

# **Business Ethics in Subsidiaries of Multinational Companies in the Czech Republic**

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## **Abstract**

Business ethics is developing in the environment of subsidiaries of multinational companies operating in the Czech Republic. In 2011 the empirical research covering the analysis and description of the functioning of subsidiaries of multinational companies operating in the Czech country was carried out. In relation to the implementation of research was held by the code of ethics at selected branches and representative offices of multinational companies. The sample consisted of 335 subsidiaries of large multinational companies with more than 50 employees and an annual turnover of more than 30 million CZK (1.2 mil. Euro). Respondents answered questions dealing with the existence and implementation process of a code of ethics in selected subsidiaries with special regard to the effect of national culture. All surveyed subjects were evaluated also in terms of economic performance and organizational structure. The results indicate an interesting approach to the concept of business ethics in the subsidiaries of multinational companies operating in the CR, in the terms of shaping the relations between headquarters and their subsidiaries. In this context also specific effects of national culture can be identified as “penetrating” the code of ethics in specific country. The results also suggest a possible relation between economic performance and the existence of an ethical code of the subsidiaries of multinationals companies.

## **Introduction**

Ethics is currently a hot topic in the region of the CEE countries; it is focused on all areas of both public and private life. In this context, the development of business ethics becomes increasingly important, interconnecting both these areas and having an impact on the behaviour of companies transacting business, which is reflected in the formation of the corresponding environment. In countries with the developed market economy, the ethics of the environment evolves in the long term; a similar course can be expected also in the countries where the economy transformation is taking place or has taken place. We can encounter many findings that show unethical practices in connection with the process of transformation (the origin in the operation of the “black market” known in the CEE environment) and globalization of the economy (Chakraborty, 1997). Very often a discussion takes place the aim of which is to find global ethical rules, particularly with regard to the growth of direct foreign investments and increasing proportion of countries being involved in the international trade (Payne, Raiborn and Askvik, 1997). The influence of culture on the ethics is also greatly discussed, as well as the associated risk of investments made through the entry of the MNCs in selected CEE markets (Brouthers, Brouthers and Nakos, 1998). In this paper, we can build on a study elaborated in the past, describing the transformation of the economy from planned economy to market economy in the Czech Republic, which provided some paradigms associated with unethical behaviour. Mentioned were mainly the aspects historically connected with the totalitarian regime, phenomena reacting to the opportunities

and moral hazards of the transformation of the economy (embezzlement), and last but not least the initial shortcomings of the market system itself (Bohatá 1997). It was assumed that the shortcomings of the newly created market system would be adjusted to standard conditions after building a fully functioning market environment and the legal framework and after the integration of the CR into the international structures, especially EU. This was also shown by some other researches that outlined the issue of economic and ethical attitudes of CEE citizens (Padelford and White 2010).

Multinational companies (hereinafter MNC/MNCs) are important elements of well operating market environments, which mediate the involvement of the country in international structures. Their other benefits include their contribution to the culture and business ethics in the given country (Barker, Cobb, 1999). This is closely related to the issue currently dealt with, which covers social aspects of the MNC personnel policy, ambiguity of values, behaviour in the international environment and the broader concept of ethics derived therefrom, which also includes interest groups cooperating with MNCs (Banai and Sama, 2000; Elms, 2006). In the overall evaluation of current perception, a positive view prevails of MNCs activities in CEE host countries; the only objection is an inadequate exploration of possible negative impacts influencing local interest groups (Meyer, 2004). In this context, attention is paid mainly to the international code of ethics (Schwartz, 2005). The complexity of this problem with regard to the international environment, however, shows the difficulty of creating a universally usable code of ethics for MNCs (Winkler and Remisova, 2007). Some works suggest the union of all aspects focused on social goals, social and ethical norms and cultural values that reflect the global market environment (Asgary and Mitschow, 2002). Deeper findings suggest that the requirements of domestic and host countries in terms of ethical expectations are adjusted to each other through the institutionalized role of MNCs (Tan and Wang 2011); nevertheless, the actual process of transferring corporate codes of ethics within MNCs and the way they influence the behaviour of organizations is not yet adequately described (Helin and Sandström, 2007). This is evidenced also by the results investigating the differences in corporate cultures in politically developed countries with regard to the transfer and implementation of codes of ethics, where the CEE countries are not yet included (Scholtens and Lammertjan Dam, 2007).

In the light of this knowledge, research took place in the Czech Republic in 2011, focusing on the activity of MNC subsidiaries in the environment of the CR, and one of the areas of interest was the investigation of business ethics (Blažek, 2011). The research was directed at a comprehensive description and analysis of the behaviour of subsidiaries of multinational companies operating in the environment of the CR. It focused on the areas of the establishment of the subsidiary in the Czech Republic, organizational structure of the subsidiary and of the whole multinational company, on the cooperation, knowledge and innovation, ethics and implementation of strategy.

### **Research methodology**

The methods of qualitative and quantitative research were used, which included 3 sets of subsidiaries of companies - a population, a sample in which a survey by questionnaire was conducted, and a sample associated with the elaboration of an empirical study. The population contained 2,509 subsidiaries of multinational companies operating in the CR and meeting the parameters of size (50 and more employees), legal form (joint-stock companies and limited liability companies) and the origin of registered capital (full or partial share of

foreign capital in the registered capital). The subject of the paper was a sample of 335 MNC subsidiaries arising from the population by self-selection. The said companies participated in the survey by questionnaire, which covered issues related to the formation and implementation of the code of ethics from the head office to the subsidiary and the effect of the national culture on the culture of the MNC subsidiary. The results obtained were verified through a set of 10 MNC subsidiaries, where empirical enquiries were conducted including a controlled interview with a senior manager of the subsidiary and the processing of received internal materials.

Given the primary role of the survey by questionnaire in the presentation of the results obtained, it is necessary to briefly introduce the method and realization of this research. Four hundred and three MNC subsidiaries participated in the survey; however, 68 of them did not meet the basic conditions of the multinational company's subsidiary (size, legal form), or were in the stage of bankruptcy or liquidation. These companies were not included in the sample. The sample consisted of 335 MNC subsidiaries, which represented 13.35% of the population introduced. From an industry point of view, most represented were MNC subsidiaries in industry sector C - processing industry (59%), G - wholesale and retail; repairs and maintenance of motor vehicles (13%), M - professional, scientific and technical activities (6%), and sector J - information and communication activities (4%). Eighty-two percent of the surveyed MNC subsidiaries fell within the said most important industry sectors of the sample.

In brief presentation of the sample we can state that the proportion of the size of the subsidiaries by the number of employees was as follows: from 50 to 99 employees - 24.2%; from 100 to 249 employees - 39.7%; more than 250 employees - 36.1%. In terms of the legal form, the sample was composed of 20% of joint-stock companies and 80% of limited liability companies. In the sample presented, subsidiaries with the registered capital comprising of 100% of foreign capital prevailed (85.1% of MNC subsidiaries) over the subsidiaries with the majority share of foreign capital - over 50% of foreign capital in the registered capital (13.4% of MNC subsidiaries), and subsidiaries with the minority share of foreign capital - less than 50% of foreign capital in the registered capital (1.5% of MNC subsidiaries). Financial performance parameters of the surveyed MNC subsidiaries were also monitored; nevertheless, it needs to be stated that the presented sample was not comprehensive due to the lack of information (missing financial indicators in 68 subsidiaries). On the basis of the comparison of key parameters, the sample can be considered relevant in relation to the population.

Statistical processing of the survey by questionnaire was conducted after the data collection, which took place in cooperation with an external company specialized in the collection of questionnaire data (addressing, data acquisition, processing in a data matrix). After checking the data, they were coded and subjected to a univariate analysis determining the frequency of the occurrence of individual responses. Arithmetic mean, median and standard deviation were also determined. In the following stage, bi-variation analysis was conducted, which examined the frequency and degree of central tendencies of the given area with regard to the industry sector, number of employees and the size of the share of foreign capital in the registered capital.

## Results

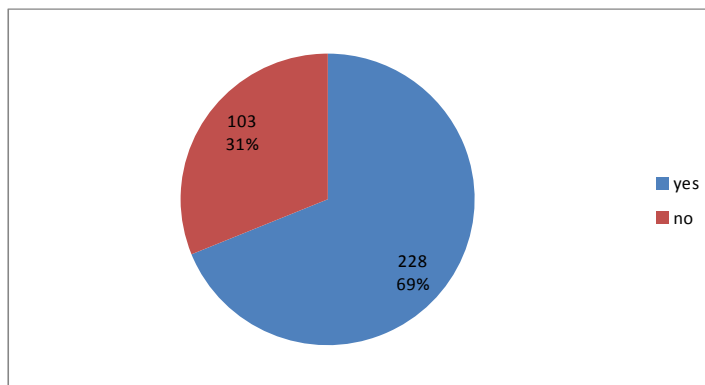
The results obtained show that in MNC subsidiaries, the code of ethics exists and is implemented. In conclusion, the financial performance of MNC subsidiaries is briefly introduced in connection with the existence of the code of ethics.

All reported results are presented with respect to the breakdown used - industry structure, size of subsidiaries in terms of the number of employees and share of foreign capital in the subsidiary's registered capital.

### *Code of ethics - existence*

The obtained results of the survey by questionnaire demonstrate the knowledge of the code of ethics of almost all (99%) MNC subsidiary managers. Most respondents (68%) confirmed the existence of the code of ethics in the subsidiary. Over 30% of the respondent gave a negative answer to this question.

*Graph No. 1: Code of ethics - existence*



*Source: Authors*

In terms of the industry representation, the existence of the code of ethics was demonstrated to varying degrees in all industries. The greatest representation was found in industry sector M - professional, scientific and technical activities with a 95% existence of the code of ethics. This sector was followed by industry sector G - wholesale and retail; repairs and maintenance of motor vehicles with a 75% existence of the code of ethics, and C - processing industry, where the existence of the code of ethics was reported in 61% MNC subsidiaries. In terms of the issue of procurement transparency in the CR, we can consider as interesting the result of industry sector F - civil engineering: it confirms the existence of the code of ethics only in 55%.

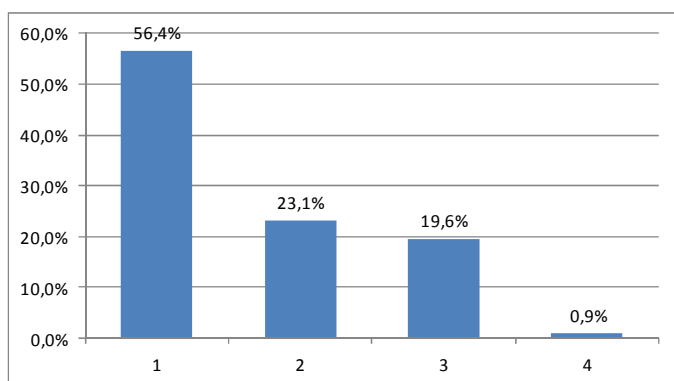
Enterprises with more than 250 employees have a higher degree of existence of the code of ethics (77%) than other enterprises of different sizes. In enterprises in the size group of 50-99 employees, the existence of the code of ethics appears in 60% of cases, and in the size group of 100-249 employees, the existence of the code of ethics was confirmed by 65% of answers.

The existence of the code of ethics prevails in enterprises 100% owned by foreign entities, where 72% of positive responses were given. Even greater representation of positive answers (80%) was obtained in enterprises with a minority share of a foreign partner (up to 50%). In the category from 50 to 99% of the foreign partner ownership, the existence of the code of ethics was found only in 53% of enterprises.

### ***Implementation of the code of ethics***

The formation of the code of ethics was confirmed by 67% of respondents of the sample, i.e. by a nearly 100% of enterprises that are recruited from the group of MNC subsidiaries having the code of ethics. Of them, the majority of respondents (56.4%) state that the already existing code used by the head office was transferred to the MNC subsidiaries (1). Over 23% of respondents state that the code of ethics was taken over from the group and adapted to the local conditions; 19.6% of respondents say that the document was initiated and processed on the basis of the conditions of the local environment. Less than one percent indicates the formation of the code of ethics by other means.

*Graph No. 2 Implementation of the code of ethics*



*Source: Authors*

In different selected industries the proportion of the codes of ethics completely taken over from the head office varies. In industry sector M - professional, scientific and technical activities, the take-over of the code of ethics from abroad prevails with 58% over 32% of responses in which the code of ethics was taken over from abroad and adapted to local conditions. In industry sector G - wholesale and retail; repairs and maintenance of motor vehicles, the code of ethics was taken over from abroad in 44%; 13% of responses confirm that the code of ethics was taken from abroad and adapted to local conditions. A significant number of responses (13%) stated that the code of ethics was prepared by the subsidiary itself.

A similar result of the elaboration of the code of ethics by the subsidiary itself (13%) applies to industry sector C - processing industry. In this industry sector, similarly dominated is the take-over of the code of ethics from abroad (30%), or its take-over and adaptation to local conditions, which accounts for 15% responses.

A different result comes only from industry sector J - information and communication activities, where in the prevailing 50% cases the code of ethics was elaborated only at the subsidiary level.

The formation of the code of ethics according to the number of employees is mainly characterized by the take-over of the code from a foreign head office; this applies to all size types of the MNC subsidiaries surveyed. The only peculiarity is the finding that in the size group of more than 250 employees, there are several cases of the adaptation of the code of ethics to local conditions.

In terms of the capital participation in the registered capital of the MNC subsidiary, there is an obvious superiority of taking over the head office code of ethics in the companies with 100% capital share in the registered capital of the MNC subsidiary. In companies with lower capital share in the registered capital, there are more cases of local adaptation of the code of ethics by the MNC subsidiary.

### ***Existence of the code of ethics according to the national culture of the head office***

The research conducted included the determination of national cultures and the way how they are demonstrated in the MNC subsidiaries in the host country, in our case in the Czech Republic. The existence of the code of ethics was able to be assigned in relation to the identification of the national culture connected with a specific state where the head office of the multinational company operated.

For the evaluation, it was possible to determine a dominant national culture of the MNC in the sample for a total of 271 MNC subsidiaries. In cases where the identification of the influence of the national culture was difficult, the response was marked as 'other', which was the case of 54 respondents of the sample. Seven respondents did not give a clear answer to this question.

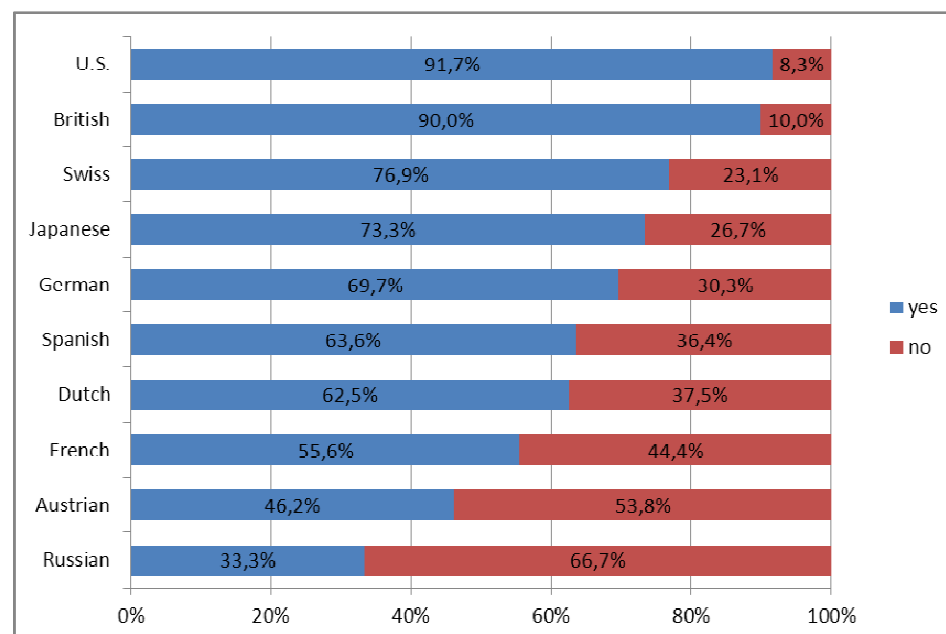
The sample was dominated by the representation of German culture (122 subsidiaries), followed by American culture (36 subsidiaries), Austrian culture (26 subsidiaries) and British culture (20 subsidiaries). The influence of other cultures was also found - see Table No. 1 enclosed.

*Table No. 1 Influence of the culture*

Kultura	Počet respondentů
German	122
U.S.	36
Austrian	26
British	20
Dutch	16
Japanese	15
Swiss	13
Spanish	11
French	9
Russian	3
Celkem	271

Source: Authors

Graph No. 3 Implementation of the code of ethics



Source: Authors

The results obtained showed that the most significant representation of the code of ethics prevails in American and British MNC subsidiaries. A bit surprising are the results of German, French and especially Austrian MNC subsidiaries. The results suggest a deficit of the code of ethics in the MNC subsidiaries with the identified national culture of the state, in which the planned economy is being transformed to a market system. Nevertheless, it needs to be stated that the number of respondents was very limited for a significant demonstration of this phenomenon.

### ***The connection between the code of ethics and financial performance***

Financial performance considered in the light of the existence of the code of ethics is not significantly different in the MNC subsidiaries surveyed. The MNC subsidiaries with high financial performance show - in 75% - the existence of the code of ethics; with the declining financial performance, also the occurrence of the existence of the code of ethics in the relevant MNC subsidiary declines - in 70% with average financial performance and in 63% with low financial performance. Financial performance in connection with the manner of the formation of the code of ethics is similar for all MNC subsidiaries, with no significant differences.

### **Conclusions and evaluation**

All partial results imply that the code of ethics in the subsidiaries of multinational companies operating in the Czech Republic is significantly represented. The results obtained

show that where the code of ethics exists, its formation and implementation are usually strongly associated with the code of ethics of the MNC head office.

It turns out that the frequently publicized ethical problems in the CR are associated with the industry where the representation of the existence of the code of ethics is lower (civil engineering). To a greater extent, the code of ethics can be found in big MNC subsidiaries in terms of the number of employees, which can be described as a positive phenomenon. An interesting finding is the significantly higher occurrence of the code of ethics in the subsidiaries with a minority share of the foreign partner. This raises possible questions whether this is the consequence of a requirement of the foreign partner who does not have a direct impact on the management of the subsidiary due to the partial participation in the capital to ensure the transparency. These questions cannot be answered through a limited survey and become a subject of further research in this area.

The formation and implementation of the code of ethics indicate the significance of the local adaptation in a non-negligible number of MNC subsidiaries especially in the rapidly growing IT industry. This industry is represented in the CR by strong mutual clashes of the MNC subsidiaries and young, globally developing domestic firms. The observed greater emphasis on the incorporation of local requirements may complete the specifics given for the ethical approach in this sector.

The connection between the code of ethics and financial performance of the MNC subsidiary indicates a positive answer. The survey conducted showed that high financial performance of the MNC subsidiaries is connected with the higher representation of the code of ethics. In subsidiaries with lower financial performance, the representation of the code of ethics appears to be less.

The presented results show some new information in the field of business ethics of MNC subsidiaries. Despite the possible limitations of the research (the set of enterprises surveyed, the number of respondents, etc.), some interesting things are obvious that will have to be further verified. In the following stage of processing the results obtained, the causalities can be focused on that bring new knowledge in the field of the business ethics of the MNC subsidiaries in the post transformation phase of the market system.

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