

# SOURCES AND EFFECTS OF CONFLICTS IN BUSINESS RELATIONSHIPS OF MULTINATIONAL ENTERPRISES

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## Work in Progress

### ABSTRACT

**The aim of the study:** Conflicts, as an inherent part of many business relationships, may appear with different intensity. Additionally, their impact and effects on an enterprise's activities can range from positive to negative, including the termination of the business relationship. In the paper conflicts are analyzed from the perspective of the multinational enterprise (MNE). A MNE, which operates in many international markets, forms a globally dispersed internal network consisting of a parent company (headquarters) and its subsidiaries. The multitude of relationships that MNEs establish with diverse actors highly increases the probability of internal and external conflict situations.

The aim of the paper is to analyze sources of conflicts experienced by MNEs in their internal and external relationships and the effects of these conflicts on their activities in foreign markets.

**Methodology:** We present results of in-depth interviews conducted in 7 different units (headquarters and subsidiaries) of Polish-based MNEs. After internal and comparative analysis, the obtained results are compared with the existing research.

**The main findings:** The analysis shows that in the 7 analyzed MNE units most conflicts were observed in external relationships. The MNE units adopted different approaches to handling conflicts – from attempts to find a convenient and acceptable resolution to terminating the relationship and finding another partner. The effects of conflicts were mostly assessed positively by representatives of the MNE units.

**Keywords:** MNEs, conflicts, foreign business relationships, business networks

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# **SOURCES AND EFFECTS OF CONFLICTS IN BUSINESS RELATIONSHIPS OF MULTINATIONAL ENTERPRISES**

## **INTRODUCTION**

Business cooperation involves the risk of conflict since conflicts are an inherent part of both social and business interactions. Conflicts in business relationships manifest themselves with different intensity – from marginal, such as everyday problems, to severe, posing a threat to the existence of the relationship or the company itself.

The risk and intensity of conflicts in business relationships involving foreign actors is higher than in relationships with domestic ones (Skarmeas, 2006). This is mainly due to cultural differences between markets and the geographical distance. Additionally, if we look at international activity and foreign business relationships from the perspective of a multinational enterprise (MNE), the multitude of relationships maintained by this type of enterprise with different actors highly increases the probability and diversity of conflict situations. MNEs form a globally dispersed internal network consisting of a parent company (headquarters) and subsidiaries and an external network with external actors (Forsgren, Holm and Johanson, 2005). Adopting this perspective, we define a multinational enterprise as “a network of exchange relationships among different organizational units, including the headquarters and different national subsidiaries” (Ghoshal and Bartlett, 1990, p. 604). Given the complex character of a global network of MNE units, conflicts are unavoidable (Thomas, 1992; Skarmeas, 2006).

In the existing literature conflicts in MNEs have been analyzed through the perspective of research instruments for conflict measurement (Habib, 1987), by considering different aspects of conflicts, such as conflict resolution behavior (Koza and Dant, 2007) or by referring to characteristics of inter-organization conflicts and conflict management (Lumineau, Eckerd and Handley, 2015). As regards international aspects, analysis usually focuses on foreign business relationships (McKenna, 1995; Leonidou, Barnes and Talias, 2006; Skarmeas, 2006) or conflicts within joint-ventures (Kemp and Ghauri, 1999).

However, to the best of our knowledge, there is little or no research on sources and effects of conflicts in MNEs relationships (with the exception of Vahtera, Buckley and Aliyev, 2017). For this reason, the aim of this paper is to analyze the sources of conflicts in internal and external relationships of MNEs and how these conflicts affect their activities in foreign markets.

## **LITERATURE REVIEW**

Every business cooperation involves social tensions or differences, which may lead to conflict situations (Thomas, 1992; Skarmeas, 2006). According to Vaaland & Håkansson (2003), conflicts do not arise rapidly but emerge gradually, with various negative symptoms occurring within the relationship or the network. Networks can foster cooperation but can also generate conflicts (Håkansson and Snehota, 1995; Welch and Wilkinson, 2005). This aspect is particularly relevant with respect to MNEs, which operate in many international markets and can be regarded as globally dispersed networks. Such global networks combine an internal network consisting of a parent company (headquarters) and its subsidiaries and external networks, connecting MNEs with other external actors (such as external customers,

suppliers) (Forsgren, Johanson and Holm, 2005). That is why, MNE can be viewed as a network of units (Ghoshal and Bartlett, 1990; Vereecke, Van Dierdonck and De Meyer, 2006; Rugman, Verbeke and Nguyen, 2011). Existing research has mainly focused on internal relationships between headquarters and subsidiaries (Vereecke, Van Dierdonck and De Meyer, 2006, p. 1738). We propose a more complex analysis of relationships maintained by MNEs, which includes both internal and external relationships.

There are many different approaches to conflict analysis. Some researchers study conflicts from the inter-organizational perspective (Vaaland and Håkansson, 2003; Vaaland, Haugland and Purchase, 2004; Lumineau, Eckerd and Handley, 2015) while others focus on the intra-personal (Rahim, 1983; Zhang and Huo, 2015) or intra-group (Jehn and Mannix, 2001; Greer, Caruso and Jehn, 2011) perspective. However, there are no studies (with exception of Nordin, 2006) that combine the inter- and intra-organizational perspective on sources and effects of conflicts.

When conflicts are viewed from the perspective of MNE units, it is necessary to consider the multitude of relationships that a MNE typically maintains. Therefore, conflicts in MNE units can be analyzed by taking into account both internal and external network relationships. Under this approach, two types of conflicts can be distinguished: internal conflicts (occurring within the MNE's internal network) and external conflicts (involving external actors).

Regardless of the type, conflicts in MNEs' relationships can have different causes. Common sources of conflict listed in the literature include power and interdependency (Welch and Wilkinson, 2005; Olsen *et al.*, 2014; Lumineau, Eckerd and Handley, 2015), differences in actors' goals (Habib, 1987; Plank and Newell, 2007), misalignment of interests or mutual inability to adapt (Duarte and Davies, 2003; Finch, Zhang and Geiger, 2013). Conflicts can also be triggered by social ties (Emiliani, 2003; Plank and Newell, 2007), misunderstandings and problems in communication (Habib, 1987; Duarte and Davies, 2003).

International activity and relationships of MNEs can also be affected by conflicts resulting from cultural differences and psychic distance (Alajoutsijarvi, Möller and Tähtinen, 1998; Vaaland, Haugland and Purchase, 2004). As pointed out by Skarmeas (2006), "managing international trade relationships is a more challenging task compared with exchanges in the domestic context, due to geographical and cultural separation between exchange partners". Cultural distance makes it more difficult and risky to handle problems in relationships and can even lead to the termination of cooperation (Vaaland, Haugland and Purchase, 2004). Some studies, however, do not confirm these results (Barkema and Vermeulen, 1997; Pothukuchi *et al.*, 2002).

With respect to effects of conflicts, conflicts have been shown to have a negative impact on such aspects of the relationship as trust (Anderson and Narus, 1990; Leonidou, Barnes and Talias, 2006), satisfaction (Frazer, Gill and Kale, 1989; Skinner, Gassenheimer and Kelley, 1992) or commitment (Leonidou, Talias and Leonidou, 2008). Conflicts can also impede the development of relationships (Nordin, 2006), or the company's foreign activities. As Duarte and Davies state, "all other factors being equal, relationships where conflict levels are low will outperform relationships where conflict levels are higher" (Duarte and Davies, 2003, p. 91). This includes joint venture relationships (Lin and Germain, 1998), relationships in distribution channels (Frazer, Gill and Kale, 1989; Duarte and Davies, 2003) and customer-supplier collaborative new product developments (Lam and Chin, 2005). In extreme cases, conflicts may even lead to the relationship termination (Halinen and Tähtinen, 2002; Welch and Wilkinson, 2005). Some negative effects of relationship termination are visible, like

worse financial results, while others remain largely invisible, e.g. “switching costs, lost market opportunities or reputation” (Tähtinen and Vaaland, 2006, p. 14).

Interestingly, the impact of conflicts is not always negative – in some cases they can positively affect the relationship and company’s activity. Vaaland (2004) states that conflicts “provide the parties with insight into the core of the relationship, increase relational sensitivity, and as a result of these insights restore the ability to manage a relationship under pressure”. Conflicts can strengthen a relationship (Tahtinen and Vaaland, 2006). Studies show that conflict in relationships and in the industry network can have a positive influence on performance in general (Assael, 1969; Finch et al., 2013), and performance in export marketing channels (Rosson *et al.*, 1980).

Given their potentially different effects, conflicts can therefore be damaging and beneficial at the same time (Vaaland and Håkansson, 2003; Mele, 2011; Finch, Zhang and Geiger, 2013). According to Koza and Dant (2007), conflicts are more likely to have positive effects if they occur in the conditions of cooperative orientation and trust based governance. These factors facilitate mutual communication between the actors involved and make them better prepared for unknown and unplanned situations. Another important factor which increases the chances of a positive conflict resolution is the “willingness to find a mutually satisfactory agreement” (Rognes and Schei, 2010). It is also stressed that a conflict can have positive effects when it is managed with a certain degree of assertiveness on the part of the actors involved, who seek to satisfy their own goals during the cooperation (Fu *et al.*, 2008).

## METHOD

In the paper we present the results of in-depth interviews conducted in seven units of different Polish-based MNEs. We use this qualitative method to understand the underlying causes of events (Marschan-Piekkari and Welch, 2004). Data were collected in the first half of 2016. Each interview lasted 1-2 hours and was recorded and later transcribed. Based on the transcriptions, we prepared interview protocols, which were used as the basis for the analysis described in the paper. The data were analyzed from the perspective of the MNE units using the constant comparative method (Thomas, 2011). After internal and comparative analysis, the results were compared with findings of existing studies.

The sample for case analysis was purposive. We had chosen Polish-based units of MNEs, which were also active in at least one foreign market. The enterprises represented different industries. The main characteristics of the seven MNE units are shown in Table 1 (see Appendix 1).

## CASE ANALYSIS

On the basis of case analysis, we have identified conflicts in both internal and external relationships of the analyzed MNE units. As shown in Table 2, five of them were conflicts within external networks (see Appendix 2). These included conflicts with external customers (e.g. distributors) and an external supplier. These external conflicts mostly concerned various everyday problems regarding operational activities, such as work standards or supply punctuality, cultural differences and financial problems. Conflicts within internal relationships of MNEs stemmed mainly from interpersonal problems.

Different aspects of cultural differences were listed as a source of conflicts, mainly with customers (B, U, ZD) but also with the supplier (Z). Two specific problems were identified in this respect. The first one was the difference in attitudes to work and safety standards or work organization (B, Z, ZD), which results from cultural differences. The second specific problem with a cultural background involved local final customers (U, the company makes products sold by distributors to final individual customers): they wanted products with translated labels, which meant extra costs for the MNE because the size of the target market was limited. This is an example of how indirect relationships (with individual customers) influence the conflict situation in direct relationships (with external customer – distributor).

Other conflicts in external relationships were caused by different aspects of MNEs' operational activities. These included everyday problems regarding product quality and supply punctuality (B, U, X). In these cases the negative situation was not perceived as a conflict but rather as a problem. This source of conflict was related to the third one, i.e. financial aspects of cooperation. In one case, the conflict resulted from financial demands made by an external foreign customer, which were hard to accept by the company in question (ZD). In another case (X), the conflict was caused by financial problems of an external customer.

As regards conflicts in internal relationships, they were attributed to interpersonal problems between employees engaged in cooperation (F1, J). In addition, the interviewees mentioned the negative impact of cultural differences on communication within the MNE (J) and a different approach to work and adopted solutions (F1). All these factors suggest that conflicts in internal relationships have a rather social background.

The most frequently reported approach to handle conflicts in external relationships was to take formal actions (B, X, Z). These actions included establishing new procedures or referring to existing ones (B, X) and introducing common work standards based on the organizational culture existing at the MNE's headquarters (Z). Another approach to conflict resolution was to strengthen the atmosphere of cooperation by both partners making efforts to resolve the conflict and reach a compromise (U, X, ZD). The interviewed managers stressed the importance of mutual good will and determination to resolve the conflict (X, ZD). According to one manager (X), „one feature of a crisis is that when you get out of it, you are stronger”. Actions focused on improving the attitude to cooperation also included willingness to learn (B, Z). In this case, the two managers admitted that they relied on knowledge and developed competencies to be able to handle the conflict with external actors in a positive way. In one case, this focus on the development of knowledge and competences involved extra costs and was perceived as an investment in employees' competences (Z). Willingness to incur extra costs was another strategy of handling conflicts in external relationships (X, Z, ZD).

As already noted, most of the managers were dedicated to finding a solution and resolving the conflict so that it would not jeopardize further cooperation with external actors. According to one interviewee, “if problems are managed quickly and effectively, they do not have a negative impact on cooperation and the relationship between partners” (B).

Conflicts in internal relationships were handled in similar ways. The managers were taking actions to use their employees' knowledge to resolve the conflict (F1) and to improve internal communication within the MNE network (J). Formal actions, like referring to internal procedures (J), were also mentioned. In one unit (F1), the conflict was resolved by replacing people engaged in cooperation in this particular relationship.

The conflicts identified in the 7 MNE units had mainly positive effects. In nearly all of the cases, they enabled the companies to strengthen their external (B, U, X, Z) and internal relationships (J). According to one manager, “a problem situation is an opportunity to check the partner. And partners do not run away from problems. On the contrary, they try to analyze the problem quickly and end the conflict” (B). However, in one case the conflict did lead to the termination of the external relationship (ZD).

With respect to the impact of conflict on MNEs’ activities, the interviewed managers also reported positive effects. In their opinion, the conflicts had had a positive impact on the development of their units (B, X).

The same was true about the impact of conflicts on internal relationships. Positive effects mentioned in the interviews included the unit’s development (F1) and a valuable learning experience (F1), as well as an improvement in internal communication (J). The two latter effects can be linked to positive effects concerning knowledge management.

## **DISCUSSION**

In the analyzed MNE units conflicts occurred mainly in their external relationships. This may be due to the fact that companies operating in different markets, and dealing with a number of external actors run a higher risk of conflict. Of course, if we could analyze all units of each MNE, the number of external conflicts would be much higher. However, those external conflicts were not severe: they were mainly triggered by everyday problems, supply punctuality or cultural differences. Regardless of the source, in the majority of cases, we have concluded that conflicts had a positive effect on the external relationships themselves and the MNE’s activities.

The number of reported conflicts in internal relationships was smaller. It can be argued that MNE units which operate in foreign, diversified markets are more aware of having a well-established corporate culture and formal procedures in place. It is likely that these elements helped the MNE units to handle internal conflicts in a positive way. Some interviewed managers actually admitted that faced with conflict situations, they acted according to procedures and took formal actions. Reliance on procedures to handle conflict was also a strategy used in external relationships. With the formal approach to conflict resolution, a similar course of action is taken throughout the MNE’s network, which has a positive influence on its international activities. Although the less frequent occurrence of conflicts in internal relationships may be due to the formal procedures implemented in MNEs, we can notice that internal conflicts were caused by social factors, such as interpersonal and communication problems. In such cases, conflicts were resolved not only by applying formal procedures but also by replacing people involved in the relationship or improving the internal communication.

Another important group of actions undertaken by the MNE units to handle internal and external conflicts was related to knowledge management and ways of improving communication and learning. Since MNEs operate in many markets, they need pay special attention to these aspects and support knowledge transfer between internal and external actors. It is such measures that helped the MNE units to benefit from their conflict situations in international activities.

The study showed that the managers were aware of the need to handle conflicts appropriately. This confirms previous research findings, which indicate that a conflict can bring positive effects only when there is “managerial involvement aimed at reducing negative emotions in personal relationships, improving abilities to resolve conflicts as tasks, and encouraging open norms in resolving conflicts of tasks and processes” (Finch, Zhang and Geiger, 2013). In some cases, conflicts were resolved by joint efforts of both actors. This also included common meetings and discussions.

The interviewed managers were also aware of cultural differences and their possible negative impact on foreign relationships. That is why, they took actions in order to diminish cultural barriers. Examples of such actions included offering additional language courses and other investments in developing employees’ competences. However, adaptation to the cultural environment was not always perceived as the right solution, in which case cost analysis was used as a way of choosing the right course of action. MNEs tend to be large organizations and can sometimes afford to bear extra costs in order to resolve conflicts. This strategy was actually used to resolve conflicts in external relationships. However, as the example with cultural differences indicates, a company will only be willing to bear extra costs if this is likely to bring positive financial effects in the future.

Although it has been demonstrated in earlier studies that conflict has a negative impact on different elements of relationships (like trust) between foreign actors (Anderson and Narus, 1990; Leonidou, Barnes and Talias, 2006), this tendency was not confirmed by the interviewed managers. On the contrary, the results show that properly handled conflicts have a positive impact on trust and contribute to strengthening the relationship. The analysis also shows that, when properly handled, internal and external conflicts experienced by MNE units can have mostly positive effects their relationships and international activities.

Our analysis confirms the findings reported by Vaaland & Håkansson (2003) and Finch *et al.* (2013), which indicate that conflict can increase the perceived value of the relationship. Conflicts described in our study helped partners to analyze the sources of conflict in foreign business relationships and to find ways of resolving them. The analysis revealed that in some cases the termination of the relationship was thought to be the best solution. This strategy was chosen when the MNE unit and its external partner were not equally engaged in the relationship and were not dedicated to resolving the conflict to the same extent. However, it has to be emphasized that such a termination did not have a negative effect on the unit’s general development.

## CONCLUSIONS

The results of the study contribute to the existing, rather limited, body of literature by analyzing sources and effects of conflicts occurring in foreign relationships maintained by MNEs and by identifying actions that can be taken in order to handle conflicts in a positive way.

Our analysis has practical implications. It can be used to formulate recommendations for managers on how to handle conflicts in order to obtain positive effects for MNE units. Cultural differences between actors within and outside the network as well as operational problems are the common sources of problems that MNE encounter during their activities. In order to diminish the negative impact of internal and external conflicts managers can take formal actions, such as following rules and established procedures, or bear extra costs to

resolve the problem. Another approach involves more informal strategies, such as making a joint effort to solve the problem, looking for a compromise, or knowledge management including openness to learning. Sometimes, however, the best way to solve the problem is to replace people involved in the conflict. As the analysis shows, it is not always possible to achieve a positive conflict resolution since in extreme cases, conflict leads to the termination of the relationship. However, most interviewed managers were able to handle conflicts in a positive way.

Because MNEs maintain a diverse network or relationships in foreign markets, the risk of conflict is always high. Further research should therefore concentrate on a more detailed analysis of ways of handling internal and external conflicts and their effects on relationships and on international activities of MNE units. In particular, research should focus on investigating differences in conflict handling strategies and conflict effects from the perspective of the MNE's position in the network (subsidiary or headquarters). Additionally, it would be useful to conduct more detailed single case studies aimed at analyzing conflicts within an entire MNE network and assessing them taking into consideration different actions used to resolve them.

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## Appendix 1

Company	Industry	Main foreign markets	Year of starting foreign activity	Unit described in the interview	Market described in the interview	Year of starting foreign activity in the described market
<b>B</b>	production of household equipment	UE, Eastern Europe	early 90s	headquarters	Germany	1991
<b>F1</b>	production of utility meters	UE, Eastern Europe	1994	subsidiary	The Czech Republic	2013
<b>J</b>	pharmaceutical industry	global activity	2005 (of the analysed unit)	subsidiary providing IT services	USA, Malaysia and Great Britain	2015
<b>U</b>	food industry	UE, Eastern Europe	2002	headquarters	Hungary	2010
<b>X</b>	fast-moving consumer goods	global activity	1995	headquarters	Germany	2006
<b>Z</b>	transport of containers in ports and cargo terminals	global activity	1983	subsidiary	China	2005
<b>ZD</b>	production of packaging equipment for food industry	post-Soviet states, Germany, selected African countries, CEE, the Balkan countries	1993	subsidiary	Kenia	2007

**Table 1: Characteristics of analyzed MNE units**

## Appendix 2

<i>Company</i>	<i>Internal/external conflict</i>	<i>Sources of conflict</i>	<i>Actions taken to handle the conflict</i>	<i>Effects of conflict</i>
<b>B</b>	External (with external customer)	- Everyday problems regarding operational activity, quality of products, supply punctuality - Cultural differences regarding the organization of work and procedures	- Formal actions – referring to procedures - Formal actions – changes in the organization of work and procedures - Importance of attitude – being open to learning	- Positive impact on trust and reliability in the relationship - Strengthening of the external relationship - Positive impact on the unit's development and development's growth rate
<b>F1</b>	Internal (with other unit of MNE)	- Interpersonal problems between employees engaged in cooperation - Different approach to the organization of work and adapted solutions	- Replacement of people engaged in the cooperation - The use of employees' knowledge	- Retention in the unit of the experience from the other unit - Positive impact on the unit's development
<b>J</b>	Internal (with other units of MNE)	- Interpersonal problems connected with MNEs human resources policy - Cultural differences having an impact on communication within the MNE	- Formal actions - clearly sticking to the rules. - Formal actions – clear communication procedures	- Strengthening of the internal relationships - Improvement of internal communication within MNE units
<b>U</b>	External (with external customer)	- Everyday problems regarding the quality of products, supply punctuality - Problems with communication - Customer's demand to adapt the product to local needs, which resulted in additional costs (adaptations regarding language differences)	- Joint effort of both actors to solve the problem and look for a compromise	- Strengthening of the external relationship
<b>X</b>	External (with external customer)	- Financial problems of customer - Everyday problems regarding supply punctuality	- Formal actions - clearly sticking to the rules. - Joint effort of both actors to solve the problem - Bearing additional costs to solve the problem.	- Strengthening of the external relationship - Positive impact on unit's growth
<b>Z</b>	External (with external supplier)	- Cultural differences in terms of business etiquette, organization of work and working safety standards	- Formal actions: sticking to the work standards and Scandinavian organizational culture - Bearing additional costs – investment in employees' competences	- Strengthening of the external relationship
<b>ZD</b>	External (with external customer)	- High financial requirements of the external customer - Interpersonal problems connected with misunderstandings - Cultural differences in terms of attitude to work standards	- Joint effort of actors to solve the problem and look for a compromise (more effort on the part of the ZD unit) - Bearing additional costs to solve the problem	-Termination of the external relationship

**Table 2: Sources, handling strategies and effects of conflicts occurring in foreign relationships of MNE units**