study presents an in-depth illustrative description of forces that managers see as important determinants of the level of their discretion. The findings of this paper resonate well with previous research combining multiple perspectives to study managerial discretion (Shen/Cho 2005; Finkelstein/Peteraf 2007).

Second, the paper advances existing knowledge on the concept of managerial discretion by exploring the interdependence between strategic and governance forces. In particular, our data indicate that governance may impact the scope of recognized strategic opportunities. As an example, concentrated ownership combined with the CEO role makes the owner a single threshold determining the nature of corporate strategy, thus limiting the ability of the firm to adapt to the forces of its external environment. On the other hand, we can also observe that the nature of strategic opportunities influences governance structure. As an example, the strict conditions of the contract with the main buyer are perceived as a disciplinary mechanism for managerial behaviour. They increase transparency and improve monitoring.

Third, the present research has provided an empirical illustration and a refinement of the spectrum of forces that shape the degree of managerial discretion.

The mixture of forces is context-specific because the study was carried out on a company operating within the process of economic transition. The specificity of the Russian business context allowed us to differentiate between formal and informal governance mechanisms, thus contributing to the literature arguing for their complementarity (Poppo/Zenger 2002). In line with Peng's (2003) propositions, the study revealed both formal and informal contracts to provide the structure of economic transactions within and outside the firm. Interpersonal trust was seen as an important guarantee that strengthens the legitimacy of formal contracts. Moreover, the findings indicate that in environments characterized by economic transition, governance forces are rather context-specific. In particular, the results indicated that external instruments of corporate governance such as market for managerial labour or market for corporate control might not be fully functioning, while internal organizational mechanisms such as ownership concentration may be more relevant for managers in defining their discretionary level. These findings indicate that the array of factors that define managerial discretion may depend on the context where managers operate. The concept of managerial discretion originated in the Western context; but when applied in the context of transition, it becomes apparent that both formal and informal institutions need to be considered when defining the boundaries of managerial discretion.

The present study has contributed to the operational definition of powerful forces. In particular, it has illustrated how the relationships of a firm with its buyers and suppliers affect the degree of perceived managerial discretion. Previous research has often omitted these factors as a potential influence on managerial discretion because of the somewhat vague description provided in the initial model proposed by Hambrick and Finkelstein (1987).

Our study has several limitations. First the concept of managerial discretion was explored in the case of a single firm, which excludes the possibility of generalizing findings to other firms. The empirical study was conducted in the distinct institutional environment of a particular stage of economic transition. Thus, it would be interesting to explore the application of the present conceptual model to different stages of economic transition in order to capture the dynamic nature of managerial discretion (Finkelstein/Peteraf 2007). Our study analyses managerial discretion at a particular moment within a firm. It would be interesting to analyse the dynamic of managerial discretion through time. Longitudinal studies of managerial discretion could be a fruitful endeavour for future research.

This study outlines several interesting directions for future research. The applicability of the model may be explored further by applying it to various institutional environments. Exploration of the interrelationships between strategic and governance forces of discretion may be explored further in empirical research. More research on the larger samples of companies varying in industries and

sizes may serve as a worthy endeavour for developing and testing theories of managerial discretion. Using an integrative approach to measure managerial discretion may contribute towards further refinement of operationalization of the concept.

This study has also a number of managerial implications. First, by illuminating the forces shaping managerial discretion, the study provides for both managers and owners of firms in the context of economies in transition an understanding of how internal and external forces in interaction create the limits of managerial actions. In particular, it is important to stress the existence of the double-edged sword of managerial discretion. While for managers the scope of strategic actions can be of the most importance, owners may find the governance forces to be important in order to assure that their interests are aligned with managerial actions. Second, the findings of this paper could be useful to the owners of established and potential new entrants into the Russian market, showing how governance structures and strategic factors might hinder or enhance strategic flexibility of the firm, illuminated through the prism of managerial discretion. This implies that owners may face a choice between providing the managers with high level of discretion necessary to adapt to a fast-changing environment and by imposing governance mechanisms that are aimed at limiting opportunistic behaviour by managers. Third, results of the study could be useful to managers of firms that find themselves in economies in transition, in understanding the expectations imposed on them by governance and strategy factors, as well as providing some answers as to how their individual perceptions of managerial discretion might collide with ones imposed by the organizational and external organizational factors.

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## Appendix

*Appendix A: questionnaire used to guide interviews with managers.*

### 1. General questions

Warming up

- Please tell me about yourself and your career. When and from which position did you start working in the company?
- Could you please tell me a short history of the company. How was it established?

### 2. Strategy-related environmental factors

#### 2.1 Intro/macro environment perception and experiences

##### 2.1.1 General macro environment questions

- Please describe what characterizes doing business in Russia? What makes it hard/easy?
- How would you describe the environment your firm operates in? What are the important factors that you as a manager should consider when making decisions/planning?

##### 2.1.2 Macro environment through PESTLE

- How would you characterize the *political* situation in the country? Which political factors in your opinion are the most important to consider when you make decisions in the company?
- How would you characterize the *economic* environment of Russian business? Which economic factors in your opinion are the most important to consider when you make decisions in the company?
- How would you characterize the *social* environment of Russian business? Which economic factors do you consider as important for your decisions as a manager?
- What are important *technological* economic factors that influence your decisions as a manager
- Legal factors were explored in section 2.4.1.
- What are important *environmental* factors that influence your decisions as manager? (for example, regulations regarding environment, pollution, etc.)

#### 2.2 Industry level environment

##### 2.2.1 Industry competition

Porter (1979) Five Forces Analysis:

- Buyers: Who are the main buyers of your product? Please describe them.
- Suppliers: Who are your main suppliers? How long have you been working with them? How difficult/easy is it to change suppliers? How difficult or easy is it for the buyers to change partners they are working with?

- Barriers of entry: How difficult/easy is it to establish a business in your industry? How difficult/easy is it to liquidate a business in your industry?
- Threats of substitutes: What are the alternatives choices your customers have to buying your product/service?
- Competitive rivalry: Who are your main competitors? Please describe the overall competition within the industry.

#### 2.2.2 Product differentiability

How often are your products/services changed/updated?

#### 2.2.3 Market growth

- Which industry/industries do you compete in? How fast in your opinion does the market grow in each of the industries? How stable is the growth/decline? If you have such information, compare the industry(ies) growth you are operating in to other industries.
- What is the demand for your products/services? Is it seasonal? How is demand for your products changing through time? What influences the changes?
- What are the forces of influence within the industry(ies) you are operating in do you take into consideration in your decisions as a manager? Which actors on the market you consider as the most influential? Please provide some examples.

### 2.3 Macro environment (specific forces for economies in transition)

#### 2.3.1 Quasi-legal constraints and facilitators

- In your opinion, what is the amount of regulations and laws that constrain your actions as a manager of the firm? (many/few) How important is it to follow them? How easy is to avoid them (for you personally and for the managers of other companies)?
- Are there any regulations that give your firm an advantage compared to other firms (laws oriented towards competitors)?

#### 2.3.2 Powerful external forces

- How does your company interact with the governmental authorities? How do you personally interact with the governmental authorities? Which level of authority: municipal or national? Provide some exemplary situations where you as a manager had to communicate with the state authorities.
- How important are informal connections (*svyazi*) in your business? How do maintain your networks? How do you establish new ones?
- Are there any other influential actors that you acknowledge as a manager and also your company functioning in the process of adoption strategically important decision?

### 3. *Organizational factors*

#### 3.1 Inertial forces

- Please provide an example of an important strategic decision which could lead (or has led) to radical changes in your company? How hard/easy would it be / was it to implement? Why?

(In case one received short answers, the follow-up questions will elaborate on the following):

- Hierarchical structure: How many organizational levels are involved in creating and implementing important strategic decisions? How are decisions made in your company?
- Organizational culture: Please describe the existing culture/climate within your organization. How would you describe the existing attitudes towards change within the firm? Is it hard to bring change in the existing routines within the company? Why?
- Size of the firm. How many employees does your firm have? (Optional: Please compare the company with the competitors (turnover and assets)).
- Age of the firm? When was the company established?

#### 3.2 Resource availability

- Referring to the previous question: In situations when you are implementing significant changes within the company, what kind of resources you would need for a successful implementation of the decision? What difficulties may you face in obtaining these resources? Why?
- What type of resources do you consider to be of importance in the achievements of your goals as a manager of a company? Why?  
Examples: Financial, human, strategic (support from influential groups).

#### 3.3 Powerful inside forces

##### 3.3.1 Strategy creation and implementation

- Do you have plans for the future: long-term, short-term? Please describe.
- What kind of important strategic decisions have you recently undertaken? What kind of decisions have you made recently in order to achieve your future plans? What constraints did you face when implementing your decisions?
- How were these decisions/changes initiated? By whom were they approved? Who realized them?

##### 3.3.2 Managerial discretion

- What are your responsibilities as a manager of the company?
- What do you consider to be your role in these decisions? What would do you usually do to fulfil this role?
- How would you characterize the overall involvement of managers in organizational decision-making process?

#### 4. *Corporate governance mechanisms*

##### 4.1 Ownership concentration

- Do you know who are the owners of your firm? What is their role? What are their formal responsibilities? What are the activities they are involved in? To what extent do they influence planning: long-term? short-term?
- What role do owners play in planning within the organization? What type of decisions are they involved in? What influence are they able to execute? What influence do they typically execute on managerial decisions?
- What kind of information do you provide to the owners? To what extent are they informed about current situation and your plans as well?
- How would you describe the existing system according to which you report your actions to the company owners? To whom do you need to report about your actions? How often? How do you report about your activities? In what settings (formal or informal)? To what extent are you accountable for your decisions? What are the systems directed towards minimization of unprofessional actions of managers?

##### 4.2 Managerial labour market

- How developed is the market for managerial labour? How fierce is the competition there? How are managers usually recruited in your firm? What about other firms? How do you hire top managers in your company? How do other firms hire top management? How would you describe the current situation in the market for managerial labour? What are the peculiarities of the Russian managerial labour market?
- Could you describe how you obtained your position in the company? What are the criteria according to which you were hired?
- Which criteria do you consider when hiring new managers? How hard is it to recruit a skilled professional manager?

##### 4.3 Financial capital structure

- Does your firm have an opportunity to use sources of external financing? If yes, what sources of external financing is the firm now using? What does the process of getting external financing look like? What are the issues associated with obtaining external financing for the firm? What is the relative proportion of external capital in your firm?
- Do you use any supplier credit systems? When do you usually pay your suppliers? Do you have an option of delayed payments to your suppliers?

##### 4.4 Control questions

[If none of the other mechanisms of corporate governance appear during the interview, we will still ask what role is attributed to each of the following mechanisms:]

#### 4.4.1. The board of directors:

- Do you have a board of directors in your firm? Is there any formal or informal committee involving managers, owners, and other affiliated parties that undertake decisions regarding planning within the firm?
- Do your owners have formal meetings? Do they have informal ones? If yes, what kind of decisions do they usually undertake during these meetings?

#### 4.4.2. The auditors

- What kind of audit system does your firm have? In case of external auditing, what company does the audit service for your firm?
- How important is it to comply with auditing standards in your business industry? What are the internal policies of the firm regarding the auditing process?

#### 4.4.3. Managerial compensation

- How are you being rewarded for your work? What is the top managers' compensation system in your company? Is there an option of obtaining company stock at discounted prices?
- Is your salary negotiable? What influences changes in your salary?

### 5. *Boundaries of discretion*

Have you had any crisis situations where you as a manager had to act without approval from higher authority? Was your action motivated by its importance for the firm's future development? Could you please give an example? What kind of constraint did you overcome to implement your decision?

### 6. *Final remarks*

To sum up, could you state a general opinion about what are the factors that influence the process of your decision making? What decisions can you make in the organization? What kind of decisions can you *not* make in the organization? Why?

## A born global's radical, gradual and nonlinear internationalization: A case from Belarus\*

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*This paper contributes to the literature on internationalization processes by showing that a born global can experience nonlinear internationalization (de- and re-internationalize) after radical/fast initial growth, and use some subsidiaries as bases for further gradual expansion. After studying a case of a Belarusian door producer that has invested to seven and exported to 11 more countries, we conclude that a home country's political/economic environment can be a crucial 'push' factor for a firm's fast internationalization but, thereafter, it can internationalize gradually due to lacking knowledge or other resources, and de- and re-internationalize due to various internal and/or external reasons.*

*Key words: internationalization, born globals, de-internationalization, Belarus, case study (JEL: M16, F23, F20)*

### Introduction

Internationalization processes have received considerable research attention since the 1970s. Most authors have focused on early internationalization stages and studied either 1) very fast/radical internationalizers – born globals<sup>1</sup> and international new ventures (Oviatt/McDougall 1994; Bell 1995; Madsen/Servais 1997; Cavusgil/Knight 2009; Coviello 2015; Knight/Cavusgil 2015) – or 2) slow, gradual internationalizers (Johanson/Wiedersheim-Paul 1975; Johanson/Vahlne 1977, 1990; Bilkey 1978).

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1 In defining born globals, we follow Kuivalainen/Sundqvist/Servais (2007) that they achieve at least a 25% export share and enter culturally distant foreign countries during the first three years since establishment, Madsen and Servais (1997: 579) that they "derive significant advantages from .../ the sale of outputs to multiple countries/continents right from their legal birth" and Coviello (2015) and Knight and Cavusgil (2015) that they mainly prefer exporting. Thus, a born global should enter at least one other continent in three years or less since establishment and achieve a 25-percent or higher export share during this period.

There is still not enough evidence on firms' later internationalization stages: for instance, on born globals' longitudinal development (Trudgen/Freeman 2014; Welch/Paavilainen-Mäntymäki 2014; Zander/McDougall-Covin/Rose 2015). This topic needs more research attention as such firms cannot grow very fast/radically forever. Consequently, born globals that have slowed internationalization down, exited or re-entered markets (Jones/Coviello/Tang 2011; Freeman/Deligonul/Cavusgil 2013; Nummela/Saarenketo/Loane 2016; Sleuwaegen/Onkelinx 2014) or done this several times like serial nonlinear internationalizers (Vissak/Francioni 2013; Vissak/Masso 2015) still need considerable research attention.

Due to differences in foreign countries' economic/political environments, firms cannot use the same strategy on all markets (Dikova 2012; Drummond 2012; Xu/Meyer 2012). Also, the home context affects both internationalization motives and processes (Dikova/Jaklič/Burger/Kunčič 2016; Zander et al. 2015). Thus, many authors (see Meyer/Peng 2005; Meyer/Gelbuda 2006; Svetličič/Jaklič/Burger 2007; Vissak/Ibeh/Paliwoda 2007; Gelbuda/Meyer/Delios 2008; Ninan/Puck 2010; Nowiński/Rialp 2013; Musteen/Datta/Francis 2014; Vissak 2014; Dikova et al. 2016) have emphasized the need of studying firms from CEE as due to the region's complicated history, they could follow untraditional internationalization paths. Moreover, according to Nowiński and Rialp (2013: 192), there is a deficit of "studies concerning early internationalization of SMEs from transition economies and particularly from Central and Eastern European (CEE) countries". Also, only a few authors have studied if the ability of internationalizers from emerging economies to operate successfully in their home country's unfavourable business environment can help them to operate elsewhere (Anil/Tatoglu/Ozkasap 2014). Thus, it is especially interesting to study Belarusian born globals' internationalization as, due to a complicated political/economic situation (Welter/Smallbone/Slonimski/Slonimska 2008; Liuhto/Heikkilä/Laaksonen 2009; Zashev/Ehrstedt 2010; Weiss/Welsh 2013) they could experience unique internationalization paths both in early and later internationalization stages.

This paper aims to contribute to the literature on internationalization processes – especially the literature on born globals and nonlinear internationalizers – by showing that a born global can experience nonlinear internationalization (de- and re-internationalize) after radical/fast initial growth, and use some subsidiaries as bases for further gradual expansion. It is based on case study data of a Belarusian door producer. The paper starts from an overview of internationalization literature. After the method section, case study results are analysed and, thereafter, discussed. The paper ends with managerial and research implications.

## Literature review

Different factors can simultaneously cause and affect internationalization (Benito 2015; van Tulder 2015). Below we will give a short overview of the literature on internationalization pathways and factors affecting its speed, but also exits and re-entries.

*The internationalization literature focusing mainly on growth.* In this literature, two internationalization paths have received the most attention<sup>2</sup>. According to studies on born globals and international new ventures (Oviatt/McDougall 1994; Bell 1995; Madsen/Servais 1997; Cavusgil/Knight 2009; Knight/Cavusgil 2015), some internationalizers enter distant countries soon after establishment and often, view the world market similarly to their home country. Moreover, they achieve a relatively high export share soon after foundation. Fast internationalizers can compensate their initial lack of experience, knowledge and other resources with active networking, innovativeness, flexibility and adaptability (Knight/Cavusgil 2004, 2015; Svetličič et al. 2007; Freeman et al. 2013). They can also use internationalization for learning (Dikova et al. 2016) and capability-building (Benito 2015; Meyer 2015). Moreover, some firms tend to use effectuation logic: react flexibly to market changes and experiment in market entry instead of following a systematic plan (Andersson 2011; Nowiński/Rialp 2013). Sometimes, the host country's economic/political environment also matters. For instance, Kahiya (2013: 3) stated that "rapid internationalization ensues from positive managerial orientation and lack of confidence in the host market".

According to studies on slower internationalizers (Johanson/Wiedersheim-Paul 1975; Johanson/Vahlne 1977; Bilkey 1978; Johanson/Vahlne 1990; Morgan/Katsikeas 1997; Ninan/Puck 2010), the first foreign market entry takes more time and firms start internationalizing from closest and/or more familiar markets because they lack contacts, knowledge and other resources to enter more distant and/or less similar markets first. They will gradually enter such countries only after acquiring foreign market knowledge and other resources and creating necessary contacts. Moreover, firms tend to start internationalization from exporting and invest abroad later. Still, some authors have stated that market knowledge, but also other resources, can be acquired through acquisitions (Luo/Tung 2007; Elango/Pattnaik 2011) or network linkages (Musteen et al. 2014): this can speed up internationalization. Thus, for instance, emerging market multinationals "are often not path dependent nor evolutionary in selecting entry modes and project location" (Luo/Tung 2007: 482).

*The internationalization literature focusing on fluctuations in international involvement.* The above-mentioned growth-oriented approaches tend to overlook

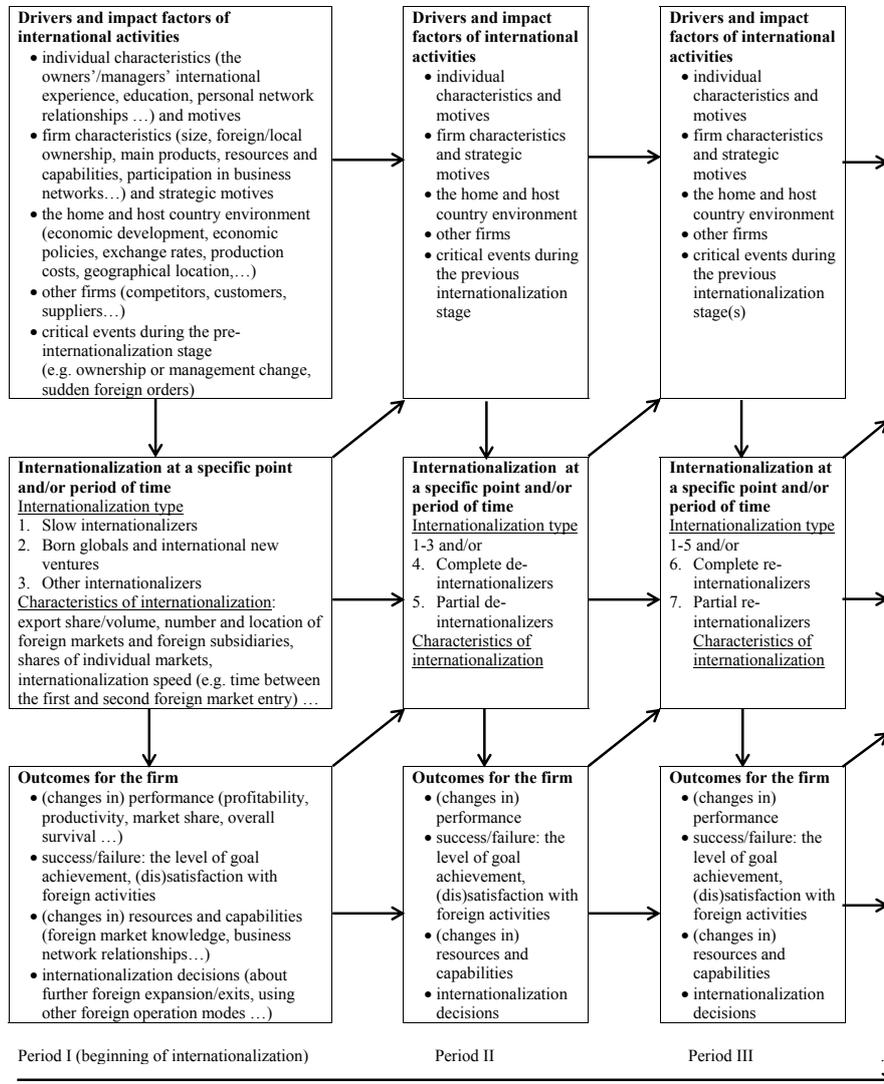
<sup>2</sup> As our case firm did not resemble a born-again global/late starter (Johanson/Mattsson 1988; Bell et al. 2001; Sheppard/McNaughton 2012), we will not give an overview of this literature here.

fluctuations in internationalization (Freeman et al. 2013; Vissak/Francioni 2013). Several authors have stated that internationalization does not always mean constant growth. For instance, Macharzina and Engelhard (1991) found that some internationalizers experience periods of “leaps” and also some stable international development periods, Kutschker, Bäurle and Schmid (1997) distinguished between evolution (slow and minor changes), episodes (rapid and considerable changes) and epochs (consisting of both) while Bell, McNaughton, and Young (2001: 177) noted that “firms may experience ‘epochs’ of rapid internationalisation, followed by periods of consolidation or retrenchment”. Finally, Olejnik and Swoboda (2012: 486) found that “committed internationalising firms may slow down their internationalisation and focus on their home market” and Trudgen and Freeman (2014: 557) stated that born globals “may also undertake non-linear internationalisation and move back and forth between stages as they de- and re-internationalise”.

During de-internationalization – reducing geographic scope and/or foreign market penetration (Turner 2012) – some firms withdraw from all foreign markets completely (Oviatt/McDougall 1995; Crick 2004; Welch/Welch 2009) but some continue with foreign operations in one or more countries (Calof/Beamish 1995; Benito/Welch 1997; Swoboda/Olejnik/Morschett 2011). Moreover, some firms retain activities in all countries but in partially reduced form (Vissak/Francioni 2013). During re-internationalization – advancing steps after de-internationalization (Luostarinen 1994) – some firms re-enter all markets completely (Welch/Welch 2009; Javalgi/Deligonul/Dixit/Cavusgil 2011) but some enter different markets (Pauwels/Matthyssens 1999; Crick 2004; Matthyssens/Pauwels 2004; Javalgi et al. 2011; Freeman et al. 2013). Some firms – serial nonlinear internationalizers – de- and re-internationalize several times (Vissak/Francioni 2013; Vissak/Masso 2015) and use combinations of entry and exit strategies (Axinn/Matthyssens 2002).

Changes in a firm’s internationalization path can be caused by the need to adapt its strategy due “to changes in the firm and in the external environment” (Trudgen/Freeman 2014: 557) including changed economic policies and conditions (Akhter/Choudry 1993; Turner 2012; Figueira-de-Lemos/Hadjikhani 2014; Gnizy/Shoham 2014; Vissak 2014): for instance, competition (Javalgi et al. 2011), demand or exchange rates (Welch/Wiedersheim-Paul 1980). Moreover, they can be affected by the firm’s resources – including its network relationships (Hadjikhani 1997; Welch/Welch 2009; Turner 2012) and foreign market knowledge and/or experience (Gnizy/Shoham 2014) – and capabilities (Javalgi et al. 2011; Cuervo-Cazurra/Narula/Un 2015; Dikova et al. 2016). Managers’ attitudes (Benito/Welch 1997), perceptions regarding the market’s importance (Sleuwaegen/Onkelinx 2014) and the firm’s (dis)satisfaction with its internationalization (Javalgi et al. 2011; Swoboda et al. 2011) and home market situation (Cuervo-Cazurra et al. 2015) can also affect internationalization decisions. For some

Figure 1: The process perspective of international activities



firms, de-internationalization or other changes in internationalization are strategic choices (Benito 2005; Freeman et al. 2013; Vissak/Francioni 2013), but some are forced by political pressure (Akhter/Choudry 1993) or, in some cases, cultural differences (Crick 2002).

From the above we conclude that internationalization processes can differ considerably: some firms experience fast international growth while some expand

slowly, some de- and re-internationalize once, but some do it several times. Changes in internationalization can be voluntary or forced and they can be caused by several internal and external factors and actors (see also Figure 1).

After the method section, we will explain which factors influenced a Belarusian firm's nonlinear internationalization. Thereafter, we will discuss the results.

## Method

We selected the case study method as it enables to combine previously developed theories with new empirical results and, resultantly, expand them; investigate complex phenomena and processes within their contexts and develop new and empirically valid theoretical and practical insights (Eisenhardt 1989, 1991; Yin 1994; Dubois/Gadde 2002; Ghauri 2004; Eisenhardt/Graebner 2007; Welch/Piekkari/Plakoyiannaki/Paavilainen-Mäntymäki 2011). Moreover, several authors have suggested this method for studying internationalization due to the complexity of this phenomenon and the necessity to use a longitudinal perspective (Eckert/Mayrhofer 2005; Welch/Welch 2009; Vissak/Francioni 2013).

This paper is based on a single case study. This increases observer bias and the risk of misjudging single events or even (accidentally) distorting important evidence (Leonard-Barton 1990; Eisenhardt 1991; Voss/Tsikriktsis/Frohlich 2002) and reduces the generalizability of the results – for instance, based on one firm, we cannot assume that all others internationalize similarly and are affected by the same factors – but it allows presenting the richness of the results and retaining the depth of the study (Dubois/Gadde 2002; Eisenhardt/Graebner 2007; Piekkari/Welch/Paavilainen 2009). The latter is necessary for understanding the complexity of the case firm's internationalization and the factors affecting it. Moreover, even a single case can be used for theory-building (Dyer/Wilkins 1991).

To find an information-rich case, X. Zhang used purposeful sampling (Patton 2001). According to Banalieva and Dhanaraj (2013: 99), a “ten-year period is sufficiently long to capture the evolutionary nature of internationalization”. Initially, he also explored some other firms, but the selected case firm's owners were ready to provide more information about its internationalization activities by countries since its foundation in 2000.

In total, X. Zhang conducted 8 hours of interviews via Skype and phone in June 2014, 1 hour in October 2014, 0.5 hours in January 2015, 0.5 hours in May 2015 and 0.5 hours in January 2016. He selected several major informants – two founders and a sales manager – from the firm to investigate multiple viewpoints and to reduce the likelihood of misinterpretation (Ghauri 2004). He conducted all semi-structured interviews with open-ended questions (see Appendix 1) in Russian. All the interviewees received questionnaires at least four days before interviews. In addition to interview materials, he used the case firm's financial

data from its annual reports for validating the conclusions made based on interviews (Eckert/Mayrhofer 2005). Due to the sensitive nature of the case and the requirement of the case firm's owners, he could not disclose the firm's name.

The data analysis followed three phases proposed by Miles and Huberman (1994): data reduction (writing summaries and discarding irrelevant data); display (creating figures and tables to draw conclusions) and the verification of the initial conclusions through further data collection. In the discussion section, we will also compare the results with other studies' conclusions.

### **Case evidence**

*An overview of the case firm.* Two Belarusian entrepreneurs established the firm in 2000. It produces doors and door-frames from metal, wood and PVC-U. In 2015, its turnover was 20.55 million USD. It exported to 18 countries and had 219 employees (see Table 1) in eight countries. Below we will explain how and why this firm internationalized.

*The founders' background.* The owners studied economics and business administration in Belarus and thereafter, worked in the public sector for four years. As in the end of the 1990s, a construction boom started in Minsk, they decided to start doing business. They used their savings and borrowed from their parents to acquire second-hand machines from Germany and Poland. Their first customers were local decoration companies.

*Motives for initial internationalization.* Although the owners did not aim to internationalize since the beginning, already in 2001 they decided to do it as according to one of them, "*there is no stability for private business in this country*" and "*as many foreign markets were growing, it was much more profitable for us to sell there.*" Moreover, the other owner stated that in Belarus, "*the government has very strict control on foreign currency exchange and sometimes a company needs U.S. dollars to purchase materials, but it cannot buy currency from the bank*", so they needed to export to earn foreign currency. In addition, both owners wanted to grow their business without the risk that the government would take over their firm as "*here, even a large privately owned firm can be suddenly taken over*" and they had already started attracting 'governmental attention'. Thus they felt that staying only in Belarus would become more risky as turnover growth would increase the possibility of governmental takeover. Still, they did not want to move the whole business abroad as "*after all, we are Belarusians*".

Table 1: The firm's turnover, export share, net profit growth/decline and number of employees by countries in 2000-2015, million USD

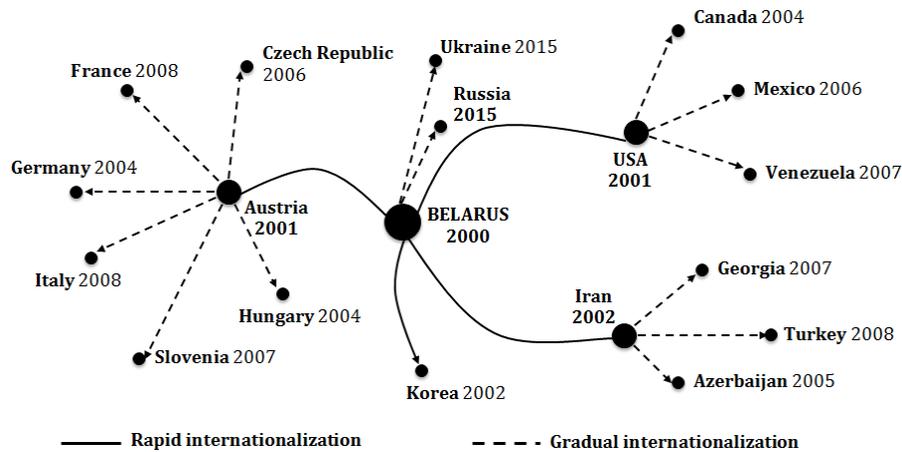
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Turnover	0.15	0.33	0.98	1.26	1.93	2.47	2.68	3.57	5.00	5.75	6.62	8.42	10.29	11.66	12.28	20.55
Belarus	0.15	0.12	0.15	0.20	0.10	0.15	0.23	0.18	0.18	0.22	0.15	0.11	0.16	0.12	0.10	0.23
USA		0.11	0.28	0.32	0.50	0.43	0.65	0.73	0.95	1.12	1.00	1.15	1.38	1.95	2.03	2.60
Austria		0.10	0.30	0.45	0.46	0.50	0.52	0.48	0.45	0.51	0.70	0.66	0.68	0.92	1.12	1.33
Iran			0.17	0.20	0.29	0.52	0.18	0.55	0.68	0.65	0.73	0.71	0.77	0.75	0.39	0.89
South Korea			0.08	0.09	0.08					0.12			0.15			0.09
Germany					0.23	0.35	0.42	0.55	0.52	0.52	0.79	1.00	1.25	1.32	1.56	3.03
Canada					0.19	0.22	0.22	0.23	0.18	0.38	0.52	0.69	0.80	1.01	0.99	1.91
Hungary					0.08	0.10	0.09	0.05	0.20	0.09	0.12	0.19	0.22	0.29	0.29	0.25
Azerbaijan						0.20	0.15	0.32	0.38	0.50	0.55	0.60	0.62	0.68	0.70	0.72
Mexico							0.13	0.19	0.22	0.21	0.52	0.68	0.93	0.53	0.62	0.66
Czech Rep.							0.09		0.15	0.11		0.19	0.23	0.52	0.35	0.44
Slovenia								0.10	0.16			0.36	0.56	0.53	0.58	0.61
Georgia								0.10	0.20	0.22	0.29	0.45	0.32	0.48	0.61	0.83
Venezuela								0.09	0.11	0.19	0.20		0.35	0.38	0.33	0.44
Turkey									0.30	0.50	0.38	0.56	0.82	0.88	1.12	1.78
France									0.21	0.30	0.48	0.68	0.55	0.82	0.89	1.52
Italy									0.11	0.11	0.19	0.39	0.50	0.48	0.60	1.28
Russia																1.55
Ukraine																0.39
Export share, %	0.0	63.6	84.7	84.1	94.8	93.9	91.4	95.0	96.4	96.2	97.7	98.7	98.4	99.0	99.2	98.9

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Net profit growth/decline (-) compared to the previous year, %	n.a.	35.8	33.2	12.5	36.9	23.5	10.6	18.7	27.2	20.2	-10.1	10.3	20.4	19.8	18.3	17.8
Number of full-time employees	19	36	45	45	62	85	112	103	147	160	156	183	190	212	215	219

*Initial fast internationalization.* As one of the owners had contacts abroad, the firm started exporting to Austria and USA in 2001 and to Iran and South Korea in 2002. After direct exports, the owners decided to establish sales subsidiaries in Austria and USA in 2003 and in Iran in 2004 although they lacked knowledge. One of them explained: “We did not know that much about these markets... and we only had a few contacts. We decided to establish sales subsidiaries in Austria and USA to understand their market situation. We also established a subsidiary in Iran in 2004 as their government promoted trading with Belarus and as we needed to learn due to huge cultural differences.”

*The reasons for slowing internationalization down.* After the initial fast internationalization, the owners decided to slow the further process down so that they could focus on renewing their production technology and learning about foreign markets. They formed profitable partnerships with one customer in USA in 2002, two in Austria in 2003 and one in Iran in 2004. One of the owners stated: “We needed to stabilize these relationships, this way we could plan our production quite well and gain stable profit to support our firm’s development. This gave us time for deciding where to go next.” In 2004, they decided to use their sales subsidiaries in Austria, USA and Iran not only for learning how to operate there, but also for gradually entering their neighbouring countries (see Figure 2). The owners had three main reasons.

**Figure 2: The firm’s internationalization process**

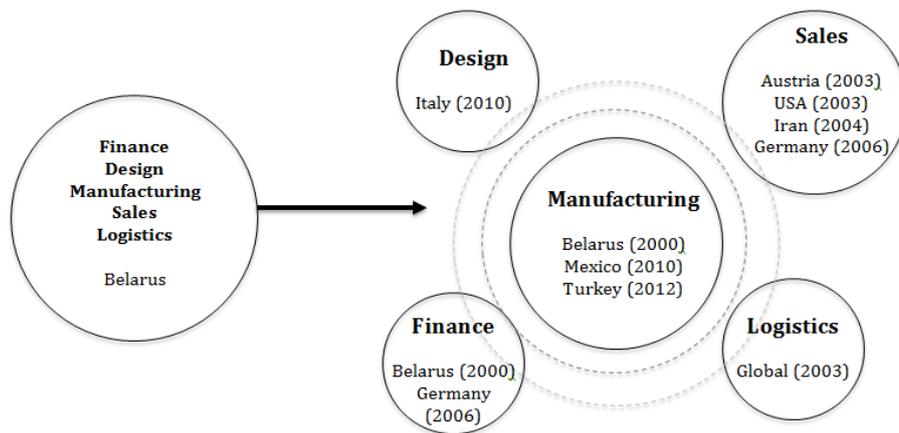


1. They had difficulties in finding new customers in their initial markets. One of the owners explained: “We entered our first markets fast, but did not understand them well. We realized that finding new customers was much harder than we had initially thought. Still, as our sales were quite stable, we decided to find more customers in their neighbouring countries.” More-

over, the sales manager of the firm's American subsidiary stated: "*Stability in the first three markets gave us opportunities to learn about nearby foreign markets. In USA, we found many potential customers from Canada and Mexico.*"

2. They wanted to diversify risks. According to one of the owners, "*Our government is still able to cut off our export channels. Very often, it has conflicts with American and European governments. So, to be more secure, we needed to export to as many markets as possible. However, taking into account our resources and knowledge, we tried to expand slowly.*"
3. They wished to achieve long term development. One of the owners stated: "*Entering a new market is like reading a new book: you learn something. In the future, we plan to move most of our company abroad, but we have to do it slowly and we do not want our government to notice us: it is risky to grow large in Belarus because you will attract our government's attention.... Thus, we are gradually entering new markets to understand where to relocate.*"

**Figure 3: Changes in the firm's structure in 2000-2015**



*The reasons for relocating activities and establishing new subsidiaries.* Relocation of some subsidiaries (see Figure 3) was not only motivated by the country's political environment but also by the owners' wish to lower production and logistics costs, improve product quality and quicken innovation. In selecting locations for their subsidiaries, they followed the principle "*let the country do the job it is good at*". Thus, in 2006 they established both a sales and a financial subsidiary in Germany.<sup>3</sup> Relocating some financial functions to Germany was

<sup>3</sup> In terms of sales, it focused only on a few most important customers, while the Austrian subsidiary continued co-ordinating most of the firm's exports to Germany.

reasonable as they found a partner there; moreover, they could keep capital in Euros (according to one of the owners, “*we needed foreign currency both for our business and personal life and we needed freedom for using our funds*”). Only some employees were retained in Belarus to handle some production operations and serve local customers.

In 2010, the owners opened a new manufacturing subsidiary in Mexico. It serves customers from USA, Canada, Mexico and Venezuela. One of the owners explained: “*We entered Venezuela, as our countries are on friendly terms*”. In 2012, they also established a new manufacturing subsidiary in Turkey to serve European and Eurasian customers. One of the owners stated: “*Moving manufacturing abroad was risky, yet it was strategically important. We are glad with this decision as we reduced logistics and raw material costs; moreover, now we have much more freedom.*” The other owner added: “*We still kept a part of production in Belarus, as labour costs were still low and we were not totally certain how well our foreign manufacturing subsidiaries would start operating. Of course, we still also try to avoid our government’s radical attention. As long as the situation in Belarus stays fine, we will keep a part of production here, but if anything will go wrong, we will still survive.*”

The owners also established a design subsidiary in Italy and hired five Italian designers. They did it because of the economic crisis in 2009-10 and due to the wish to serve premium customers, thus they needed to improve product quality and design. According to one of the owners, “*If we tell our customers that our doors are produced in Belarus, this does not sound attractive to them, especially to premium customers. Thus, we hired Italian designers to add value to our products.*” The other owner added: “*We plan to hire more people to the design subsidiary in Milan, not only for designing doors, but also for developing new materials and components. This will enhance our future competitiveness.*” In 2015, the firm also started exporting doors to Russia and Ukraine. Standard doors were produced and designed in Belarus while doors for premium customers were designed in Italy.

*The reasons for unstable sales in some countries.* In South Korea, sales have been unstable. The firm started exporting there in 2002. While in 2003 and 2004, sales continued and the firm found another customer there, in 2005-8, 2010-11 and 2013-14 it did not export anything. One of the owners explained: “*As our company was growing rapidly, we had no time to really explore this market. Also, Korea is culturally very different: they have a different taste regarding door design and materials.*”

The firm started exporting to the Czech Republic in 2006, but the customer did not order anything in 2007. At that time, the firm did not regard it an important market. However, the Austrian sales subsidiary started developing new contacts there, thus they exported to this country again in 2008 and 2009. In 2010, they

did not export again, as the customer had bought enough doors in 2009. In 2011, the Austrian subsidiary found new customers and sales continued.

Exports to Slovenia started in 2007 and continued in 2008 but then, the firm lost both customers due to a price war. Developing new networks and sales channels took two years. In 2011, sales continued.

In 2007, the firm also started exporting to Venezuela. It did not export anything there in 2011 due to problems with a partner that was responsible for logistics. In 2012, sales continued. As the Belarusian government promotes trade with Venezuela and as competition is low due to high entry barriers, orders have been relatively stable recently.

Future plans. In the future, the owners plan to establish a sales subsidiary in Brazil and, through that, expand activities in South America. Still, they are not certain yet when they will be ready for that as *“We were there... It is attractive, but currently we are not sure that we can compete there as local competitors have considerable advantages in terms of access to raw materials, lower production costs and due to corruption.”*

They also visited China in 2015 to explore expansion opportunities but found that demand and customer preferences differed considerably from region to region and competition was high: local Chinese manufacturers had focused on mass market products while American and German firms had already started offering premium products. However, in Dalian, a Chinese firm proposed partnership. Both founders are considering this offer.

In addition, they wish to achieve a leading position in Russia and Ukraine, and buy a production unit close to Moscow. They did not enter these countries earlier due to *“the Belarusian government's direct and indirect control of firms' activities in Russia and Ukraine”*. As these countries' current situation is unstable and their currencies are weak, they will buy the property through their German or Italian subsidiary as then they can hide their actions from the Belarusian government and, also, in the future, gain from a higher brand value as the customers *“prefer ‘real European’ brands”*. They also plan to establish an independent financial company in USA to gain more freedom in using their capital. In the future, they will keep entering some new markets sporadically to learn from them and not necessarily export there every year (like in cases of Slovenia and South Korea): they will mainly focus on their main markets and wish to achieve stable growth there.

## Discussion

From the above we can conclude that the case firm internationalized like a born global (Oviatt/McDougall 1994; Bell 1995; Madsen/Servais 1997; Kuivalainen/Sundqvist/Servais 2007; Cavusgil/Knight 2009; Coviello 2015; Knight/Cavusgil

2015) in the beginning as it entered countries outside Europe soon after establishment but, thereafter, its internationalization slowed down and became more systematic. The firm started expanding further from its three foreign subsidiaries to their neighbouring countries (using them as “springboards” (Luo/Tung 2007)). Thus, these subsidiaries followed behaviour that is more characteristic to the Uppsala model and innovation-related internationalization models (Johanson/Wiedersheim-Paul 1975; Johanson/Vahlne 1977; Bilkey 1978; Johanson/Vahlne 1990; Morgan/Katsikeas 1997; Ninan/Puck 2010). Moreover, lack of knowledge slowed down this firm’s internationalization and this is also characteristic to these two models. On the other hand, its entry mode choice did not completely fit these models as it invested abroad soon after starting exporting. Consequently, we can state that this firm represents an internationalization path that has not yet acquired a specific name in the literature (see Table 2).

**Table 2: Classification of internationalization processes**

		internationalization in the early years since foundation	
		slow or none	fast
further internationalization	slow or none	slow, gradual: like described in the Uppsala model and innovation-related internationalization models (Johanson/Wiedersheim-Paul 1975; Johanson/Vahlne 1977; Bilkey 1978; Johanson/Vahlne 1990; Morgan/Katsikeas 1997; Ninan/Puck 2010)	fast at first, then slow: has not attracted full focus from any literature stream yet, except, to some extent, some studies on “epochs” and “episodes” (Eckert/Mayrhofer 2005; Kutschker et al. 1997) and also, shortly, in Olejnik and Swoboda (2012) and Freeman et al. (2013)
	fast	slow or none at first, fast after that: like described in the literature on born-again globals (or born-again internationals) and late starters (Johanson/Mattsson 1988; Bell et al. 2001; Sheppard/McNaughton 2012)	very fast: like described in the literature on born globals (or born internationals) and international new ventures (Oviatt/McDougall 1994; Bell 1995; Madsen/Servais 1997; Cavusgil/Knight 2009; Coviello 2015; Knight/Cavusgil 2015)

Taking into account the firm’s nonlinear internationalization path – not only slowing down its internationalization, but also not exporting to some countries in all years – we can support the findings of Bell et al. (2001: 177) that “firms may experience ‘epochs’ of rapid internationalisation, followed by periods of consolidation or retrenchment” and Macharzina and Engelhard (1991) and Kutschker et al. (1997) that periods of “leaps” can be followed by more stable international development periods. As the firm reduced exports to some markets and, in some years, did not export to South Korea, Czech Republic, Slovenia and Venezuela, we can state that it de-internationalized (Calof/Beamish 1995; Benito/Welch 1997; Swoboda/Olejnik/Morschett 2011; Turner 2012) and as it

continued exporting there later, it also re-internationalized (Welch/Welch 2009; Javalgi et al. 2011). As it did this several times, we can call it a serial nonlinear internationalizer (Vissak/Francioni 2013; Vissak/Masso 2015).

The firm's internationalization was affected by its home country's situation/context (Cuervo-Cazurra et al. 2015; Dikova et al. 2016; Zander et al. 2015), including its political environment (Akhter/Choudry 1993; Welter et al. 2008; Turner 2012; Kahiya 2013; Figueira-de-Lemos/Hadjikhani 2014; Gnizy/Shoham 2014; Vissak 2014). The owners were afraid that the government would take over the firm. Moreover, they had to consider other internal and external factors: for instance, lack of foreign market knowledge and experience (Gnizy/Shoham 2014) and cultural differences (Crick 2002).

As the owners perceived some markets less important than others (Sleuwaegen/Onkelinx 2014), they took this into account in developing the firm's internationalization strategy (Trudgen/Freeman 2014). The case firm's internationalization was rapid in 2000-2003/4 (see Table 3) as the owners wished to reduce domestic market risks and earn profits to survive and develop further. Moreover, they used their contacts (Hadjikhani 1997; Welch/Welch 2009; Turner 2012; Musteen et al. 2014) in their first target markets. Finally, they partially used effectuation logic in the initial internationalization (Andersson 2011; Nowiński/ Rialp 2013) as they did not always have a clear plan where to expand. Thus, we can agree with Benito (2015) and van Tulder (2015) that different factors can simultaneously cause and affect internationalization.

In 2003/4, the owners slowed down the firm's internationalization and turned the process more gradual. Such a strategic decision allowed them to learn about their first markets, investigate these countries' neighbouring markets and plan the firm's future development. Thereafter, they increased their foreign market commitment and started using more complicated foreign operation modes. Thus, we can state that in further expansion, capabilities (Javalgi et al. 2011; Cuervo-Cazurra et al. 2015; Dikova et al. 2016) can be very important and that flexibility, adaptability, innovativeness and active networking can help firms to overcome their initial resource constraints and internationalize successfully (Knight/Cavusgil 2004; Svetličič et al. 2007; Freeman et al. 2013; Musteen et al. 2014; Knight/Cavusgil 2015). Moreover, internationalization can be useful for learning (Dikova et al. 2016) and capability-building (Benito 2015; Meyer 2015). Finally, we can conclude that changes in internationalization can be caused by the owners'/managers' attitudes (Benito/Welch 1997), they can be voluntary (Benito 2005; Freeman et al. 2013; Vissak/Francioni 2013) and, to some extent, also forced (Akhter/Choudry 1993) as the owners were afraid of governmental takeover.

**Table 3: The firm's internationalization process**

	2000-2003/4	2003/4-2015
<b>Speed of internationalization</b>	Very fast	Relatively fast
<b>Factors leading to/affecting internationalization</b>	<ul style="list-style-type: none"> <li>■ Avoiding domestic market risks</li> <li>■ Gaining high profits fast to survive</li> <li>■ Good contacts in some foreign markets</li> <li>■ Needing subsidiaries abroad for future development</li> </ul>	<ul style="list-style-type: none"> <li>■ Avoiding attention from the Belarusian government</li> <li>■ Lack of knowledge about foreign markets</li> <li>■ The economic crisis</li> <li>■ Need to improve the firm's image: reduce the "Made in Belarus" effect</li> </ul>
<b>Internationalization strategy</b>	<ul style="list-style-type: none"> <li>■ Entering first foreign markets – Austria, USA, Iran and South Korea – with exports fast (in 2001-2002)</li> <li>■ Achieving a substantial export share – 84.7% – already by 2002</li> <li>■ Achieving stable sales in the first three foreign markets through partnerships with a few key customers</li> <li>■ Establishing sales subsidiaries in both Austria and USA in 2003 and in Iran in 2004</li> </ul>	<ul style="list-style-type: none"> <li>■ Using the first three foreign subsidiaries as "springboards" for gradually entering neighbouring countries – from Austria to Hungary, Germany (2004), Czech Republic (2006), Slovenia (2007), Italy and France (2008), from USA to Canada (2004), Mexico (2006) and Venezuela (2007) and from Iran to Azerbaijan (2005), Georgia (2007) and Turkey (2008) – with exports but also for learning</li> <li>■ Moving some of the firm's operations – logistics (global 2003), sales (Austria, USA 2003, Iran 2004, Germany 2006), finance (Germany 2006), production (Mexico 2010, Turkey 2012) and design (Italy 2010) – partially or fully abroad</li> <li>■ Having sporadic activities in less important countries (like Slovenia and South Korea), but using this experience for learning</li> </ul>
<b>Commitment to internationalization</b>	High	Very high

### Conclusions and implications

The paper showed that a born-global's internationalization can slow down and that it can experience nonlinear internationalization. These aspects have still not received considerable attention in the literature on internationalization processes. We also explained which factors caused or affected this firm's international activities in different markets. As it was established in Belarus, its owners al-

ways had to consider their home country's political and economic environment. They could not grow too much in Belarus; otherwise, the government would have taken over the firm, so they had to internationalize as this enabled them to reduce this risk. In addition, the firm's internationalization was affected by its owners' contacts, foreign market knowledge and attitudes: they were flexible and able to adapt to local and foreign market changes fast, but, on the other hand, they regarded some markets less important than others, so they did not try to export there every year.

Based on the above case, we developed several managerial implications. Despite of a slow-down of internationalization after the initial fast expansion and several fluctuations in its foreign activities, the firm's international development has been successful and its net profits have increased in all years except in 2010. Thus, other companies' managers should not always regard such internationalization a failure. A firm has to react to changes in its economic and business environment but also take into account its resources and capabilities. Thus, making adjustments in the pace of internationalization – including not exporting to all markets in every year – can be reasonable. Still, such internationalization should not be also regarded as a goal in itself. Moreover, based on the firm's experience we suggest that managers should have a global vision and they should pay considerable attention to improving their firm's resources and capabilities. Also, actively acquiring foreign market knowledge and creating contacts can be important. In this case, it is possible to continue growing even during economic recession and survive if the home country's political/economic environment is extremely unfavourable. Finally, managers should understand that “many developments inside and outside corporation cannot be anticipated and cannot be fully controlled by top-management” (Kutschker et al. 1997: 110). Thus, following the above suggestions will not guarantee success as to some extent every firm's situation is unique.

Future research could develop in several directions. For example, it could be studied how this firm will develop further on each market – if it will continue using its subsidiaries as “springboards” and its export markets as learning bases – and more data could be collected on its activities in each market. Similar firms from Belarus but also from some other (CEE) countries should be investigated as this would increase the generalizability of the results. In addition to collecting case study data, surveys should be conducted as this enables collecting more evidence about factors leading to or influencing such internationalization. This should also help to provide more detailed managerial advice. Finally, data from some countries' statistical databases should be used to find out how frequently such internationalization processes occur and if these firms differ from others in terms of export market or entry mode selection, subsidiary size, ownership, export or import structure, productivity or other indicators as this information would be also relevant for policy-makers.

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**Appendix 1: The main interview questions**

- How did your business start and why? Which obstacles did you face? How did you overcome them?
- How does starting and doing business in Belarus differ compared to other countries? How has the Belarusian political/economic environment affected your local or foreign activities? How have you overcome the obstacles?
- What were/currently are your main strengths and weaknesses compared to your foreign competitors?
- When, how and why did your firm enter its first, second, third... foreign market?
- When, how and why did your firm establish foreign subsidiaries? How do you manage these subsidiaries? Which obstacles have you faced? How have you overcome them?
- Have you exited or re-entered any markets temporarily or permanently? Why?
- How satisfied are you with your firm's internationalization so far? Why?
- How do you plan to develop in the future (in terms of internationalization (including exits and re-entries), production, brand, organizational management...)? Why?