

Subsidiary evolution the role of subsidiary initiative management essay



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Intro:

what is subs. Evo?

A detailed definition of subsidiary evolution will be given later in this chapter, but for the time being, it can be referred as the process of accumulating and depleting either resources or capabilities within the subsidiary over time.

Problem Statement

What is the value of initiative in the subsidiary evolution process?

Research Questions

RS1

What are the drivers of subsidiary evolution?

RS2

What are the different processes of subsidiary evolution?

RS3

Is there a link between subsidiary initiative and the subsidiary evolution process?

Relevance

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Research Design and Data Collection

The nature of this thesis is a literature review. Therefore, the author undertakes a descriptive research based on secondary data. The source of Data will be a selection of relevant books, academic and professional journals, PhD theses, reports (corporate commissions), and newspapers. Especially journals in the field of strategic management play a fundamental role. Some relevant journals are: Strategic Entrepreneurship Journal, Strategic Management Journal, Business Strategy Review, and International Business review.

The author made use of the catalogue of Tilburg University as well as external databases such as JStor, InterScience, ABI/Inform Global, or Web of Science. The keywords used were subsidiary evolution, initiative, corporate entrepreneurship, autonomy, network model, decision-making processes, charter changes and organizational capabilities.

Overview of the other chapters

The thesis continues with chapter two which will shed light on the concept of subsidiary evolution. In specific, it will provide a general introduction of the topic, emphasizing on the notion of charter and capabilities. Moreover, the drivers of subsidiary evolution will be discussed. Three perspectives, namely head-office assignment, environment determinism and subsidiary choice will be analyzed. The latter has been chosen to provide an in-depth analysis of the distinctive processes of subsidiary evolution. This is the subject of chapter three. In this chapter, the author identifies five processes of subsidiary evolution, which has been broadly categorized as either upwards
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or downwards moving processes. Next, chapter four provides a framework to understand the concept of subsidiary initiative. In specific, it identifies three drivers of subsidiary initiative as well as four types of initiatives. Each type is evaluated on the three factors, namely facilitating conditions, initiative process, and intended outcome. Thereafter, the author will attempt to connect each of the upward processes of subsidiary evolution with one type of initiative. The last chapter will provide a final conclusion and an potential answer of the problem statement. This chapter will end with recommendations for future research.

RS1

What are the drivers of subsidiary evolution?

This chapter attempts to shed light on the concept of subsidiary evolution. It will provide the theoretical background for the following chapters. In specific, three determinants of subsidiary evolution, namely head-office assignment, local-environment determinism, and subsidiary choice, are identified and analyzed as the mechanism that drives the process. For the purpose of this thesis, the author emphasizes more on subsidiary choice as an important driver as it focuses on the subsidiary as the unit of analysis.

Subsidiary Evolution

Putting it in simple words, subsidiary evolution can be understood as the process of accumulating and depleting resources or capabilities in the subsidiary over time; the keywords here are resources and capabilities[1]. In the context of a multinational corporation, the notion of capabilities is somewhat different to the extent that capabilities can be accumulated and

dissipated both by the parent and the subsidiary. Another distinguishing aspect is that each subsidiary shares a unique set of capabilities, originated from its different development path of geographical location and history (Teece, Pisano & Shuen, 1997). In addition, capabilities could be shared between different units within the MNC's network, but previous research suggest that capabilities are rather 'sticky', implying the difficulty of transfer (Andersson, 2003). Similar to the notion of stickiness is the aspect of path dependency of capabilities for subsidiaries; they were built over time from past experience and subsequently utilized in new or related business areas in response of internal and external competitive demands. Hence, from the different capability development path and path dependency of the subsidiary, it follows that each subsidiary share a unique capabilities profile.

Another important dimension to understand the concept of subsidiary evolution is the subsidiary's role in a multinational corporation. This role is best manifested by its charter[2]. It is a mutual agreement between head-office and subsidiary on the subsidiary's scope of responsibility.

The relationship between the subsidiary's charter and its underlying capabilities is not simple. In the case where subsidiary's charter is constant over time, subsidiary managers are more likely to focus subsidiary's resources and capabilities towards fulfilling its charter, so that eventually the underlying capabilities will match its charter (Birkenshaw & Hood, 1998). In contrast, in the case of fluctuations and changes (either in its charter, target market, or resource base) mismatches between the subsidiary's capabilities and official charter are highly probable. The key take-away here is, that the

relationship between subsidiary's charter and its underlying capabilities is very dynamic; they don't necessarily move together.

Last but not least, there is the aspect of internal competition for charters within a multinational enterprise. It is relevant for existing charters as well as for new charters. The former is exhibited by one subsidiary's action to 'take-over' a charter of another, and the latter refers to the bidding process of two or more subsidiaries for one charter (Galunic & Eisenhardt, 1996). The resulting implication is the possibility of moving charters within different units of the MNC. Charter competition can be also found in researches done by Birkinshaw (1996) and Crookell (1986). Both charter competition and the mobility of charters are fundamental drivers of the subsidiary's evolution process (Birkinshaw & Hood, 1998).

Drivers of Subsidiary evolution

Birkinshaw and Hood (1998) provided an organizing framework of subsidiary development focusing on three main drivers. The first driver is head-office assignment, which refers to the dominant position of the head quarter in the subsidiary's decision-making process; it implies head-office inclination to prefer central control (Bartlett & Ghoshal, 1986). The sphere of control includes aspects such as assigning and changing charters to subsidiaries or allocating resources (Paterson & Brock, 2002).

The second driver is local environment determinism, which understands the role of the subsidiary as a function of local market characteristics i. e. its constraints and opportunities (Birkinshaw & Hood, 1998; Birkinshaw, Hood, & Johnsson, 1998). The implication is that each subsidiary interacts within its

unique task environment, which also limits, directs and influences its activity. Previous research supports this stance (Ghosal & Nohria, 1989; Westney, 1994). Emphasis is put on the subsidiary's ability to adapt to its unique environment and maintain or even improve its competitive position.

The last driver is subsidiary choice, which includes subsidiary-management aspiration for more autonomy, increased network importance and justification of its existence to the parent and host country (Paterson & Brock, 2002). The author underscores that different researchers emphasize on different drivers as the important determinant for subsidiary evolution[3]. As stated earlier, for the purpose of the thesis, the author puts a limitation in analyzing the first two drivers in more depth. The author will focus more on the last driver, namely subsidiary choice, as the main driver of subsidiary evolution.

Subsidiary Choice

Two theoretical perspectives provide great support to understand the concept of subsidiary choice. The first is the network model of the multinational enterprise. This is not the place for an in-depth analysis or a review of the network literature. In essence, it describes the MNC as an 'inter-organizational network' (Ghosal & Bartlett, 1991) of interdependent units which are loosely or densely connected rather than arranged in a rigid hierarchical construct. It follows, that the subsidiary is able to shift from a subordinate position to one of equality, or even leadership (Birkinshaw & Hood, 1998). Moreover, Rugman and Verbeke (1992) recognize that ownership-specific advantages do not necessarily need to be location-bound to the MNC's home country; instead it be obtained or developed within the <https://assignbuster.com/subsidiary-evolution-the-role-of-subsidiary-initiative-management-essay/>

subsidiary. This is very much a reflection of reality as it supports the stance that many subsidiaries possess their own unique capabilities on which the MNC depends on.

Evolution, within the network model perspective, is regarded as a natural process, which is constructed around the growth and decrease of subsidiary's unique and important resources (Birkinshaw & Hood, 1998). Especially subsidiary growth is tied to the natural growth rate of resources[4] (Penrose, 1959) as well as to the actions of other units in the network (most likely the parent firm) who impose their relative power to assert their will on the subsidiary. However, with the increase of distinctive and valued resources, subsidiary's relative importance will increase. It follows that the subsidiary gains more control over its own destiny (Pfeffer & Salancik, 1978; Prahalad & Doz, 1981). One way to do so is through subsidiary initiative taking, which will be discussed in the following chapters.

The second theoretical approach includes the decision process perspective. In the interest of this thesis, the author will mainly focus on the notion of autonomous behavior in the decision process. This term was coined by the work of Burgelman (1983a, b) in which he recognizes that strategic behavior often takes place below top management levels and occasionally occurs without its active encouragement. In the context of subsidiary evolution, autonomous behavior is an important aspect since it allows for actions towards subsidiary internal growth in the network. It is recognized as potent force of subsidiary development (Burgelman, 1983b).

Conclusion

The first part of this chapter explained the concept of subsidiary evolution in terms of subsidiaries capability and charter. It discussed both the importance as well as the relationship between them. A key finding is the mobility of charters, meaning that charter roles can switch between entities within the MNC's network due to internal charter competition. Moreover, capability and charter do not necessarily move together, suggesting a dynamic relationship.

The second part identified three main drivers of subsidiary evolution; special attention was given to subsidiary choice. Two theoretical approaches helped to grasp this perspective. The first approach, namely the network model of the MNC, offered valuable insight regarding the role of underlying capabilities in the subsidiary. It also recognized that the subsidiary is connected with a number of other units, rather than interacting solely with the parent company. The second approach, i. e. decision process perspective, served as a means to understand autonomous behavior on the subsidiary side.

RS2

What are the different processes of subsidiary evolution?

Based on the findings of the previous chapter, this chapter aims to provide five distinctive pathways of subsidiary evolution. These five different processes of subsidiary evolution are manifested through either changes in charter or capabilities. Again, for the interest of the thesis, the author specifically focuses on the forward movements in the evolution process,

namely parent driven investment, subsidiary-driven charter extension, and subsidiary-driven charter reinforcement. SUBSISIDARY INITIATIVE, not identified as backwards moving (f Source). The downward moving processes are parent-driven divestment and atrophy through subsidiary neglect. These categorizations of evolution processes are coined by the work of Birkinshaw and Hood (1998). The author uses those proposed processes as the main source of reference. Figure X represents a graphical representation of the various evolution processes which the author will discuss next. The first part briefly discusses the two downward moving evolution processes; the second part will deal with the three upward moving processes.

Figure X: Subsidiary evolution as a function of capability and charter change

Source: modified figure of Birkinshaw & Hood (1998)

Downward Processes

Parent-driven divestment (PDD)

Parent-driven divestment refers to the scenario in which the parent company takes away the initial charter from the subsidiary; eventually, as a consequence the corresponding capability will deteriorate. The charter withdrawal decision mostly originated from parent company's conclusion to cut cost and/or to focus on core business activities. As a result, the worst-case scenario for the subsidiary is either its closure or sell-out. However, another possible scenario is that the subsidiary will continues to exist as a whole even with its charter loss (Galunic & Eisenhardt, 1996); its original charter might be deployed to develop a new charter. This process is referred as charter renewal (Birkinshaw, 1996).

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Atrophy through subsidiary neglect (ASN)

This process is referred to the situation in which the parent company deprives the subsidiary of its charter due to its neglect of its capabilities and the resulting performance drop (Birkinshaw & Hood, 1998). This neglect can be due to poor management or due to lack of competition, both either internal or external. Simply put, the subsidiary faces low pressures or immediate need to cost and run its operations efficiently.

The charter loss process can take two pathways. (Birkinshaw & Hood, 1998). The first is that the subsidiary maintains satisfactory results. However, in global comparison with sister-subsidiaries, the one subsidiary lags behind them, simply because these subsidiaries were able to upgrade and improve their capabilities to a greater extent. In essence, this subsidiary is victim of global rationalization within the MNC's network. In the second pathway, the subsidiary loses its charter due to gradual atrophy of its capabilities due to lack of attention. The result is exhibited in subsidiaries under-performance regarding internal performance benchmarks of the parent company.

Upward processes

Parent driven investment (PDI)

The basic assumption for parent driven investment is that responsibilities for charter assignments are held by the parent company. The underlying process is that subsidiaries within the MNC's network are actively competing for the new charter at stake. This process is highly characterized through a period of negotiation between corporate and subsidiary management and

heavy lobbying by the subsidiary managers for the potential and benefits when deciding in favor of the subsidiary.

The new charter is attached with commitments by the parent company to invest in the subsidiary, for example through building a new factory, or purchasing new required equipment and machines. An intangible commitment might be exhibited through broadening the subsidiary's sphere of responsibility, for example by extending its regional scope to more countries. Usually after winning the charter assignment, the subsidiary begins with its development of the corresponding capabilities (Birkinshaw & Hood, 1998).

Subsidiary-driven charter extension (SDE)

The process of subsidiary-driven charter extension resembles the process of corporate entrepreneurship (Birkinshaw 1997; Burgelman, 1983b). Different than the parent-driven investment process, the subsidiary takes an active role by taking initiative. It is described as a long and tedious process of capability development, with subsequent charter extension of the subsidiary (Birkinshaw & Hood, 1998). The baseline here is to build the required capabilities first to create greater bargaining power and overcome the parent company risk averseness by displaying tangible success and its adequate competence for an upgraded charter. Essentially, it's the reverse process order than the previous described upward-moving process.

Subsidiary's active role is characterized by taking conscious effort to extend its charter. It has recognized new business and market opportunities and take measures to pursuit them. Birkinshaw and Hood (1998) recognized a <https://assignbuster.com/subsidiary-evolution-the-role-of-subsidiary-initiative-management-essay/>

three steps process, in which the subsidiary, first, starts to actively look out for opportunities in its local as well as its network (Birkinshaw, 1997; Kirzner, 1973). Second, upon recognition of a worthy and pursuable market opportunity, the subsidiary takes action towards developing the required capabilities. Last but not least, the subsidiary approaches the parent company to propose its charter extension. Besides, heavily championing for its proposal, subsidiary managers can significantly increase their chances for grant by using their personal contacts in the corporate management. Birkinshaw and Hood (1998) argue, this is due to the familiarity effect of knowing the individual, which in result decreases suspicion.

Subsidiary-driven charter reinforcement (SDR)

While the previous upward-moving processes are clearly enhancing either charter or capabilities, this process does not exhibit changes in either aspect. What it rather does, is that it rectify and strengthens its current capabilities and thereby manifesting its charter. Notwithstanding, this process positively effects subsidiary's performance by achieving cost cuts as well as operational benefits such as quality and service improvements (Birkinshaw & Hood, 1998).

This process originates from subsidiary's management interest of not losing its competitive edge against internal, i. e. sister-subsidiaries, and external competitors (Morrison & Crookell, 1990). So essentially, this process undermines the possibility of losing its charter due to lack of attention or management deficit, which are, as previously discussed, the origins of 'atrophy through subsidiary neglect'.

Conclusion

This chapter discussed five processes of subsidiary evolution, which the author categorized as upward- and downward-moving processes. It has been identified that evolution processes can be the result of either action undertaken by the parent company or by the subsidiary.

The downward-moving processes are consequences of under-utilizations of capabilities in terms of absolute or relative terms. The former describes underperformance by not meeting internal benchmark set by the parent company; the latter describes the situation in which the subsidiary maintained satisfactory level of work on its capabilities, but seen in comparison with other sister-subsidiaries, they managed to increase their capabilities more effectively. As discussed earlier, these are termed as parent-driven divestment and atrophy through subsidiary neglect.

In contrast, it has been shown that upward-moving processes can be achieved and influenced directly, through initiative taking, or indirectly, through active bidding and competing against sister-subsidiaries. Both require action to be undertaken by the subsidiary. The author will discuss how the subsidiary could achieve changes and/or strengthening its charter and capabilities in the next chapter.

RS3

Is there a link between subsidiary initiative and the subsidiary evolution process?

Building on the theories and findings from previous chapter, this chapter aims to shed light on the concept of subsidiary initiative. It investigates

whether subsidiary initiative can be used as a means to change its charter and capabilities.

First, the chapter starts with a general introduction of the concept of subsidiary initiative. Second, it will continue with identifying the determinants of subsidiary initiative. Here, facilitating conditions, in which subsidiary initiative are most likely to occur, will be discussed. Next, concrete types of initiative will be identified and discussed in respect of its initiative process and outcome. This chapter will end with the conclusion.

Introducing the concept of subsidiary initiative

Using the definition suggested by Birkinshaw, an initiative is regarded as a 'discrete, proactive undertaking that advances a new way for the corporation to use or expand its resources' (1997: p210). Relating it to the subsidiary, it refers to subsidiary's actions of identifying a new business opportunity, which is followed by selling the idea to headquarter to get approval. Upon grant, the subsidiary will pursuit its opportunity by focusing its resources and capabilities to fill in the market gap. These three steps have also been indentified in the subsidiary-driven charter extension (chapter 3).

In chapter two, the author introduced the network model. This model, Birkinshaw argues (1998), creates the base in which entrepreneurial activities can arise; it provides the pre-requisite to foster and encourage entrepreneurial behavior. For example, it gives the subsidiary manager the level of independence and discretion to follow an idea without legitimizing it immediately. In addition, the network structure creates greater acceptance for new ideas at head office (Birkinshaw, 1998). Given that, there are <https://assignbuster.com/subsidiary-evolution-the-role-of-subsidiary-initiative-management-essay/>

determinants, which drives the process of initiative. Based on the suggested factors[5]associated with subsidiary initiative by Ghosal (1986), the author will use a slight variation and analyze three drivers – subsidiary-parent relationship, corporate-subsidary communication and distinctive capabilities – in the next part.

Drivers of subsidiary initiative

Subsidiary-Parent relationship

In the organizational context the parent-subsidary relationship can be characterized as a function of the decision-making pathway (Birkinshaw, 1999). The first pathway is rooted in decision centralization, which describes the extent in which corporate management holds responsibility for its decisions directly affecting subsidiaries activity. In addition, it can serve as reflection of the relative power division between corporate and subsidiary management (Prahalad, 1975)

In contrast stands the decentralized form of decision-making in which the subsidiary posses more autonomy. Its autonomy is reflected in its scope of action both on product or market level such as decisions on changes in product design, introductions of new products or new market entries within the host country (Roth & Morrison, 1992). Higher level of autonomy includes decisions on recruitment decision of senior management positions, outsourcing, or changes in production processes (Roth & Morrison, 1992).

Widening the sphere of influence can potentially result in continuous operational improvements and faster adaptations to market changes, which allows to pursuit local market initiatives. The aspect of increasing efficiency
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improvements relative to its sister-subsidiaries has been identified as a factor for subsidiary-driven charter reinforcement.

The effect of decentralized decision-making has been studied in previous research. For example, studies in corporate entrepreneurship suggest a correlation between decentralized decision-making and entrepreneurial activity (Burns & Stalker, 1961; Galbraith, 1982; Kanter, 1985; Sathe, 1986); studies regarding multinational enterprises also link decentralized decision making with innovation (Ghoshal & Bartlett, 1988; Gupta & Govindarajan, 1994). The underlying implication is that decentralized decision-making, or autonomy, is important for initiative occurrence (Birkinshaw, 1999). In terms of subsidiary evolution, Birkinshaw and Hood (1998) argue, that decentralized decision-making will offer the subsidiary the required level of freedom to take autonomous actions as well as the stimulus to take responsibility; thus, having a positive influence on subsidiary-driven charter reinforcement and extension, and atrophy through subsidiary neglect. Other research suggests that different level of autonomy – low, middle, high – fosters different types of initiative (Birkinshaw, 1997). This issue will be discussed in PART XYZ.

Corporate-subsidiary communication

Corporate-subsidiary communication is a reflection of the degree of relationship intensity (Birkinshaw, 1997). Means of communication can be either on a face-to-face basis or via other communication channels.

High level of communication suggests a stronger integration of the subsidiary with the parent company due to its greater flow of information
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and stronger work relation (Borini, Fleury, Fleury, Oliveira Jr., 2009). Consequentially, the ' distance' between corporate and subsidiary's management is reduced. Moreover companies' values such as an entrepreneurial culture can be more easily implemented and shared (Borini et al, 2009). Another positive effect is subsidiary's lower required effort for selling and/or championing a project as well as higher chances of acceptance and support from the parent firm (Bower, 1970). The underlying implication is that greater integration fosters an environment for initiative development (Nohria & Ghosal, 1997). This is also supported by previous research studies, which indicate a linkage between communication and initiative (Kanter, 1985; Ghosal & Bartlett, 1988). However, as it will be discussed in subsequent parts of this thesis, initiative can also arise from low-level of communication. Thus, adding to Nhoria and Ghosal (1997) findings, Birkinshaw (1997), suggest that also low level of communication can be a source of initiative, i. e. local and global market initiative.

Distinctive Capabilities

Previously (chapter 2) the notion of capabilities has been discussed. Adding to that distinctive capabilities are referred as value adding capabilities, which are believed to be unique and superior across the MNC network (Frost, Birkinshaw, and Ensign, 2002). In addition, Roth and Morrison (1992), and Birkinshaw and Ridderstråle (1996), found out that subsidiary's distinctive capabilities are related to its contributing role. And indeed, these research findings are strengthened by further studies (Birkinshaw, 1999), implying that subsidiary initiative will be enhanced by high level of distinctive capabilities. In fact, Birkinshaw's findings (1999: 24) consider it as the '
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single most important predictor of subsidiary initiative.' Possible explanations are the stickiness of relevant capabilities with technical expertise and market knowledge, on which the initiative will be based on. If the subsidiary faces resistance with corporate management for its new proposal, distinctive capabilities serve as a credential for proven competence. However, it is a necessity but not a guarantee for the success of the initiative (Birkinshaw, 1999).

Closely related to distinctive capabilities are proven resources, which are also implicit indicators of a strong track record. It has been identified as a critical parameter in previous research (Delany, 1996; Hood, Young & Lal, 1994; Morrison & Crookell, 1990). So, similar to distinctive capabilities it decreases perceived uncertainty by displaying competence and credibility. There should be no doubt that distinctive capabilities take an important part in the subsidiary evolution. In fact, Birkinshaw and Hood (1998) suggest a positive correlation between distinctive capabilities and parent-driven investment and subsidiary-driven charter extension.

Types and dimension of subsidiary initiatives

Birkinshaw (1997) identifies four distinct types of initiatives, which had all the ability to add value in respect to scope and scale of the subsidiary. In this research, which was based on U. S. owned subsidiary in Canada, Birkinshaw (1997) recognizes that the subsidiary is integrated in three markets comprised in internal and external markets. From that it follows, taking the subsidiary's perspective, that market opportunities arise from multiple markets i. e. are not stringed to one single market such as the local market.

The three different markets are the local, internal and global market. The local market consists of four different actors – local suppliers, local competitors, local customers and host countries' regulatory institutions (Delany, 2000). In contrast, the internal market comprises of head quarter operations and all globally controlled affiliates of the subsidiaries' parent company. Last but not least, the global market includes competitors, suppliers, and customer outside of the internal and local market. The various relationships between the different markets and the subsidiary are depicted in figure 1.

source: Birkinshaw (1997)

Each of markets can be an originator of a market opportunity which if recognized as pursuable would be translated into an initiative. Depending on the locus of the opportunity – namely local, internal, and global – these initiatives are classified as local market initiative (LMI), global market initiative (GMI), and internal market initiative (IMI) (Birkinshaw, 1997). Birkinshaw has identified another initiative in the process of his research, namely hybrid initiative (HI).

The different set of dimensions for each of the initiative will be characterized by looking at the facilitating conditions, the initiative process, and the intended outcome as suggested by Birkinshaw (1997). The facilitating conditions, as distinguished in the previous parts of the thesis, are features of the subsidiary's structural context, which promotes an initiative-taking environment. The initiative process represents the pathway from which the initiative originates and the underlying steps that the initiative goes through.

Finally, the intended outcome indicated the effect of the initiative on its charter and capabilities.

It should be noted, that in the interest of thesis, the author will use the categorization and characteristics suggested by Birkinshaw (1997); other research studies suggest a different classification such the one proposed by Delany (2000)[6].

External focused initiatives

Local Market Initiative (LMI)

Local market initiative describes the pursuit of a new business opportunity, identified in subsidiary's home market (Birkinshaw, 1997) such as