

Subsidiary in a neighbouring country

Abstract

German family-owned company RESCH, founded in the early 20th century, focuses on the production of home appliances. The company is a traditional producer that has so far expanded abroad only with its business activities, but production has remained at its headquarters with a large production plant that produces the entire range of products. Both the headquarters and the production plant are located in Northern Germany.

Due to the growing demand for new products, the German company has decided to build a new production plant to cater for a part of its product range in a neighbouring country, specifically in the Czech Republic. An increase in capacity or the addition of a new building at the home plant is not possible. The decision on the selection of the Czech Republic, as well as the technological and technical parameters, has already been made. The reasons for that decision were as follows: expected low labour costs, geographical proximity of the parent company, similar culture and logistics availability towards growing markets in the CEE region.

In order to make a final decision on the new investment project, it is necessary to procure lots of information and then select the appropriate economic and management steps. Usually, such a solution is accompanied by a number of shortcomings and managerial errors that reduce the expected economic effect, or even the rationality of the decision itself.

Students deal with international strategy of a company expanding abroad and risks that are connected with this process

KEYWORDS: Intercultural management – Czech-German intercultural differences –
Corporate culture – International strategy

The use of case studies offers, especially in business studies, the possibility for students to deal independently with complex, economic questions and problems, so that networked thinking and problem solving are promoted.

The present case study can be assigned to the **Case Problem Method**¹, which in this case has the following characteristics:

- The problems are roughly mentioned and the necessary information is given.
- The students identify possible causes, further partial problems and interdependencies. They independently develop varied solutions and make a decision.

¹ inspired by Kaiser 1983, p. 23

TEACHING NOTE

1. Intended audience

1.1 Student group

The case study is for students of

- Bachelor degree or
- Master's degree

in the field of business administration.

Intended courses of study for the use of the case study are International Management, International Strategy, Management. However, the CS is designed in such a way that it can also be easily applied in other economic fields.

1.2 Required previous knowledge

Students should have a basic knowledge of business administration and be familiar with basics of management or leadership.

2. Case background

At the turn of the century, the business strategy of many Western European firms was influenced by reflections on cheap Central European countries, which could simply be seen as a never-ending source of future profits. Without a knowledge of local facts and experience in international business, they expected universally that the local experience of the headquarters could be copied into the new business environment at a lower cost.

However, international business strategies must work with and respect local economic, business, legal and cultural specifics. Otherwise, the risk of failure is very high.

3. Didactic instructions

3.1. Learning goals

3.1.1 General learning goal

Students learn about the key risks of international expansion of a company

3.1.2 Specific learning goals

Content competences:

- Students determine, collect and evaluate the information necessary for the managerial solution of the new investment.
- Students indicate and assess the risks to the success of the entire project.
- Students define the cultural differences in management and business which influence the company's operation.
- Students understand the issues in economic, logistic, personal and social-psychological contexts and suggest potential solutions.
- Students present solutions and argue in favour of their investment decision.

Social competences:

Social competencies are not the special focus of learning in this case study. The learning success is therefore not explicitly identified and measured. Nevertheless, cooperation in groups implicitly enhances team competence, including conflict resolution.

Self-competences:

Self-competences are not the special focus of learning in this case study. The learning success is therefore not explicitly identified and measured. Nevertheless, it can be assumed that, for example, time management, self-learning competence or the assessment of one's own performance are also implicitly promoted.

4. Organisation

4.1 Procedure and time

The following sequence is suggested for the case study, but, of course, it can also be adapted structurally or temporally depending on your preferences.

Time schedule for the use of the case study:

<i>Time</i>	<i>Phase</i>	<i>Classroom activity</i>
0,5h	1. Confrontation: groups address the case study	The group deals with the case and the accompanying materials and develops a plan for the processing of the case
1h	2. Information: groups survey the case material provided and identify their own sources of information	The group works on the case study and researches the necessary contents
3h	3. Exploration: each group discusses alternativesolutions	The group develops solutions and compares the different results so that the alternatives are discussed
0,5h	4. Resolution: each group makes its decision	The group comes up with a solution for the case study
1h	5. Disputation: each group defends its decision ²	The groups present their results with reasons and a final discussion takes place

Time schedule for final presentation and discussion:

<i>Minutes</i>	<i>Classroom activity</i>
0-45	Each group presents a summary of its approach to the solution and records this in key points on the blackboard or similar media.
45-60	The students get into a discussion about the collective solution.
60-75	If necessary, the lecturer stimulates controversy again by impulses. The following reflective questions can be used for this purpose.
75-90 and in further course	Lecturer establishes references to the specialist science and, together with the plenum, places the solutions in the theoretical context.

5. Teaching tips

5.1 Use in the university context

- Recommended group size: Up to 4 students.
- Resources: Lecture or seminar room, in the best case with group tables and information or research facilities such as access to the internet.
- Accompanying material: As a lecturer, you decide which material you want to give, when you want to add it or to what extent you want to differentiate internally.
- Adaptation to learning group: This case study is designed for Europe-wide use. However, you can of course adapt or modify it to your learning group and their environment or professional orientation, previous knowledge and competences.

The key task is to lead the students to formulate the criteria used to make a decision about the construction and select a specific way of implementing the new plant.

This includes, in particular:

- Plant location in terms of the logistic suitability with respect to the parent company and key customers. This is mainly due to the technical and technological interconnection with the home plant.
- Selection of a suitable local law firm with international experience that will ensure the establishment of the subsidiary as scheduled.
- Economic considerations in terms of current and future costs in a country where wages and prices for the construction work and other services are still low. Ability to evaluate the dynamics of the future growth of prices and thus the effectiveness of the investment.
- Choice of international corporate culture with regard to the technical, technological and logistic (i.e. Global) interconnection.
- Training of key managers for work in the Czech Republic (intercultural training)
- Procurement of a sufficient number of interpreters, in particular, for the first phase of the commencement of production

Available data and resources that should be found and evaluated:

- a. Unemployment by region
- b. Motorway network, railway network, airports in the Czech Republic
- c. Wage growth dynamics in the Czech Republic in recent years by region
- d. Typology of the international corporate culture
- e. Cultural standards – Czech and German
- f. Universities by region

5.2 Role of the lecturer

As a lecturer, you merely take on the role of a learning advisor and moderator when working with the case study. The students should work on the case independently in groups, acquire the necessary knowledge, identify problems and find solutions by themselves. You do not give tasks, instructions or directions. Only if a group of students does not progress and the learning process is prevented, you can act as a learning guide and help through impulses or clarify difficulties in understanding.

5.3 Questions for reflection

A case study is for students to discover problems themselves, control the learning process and develop their own solutions. Tasks or questions within the case study therefore are unnecessary. These reflective questions should only be asked if the discussion stops or remains too superficial. They only serve to give new impetus in the final discussion at the end or to open up other perspectives. Ideally, students should consider and discuss these questions and interdependencies/considerations themselves.

- Which aspects of doing business abroad should be considered?
- In which areas of business can the greatest risks be expected?
- Which areas of business are universal and which are usually specific?
- What sources of information are most valuable for local decision-making?
- Which managerial skills, knowledge or experience are crucial for the manager's success in a foreign environment?
- Which cultural characteristics can relativize some managerial steps and measures?

Further case studies of this kind, a Manual for your own development of didactically high-quality case studies as well as an Online-Planning-Guide for the digital, cross-location use of case studies in cooperation with other universities and a partner-tool for contacting interested institutions can be found at: <https://www.e3cases.uni-koeln.de/en/>.

CASE

Subsidiary in a neighbouring country

German family-owned company RESCH which produces home appliances is making a decision to invest in a new plant in a neighbouring country, specifically the Czech Republic. The product range will be the same as in the home plant in Northern Germany where both the headquarters and the only production plant are located. The goal is to double the production capacity by means of a greenfield plant construction investment with the production corresponding to product type and range to the plant in Germany. Therefore, the company assumes that the production and processing parameters will be identical to those in the German plant, but the costs will be reduced due to expected significantly lower personnel and operating costs.

For these purposes, the company intends to build a new production plant and commence production with the required quantity and quality parameters in 18 months (based on the agreed shipments to customers). This decision is based on a number of premises for a successful course of action and, therefore, the Head of Strategy Department has been tasked with drawing up a plan that proposes the individual steps and specifies the risks.

This includes, in particular:

- Company establishment
- Selection of suitable location for the construction of the plant
- Analysis of the labour market in the location concerned and recruitment of new employees in the required qualification structure
- Selection of German managers to assume the management positions in the new plant
- Preparation of processes for incorporation of the new plant in the organisational and managerial structure of the company

It is necessary to draw up a checklist of steps necessary for the implementation including the determination and evaluation of risks and the final recommendations for/against the implementation of the investment.

Industry Background and Company Description

A traditional German company founded in the early 20th century that produces luxury home appliances of high quality and high prices. Therefore, the expansion of production must not jeopardize the brand image, quality of products or accompanying service. The pressure on lower production costs led the

company management to find a country with a lower wage level and other cost savings, while maintaining the quality of labour, production and products.

While research and development remains at the company's headquarters in Germany, expanding production will gradually be transferred to other countries. The first example is production in the Czech Republic. If this decision is successful, it is expected that the development work will be gradually moved to the Czech Republic.

It is therefore essential that this step becomes a successful example. Given the lack of international cooperation, which only took place at the level of sales and distribution centres around the world, there is clear uncertainty in the company's management. The project is currently in the form of a strategic decision and defines the conditions for successful implementation.

Situation

The parent company's legal representatives in Germany **have decided to implement the same legal procedure to establish the subsidiary in the Czech Republic as in Germany.** However, it turned out that, despite similar European legislation, the requirements for the relevant documents, processes, deadlines and liabilities in the Czech Republic differ. Due to language barriers, meaning ambiguities and the resulting misunderstandings, long deadlines of the relevant authorities, appeals to the original decisions of the parties concerned, etc., misunderstandings took place, original deadlines were postponed and delays in the deadlines set in the original German plans have occurred. Accordingly, the risk of delay of the construction and failure to comply with the previous commitments to the customers have increased.

With regard to the selected location, the decisive criteria were the logistic availability, sufficient number of prospective employees and their expected wages. The logistic availability is ensured by the connection of the selected location to the motorway network both in the direction of Germany and Austria, Slovakia, Hungary and Poland where the largest prospective customers of the products planned produced in the Czech Republic are located. The proximity of an airport and main railway line also had a positive effect on the selected location.

Due to the low unemployment rate in the Czech Republic, one of the decisive factors for the HR Department at its headquarters regarding the new plant location was the relative proximity to a university. The HR Department at its headquarters, therefore, assumed that the new foreign employer would be attractive enough to easily attract a sufficient number of both regular workers and employees with university qualification.

Therefore, the location has been selected according to the criteria above and; furthermore, the Czech government has promised an **investment incentive of 50 % tax deduction over the next three years, provided that the promised deadlines, numbers and qualification structure of the employees are met.**

As far as the managerial positions are concerned, the managing directors (company management) were supposed to come from the current German plant/headquarters, and they were chosen on the basis of the personal initiative of two current mid-level managers. Their previous managerial experience has been extensive and positively evaluated, but exclusively local (in the German plant) and they only have German language skills. Considering the expected lean management structure, the production was expected to have a flat organisational structure, i.e. without the mid-level and low-level management. The HR, economic, logistic and quality section positions were expected to be occupied by local Czech employees.

Given the reputation of the Czech Republic as an “inexpensive country”, the German managers have announced a selection procedure for the construction part of the investment where, provided that the deadlines and construction quality were complied with, **the price was decisive. Ultimately, this was the main reason to select the Czech Republic for the investment.** Given the expected reduced number of German managers seconded to the Czech Republic, the expected costs are relatively low, despite including the living, travel, schooling and similar expenses of the two managing directors and their families. The Czech workers are expected to receive short-term training from their German counterparts who are responsible for the equivalent production in the German plant. A three-month training of the Czech workers will take place directly at their workplace, i.e. a three-month stay of the German workers in the Czech Republic is required.

However, it soon became clear that the German language skills of the Czech population in the region concerned were insufficient and, therefore, when communicating with the local workers, the German managers had to rely solely on professional interpreters (which increased the costs significantly) or the two assistants working in the management office. The managing directors soon developed close personal relationships with the assistants. This fact proved to be a bigger problem than expected at the company's headquarters. After many conflict situations caused by language misunderstandings, it has been discovered that both assistants did not just translate but also interpreted information given based on their own preferences and personal interests.

Due to the proximity of the university, the recruitment of employees for engineering and economic-administrative positions was not expected to be an issue. However, it turned out that the university was focusing primarily on natural sciences, medicine and humanities, and the required expertise for the technical positions was not available at the university.

Gradually, due to the lack of local knowledge, delays have occurred, costs have increased in connection with a number of additional measures, the start of production has been postponed several times and the customers have cancelled their orders one by one. This resulted in the loss of the parent company's good reputation and a loss of long-term clients.

The recruitment of new employees did not meet the expected numbers or the required qualification structure. The low wages have also led to the high employee turnover from the very start of production.

The current employees from the German plant have been brought in to train the Czech employees and eventually hand over the full production in the course of three months. However, the German employees seconded had no managerial and international experience including knowledge of the language.

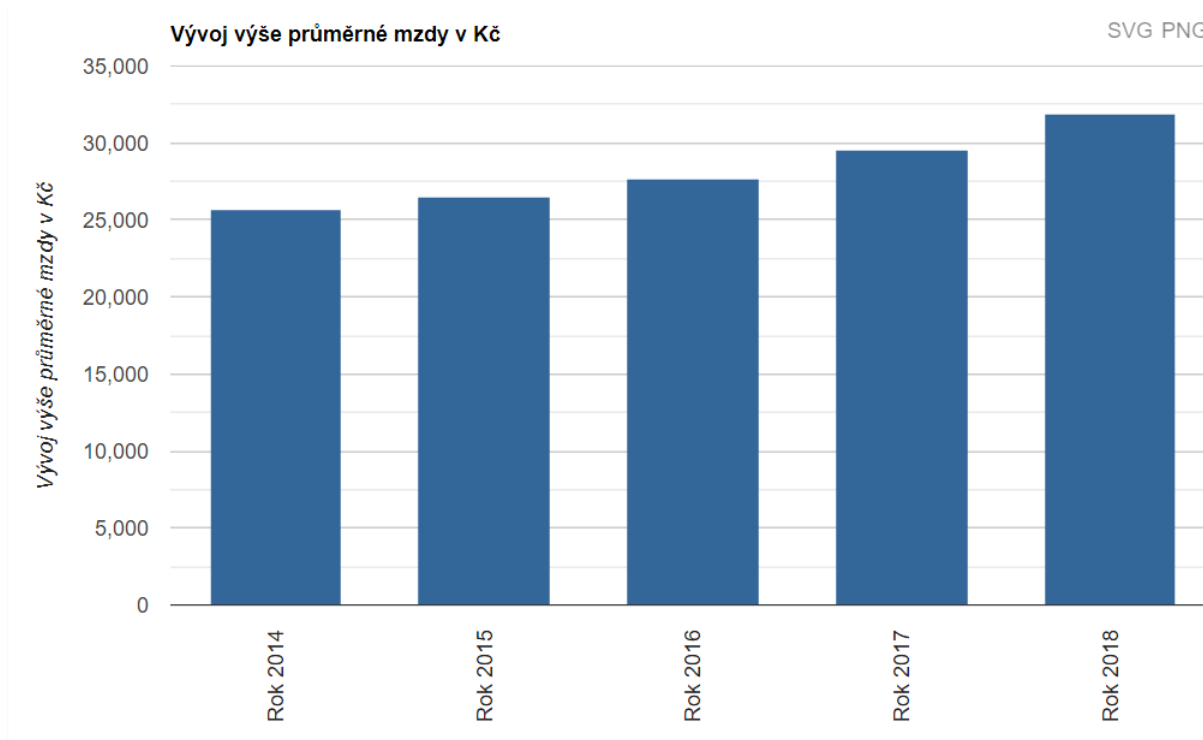
Due to their arrogant behaviour, lack of knowledge of local language and absence of support from local supervisors (due to lean management), gradually intensifying conflicts between the Czech and the German sides have occurred. Moreover, the German managing directors also flew back to Germany every weekend (Friday till Monday) and returned in the late Monday morning of the following work week.

Distrust and mutual hostility between the German and the Czech sides has increased, as well as the unexpected costs (even after three months, the production had not been handed over in full to the Czech workers), the managing directors were unable to correctly evaluate the situation and, in particular, its causes, and the production was both delayed and insufficient in quality and reliability.

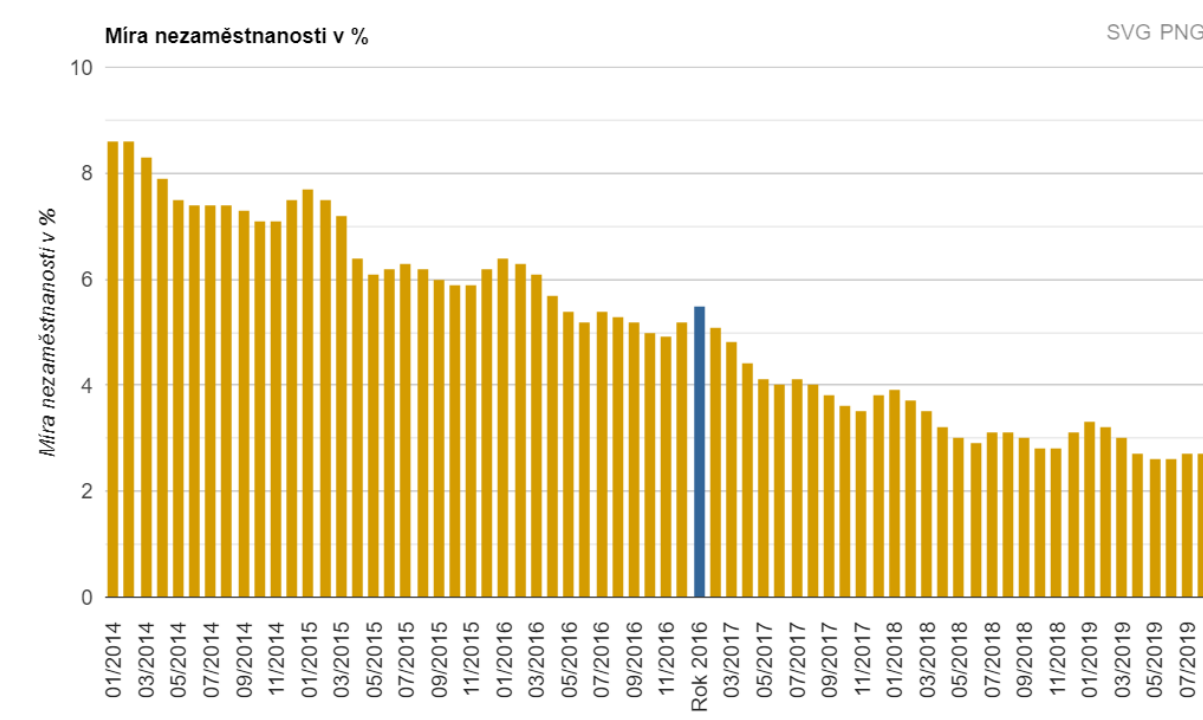
The logistic, technological and technical interconnection between the German plant and the new subsidiary in the Czech Republic was extremely strong, and, therefore, it was necessary to create a similar, or possibly the same, corporate culture as the one at its German headquarters and the German production plant. However, the pressure on the unified corporate culture without the willingness to get acquainted with the cultural specifics of people management has only increased the mutual hostility and reluctance to seek the true causes of the failures and to establish positive cooperation leading to the standard operation of the new plant.

MATERIAL

1) Development of the average wage in the Czech Republic in the last 5 years



2) Unemployment rate in the Czech Republic in the last 5 years (in %)



3) Regions and districts in the Czech Republic

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