

**Successful subsidiary strategy patterns in different environments –
A configurational perspective**

ABSTRACT

The corporate strategy of MNCs is realized in a geographically dispersed network of foreign units that have specific subsidiary strategies in their host countries. Most modern MNC models suggest that these strategies can and should be heterogeneous and that they have to be contingent on the host country environment.

We propose that various host country characteristics are not considered in isolation by managers but that a complete bundle of characteristics, in a typical pattern, influences MNC decisions. Furthermore, we show that specific patterns of elements exist that describe a subsidiary strategy comprehensively. Finally, our empirical findings are supportive of the contingency assumption which suggests that subsidiary performance is dependent on the fit between the subsidiary strategy and the host country conditions.

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INTRODUCTION

The corporate strategy of MNCs is realized in a geographically dispersed network of foreign subsidiaries (Hedlund & Rolander, 1990) and MNCs seek a variety of ways in which their units abroad can contribute value to the company with their strategy at the local level (Taggart, 1998).

A firm may implement very different strategies in each of its subsidiaries, in order to shape the best overall strategy (Jarillo & Martinez, 1990). The perspective that foreign subsidiaries can take over differentiated roles or follow differentiated strategies is now commonly accepted in international business literature (White & Poynter, 1984; Bartlett & Ghoshal, 1986; Jarillo & Martinez, 1990; Birkinshaw & Morrison, 1995; Taggart, 1997). Even more, such a differentiation of subsidiary strategies is prescriptively seen as enhancing performance: „... to be truly effective, multinational corporations *should* be differentiated“ (Nohria & Ghoshal, 1997, p. xv) (italics added by the authors). However, there is yet no commonly agreed upon framework to analyze the subsidiary strategy and numerous typologies have been proposed (see, e.g., the overviews by Taggart & McDermott, 1993; Hoffman, 1994; Birkinshaw & Morrison, 1995; Schmid, 2004).

Following different theoretical perspectives, e.g. industrial organisation theory (Bain, 1972) and institutional theories (Zucker, 1987; Kostova & Roth, 2002), the strategy of the subsidiary is likely to be influenced by external host country conditions; a coalignment of the subsidiary strategy with the external environment can be expected (Venkatraman & Prescott, 1990; Roth & Morrison, 1992a; Hoffman, 1994; Hewett, Roth, & Roth, 2003). Indeed, the specific characteristics of a foreign country are generally seen to be essential when choosing the local subsidiary's strategy and structure (Bartlett & Ghoshal, 1986; Zhao, Luo, & Suh, 2004; Tallman, 1992; Hyuk Rhee & Cheng, 2002; Yiu & Makino, 2002).

This study takes a configurational perspective both on subsidiary strategy and on the environmental characteristics. In the configurational approach, it is emphasized that the gestalt of an organization has a

stronger influence on its efficiency than each single element of a configuration (Khandwalla, 1973). It has been argued that specific patterns of mutually supportive strategy components exist as constellations which can be used to describe the strategy of a business unit comprehensively (Miller, 1986; Birkinshaw & Morrison, 1995). Moreover, the configurational approach has been argued to be adequate for the analysis of the external environment since facets of the external environment are not independent of each other and because organizations are more likely to be influenced by the whole set of interrelated external conditions (Macharzina & Engelhard, 1991; Hewett, Roth, & Roth, 2003). We expect a link between the subsidiary strategy, seen as a complex bundle of strategy elements, and the host-country conditions, understood to be a coherent set of various interdependent country characteristics.

In addition, taking a contingency perspective, we suggest a performance effect of a fit between the subsidiary strategy and the external environment (Roth & Morrison, 1992b). We assume that there is an ideal subsidiary strategy under certain environmental conditions. Subsidiaries that conform more closely to these ideal types and thereby show a fit between environment and strategy are expected to outperform subsidiaries that do not show such a fit (Drazin & Van den Ven, 1985; Hewett, Roth, & Roth, 2003).

Thus, the paper attempts to contribute to literature in two ways: *First, we intend to identify complex patterns of environmental characteristics that collectively influence subsidiaries of MNCs in a host country in a rather homogeneous way. Second, we try to identify ideal profiles for the strategies of the subsidiaries and investigate whether a deviation from this profile leads to lower subsidiary performance.*

CONFIGURATIONAL APPROACH

In organizational research, Miller criticized in the early 1980s that organizations are complex entities and that a “partist approach which studies a tightly circumscribed set of linear relationships is inadequate” (Miller, 1981, p. 2). Instead, the configurational approach that can be understood to be an extension of the contingency approach assumes that an organisation is effective if there is consistency between the organisational variables within the organisation as well as alignment between the internal organisation and the external environment of the organization. This demand is rooted in the gestalt concept that argues that

the gestalt of an organization is more than the sum of its parts and that the interaction among variables is crucial (Khandwalla, 1973; Mintzberg, 1979; Mintzberg, 1981).

Macharzina & Engelhard (1991) apply this logic to IB research and argue that much previous research has followed a partist approach and looked at fragments of the structure of MNCs instead of trying to understand some of the fundamental patterns in which MNCs react to the challenges of their international environment. They demand a holistic approach in which the researcher looks simultaneously at a large number of variables. The complementary fit between different elements of the MNC's structure constrains the set of feasible alternative combinations (Macharzina & Engelhard, 1991) because the integrity of alignment among organizational elements is an important antecedent of its performance (Miller, 1981).

Empirical studies have shown that the internal consistency between organizational variables is positively related to the efficiency of an organization (Drazin & Van den Ven, 1985; Khandwalla, 1973). Thus, an analytical decomposition of the elements and an isolated investigation is not sufficient to comprehend the total pattern (Drazin & Van den Ven, 1985). Instead, some tight constellations of mutually supportive elements are superior which leads to the emergence of specific patterns (Miller, 1986). Proponents of the configuration approach suggest that only specific combinations of organizational and system variables are viable in the long run since different characteristics are interdependent and influence each other (e.g. Miller, 1981; Miller & Friesen, 1984; Macharzina & Engelhard, 1991). Thus, it is assumed that a relatively small number of typical configurations of organizational variables exist that represent the majority of the empirically existing combinations of organizational variables (Miller & Friesen, 1984). In IB research, configurational studies were presented by different authors (e.g. Roth, Schweiger, & Morrison, 1991; Birkinshaw & Morrison, 1995; Nohria & Ghoshal, 1997; Hewett, Roth, & Roth, 2003).

The impact of the environment on an organization is equally complex. For example, in the last decade, India and China, both population rich countries with very low income per capita have displayed very high economic growth rates. From the perspective of MNCs headquartered in Europe or in the USA, both countries are culturally distant and both countries impose legal restrictions on foreign firms. Thus, in reality, external host country conditions are not fully independent but appear in typical patterns. MNCs,

when deciding on their subsidiary strategy, are most likely not able to address each country characteristic individually but are probably influenced by the overall configuration of these elements (Hewett, Roth, & Roth, 2003). Macharzina and Engelhard (1991) have therefore demanded that “we should not look anymore separately at locational advantages, cultural differences or oligopolistic market structures rather than at the whole set” (p. 30). In addition to the applications of the configurational approach on the organizational level, the logic can therefore be utilized at the environmental level as well.

PROPOSITIONS

Given the exploratory nature of this study we suggest a number of propositions in the following discussion instead of hypotheses. This indicates a lack of a priori expectations concerning the patterns of subsidiary strategies and concerning the types of external environments. As we have shown in the example above, country characteristics are not independent but there is no empirical evidence as to which different groups of host country environments exist. Before a clear set of configurations has been identified, it would be premature to discuss hypotheses about the concrete effect of these types.

Country characteristics, such as cultural distance, country risk, market size, or income level, have frequently been used in IB studies to argue and investigate their influence on subsidiary strategies (e.g. Bartlett & Ghoshal, 1986; Gupta & Govindarajan, 2000; Shenkar, 2001; London & Hart, 2004; Tihanyi, Griffith, & Russel, 2005; Brouthers, Brouthers, & Werner, 2008; Morschett, Schramm-Klein, & Swoboda, 2010). Most of these studies, though, only consider a few country characteristics, mainly as independent variables in multiple regression analyses.

Another procedure that has been used in previous studies to consider the external environment has been clustering. For example, studies compared developed countries and emerging countries (Delios & Henisz, 2000; Alam, 2007), or Asian countries and other regions (Isobe, Makino, & Montgomery, 2000; Mitsudome, Weintrop, & Hwang, 2008). The GLOBE study clustered countries into groups with similar national cultures (House et al., 2004). However, countries are simultaneously characterized by all of these variables, making a small selection of the variables appear arbitrarily. The scope of our study is broader in

that we are concerned with the full complexity of country characteristics. While a large number of country attributes has the inherent disadvantage that it is difficult to interpret differences with respect to single variables, it is eventually closer to reality. Following the suggestion by Macharzina and Engelhard (1991) we posit that host country environments can reasonably be grouped into rather homogeneous host countries with rather large differences between these groups in the following proposition:

P1. There exist distinct types of host country environments that characterize the differences among these host countries along a set of variables.

One of the fundamental decisions concerning a specific foreign subsidiary is the choice of a market entry mode (Wind & Perlmutter, 1977; Anderson & Gatignon, 1986; Brouthers & Hennart, 2007). Morschett, Schramm-Klein, & Swoboda, 2010) demonstrate in a meta-analytic study that a number of environmental variables have been shown to exert an influence on firms' choices of a market entry strategy across numerous empirical studies. However, these results are only referring to isolated effects of specific variables; the interaction of these variables and their joint effect is not investigated. At the same time, the tight interrelationship between different environmental variables makes it difficult to really isolate specific effects. Furthermore, managers in MNCs are likely to have a selective perception (Cyert & March, 1963) and they are, due to the complexity, probably not able to investigate the influence of each variable on their decisions. Thus, a collective pattern of country characteristics is likely to be judged together with regard to its effect on specific decisions (Hewett, Roth, & Roth, 2003).

Given that single external influences have been shown to exert an influence on the market entry choice and that bundles of environmental characteristics are likely to exert an even stronger influence, we formulate the following proposition:

P2. The type of host country environment influences the choice of a foreign market entry strategy.

When accepting the perspective of the MNC as a differentiated network, different subsidiary strategies have to be investigated. While early IB research looked at a uniform management of all subsidiaries, the last three decades have brought many studies that indicated that differentiated subsidiary roles exist. The role typology research stream in international business literature focuses on this differentiation of subsidiary roles. While diverse role typologies have been proposed in literature (see the recent overview by Schmid (2004), the basic assumption that different subsidiaries take over different roles is widely acknowledged in IB research (Bartlett & Ghoshal, 1986; Jarillo & Martinez, 1990; Birkinshaw & Morrison, 1995; Harzing & Noorderhaven, 2006).

As a dominant characteristic of the subsidiary strategy which is, though, seldom integrated in role typologies, the motive of the MNC to establish the subsidiary clearly differentiates subsidiaries from each other. Foreign subsidiaries are established for various reasons (Mudambi & Navarra, 2004) which at least reveal the MNC's intended strategy (Mintzberg, 1978). While in literature, the market seeking motive is usually predominant, more recent studies distinguish between different motives, such as market seeking, resource seeking, efficiency seeking and know-how seeking (Dunning, 1988; Martinez & Ricks, 1989; Rugman & Verbeke, 2001).

Role typologies have demonstrated that subsidiary strategies can differ, e.g. with respect to their domain of responsibility. For instance, subsidiaries can be serving only their local market or they may even be responsible for the world market ("market scope", White & Poynter, 1984). Also, the nature of their operation can vary in the scope of value chain activities included in their operations (White & Poynter, 1984; Porter, 1986; Gupta & Govindarajan, 2000) with some subsidiaries only carrying out marketing or production activities while others realize full value chains. Gupta and Govindarajan (1991) characterize the MNC as a network of transactions and from this perspective, the strategy of a subsidiary can be distinguished along the magnitude and the directionality of flows of products and of knowledge. It has been demonstrated that subsidiaries greatly differ with respect to knowledge flows to and from the rest of the MNC (Gupta & Govindarajan, 1994; Gupta & Govindarajan, 2000; Harzing & Noorderhaven, 2006) as well as with respect to product flows (Andersson & Forsgren, 1994; Randøy & Li, 1998).

Overall, previous role typologies, based on different attributes of subsidiary strategies have been shown to come to similar results and to identify subsidiary strategies with the same underlying characteristics (Birkinshaw & Morrison, 1995; Harzing, 2000). For example, knowledge flows, product flows and the market scope have all been linked to the integration-responsiveness framework (Bartlett & Ghoshal, 1989; Gupta & Govindarajan, 1991; Andersson & Forsgren, 1994). So the different typologies may be synthesized and the number of characterising dimensions may be reduced. However, different strategy elements highlight different facets of the subsidiary conduct, and different authors have emphasized the relevance of different aspects. Reducing the investigated strategy elements to a few inevitably fails to pick up some of the distinctions made by researchers (Birkinshaw & Morrison, 1995). Thus, the configurational perspective in which the interrelatedness of the subsidiary strategy facets is acknowledged but the different variables still kept in the investigation seems to be useful to reconcile both arguments.

While few subsidiary strategy studies clearly link the subsidiary strategy to external influence factors, there is an extensive body of literature that emphasizes that a congruence must exist between the strategy of an organisation and its contextual setting (Hofer & Schendel, 1978; Roth & Morrison, 1992b). Subsidiary strategies have to be tailored to a specific context which is composed of internal factors and external factors (Birkinshaw & Hood, 1998). The external context represents external contingencies to which a business unit must respond (Pfeffer & Salancik, 1978). For example, MNCs establish their subsidiaries in different countries and the factor conditions in the country will influence which dominant objective the MNC follows with this subsidiary (e.g. efficiency seeking, know-how seeking). Furthermore, from an institutional perspective, subsidiaries will experience pressure to adopt practices that are considered adequate in their respective local environments (Kostova & Roth, 2002).

We concur with Hewett, Roth, and Roth (2003) in that the performance effect of a specific subsidiary strategy is contingent on the prevailing country conditions. Systems theory suggests that optimal strategies exist for a set of specific external influences (Venkatraman & Prescott, 1990). Following the configuration approach, it is less the bivariate relationship between single variables than an alignment between specific

configurations of the environment and specific configurations of subsidiary strategy variables that makes the subsidiary strategy viable in the long run since the internal consistency between the internal variables is crucial for an efficient response to the external forces (Miller, 1981; Macharzina & Engelhard, 1991). Thus, we posit:

P3. The type of host country environment is associated with a specific success pattern of the subsidiary strategy.

SAMPLE

Data were collected through a mail and e-mail questionnaire survey of the heads of international operations or of directors of organization of German MNCs. Each respondent was asked to fill in the questionnaire with respect to one specific foreign subsidiary in a specific foreign market. Data were gathered concerning the MNC, the subsidiary and the host country of the subsidiary.

Contact addresses were generated from two different industry databases. Overall, 5,400 questionnaires were successfully send to different MNCs of which 408 responded. A number of questionnaires had to be eliminated for the analysis of the research questions in this paper due to a high rate of missing values. Thus, the following analysis is based on 238 questionnaires.

The response rate of 7.6% is low, but not unusual for international studies with high-level executives as respondents (Harzing, 1997). To evaluate the risk of a non-response bias, we applied two methods. First, following the procedure proposed by Armstrong and Overton (1977), we compared the group of early respondents (first quarter of the sample to answer) with the group of late respondents (last quarter of the sample to answer) on seven different variables by ANOVA. The F-Values did not display any significant differences. Second, we compared responding and non-responding firms from the original sample. Since the only quantifiable information in the original database was the location of the company, we compared the location of responding and non-responding firms on the level of the first digit of the post codes (from 0 to 9, i.e. ten areas). A Chi²-test did not display any significant differences. Thus, both procedures show no indication of a non-response bias.

The companies are from a diverse field of services, like advertising agencies, consulting companies, software companies, etc., and different manufacturing industries, mainly machine manufacturing and electrical equipment and appliances manufacturing. The location of the 238 subsidiaries is spread over 38 countries on all continents. The most important host countries are USA (12.7% of subsidiaries in the sample), China (11.2%), Western European countries (mainly France, UK, and Switzerland), and Eastern European countries (mainly Poland, Romania, Czech Republic). The MNCs in the sample have sales between 0.3 million EUR and 6.4 bn. EUR (mean: 215 million EUR); the subsidiary size varies from 0.02 to 445 million EUR sales (mean: 24.8 million EUR).

MEASUREMENT

To measure the variables, we used standard well-established research instruments. A detailed explanation of the measurement scales is displayed in Tables A, B and C in the appendix.

Concerning *country characteristics*, we gathered information on a comprehensive set of country attributes that have been used in previous research. Data on market size, market growth, country risk, international competitiveness, income level, factor costs, cultural distance, geographical distance, legal restrictions, and trade barriers were collected from secondary sources, such as the Worldbank, the World Economic Forum, etc. Data on the strategic relevance of the host country in the particular industry, the market heterogeneity and the competitive intensity were captured with a direct question in the survey. Given the long questionnaire and the many items, we accepted measuring these country characteristics, even though subjective, with a single item. Since the characteristics are not used as individual variables but only in the bundle of country characteristics, we assume that this does not distort our results for the country classification.

To identify the chosen *market entry mode* for the subsidiary, we provided the respondents with a comprehensive list of 13 different market entry modes (e.g. indirect export, direct export, licensing, joint venture, wholly-owned subsidiary via acquisition, wholly-owned subsidiary via greenfield investment) and

grouped them into (1) export-oriented market entry modes, (2) cooperative arrangements in the host country, and (3) wholly-owned subsidiaries in the host country.

To capture the strategy of the subsidiary, we referred to the most frequently discussed differences between different subsidiaries. Considering the major *motives to establish a foreign subsidiary*, most authors distinguish between market seeking, resource seeking, efficiency seeking, and know-how seeking (also labelled strategic asset seeking) (Dunning, 1988; Rugman & Verbeke, 2001). As fifth potential motive, we capture whether a company moved abroad to follow their clients into a foreign market (Sarkar & Cavusgil, 1996; Coviello & Martin, 1999; Erramilli & Rao, 1990). MNCs usually follow a bundle of objectives with their subsidiaries, so that the five motives are not excluding each other (Shan, 1991). We captured the relevance of each motive on a seven-point Likert scale.

As major components of the subsidiary strategy, we captured the *market scope* as the number of countries to which the subsidiary delivers (D'Cruz, 1986; Birkinshaw & Morrison, 1995), the *value-added scope* as the number of activities that the subsidiary carries out (White & Poynter, 1984), and the *local adaptation* of products and processes of the subsidiary to the host country (Harzing, 2000; Gates & Egelhoff, 1986).

To measure the magnitude and direction of *product flows* between the subsidiary and the headquarters or the peer subsidiaries, four questions were asked following Andersson and Forsgren (1994) (e.g. "Estimate the share of output of the subsidiary (incl. parts/components) that is sold to other subsidiaries of the MNC relative to the total output of the subsidiary."; six-point scale, from 0% to 100%). Similarly, to measure the magnitude and direction of *knowledge flows* between the subsidiary and the headquarters or the peer subsidiaries, four questions were asked following Gupta and Govindarajan (1994).

To capture *subsidiary performance*, we followed Brouthers, Brouthers, and Werner (2000) and Nohria and Ghoshal (1997) and asked for the satisfaction of HQ managers concerning three performance measures of their subsidiary: sales, ROI and the overall performance of the subsidiary ($\alpha = 0.844$).

EMPIRICAL RESULTS AND DISCUSSION

Types of host country environments

The comprehensive set of attributes of the host country shows a great number of significant correlations, as Table 1 reveals. This makes the interpretation of results with regard to the influence of specific country characteristics difficult. Furthermore, the very tight relationships between various country attributes make it practically impossible to isolate specific effects (given, moreover, that the total population of countries in the world consists of less than 200).

display Table 1 about here

For example, countries with a high country risk are simultaneously characterised by low income which is, in turn, closely related to low factor costs. From the perspective of the home country in this study – Germany – these countries are also culturally more distant. Legal restrictions are higher.

Partly these intercorrelations are a result of direct economic relationships (like income level and factor costs), others are more artefacts of current developments than causal relations (such as the finding that countries with a high growth rate in the last years also exert a higher level of legal restrictions). Given that the host countries are also evaluated from the perspective of MNCs, it seems plausible that larger markets are considered strategically more relevant countries in the industry. We omit the discussion of potentially underlying reasons for the associations between the variables and proceed to discuss the consequences.

To investigate the influence of country variables on company decisions, multivariate regression is a common method (e.g. Bradley & Gannon, 2000; Anderson & Coughlan, 1987), often, multiple discriminant analysis is utilized (e.g. Davis, Desai, & Francis, 2000; Kim & Hwang, 1992; Taylor, Zou, & Osland, 2000; Brouthers, Brouthers, & Werner, 2000). But in the case of our sample (comprising 38 different countries) – and very likely also on the level of all potential host countries – multicollinearity would strongly distort the results of a regression analysis. Besides the correlation matrix, this becomes evident when calculating a regression analysis with all fourteen country characteristics as independent variables. For many variables,

the variance inflation factors would be far above ten which is considered a critical threshold for multicollinearity (Mason & Perreault, 1991).

If intercorrelations between items appear, a factor analysis could reduce that problem and identify underlying factors. However, many of the country characteristics correlate without representing a single factor. If, for instance, legal restrictions and market growth highly correlate not due to a causal relationship but because currently the highest growth rates in the world are not achieved by the rather saturated (and liberal) markets in the USA and Europe but rather by China and India who have – probably rather independent of their market growth – higher restrictions than Europe. The first attempt of a factor analysis in our sample combined, for example, variables as cultural distance and trade barriers. Again, there is most likely not an underlying factor but an artefact. Examples like this are common, as the correlation matrix indicates.

Instead, the relationship between sets of variables shall be captured with the configuration approach. Methodologically, the configurational approach attempts to identify configurations by aggregating individual variable profiles (in this case, profiles of characteristics of countries). Thus, it reduces the number of patterns by sorting them into groups which are homogeneous within and distinct to other groups. We apply the commonly used method – cluster analysis (Macharzina & Engelhard, 1991; Drazin & Van den Ven, 1985; Venkatraman, 1989). The empirical observation in the correlation matrix that influence factors are not easily isolated but are more or less tightly related to each other, is one of the arguments in literature for the creation of typical patterns or configurations, and, thus, for the demand to look at the whole set of country characteristics simultaneously.

Therefore, for the further analysis, we try to identify typical patterns of host country conditions. In the first step, we specify the number of clusters by looking at error square sums of a hierarchical cluster analysis based on a ward-algorithm with Euclidian distances. Following the elbow criterion, a four-cluster solution appears to best fit the data. The cluster analysis is carried out with the two-step method without prefixing the number of clusters and this method also suggests a four-cluster solution to be optimal. The means of the country conditions in each of the four clusters is displayed in Table 2. For the sake of

readability, the pairwise comparisons between the four clusters are not displayed. However, for each variable, pairwise comparisons with the procedure Tamhane-T2 for heterogeneous variances and with the Scheffé-test for homogeneous variances were carried out. For almost every variable, all pairwise comparisons were significant, demonstrating clear heterogeneity between the country clusters. Thus, the empirical analysis provides support for *proposition P1*.

display Table 2 about here

To characterise the clusters better, they were labelled by the dominant countries in the clusters. However, even though regional labels were used, the type “Eastern Europe” may well include non-European countries and a country like Canada could – looking into the attribute pattern – be a part of the cluster “Western Europe”. Based on this, we will shortly characterize the clusters by looking into some key variables. However, it has to be noted that the basic logic of the approach is to identify patterns, i.e. aggregated profiles, on the basis of a comprehensive list of country attributes so that the discussion of single variables may actually be misleading:¹

- The first host country pattern („Type BRICs“) comprises countries that are very large but with a very low income per capita. In our sample, the two countries in this cluster are China and India. The cluster, thus, seems to represent a type of fast-growing, very large but still emerging countries such as the BRIC countries.
- The second country pattern („Type Eastern Europe“) includes a number of host countries that are rather small with a low income per capita (but well above that in cluster 1). Growth is moderate and country risk still rather high. The cluster contains many host countries; the most important ones are countries from Eastern Europe.
- The third country pattern („Type Western Europe“) consists of medium-sized, income-rich countries with a moderate growth and low legal restrictions. Trade barriers are rather low. Dominant countries in

the cluster are France, the UK and Spain, thus, the cluster mainly consists of Western industrialized nations.

- The last host country type consists in our sample solely of the USA („Type USA“). The cluster is characterized by a very large market with high income and excellent international competitiveness. Low country risk is combined with a liberal policy, concerning low legal restrictions and trade barriers. Furthermore, the strategic relevance of this host country type is high for most surveyed MNCs.

This short characterization shows that it is necessary to look into the full pattern of host country attributes at the same time which we do in the form of profiles, aggregated to patterns. The partial perspective on specific variables (country risk, market size, etc.) is very difficult. Non-consideration of this aspect in many previous IB studies has – presumably – lead to distorted results and to the fact that spurious correlations had an influence on the results without that being acknowledged in the interpretation.

Explanatory power of host country types for the choice of a market entry mode

After the identification of homogeneous groups of host countries, we investigate whether different market entry modes are utilized in different host country types. For the three basic types of market entry modes – export, cooperative arrangements in the host country, and wholly-owned subsidiary (Malhotra, Agarwal, & Ulgado, 2004) – we compare their frequency in different host country environments. The cross-tabulation is displayed in Table 3.

display Table 3 about here

Overall, there is a highly significant association between country type and market entry mode. While host countries of the type BRICs or Eastern Europe are significantly more often entered by cooperative arrangements than the frequency of cooperative arrangements in the total sample would imply, the (rather rich and also culturally and economically rather similar) host countries of the type Western Europe and USA are significantly less frequently served via cooperation. Alliance partners may, thus, be more necessary in dissimilar countries to compensate knowledge deficits (Madhok, 1998). Another reason may

be the high growth rates which enhance the necessity to a fast market entry which is better reached via cooperative arrangements (Hennart & Larimo, 1998; Chang & Rosenzweig, 2001).

The geographically close countries of Western Europe which are also characterized by high factor costs are – from the home base Germany – significantly more frequently served via exports; the low distance and the similar cost structure may not render a direct investment in these countries necessary. The geographically more distant market USA – despite similarly high factor costs – is served with wholly-owned subsidiaries.

Thus, the overall relationship and the number of particular relationships supports *proposition P2*. However, one has to be careful in the interpretation. While above, we have tried to link entry modes to specific variables in the host country types (such as economic growth), our approach does not really allow that. Instead, the configurational approach only permits to evaluate the effect of an overall pattern of country characteristics. While it seems likely that specific variables may have a stronger influence than others on specific MNC decisions, we did not attempt to investigate this in our study.

To shortly demonstrate the superiority of this approach, we compare a traditional method of investigating host country influences. In literature, an influence of a number of key variables on the entry mode decision has consistently been shown. These are cultural distance (e.g. Erramilli & Rao, 1993; Tihanyi, Griffith, & Russel, 2005), country risk (Kim & Hwang, 1992; Barkema & Vermeulen, 1998; Morschett, Schramm-Klein, & Swoboda, 2010), income level of the host country (Agarwal, 1994; Young Baek, 2003), and legal restrictions (Hennart & Reddy, 1997; Padmanabhan & Cho, 1999). These four variables are tested – as shown in Table 4 – in separate regression analyses in models 1, 2, 3, and 4 respectively. In each case, a highly significant influence is supported by the data in our sample. If, however, all four variables are included simultaneously as independent variables in the regression model (model 5), none of them have an influence. Obviously, controlling for the other variables distorts the results while looking into the full bundle of variables shows the influence of host country environment on entry mode choice.

display Table 4 about here

Ideal profiles of subsidiary strategies under different host country conditions

To analyze contingency effects from a configurational perspective, Drazin and Van den Ven (1985) have proposed a system-based method which has been applied in IB in a few studies (Roth, Schweiger, & Morrison, 1991; Hewett, Roth, & Roth, 2003). They suggest investigating the deviation from an identified “ideal profile”. System theory leads to the assumption that there is an optimal bundle of strategy elements under certain external conditions. If this extracted pattern of subsidiary strategy elements is optimally aligned to the external conditions, then a deviation from this ideal profile leads to a misfit (“fit as profile deviation; Venkatraman, 1989). Thus, the fit analysis tests whether a distance between the strategy profile of a specific subsidiary and the ideal pattern has a negative effect on the performance of this unit.

There is some discussion in literature on how to extract the ideal profile. A few authors suggest a theory-based creation of an ideal profile (Govindarajan, 1988). However, one of the basic assumptions of the configurational approach is the complexity, multi-facetness and interdependency within a set of strategy variables which makes a simple theoretical argumentation of a complete coherent bundle (which does not necessarily display extreme values for each variable) at least very difficult, if not impossible. Therefore, most authors suggest to identify the ideal profile empirically by looking into the pattern of organizational variables that the top performers realize (Drazin & Van den Ven, 1985; Roth, Schweiger, & Morrison, 1991; Venkatraman & Prescott, 1990; Hewett, Roth, & Roth, 2003).

We assume that different types of host country environments pose different contexts which will lead to different ideal profiles. Thus, we investigate the pattern of the top performers in each of the four host country environments. Based on the economic performance of the subsidiaries, we divided the sample in each type of host country based on a one-third split. Given that the distribution of the subsidiary performances is not identical in each sample, different thresholds had to be used for each type of host country. The thresholds for the identification of the third top performers were 0.1429 (type BRICs), 0.5272

(type Eastern Europe), 0.6674 (type Eastern Europe), and 0.4664 (type USA). Then, we profiled the ideal pattern of a subsidiary strategy of the top performers and the strategy pattern of the low performers in each host country type by calculating the mean level of our 16 subsidiary strategy elements. Table 5 displays the mean values for the top performers and the low performers in each type of host country. This procedure gives a first impression of the effect of a deviation.

display Table 5 about here

Without discussing each single variable, the main differences shall be shortly highlighted:

- In BRICs countries, the top performers focus more on market seeking in the host country while they acknowledge that know-how seeking is not (yet) relevant in these countries. Market scope is very narrow for the top performers, i.e., in this type of country, more successful MNCs fully concentrate on this market while low performers use BRICs countries as production base for markets in large parts of the world. Overall, the top performers in these countries are less linked to the rest of their MNCs by product flows. This seems to characterize a rather multinational strategy that may be adequate in this type of country due to cultural and other distances to the home country.
- In countries of the type Eastern Europe, subsidiaries that were established for reasons of efficiency seeking seem to be more successful; in addition, high-performing subsidiaries in this type of country realize more complete value chains. Coherent with the efficiency seeking argument, the top performing subsidiaries deliver more products to other subsidiaries and are more tightly integrated into their MNCs.
- Foreign subsidiaries in host countries of the type Western Europe do not display major differences among top and low performers on the investigated strategy variables. Overall, there seems to be a slightly stronger integration into knowledge flows with the MNC, in particular with regard to the receipt of knowledge from other subsidiaries of the firm.

Surprisingly, in host countries of the type Western Europe and USA, the top performers and the low performers are not significantly distinct with regard to most investigated subsidiary strategy elements. This

indicates that our model is under-specified and the performance-distinguishing variables in these two types of host country environments are others than the ones that we have investigated. It could also be that isomorphism has lead to convergence of the subsidiary strategies in these countries over time (DiMaggio & Powell, 1983; Haveman, 1993). However, for the types BRICs and Eastern Europe, different patterns between top and low performers become apparent. A number of subsidiary strategy variables show high and significant differences between top performers and the low performers in those two environments.

display Table 6 about here

When comparing the top performing patterns between the four different environments, significant differences emerge for almost every variable. This reveals that there are distinct subsidiary strategy patterns as a result of the different host country influences.

To further investigate whether the identified profiles are indeed ideal profiles and to which degree the fit of the subsidiary strategy to the host country environment has an effect on the performance, we calculated the effect of a profile deviation. The deviation is calculated as the Euclidian distance between the strategy profile of a specific subsidiary and the ideal strategy profile for the respective host country, establishing a multivariate specification of fit. This distance is used as an independent variable in a linear regression analysis, and the economic subsidiary performance as dependent variable. This procedure is more consistent with the basic assumptions of the configurational approach since a total, aggregated distance is considered between the subsidiary strategy profile and the ideal profile instead of a comparison of means for single variables (as we did in Table 5).

Since the sample size in the four groups is rather low (we do not consider the group of top performers in the regression analysis since these have established the ideal profile; Roth, Schweiger, & Morrison, 1991) we also conducted an aggregated analysis. Across all four groups, we calculated the relationship between the deviation from the ideal profile and the subsidiary performance. The results are displayed in Table 7. The relatively high and highly significant standardised regression coefficient for the total sample provides support for *proposition P3*.

For each type of host country, a negative regression coefficient emerges. The slopes of the regression curves are, however, different. The data show highly significant coefficients for types BRICs and Eastern Europe, significance on the 5 %-level for the type Western Europe and significance only on the 10 %-level for the type USA. As has already become evident in the previous analyses, a deviation from the ideal profile has a stronger influence on the subsidiary performance in the first two group of host countries.

display Table 7 about here

Interpreted from a contingency perspective, this indicates that the strategic choice of MNCs, i.e. the ability to deviate from a subsidiary strategy that is resulting from the pressure of the host country environment, is higher in the two host country environments USA and Western Europe than in than in the types BRICs and Eastern Europe.

CONCLUSION

The contribution of our paper is twofold: We identified complex patterns of environmental characteristics that collectively influence subsidiaries of MNCs in these host countries in a rather homogeneous way. Country characteristics are very strongly correlated to each other which renders the investigation of the effect of a single variable difficult due to multicollinearity. We concur with Macharzina and Engelhard (1991) that a more system-oriented perspective on the host countries should be pursued and as a result of our empirical study we show that host countries can be – from the perspective of corporate management – grouped into four types of host countries: BRICs, Eastern Europe, Western Europe, and USA. We demonstrated the relevance of these host country types by showing that there is a significant association between these four host country types and the chosen market entry mode. Even though we attempted to enhance the generalisability of our results by eliminating those country attributes from our clustering procedure that are judged relative to a home country, we can, though, not fully exclude the risk that this classification is only valid for MNCs that are headquartered in Germany. Further investigations into the generalisability of the classification remain necessary.

Second, for each host country type, we identified ideal profiles for the strategies of the subsidiaries. In all, the derived four strategy patterns can be seen as ideal profiles which provide an optimal alignment to the respective host country environments. The fact that low performers, in particular in the USA and Western Europe, display similar strategy profiles to the top performers indicates, though, that other variables are necessary to comprehensively explain performance in these two country types.

However, given that the subsidiary does not only experience pressure from the local environment but that other context factors, e.g., the corporate strategy of the MNC (see, e.g., Bartlett & Ghoshal, 1989; Birkinshaw & Morrison, 1995) or the resources and capabilities of the subsidiary (e.g. Gupta & Govindarajan, 2000; Birkinshaw, Hood, & Jonsson, 1998), are also likely to have an effect on the optimal subsidiary strategy, this results seems plausible. Furthermore, the role typology literature clearly follows a “strategy-structure” perspective, implying that a specific subsidiary strategy must be aligned to a specific type of headquarters-subsidiary relationship as well (Martinez & Jarillo, 1991; Birkinshaw & Morrison, 1995).

Finally, it may be that in “less sophisticated” host country environments, the choice of an optimal subsidiary strategy is already sufficient to succeed while in “more sophisticated” host countries² an optimal strategy with regard to the country is not sufficient but it has to be linked to additional contingency factors and it has to be implemented optimally as well. For the host country types BRICs and Eastern Europe, though, our study identified ideal subsidiary strategy patterns and the study demonstrated that a deviation from these patterns reduces the subsidiaries’ performance.

¹ Since a few of our variables for the characterisation of host countries are home-country-dependent (cultural distance, geographic distance, market heterogeneity) and the home country in our study is Germany for all subsidiaries in the sample, it is possible that this reduces the generalisability of the results. In this case the environmental clusters would only be valid for MNC with headquarters in Germany. To investigate the generalisability of our cluster solution to MNCs from other home countries, we repeated the cluster analysis without these variables. Only in 2.9 % of the cases, this procedure leads to other cluster assignments so that a high stability of our cluster solution is given. Thus, the cluster solution can be seen as generalisable even though the influence of a home country perspective may still exist. In particular, if the *effect* of certain characteristics on firm decisions is analyzed, it is likely that MNCs take a comparative perspective which would enhance the relevance of a measurement relative to the home country.

² It has to be noted that picking out single variables to characterize the host country types is not really adequate and only done here for the sake of simplicity.

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APPENDIX

Table A

Measurement of country characteristics – secondary data sources.

Variable	Indicator	Data source
Market size	GDP in billion USD	CIA – The World Fact Book
Market growth	average growth of real GDP p.a. in the in the last five years	own calculations based on Eurostat data
Country risk	inverted Institutional Investor's Risk Index (scale 1-100)	Institutional Investor
International competitiveness	Index of international competitiveness	World Economic Forum
Income level	GDP per capita in USD (PPP)	Worldbank
Factor cost	Average gross salary per hour in CHF	UBS
Cultural distance	Index based on the GLOBE dimensions, using the method by Kogut/Singh	Kogut & Singh, 1988; House et al., 2004
Geographical distance	Distance between the Germany and the country capital in kilometers	Geobytes.com
Legal restrictions	Index of Economic Freedom (scale 1-5)	Heritage Foundation
Trade barriers	Factor „Trade Policy” of the Index of Economic Freedom (scale 1-5)	Heritage Foundation

Table B

Measurement of country characteristics – survey data.

Variable	Direct questions (single items), scale	Source
Strategic relevance of host country for the industry	„How important is it for a company in your industry to be present in the host country? Consider aspects as technology level, presence of important customers, market size, local resources, etc.; Likert scale 1-7; anchors: host country not important at all in our industry – very important	adapted from Bartlett & Ghoshal, 1986
Market heterogeneity	„To which degree are market and competitive conditions in the host country similar to the home country?"; Likert scale 1-7; anchors: not at all – to a very large extent	adapted from Bufka, 1997
Competitive intensity	„How do you evaluate the competitive intensity in the host country compared to other countries?"; Liker scale 1-7; anchors: rather low – much more intensive	Nohria & Ghoshal, 1997

Table C

Measurement of market entry mode, subsidiary strategy, and subsidiary performance.

Variable	No. of Items	Source	Remarks
Market entry mode	13	List of market entry modes which were grouped into export (e.g. indirect export, export without permanent presence in host country, export via agency in host country, export via sales subsidiary) cooperative arrangement in host country (e.g. licensing, franchising, contract manufacturing, participation) wholly-owned subsidiary (via acquisition, via greenfield investment)	Respondents selected the entry mode from the list that was most adequate to describe their own entry into the host country.
Motives for the Establishment of the Subsidiary	5	Adapted from Dunning, 1998; Martinez & Ricks, 1989; Coviello & Martin, 1999	Each motive used separately; not aggregated, scales from 1 (not relevant) to 7 (very important motive)
Market Scope	1	Birkinshaw & Morrison, 1995	No. of countries
Value-added scope	8	Adapted from Morrison & Roth, 1993; Jarillo & Martinez, 1990	Each activity with 1 (activity carried out) or 0 (activity not carried out) Index; Sum of all value-added activities (from 1 to 8)
Local Adaptation	4	Adapted from Harzing, 2000; Gates & Egelhoff, 1986	α : 0.787; expl. variance: 61.4%
Product Flows	4	Adapted from Andersson & Forsgren, 1994; Harzing, 2000; Nohria & Ghoshal, 1997	Each product flow used separately; not aggregated, scales from 1 (0%) to 6 (100%)
Knowledge Flows	4	Adapted from Gupta & Govindarajan, 1994	Each knowledge flow used separately; not aggregated; scales from 1 (very low extend) to 7 (very substantial extent)
Subsidiary Performance	3	Adapted from Brouthers, Brouthers, & Werner, 2000; Nohria & Ghoshal, 1997	α : 0.844; expl. variance: 76.5%

Table 1
Correlation matrix of the environmental characteristics.

	Pearson's correlation coefficient													
	1	2	3	4	5	6	7	8	9	10	11	12	13	14
Market size (1)	1	.28***	-.23***	-.30***	.30***	.32***	.35**	-.17**	.01	.64***	.30***	.09	-.08	.10*
Market growth (2)		1	.36***	.48***	-.54***	-.45***	.10	.42***	.37***	.35***	-.05	-.37***	.55***	.61***
Country risk (3)			1	.89***	-.87***	-.87***	-.18**	.85***	.32***	.18***	-.31***	-.50***	.82***	.70***
International competitiveness (4)				1	-.92***	-.91***	-.147*	.84***	.31***	.02	-.25**	-.46***	.80***	.61***
Income level (5)					1	.98***	.18**	-.80***	-.35***	-.09	.30***	.49***	-.83***	-.74***
Factor costs (6)						1	.20***	-.81***	-.34***	-.08	.30***	.47***	-.79**	-.68***
Strategic relevance host country (7)							1	-.17**	-.04	.24***	.46***	.25***	-.04	-.04
Cultural distance (8)								1	.36***	.14**	-.23***	-.45***	.70***	.57***
Market heterogeneity (9)									1	.17**	-.13*	-.40***	.30***	.35***
Geographical distance (10)										1	.13*	-.07	.27***	.39***
Competitive intensity (11)											1	.35***	-.18**	-.17**
Resource availability (12)												1	-.49***	-.51***
Legal restrictions (13)													1	.79***
Trade barriers (14)														1

Two-sided significance tests.

Table 2

Typical patterns of country characteristics.

	Mean values				ANOVA	
	1 (n=34)	2 (n=75)	3 (n=92)	4 (n=37)	F	Sign.
Market size	6'914.09	409.84	1'341.82	11'750.00	2'467.26	0.000
Market growth	7.49	3.25	2.52	2.97	126.774	0.000
Country risk	34.94	41.19	10.21	7.60	441.413	0.000
International competitiveness	45.50	48.80	14.35	1	355.421	0.000
Income level	1'050.59	4'606.67	26'113.48	37'870.00	942.285	0.000
Factor cost	4.315	3.805	19.986	28.000	476.579	0.000
Strategic relevance of host country	6.00	4.96	5.65	6.51	10.549	0.000
Cultural distance	0.287	0.324	0.180	0.180	246.508	0.000
Market distance	5.06	4.48	3.00	3.16	17.366	0.000
Geographical distance	8'018.47	1'969.49	1'951.39	6'535.00	66.004	0.000
Competitive intensity	4.59	3.89	4.86	5.65	18.240	0.000
Legal restrictions	3.466	2.875	2.155	1.850	178.045	0.000
Trade barriers	4.088	2.867	1.989	2.000	489.753	0.000
Dominant countries in cluster	China (91.2%) India (8.8%)	Romania (17.3%) Czech Rep. (16.0%) Poland (14.7%) Hungary (10.7%)	France (18.5%), UK (17.4%) Italy (12.0%) Spain (10.9%)	USA (100.0%)		
Cluster label	Type BRICs	Type Eastern Europe	Type Western Europe	Type USA		

Table 3

Cross-tabulation and contingency analysis of host country type and basic type of market entry mode.

	1 Type BRIC	2 Type Eastern Europe	3 Type Western Europe “	4 Type USA	total
Export	32.4%	34.7%	58.0%*	45.7%	45.0%
Cooperative arrangement	44.1%**	43.1%***	5.7%***	5.7%*	23.1%
Wholly-owned subsidiary	23.5%	22.2%	36.4%	48.6%*	31.9%
Sum	100.0%	100.0%	100.0%	100.0%	100.0%
$\chi^2=47.636$; df=6; p=0.000					

Table 4

Binary logistic regression for the decision “cooperation in host country vs. wholly-owned subsidiary”.

	Model 1	Model 2	Model 3	Model 4	Model 5
Independent variables	B (Wald's t)	B (Wald's t)	B (Wald's t)	B (Wald's t)	B (Wald's t)
Constant	3.53 (23.02***)	-4.34 (21.91***)	-0.47 (3.77)	3.82 (25.98***)	-0.38 (0.01)
Cultural distance	-12.08 (19.87***)	-	-	-	-3.46 (0.32)
Country risk	-	-0.07 (26.47***)	-	-	-0.05 (2.15)
Income level	-	-	0.00 (21.00***)	-	0.00 (0.43)
Legal restrictions	-	-	-	-1.30 (22.06***)	-0.62
	$\chi^2=23.990$ p=0.000	$\chi^2=32.013$ p=0.000	$\chi^2=25.674$ p=0.000	$\chi^2=24.784$ p=0.000	$\chi^2=32.805$ p=0.000

Table 5

Low and top performing subsidiary strategies in different types of host countries.

	Mean values							
	1		2		3		4	
	Type BRICs		Type Eastern Europe		Type Western Europe		Type USA	
	LOW	TOP	LOW	TOP	LOW	TOP	LOW	TOP
Motives								
- Market seeking	<u>5.78</u>	<u>6.67</u>	6.00	5.91	6.45	6.41	6.67	6.85
- Resource seeking	5.22	5.50	2.27	2.85	2.28	1.96	2.00	2.31
- Efficiency seeking	5.33	5.67	<u>3.00</u>	<u>4.85</u>	2.00	2.07	1.92	1.38
- Know-how seeking	<u>4.44</u>	<u>1.75</u>	2.63	2.70	2.17	2.48	2.75	2.38
- Follow-the-customer	5.00	5.75	3.07	2.81	3.14	3.00	4.00	3.77
Value-added scope	7.22	7.50	<u>5.40</u>	<u>6.57</u>	5.19	5.63	5.17	5.83
Market scope	<u>66.88</u>	<u>1.83</u>	9.92	11.35	6.60	6.54	3.90	2.17
Local adaptation	0.46	0.53	0.11	0.32	-0.26	-0.01	0.28	0.73
Product flows								
- from HQ	<u>3.78</u>	<u>2.83</u>	2.69	2.90	3.56	3.79	4.00	4.90
- from peer subsidiaries	<u>3.00</u>	<u>1.08</u>	<u>1.17</u>	<u>1.86</u>	1.41	1.91	1.30	1.20
- to HQ	3.11	2.33	1.93	2.20	1.50	1.71	1.67	1.40
- to peer subsidiaries	<u>3.00</u>	<u>1.75</u>	<u>1.23</u>	<u>1.65</u>	1.50	1.45	1.25	1.30
Knowledge flows								
- from HQ	3.78	4.33	5.13	4.64	5.07	5.44	<u>4.17</u>	<u>5.54</u>
- from peer subs	2.44	1.75	2.93	2.86	<u>2.04</u>	<u>2.93</u>	2.33	2.62
- to HQ	3.89	2.67	3.80	3.59	4.10	4.07	4.58	4.67
- to peer subsidiaries	<u>2.11</u>	<u>1.42</u>	<u>1.50</u>	<u>2.41</u>	2.25	2.85	3.00	3.45

Significantly different variables between top performers and low performers in each type of host country are underlined with solid lines (p<0.05) or with dotted lines (p<0.10).

Table 6

Comparison of mean values for the top performing subsidiary strategies in different types of host countries.

	Mean values				ANOVA	pairwise comparison
	1 Type BRICs	2 Type Eastern Europe	3 Type Western Europe	4 Type USA	Sign.	different at p=0.05 (Scheffé, Tamhane-T2)
Motives						
- Market seeking	6.67	5.91	6.41	6.85	0.108	
- Resource seeking	5.50	2.85	1.96	2.31	0.000	S: 1/2, 1/3, 1/4
- Efficiency seeking	5.67	4.85	2.07	1.38	0.000	T: 1/3, 1/4, 2/3, 2/4
- Know-how seeking	1.75	2.70	2.48	2.38	0.432	
- Follow-the-customer	5.75	2.81	3.00	3.77	0.001	S: 1/2, 1/3
Value-added scope	7.50	6.57	5.63	5.83	0.014	T: 1/3
Market scope	1.83	11.35	6.54	2.17	0.056	
Local adaptation	0.53	0.32	-0.01	0.73	0.039	
Product flows						
- from HQ	2.83	2.90	3.79	4.90	0.001	T: 1/4, 2/4
- from peer subsidiaries	1.08	1.86	1.91	1.20	0.036	T: 1/2, 2/4
- to HQ	2.33	2.20	1.71	1.40	0.068	
- to peer subsidiaries	1.75	1.65	1.45	1.30	0.268	
Knowledge flows						
- from HQ	4.33	4.64	5.44	5.54	0.049	
- from peer subs	1.75	2.86	2.93	2.62	0.259	
- to HQ	2.67	3.59	4.07	4.67	0.035	
- to peer subsidiaries	1.42	2.41	2.85	3.45	0.025	T: 1/3, 1/4

Table 7

Regression analyses for the relationship between the deviation from the ideal profile and the economic performance of a subsidiary in the four different country clusters.

Sample	n	Standardized regression coefficient β	Sign.
Type BRICs	20	-0,608	0,002
Type Eastern Europe	48	-0,517	0,005
Type Western Europe	56	-0,322	0,045
Type USA	23	-0,450	0,070
Total sample	147	-0,428	0,000

Dependent variable: economic performance; regressor: Euclidian distance from ideal profile