

# A FIRM AND ITS ENVIRONMENT – MANAGERIAL AND REGIONAL THEORIES MATCHING

Ivana Mandysová

**Abstract:** *The aim of the article is to examine the nature and forms of different scientific approaches towards “firm” and its “environment” in order to match managerial and regional theories. The theoretical framework has been challenged by ideas derived from research studies of regional economists, as well as managerial and behavioral theorists.*

*The article consists of two parts; the first builds the theoretical framework for matching managerial and regional sciences. By conceptualizing different theoretical approaches the critical approach has been generated.*

*The mutual interaction between manager and environment is tested and modeled in the second half of this article. It creates framework through empirical research of firms in the regional environment. Qualitative study has generated hypotheses during the research. Firm’ environment has been divided into fragments (customers, suppliers, human resources, state and legislation and financial resources).*

*By examining relationship between the firm and the environment article identifies possible underlying pro-growth sources, summarizes the analysis results and provides implications for the further research.*

**Keywords:** *Firm, Environment, Regional theories, Managerial theories, Behavioral theories.*

**JEL Classification:** *D2, D21, D22, R1.*

## Introduction

The firm and its role in the region should be the focal point of research within the regional and managerial theories. The importance of firms in the region in job creation, technological innovation and in general economic growth, is accepted by most economists, management theorists and regional theorists.

Economic growth of the region as well as the overall quality of life depends on the ability of firms allocated in the regions to create, to assimilate knowledge and to capitalize commercially in the form of innovation. Khan and Manopichetwattana [9] identify innovative and non-innovative firms. Innovation in firm may be linked to positive changes in efficiency, productivity, quality, competitiveness, and market share.

A key element of the endogenous approach is the effort to change the atmosphere in the region, to strengthen confidence, to arouse positive expectations, to create a partnership for active adaptation. This effort should start strengthening mechanisms of positive feedback.

The firm operating in the region is a point where social and economic processes meet. Hence there comes an urgent need to address this issue both in the framework of regional science and in managerial theories. Deep research in this area is necessary because of its impact both on the economic development of regions and knowledge management of firms.

## **1 Statement of a problem**

Neoclassical and modern regional and managerial theories are self-contained categories of theoretical sciences. New theoretical approaches arise to fill the existing gap. According to these new theories the forces that control the development of the firms and overall regional economic growth and development, are not to be found in the environment, they start to appear inside the company instead. Thus, the region and the environment in which the company operates, is a consequence of company management behavior and its activities.

New theories presuppose a much greater freedom of choice for company management. They pay great attention to the decisions of the management, they examine the effects that these businesses have on the environment in which they operate and by which they are surrounded. This increasing scientific view considers businesses and institutions affecting significantly the region in which they operate.

Firm behavior results from events in the environment. [34] These events influence ties inside firms and among them in the region and demonstrate "environment responsive firm". This proves reasons for incorporating and matching both in the framework of regional science and in managerial theories.

In the process of discovering the role of knowledge in economic development and growth remains a number of unanswered questions. Responsive firm - is a place for genesis and intersection of social and economic processes. Understanding inner firm processes, as well as spatial processes, i.e. role and behavior of a firm in the environment could subsequently justify its inclusion in the new merging theories like system theory or chaos theory, which is the theoretical purpose of the study.

## **2 Theoretical background**

### **2.1 Regional theories and environment munificence**

Regional development perception has been gradually redirected from the quantitative growth to qualitative characteristics. The theorists' latter works [23] generally involve greater emphasis on relying on manager's own abilities, trust in human potential, regional and local development strategies that respect nature and humanity. According to Morgan [16] the transition from the original to the new perception also requires new ways of assessing local and regional development, focusing not only on jobs and incomes, but more deeply on the individual personality.

The critical examination of both classical Weber's location theory and neoclassical location theory, namely by Loesch [11], Hotelling [7], Isard [8], Smith [29] and others, starts in the early fifties. The criticism comes from regional economists. Regional economic inequalities were in fact much larger than can be explained.

Scott [26] describes the major trends in the global regional development since the early 50th of the last century, where it seemed to be the majority of the existing economy divided into two spatial regions. The first were the core regions with a dense concentration of population and economic activities. Other regions were periphery areas, largely dependent on agriculture and local service activities. Many theories considered the differences between the core regions and peripheral parts to be static or even increasing. Such is Myrdal [17] and Hirschman's [6] theory of circular cumulative causation. Hirschman talks about the negative "back-wash" effects when the developed regions are harmful to the lagging regions.

Various economic activities have been showing a remarkable and enduring tendency to aggregate in large cities and urban areas of munificence. [30] A significant contribution of these theories is the identification and classification of differentiation mechanisms [33]. Examples are Friedmann's [5] model of the core and the periphery, Perroux's theory of polarization and sectorial growth poles [19], Vernon's theory of production cycles [35] and more recently the theory of flexible specialization - Scott [26], Piore and Sabel [20], Schoenberger [25].

All these theories highlight the quality of the business environment and its munificence as a factor of economic growth using the benefits of business environment. According to Walker, the basic idea is that the spatial proximity allows firms and businesses a better access to required firm inputs, resulting in increased revenue, reduced costs and increased productivity [36]. It is understood that the total production costs are lower in munificent environment than elsewhere. Such factors include information, communication and transaction costs.

The term Environmental Munificence has been introduced by Castrogiovanni. [1] Firm' inputs would include resources such as raw materials, money, technologies and people. Firm gets these inputs from the outside environment. So environment and its munificence matters! Environment and its munificence is an important variable affecting a firm. Firm at any time seeks for munificent and suitable environment.

Environmental munificence is the scarcity or abundance of resources available in the firm environment. [1] Munificence helps to develop, innovate and thus attain greater profits. In other words, munificent environmental benefits are not simply the result of lower production costs, but also benefit of differentiation. It affects survival and growth of firms sharing the common environment as well as abilities of new firms to enter the environment.

## **2.2 Managerial theories**

The managerial theories research both managerial behavior and firm theory. Firm behavior includes topics such as cross-cultural management, power and influence, negotiation, team and interpersonal processes, innovation, trust, managerial commitment, incentives and leadership. Managerial theory addresses contemporary theories about firms and applies them to understand new managerial findings, growth, design, performance, adaptation, survival and evolution. [13] [28]

Yet for decades, managers have acted on the basis that firm's events can always be controlled. Original managerial theories dated in 19th century can be seen as rather formal. Management highly prized scientific and technical matters, including careful measurement and specification of activities and results. Managerial theories highlighted careful specification and measurement of all managerial tasks. Tasks were standardized as much as possible. Later more attention was given to individuals and their unique capabilities in the organization. Economists, who are close to sociology, challenge the assumption of rational behavior of individuals and firms. This is evidenced by the work of theorists that has been based on behavioral approaches. Behavioral approaches respect the influence of an environment where there is risk and uncertainty. Preferences of managers and entrepreneurs influence the process of decision-making [24]. Behaviorists describe behavior of firms and then correlate with explanatory factors.

The so-called behavioral school of economic theory that has emerged in the sixties attempts to fill the gap in economic theories. The new approach focuses on economic

choices and personal motives in the behavior of entrepreneurs. Allen Pred [21] improved the existing location theory by incorporating the phenomenon of "imperfect behavior", "incomplete knowledge" and other psychological variables. Pred's views are based on the ideas of satisfactory behavior, imperfectly informed managers and entrepreneurs who make the decisions. Behavioral approach compensates the lack of attention, which the classical economic theory devoted to internal aspects of the companies.

Contemporary managerial theories posit that firms undertaking complex tasks outperform well when lateral, peer-to-peer structures are emphasized over vertical, subordinate-to-supervisor structures. New contingency theory [4] asserts that when managers make a decision, they must take into account all aspects of the current situation and act on those aspects that are essential to the situation at hand. Nowadays firms face tremendous changes and they have to update the way they operate in the environment. Only recently researchers have come to this new way of thinking. Systems theorists refer to biological systems and their interpretation has brought about a significant change in managerial and regional theories. [27]

### **2.3 Managerial and regional theories matching**

In order to meet research theoretical objective and match both theories, the analysis has been conducted on both the views prevailing in regional and managerial sciences. Managerial theories accuse regional theories of determinism. We can arrange regional theories in two broad lines using purpose dichotomy. The first approach assigns primacy to the factors in surrounding region above manager role. The next one, in contrast, assigns primacy to the management above the surrounding region. It criticizes the subservience of the manager to the dictates of the regional surroundings.

Theories do not succeed in providing an adequate alternative for the explanation of role of management in the region as they treat firms in isolation. Manager is deprived of any ability to counteract the constraints of the region.

Article draws some lessons from a different economic disciplines and authors in order to overcome the gap. Philip Cooke [2] stresses the proactive state policy promoting innovation, regional innovation systems, complexity and multi-level governance. Richard Nelson [18] notes that tacit distinction is important in relation to knowledge management practice. Johnson, Lorenz and Lundvall [12] note that there is a difference between knowledge about the world (know-what) and knowledge in the form of skills and competence (know-how). McCann [14] is close to regional theories, he investigates the relationship between regional patterns and innovations in clusters. He gives a critical revision of the main assumptions underlying the existing regional literature stressing intra-regional and inter-regional cooperation with knowledge organizations.

## **3 Methodology**

### **3.1 Qualitative method**

Research is based on qualitative research method. Qualitative research is the process of searching for the essence, exploring the social or human problem. Hypotheses are not defined in advance, which is typical for qualitative research. They are generated only during the research, trying to understand a new problem. The reason for choosing qualitative method is that this area is quite complex. It involved the collection and analysis of qualitative data with a deep insight which would not be possible to access by using other method or approach. This allows us to achieve a more accurate result.

### 3.2 Collection of data

The procedure of empirical data collection: respondents were recorded and then the text has been transcribed literally.

The empirical study surveyed 54 companies. 130 pages of text have been obtained. The research has been carried out during the past 5 years, mapping 30 years of the development of individual firms. Conditions for inclusion: a) at least 10 years of functioning: some firms started in 1989, some later, minimum period was 10 years, b) to correspond to NACE variation ratio, c) entrepreneur or manager has declared his willingness to provide information, d) company has less than 250 employees, e) company has a growing or sustainable economic functioning.

Objectivity and reliability and validity is concerned with the control over and measurement of research. Research has focused primarily on the process of long-term trends in time and change.

Data were obtained by interviews with managers or owners of businesses. There were an informal semi-structured dialogs. Set was the framework of interview; questions were directed to the company surrounding environment. Investigated environment fractions are:

- A. Localization, business growth in the region,
- B. Suppliers,
- C. Human Resources,
- D. Customers, market environment,
- E. Financial environment and state.

The aim was to crystallize the situation which evokes actions of enterprise towards the environment. Questions were aimed to identify the idea of starting a business (where, when, why), they developed gradually as a manager described the development of company activities. In order to achieve confidentiality all data were anonymized. There have been removed all persons' and firms' names and there have been given the identification codes.

During the research, the main aim has split into more specific questions in order to match the theoretical outputs:

- What is the role of the environment in which the company operates?
- What kind of decisions does manager take?
- And how they are manifested externally?
- What is the situation in the firm and in the region?
- What are the problems forming regional business environment?
- How was the event in environment perceived by the company management, and what is the response back to the region?
- How do enterprises create spatial relationships?
- Which processes take place in interaction between enterprise and its environment?

## 4 Problem solving

### 4.1 Data analysis and discussion

In order to have representative statistical sample the number of SMEs in the Czech Republic and in Pardubice region was found out. They were divided by the sector. Investigated companies are in the Pardubice region. The examined companies sample has been chosen in order to correspond by its ratio to the number and structure of NACE classification. Subsequently, the data were processed and external links and decisions particularly affecting mutual relations between company and environment were identified and analyzed.

All collected and corrected text was organized and associated into five aforementioned areas (A, B, C, D, E). The whole case study text has been analyzed, selected by sentences and their meaning and integrated properly.

Ten summarizing hypotheses (AH1, AH2, ...EH1, EH2) represent the main ideas of obtained empirical text. They were designed and chosen to be appropriate in relation to recent theorists. They were set in order to evaluate whether they respond to the most essential theorists' opinions. They reflect both managerial and regional theories as well as latest behavioral and system theories.

Answers given by respondents have been compared to theoretical statements. The text has been judged whether it confirms or refutes identified hypotheses. In case the meaning of the case study text was confirming the hypothesis, it has been assigned a value of 1. In case the meaning of the case study text was negative, contradicting the hypothesis, it has been assigned a value of 0.

#### A. Business growth in relation to the environment

AH1: obstacles in the environment increases the additional cost

AH2: the growth of a business creates new trans-regional relations

#### B. Suppliers

BH1: company is forced to revise its suppliers and change them subsequently

BH2: company creates new above-regional ties with subcontractors as a replacement for the inadequate and failed old local ones

#### C. Human Resources

CH1: we acquire qualified human resources with difficulties

CH2: I had to dismiss my employees, e.g. due to the crisis

#### D. Customers, market

DH1: we are able to overcome unfavorable market conditions in the local region

DH2: environmental conditions require our stronger counteraction and increase our costs subsequently

#### E. Financial environment and state

EH1: local availability of funds is limited, we use mainly own resources

EH2: we use subsidies to support the business.

**Tab. 1: Ratio of statements/hypotheses confirmation or refusal**

company	NACE	A.		B.		C.		D.		E.	
		AH1	AH2	BH1	BH2	CH1	CH2	DH1	DH2	EH1	EH2
01	C	1	1	1	0	1	0	1	0	0	1
02	G	0	0	1	0	0	0	1	1	0	0
03	G	0	1	1	1	0	1	1	1	1	0
04	C	1	1	1	0	0	1	0	1	1	0
05	G	1	1	0	1	0	1	1	0	0	0
06	C	0	0	0	1	1	0	1	0	0	0
07	C	0	1	0	1	1	1	1	0	0	0
08	C	0	1	1	1	0	0	1	0	0	1
09	C	1	1	0	0	0	0	1	1	1	0
10	M	0	1	1	1	0	0	1	0	1	0
11	F	0	1	1	1	1	0	1	1	1	0
12	C	1	1	0	1	1	0	0	0	0	1
13	C	0	1	0	1	1	0	1	1	1	1
14	G	0	1	0	0	1	0	1	1	0	1
15	C	0	1	0	1	1	1	1	1	0	1
16	D	0	1	1	1	0	0	1	1	0	0
17	G	0	1	1	1	0	1	1	1	0	0
18	C	0	0	0	0	0	1	0	0	0	1
19	G	1	1	1	1	1	0	1	1	0	0
20	C	0	1	0	1	0	0	1	1	1	0
21	C	1	1	1	1	0	1	1	0	1	0
22	H	0	0	1	0	1	0	0	0	0	0
23	G	1	1	0	1	0	0	1	1	1	0
24	F	1	0	1	1	1	1	1	0	0	0
25	C	1	1	1	1	1	1	1	1	1	1
26	C	1	1	1	1	0	0	1	1	1	1
27	M	1	1	0	1	1	1	1	0	0	0
28	C	0	1	1	0	0	1	1	1	0	0
29	F	0	1	1	0	1	0	1	0	1	0
30	F	1	1	1	0	0	1	1	1	1	0
31	G	1	1	1	1	0	0	1	0	1	0
32	A	0	0	1	1	0	1	1	1	1	0
33	J	0	0	1	0	1	1	0	0	0	0
34	G	0	1	1	1	1	1	1	0	1	0
35	G	0	1	1	1	1	0	1	1	0	0
36	C	1	1	1	1	0	0	1	0	1	0
37	F	0	0	0	1	0	1	1	1	1	1
38	F	0	1	1	1	1	1	0	1	0	1
39	G	1	1	1	0	0	1	1	0	0	0
40	G	0	1	0	0	0	0	1	1	1	0
41	F	0	1	0	0	1	0	1	0	0	0
42	F	0	1	0	0	1	0	1	1	1	0
43	F	0	1	1	1	1	0	1	1	1	1
44	N	1	0	1	1	1	0	1	1	1	1
45	I	0	0	0	0	0	0	1	1	0	0
46	G	0	1	1	1	1	0	1	0	0	0
47	F	1	1	1	1	1	0	1	1	1	0
48	I	1	1	1	0	1	0	1	1	0	0
49	M	0	1	1	1	1	0	1	0	1	1
50	M	0	0	0	0	0	0	1	0	1	0
51	M	0	0	1	0	1	0	1	1	0	0
52	A	0	1	1	1	0	1	1	1	0	1
53	G	0	1	1	0	0	1	0	0	1	0
54	G	0	1	1	1	0	1	1	1	0	0
	number	19	42	36	34	27	22	47	31	26	15
	rate	35%	78%	67%	63%	50%	41%	87%	57%	48%	28%

Source: [own]

As chosen statements (AH1, AH2, ...EH1, EH2) are confirmed by majority of companies. Representative hypotheses are in accordance with empirical research and with theories. They demonstrate processes inside company effecting environment and vice versa matching external links affecting relations between company and environment. (Tab. 1)

## 5 Research outcome

The study output demonstrates essence of mutual ties among firm and environment. The collected text of qualitative data by its content corresponds to theoretical background stated in foregoing chapters divided into five aforementioned areas (A, B, C, D, E):

Small firms are often the victims of "vicious circle" of obstacles (A, ratio 78 %). In a business environment it is no easy to find means to ensure competitiveness [31]. However, entrepreneurs do not resign from it. They take advantage of finding the opportunities in the environment, and they resist obstacles and handicaps. As noted by McDermott and Taylor [15], for these companies is not easy to achieve higher business levels. According to these authors and confirmed by the presented research, only some few businesses are able to expand beyond the regional level. Some firms were forced to develop intense pressure B2B as well as on its surrounding environment. [10] If they do not meet their needs in the nearest region, they look for it in the larger region creating above-regional ties.

The firm's reaction to the environment has been depending on how they deal with perceived or actual constraints and opportunities. Firms remain very dependent on local availability of suppliers' service inputs (B, ratio 67 %). In inadequate supply infrastructure, they incur extra costs or incur differential disadvantages. The sample firms have been observed to exert influence on material supplier by exerting pressure, as well by means of their reputation.

Regarding labor market (C, ratio 50 %) firms make themselves immune to inadequacies of shortcomings of the local labor market in different ways. Several firms have attracted employees from outside the local area. They succeed to attract them by higher remuneration or other benefits like company cars, notebooks, cell-phone, longer holidays, etc.

Firms deal with inadequacies in the market and their customers (D, 87 %) in many different ways. Some firms face limited sales opportunities in the home region; in that case they pursue more intensively the adoption of a wider geographical action space. Local market conditions in the low munificent environment. Hence local market conditions call for the more drastic counteraction than local input conditions. The more restricted availability of input supplies does not become manifest to firms until they have been in existence for several years and have reached a certain size. Some companies are forced to handle without local customers from the beginning of their functioning.

Before firms are able to influence customers' needs and behavior, they first have to adapt to the buyers' desires. Some firms at the beginning of their functioning often fall into a vicious circle of constrain. They lack both the expertise and sufficient financial means to sell production on wider territory. They rather grow in local market than compete in supra-regional one, they face formidable sales problems. Firms tackle the environment by means of numerous measures of all kinds. These vary from high-cost to low-cost, from permanent to temporary, from locational to in situ, from conspicuous, to inconspicuous and so on.

Firms do not gain tools to be protected against deficiencies of local government [22] and financial market. One possibility is to get back on its own financial resources (E, 48 %). Often it is very difficult to scrape together enough money to sustain the growth of their business. They operate in financial straits for several years before breakthrough occurred.



## 6 Research discussion

Study has matched an existing gap among current managerial and regional theories. On the intersection of these theories lies explanation of genesis of firms' economic activities in the environment.

Empirical study has evaluated hypotheses stated above. (see 4.1) It has provided the following conclusions corresponding to contemporary theorists:

Decision making managers actively respond to the environment although there is full or insufficient information. Managers are able to take advantage of the environment and largely benefit from it. Like this they create spatial relationships [36]. In principle, firm' managers use adaptive techniques as they obtain limited managerial information. This corresponds to Watts's [37] and Taylor's [32] models and does not deviate from the classical theories. Knowledge management practice has been proved by research corresponding to Nelson theories [18].

The lack of information creates uncertainty and uncertainty leads to the "safe" decision – problem solution. In order to find means to ensure competitiveness managers tend to imitate each other and their location behavior is dominated by the "herd instinct" which is in accordance with Cyert and March [3].

Companies are rarely able to use the optimization calculations. They are often replaced by simple procedures, routines, experience or imitation. These methods are summarized in the concept of heuristics. In accordance to Pred [21] heuristic managers take consciously not optimal solution, but acceptable solution. Applying heuristic approach may be useful in particular in cases where the optimization calculation requires high cost of information, time and resources. It is thus compensation for deviation from the optimum. As noted by Cooke [2] firms take counteractions and apply innovation strategies in order to deal with inadequacies in the environment.

Inside a firm, inputs go through a process where they are planned, organized, motivated and controlled, ultimately to meet the organization's goals. Feedback also comes from the environment of the firm, e.g., influences from government, society, economics, and technologies. This overall system framework applies to any system, including subsystems (departments, programs, etc.) in the overall organization. Hence, systems theory may be seemed as solution to match a firm with environment in new paradigm theory shift. The past theorists' attitude have not followed this.

In accordance with Khan and Manopichetwattana [10] surveyed firms are innovative, proactive characterized by management quality. They have proved entrepreneurial strength. Our findings confirm that challenges to the firm in the form of environmental dynamism and heterogeneity are positively related with innovation. Managers take opportunities and innovate their day-to-day decisions in order to be competitive and more productive. Our findings could not extend the relationship to innovation as it was not the intention.

Matching managerial and regional theories allows researchers and consequently managers to look at the firm from a broader outside perspective. The current trend is what many theorists see as the trend in life itself, in firms and in the regions in general. World seems today chaotic and in firms the situation is the same. A new theory, chaos theory, recognizes that events indeed are rarely controlled. Many chaos theorists explain their theory in an analogous manner to chaotic systems. In each organized system like a firm, there is example of a sporadic manifestation of a disrupted pattern, irregularity, chaos. [4]

Theory suggests that systems naturally go to more complexity, and as they do so, these systems become more chaotic. As they expend more energy in order to keep functioning and profitability, they seek more structure to maintain stability as uncontrolled chaos leads to failure.

The existing (government) institutions need to be gradually reorganized; we need to find new administration and regional development institutions built on the basis of partnership and delegation of powers. The new structure of local and regional development has to stimulate new forms of instruments of public policy, which ensures to combine endogenous and exogenous forms of growth and development.

## Conclusion

The regional and managerial theories are not matched due to lack of appropriate theoretical framework itself. Reason to overcome this is a need to explain the origin of economic growth in the region and also to open the "black box" of firm/manager inside the region. In this way, eclectic theory creates room for matching managerial and regional theories.

The presented research output has illustrated the importance of the essential relations and mutual ties among the firm and the environment. Both inside and outside company' behavior is result of subjective presentation of the external environment. Like this a pattern is created according to which companies are acting towards each other and towards its surroundings and by which they develop relations with the region. We can therefore conclude that the emerging - probably eclectic - paradigm accentuating endogenous development is rising. We can say that this is an important step in the understanding of key actors and mechanisms of economic development.

Article findings allow us to assume that in this area there has been a new paradigm rising as managerial and regional theories matching is necessary. The consequent input into practice will be implemented only as scientists will be able to incorporate more appropriately the phenomenon of "firm" and "environment" both into the regional and managerial theories.

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## **Contact Address**

**Ivana Mandysová, Ph.D.**

University of Pardubice, Faculty of Economics and Administration, Department or Institute of Administrative and Social Sciences

Studentská 95, 532 10, Pardubice, Czech Republic

Email: [ivana.mandysova@upce.cz](mailto:ivana.mandysova@upce.cz)

Phone number: 46603 6528

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