

2. Definitions and literature review

2.1. Introduction

The relatively unexplored research topic of internationalization processes at the subsidiary level initially suggested a rather inductive study approach, which would not or only to a limited degree require a thorough examination of literature in relevant research streams. Eisenhardt (1989b: 536) supported this point by postulating that “theory-building research is begun as close as possible to the ideal of no theory under consideration and no hypothesis to test”. Gummensson (2000), however, confronted this statement by questioning the need for continuously reinventing the wheel in the course of new studies and actually urged scholars to make use of existing theory also for qualitative research undertakings. A pragmatic middle ground had already been set by Perry (1998: 789), who established ties between the two perspectives by noting that “pure induction might prevent researchers from benefiting from existing theory, just as pure deduction might prevent the development of new and useful theory”.

Understanding both sides of the highlighted scholars’ debate and acknowledging the vast amount of research that has been carried out in the field of internationalization processes and subsidiary roles and evolutionary paths up to now, a selective use of literature was eventually chosen. The focus was thereby set on bridging mentioned literature streams in order to explicitly understand process drivers for subsidiary responsibility into foreign markets. Throughout the study particular attention was paid to the right balance of induction and deduction, thereby following Sminia’s summarizing note (2009: 105) that “some amount of deduction is believed to help in guiding the researcher through the research without posing too much of a preconceived understanding on the particular course of events”. In summary, the selected approach significantly helped to structure the overall data collection process while at the same time not limiting the subsequent data analyses and interpretations to already existing findings. The core benefit of qualitative research studies to develop new theories was therefore not constrained at any point of the study.

The following section will commence with a short definition of subsidiary internationalization processes encompassing the key process stakeholders as well as subsidiary mandates that stretch beyond host market borders. Afterwards, a selection of relevant IB research streams using the MNC and foreign MNC units as the core unit of analysis will be presented to the reader. Throughout the literature review a differentiation between static and dynamic research perspectives will be used in order equally understand rationales for and drivers of peripheral internationalization processes. At the same time, a distinction between the MNC and foreign subsidiaries as the core unit of analysis will be applied in order to obtain a differentiated picture of the two involved firm levels.

2.2. Definitions

Before examining in more depth past research findings directly or indirectly related to the internationalization process of foreign subsidiaries, a brief definition of the term ‘subsidiary internationalization’ and the involved process stakeholders and process items seems appropriate in order to avoid potential misunderstandings by the reader. The primary aim is to clearly specify the unit of analysis, internationalization processes of foreign subsidiaries. In addition, the two major process stakeholders, the MNC and the foreign subsidiary, will be defined and confined from similar organizational forms. Finally, various means of cross-border interplay between corporate and subsidiary management or forms of responsibility delegation and fulfillment that are often referred to as subsidiary mandates or charters will be briefly stressed.

2.2.1. *Subsidiary internationalization*

In the course of this study the term subsidiary internationalization or internationalization of the second degree (Forsgren et al., 1992) is defined as:

The process of increasing subsidiary involvement in international operations manifested in an official foreign market mandate

According to the initial part of the definition, ‘the process of increasing subsidiary involvement in international operations’, the internationalization of subsidiaries can equally refer to cross-border trade or foreign direct investment, whereby involved process stakeholders at any MNC level can select from a wide range of market entry modes in order to benefit from cross-border participation (Kutschker & Schmid, 2011). It can further relate to gradually increasing foreign market exposure (Johanson & Vahlne, 1977), e.g. from relatively low commitment stages like indirect exports up to the setting up of fully-owned foreign subsidiaries, as well as to internationalization moves that leapfrog certain stages of the establishment chain (Hedlund & Kverneland, 1985). Moreover, it acknowledges so-called ‘born-globals’ (Weerawardena, Mort, Liesch & Knight, 2007), where foreign subsidiaries may be involved in cross-border business operations from their very establishment. Finally, the definition encompasses outward internationalization, i.e. the marketing of goods and services abroad, and inward internationalization, i.e. the supply of input goods or know-how from outside the subsidiary’s host market (Welch & Luostarinen, 1993).

The second part of the definition, ‘manifested in an official foreign market mandate’, highlights three important aspects. First, subsidiary internationalization refers to “the process of adapting firms’ operations (strategy, structure, resource etc.) to international environments” (Calof & Beamish, 1995: 116). Even though “a non-exporter may first become involved in exporting in a reactive manner, responding to unsolicited orders” (Cavusgil & Czinkota, 1990: 179), the definition explicitly excludes uncoordinated internationalization efforts.

Throughout the study internationalization therefore only occurs if “management recognizes the important contributions international business can make toward accomplishing corporate goals” (Cavusgil, 1984: 197) and commits itself on a medium to long-term basis to a certain foreign market or foreign region. This restriction is important in order to reflect on corporate management’s resource sovereignty across the MNC (Ambos & Birkinshaw, 2010) and the subsidiary’s need to constantly claim its stake in the corporate marketplace (Galunic & Eisenhardt, 1996). Second, the term mandate points to a potentially temporary nature of cross-border subsidiary responsibility as it is generally seen “as a license to apply the subsidiary’s distinctive capabilities to a specific market opportunity” (Birkinshaw, 1996: 489).

Finally, the term ‘mandate’ outlines another particularity of subsidiary internationalization that needs to be addressed when carrying out the defined study. When scholars refer to internationalization stages they generally refer to the development of new markets from a company’s home territory (e.g. Johanson & Vahlne, 1977; Santangelo & Meyer, 2011). Nonetheless, from a subsidiary perspective obtaining foreign market responsibility, expressed by an official mandate, may represent the initial cross-border reaching even though the MNC has already obtained company presence in this territory in the past. Subsidiary internationalization can therefore equally refer to the development of markets without prior MNC presence and to a transfer of existing foreign market responsibilities or charters from one MNC unit to another (Birkinshaw & Hood, 1998). As the internationalization process of foreign subsidiaries represents the core unit of analysis, the study focus is primarily set on why and how subsidiaries internationalize while the question of whether this process leads to increased foreign market exposure of the MNC only comes second.

2.2.2. MNC

The internationalization process of foreign subsidiaries is likely to be impacted by a set of stakeholders (Tallman & Chacar, 2011). In addition to external parties like customers or competitors it may be shaped by corporate headquarters, affiliated subsidiaries and the focal subsidiary itself. As the latter three units constitute the MNC, a closer look at its definition seems appropriate. According to Forsgren et al. (2005: 1) the MNC, which is also referred to as the multinational enterprise (MNE), is “one of the most significant institutions of modern societies”. Forsgren et al. (2005) further defined it as an entity that controls resources across borders and that operates in and between various countries. While the degree of resource control and the level of cross-border participation may significantly differ from one country to another, from one industry to another or one institution to another, the two aspects of cross-border resource control and business operations are most characteristic for an MNC. As with most technical terms in IB research, however, there is no single MNC definition that has been agreed upon by leading scholars around the world.

Taking different dimensions of the term ‘multinationality’ into consideration, Root (1990) offered a relatively solid overview of existing MNC definitions. He thereby differentiated by the criteria of ownership, nationality mix and organizational structure or business strategy, of which he only viewed the latter as an adequate means to distinguish MNCs. Perlmutter (1969: 11) already highlighted the difficulty in defining and measuring MNCs as “no single criterion of multinationality such as ownership or the number of nationals overseas is sufficient” and as “external and quantifiable measures such as the percentage of investment overseas or the distribution of equity by nationality are useful but not enough”. Advocates of ownership as key criterion for multi- or transnationality often postulated that an MNC exists if corporate headquarters are simultaneously owned by stakeholders of at least two nationalities. While this may hold true for exceptional cases like Shell or Unilever, most globally operating companies are owned by a parent company of a single nationality. Similarly, the criterion nationality mix comes up short and lacks generalizability for defining the MNC. According to it, a company is multinational only if its management at headquarter level is composed of individuals with varying nationalities. As many of today’s firms are strongly involved in international business activities with a management team all from the same country, the definition criterion does not seem to suit the need for the study at hand.

The remaining criterion, organizational structure or business strategy, finally sets a robust definition of the term MNC. Developing on earlier work of Vernon (1971) or Behrman (1969) and based on organizational as well as strategic considerations about the firm, Root (1994) developed a three-fold MNC definition that will be used in the course of this study. According to it, an MNC represents a business enterprise that (1) engages in foreign production through its affiliates located in several countries; (2) exercises direct control over the policies of its affiliates; (3) implements business strategies in production, marketing, finance and staffing that transcend national boundaries. The definition fits particularly well for the topic of subsidiary internationalization as it encompasses cross-border endeavor, resource sovereignty at a HQ or parent company level as well as strategy definition across various elements of the value chain. All three aspects are crucial to the study at hand.

2.2.3. *Foreign subsidiary*

Foreign subsidiaries represent one of several market entry forms (Kutschker & Schmid, 2011) and are viewed by some IB scholars as “the actual manifestations of the MNC’s international expansion” (Blankenburg Holm et al., 2009: 14). Despite the significant relevance that researchers attribute to foreign subsidiaries and their wide existence across countries and business segments, a clear and consistent definition is not as easy to obtain as an outsider may initially think. Having chosen the internationalization process of foreign subsidiaries as the core unit of analysis, however, a differentiation of subsidiary types as well as a stringent delineation from other MNC units represents an important task at the study’s offset.

Birkinshaw and Pedersen (2009: 367) defined the subsidiary as “a value-adding activity outside the home market” and thereby referred to wholly-owned subsidiary companies. By indicating the location of the subsidiary as outside the parent company’s market, Birkinshaw and Pedersen (2009) set a clear separation from home market subsidiaries that may exist for organizational or strategic purposes. Nonetheless, wholly-owned subsidiaries represent only one of various MNC unit types and a clear definition therefore seems necessary. Gatignon and Anderson (1988: 314) used the level of control in order to classify MNC governance structures in foreign markets and came up with the following four-stage subsidiary typology:

- Wholly-owned subsidiaries (the MNC holds 100% of equity)
- Dominant partnerships (the MNC holds the dominant share of equity; that is, owns more equity than any other partner)
- Balanced roughly equally partnerships (the MNC’s share is the same as that of the largest partner)
- Minority partnerships (the MNC holds less equity than the largest partner)

While all forms require equity-based investment, only wholly-owned subsidiaries (1) and dominant partnerships (2) also fulfill the subsidiary criterion of controlling interest by a single parent company of the MNC (Kutschker & Schmid, 2011: 906). Nonetheless, also equal (3) and minority partnerships (4) may qualify as subsidiaries if the controlling interest is achieved by other means (e.g. special voting rights).

By looking at the overall degree of control of a firm over a foreign entity, many IB scholars extend the definition of the foreign subsidiary beyond the aspect of equity investments. Morschett (2007), for example, called attention to the increasing relevance of non-equity-based cooperative forms in foreign market operations (e.g. licensing, management contracts or franchising). Morschett (2007) cited the statement of Buckley (1983: 43) that “it is not necessary to own a production process to control it” in order to underline the relevance of control. Joint ventures may therefore also constitute foreign subunits even though they may be influenced by stakeholders outside the MNC, e.g. joint venture partners. This view further corresponds with the definition of Birkinshaw and Petersen (2009) that a subsidiary needs to add value to the MNC as outlined at the offset of this section.

Despite the existence of various types and definitions of foreign subsidiaries, the study at hand is clearly limited to wholly-owned subsidiaries. The deliberate exclusion of any cooperative foreign market development form is aimed at avoiding additional complexity levels that may complicate the study’s contribution to the unexplored research topic of subsidiary internationalization. It is acknowledged, however, that subsidiary internationalization may equally take place among other subsidiary types with potentially deviant process mechanisms.

2.2.4. Foreign market subsidiary mandates or charters

The decision to set up a foreign subsidiary by the means of a greenfield approach or acquisition is likely to have several, potentially overlapping, reasons. As laid out by Dunning (1993) the rationale for any MNC activity can be the seeking of markets, resources, efficiencies and strategic assets. A foreign subsidiary can thus serve its parent company by gaining foreign market access (market-seeking), by exploiting locational advantages (resource-seeking), by achieving higher productivity levels (efficiency-seeking) or by strengthening the MNC's competitive positioning (strategic-asset-seeking). The subsidiary's level of value-add to its respective MNC may therefore range from specialized R&D or sales functions to covering the entire value chain (Kutschker & Schmid, 2011: 906). In the latter case the local value-add can equal or surpass its parent company counterpart, in which case foreign subsidiaries are also referred to as miniature replica (White & Poynter, 1984). In addition to varying functional scopes, the geographical scope may also differ from one subsidiary to another. In fact, while the subsidiary's responsibility for a certain product may be nationally or regionally limited it may possess a world mandate for a specific product (e.g. Rugman & Douglas, 1986). The initial functional and geographical scope of a foreign subsidiary is in most cases the result of an HQ assignment. Nonetheless, both scopes of responsibility may alter over time driven by initiatives from either corporate or local subsidiary management (Birkinshaw & Hood, 1998).

When referring to global responsibilities for a single product, the term foreign market subsidiary mandates was first used. Based on empirical examination of mandate development of several foreign subsidiaries, Birkinshaw (1996) stressed local capabilities as a key driver for mandate growth and highlighted the transient nature of subsidiary mandates. A subsidiary mandate can to a large extent be equated with its individual corporate charter. While the initial definition by Galunic and Eisenhardt (1996: 256) as a "businesses (i.e., product and market arenas) in which a division actively participates and for which it is responsible within the corporation" referred to corporate divisions rather than foreign subsidiaries, Birkinshaw and Hood (1998) later claimed its similar suitability for subsidiary responsibilities. Birkinshaw and Hood (1998: 782) viewed charter as "a shared understanding between the subsidiary and the headquarters regarding the subsidiary's scope of responsibilities".

The existence of various types of FDI strategies for foreign subsidiaries (Dunning, 2003) that may or may not be manifested in a subsidiary's mandate or charter is well acknowledged by the author. Similar to multiple subsidiary types as outlined in the previous section, however, the study is limited to foreign subsidiaries with predominately market-seeking objectives. The study limitation is equally targeted to circumvent further complexity levels that may arise when seeking to embrace all FDI strategies for the unexplored topic of subsidiary internationalization. The author admits, however, that subsidiary internationalization may also happen in

foreign subsidiaries that pursue FDI strategies other than market-seeking with possibly divergent process mechanisms.

2.3. Findings of relevant IB research streams

2.3.1. Classification of available literature

When examining fifty years of IB theory Rugman, Verbeke and Nguyen (2011) grouped most relevant research findings by their unit of analysis. While early, neoclassical studies predominately dealt with the country as the core unit of analysis, a shift of focus towards the firm in the international context marked a new era of IB research. Hymer (1960¹, 1976) is thereby seen as the “intellectual father of the second stage in modern IB studies” (Rugman, Verbeke & Nguyen, 2011: 756) as he first explicitly looked at the firm’s benefit from cross-border participation. More recently, scientists have increasingly paid attention to subsidiaries as they, in sum, constitute the MNC. Even though all three units of analysis (country, MNC and subsidiary) are at least partly interrelated, the literature review will be limited to cross-border aspects of the firm and the subsidiary as they make up the heart of the study. Limited transferability of macro-level observations with microeconomic aspects further supported this approach. As noted by Markusen (2001: 70), general-equilibrium analysis of foreign trade or direct investment theory “leaves it ill-equipped to deal with individual firms and the important role that the latter play in the real economy”.

The study examines internationalization processes of foreign subsidiaries and thereby seeks to understand why and how foreign subsidiaries obtain foreign market responsibility and how such a mandate evolves in the course of time. In order to support both types of research questions around the causality and modality of subsidiary internationalization, a further categorization of literature streams by static and dynamic viewpoints seemed appropriate. While research findings using a static viewpoint were expected to contribute to a better understanding of why foreign subsidiaries obtain foreign market responsibility, literature about dynamics of firm internationalization was browsed to shed light on how expansion processes are initiated and how they evolve over time. It should be noted that findings on the dynamic nature of firm internationalization are still relatively limited (Kutschker & Schmid, 2011) despite a request from leading scholars for a more process-orientated IB research focus for more than two decades (e.g. Doz & Prahalad, 1991).

¹ Not published until 1976.

Figure 2-1: Classification of relevant IB literature streams and guiding review questions

Study viewpoint	Static	<p>For what reasons are firms engaged in cross-border business operations?</p>	<p>What roles, mandates or charters do foreign subsidiaries fulfill in the MNC and to what extent do they stretch across host market borders?</p>
	Dynamic	<p>What factors drive or restrict cross-border business operations of firms?</p>	<p>What factors drive or restrict the evolution of subsidiary roles, mandates or charters, in particular beyond host market borders?</p>
		MNC	Subsidiary
		Unit of analysis	

The aforementioned classification of relevant IB literature by the unit of analysis and the viewpoint is summarized in Figure 2-1 above. The two-by-two matrix was further enriched by four questions that guided the overall literature review process. As a result, the following pages are strictly limited to findings directly or indirectly linked to the rationale for and the processes of subsidiary internationalization. The matrix also shows that neither the units of analysis nor the study perspectives are mutually exclusive and that there exists a certain degree of overlap in the reviewed literature streams. Overall, this literature review does not claim to exhaustively cover all relevant literature streams related to subsidiary internationalization. In fact, they are deliberately limited to the study topic on why (causality) and how (modality) firms or subsidiaries internationalize, rather than covering other interesting and neighboring aspects like where (locality) or how fast (temporality) firms or subsidiaries expand their activities into foreign territories. In addition, a focus was set on foreign subsidiaries as the core unit of analysis and on dynamic study perspectives. In summary, the screening of past studies in the field of IB was aimed at facilitating the data collection process as well as the subsequent data analysis process without limiting the theory-development process desired from the chosen case study research design.

Table 2-1: Classification of relevant IB literature with the firm as core unit of analysis

Static viewpoint	Dynamic viewpoint
<ul style="list-style-type: none"> ▪ Monopolistic advantage theory (Hymer, 1960, 1976) ▪ Transaction cost / Internalization theory (e.g. Williamson, 1975; Buckley & Casson, 1976) ▪ Eclectic paradigm (Dunning, 1977) ▪ Knowledge-based view (e.g. Kogut & Zander, 1993) ▪ Asset-seeking view (e.g. Doz, Asakawa, Santos & Williamson, 1997) 	<ul style="list-style-type: none"> ▪ Product lifecycle theory (Vernon, 1966) ▪ Uppsala model (Johanson & Vahlne, 1977) ▪ Helsinki school (e.g. Luostarinen, 1979) ▪ Network approach (e.g. Johanson & Mattsson, 1988) ▪ Innovation-related approach (e.g. Bilkey & Tesar, 1977) ▪ GAINS paradigm (Macharzina & Engelhard, 1991) ▪ Resource-based view (e.g. Teece & Pisano, 1994; Teece, Pisano & Shuen, 1997)

Source: Own illustration, based on Rugman, Verbeke & Nguyen (2011)

The classification of relevant IB literature with the MNC or the subsidiary as core unit of analysis can be viewed in Table 2-1 above and Table 2-2 below. The selection of relevant literature streams was strongly inspired and supported by two IB publications. While the work of Rugman, Verbeke and Nguyen (2011) facilitated the identification of the most relevant studies using the MNC as the core unit of analysis, the article of Birkinshaw and Pedersen (2009) strongly helped to obtain a better picture of studies with an explicit focus on foreign subsidiaries. Adding to this, significant efforts were made in order to come up with additional studies that were able to contribute to a better understanding of internationalization processes at the periphery of modern MNCs.

Table 2-2: Classification of relevant IB literature with the subsidiary as core unit of analysis

Static viewpoint	Dynamic viewpoint
<ul style="list-style-type: none"> ▪ Generic subsidiary roles (e.g. Bartlett & Ghoshal, 1986) ▪ Specialized subsidiary roles (e.g. Rugman, Verbeke & Yuan, 2011) ▪ World product mandate (e.g. Rugman, 1982) ▪ Centers of excellence (e.g. Frost, Birkinshaw & Ensign, 2002) ▪ Regional headquarters (e.g. Lehrer & Asakawa, 1999) ▪ Divisional headquarters (e.g. Forsgren, Holm & Johanson, 1995) 	<ul style="list-style-type: none"> ▪ Subsidiary evolution (e.g. Malnight, 1995) ▪ Evolution determinants (e.g. Birkinshaw, 1997) ▪ Subsidiary internationalization (e.g. Forsgren et al., 1992) ▪ Internationalization trajectories of MNC units (e.g. Araujo & Rezende, 2003) ▪ Dynamics of regional headquarters (e.g. Kähäri et al., 2010)

Source: Own illustration, based on Birkinshaw & Pedersen (2009)

2.3.2. Studies with static views and the firm as core unit of analysis

As outlined above, research streams in the field of IB have seen shifting units of analysis over the last years, decades and even centuries. While early trade theories predominately used the country as the unit of analysis, for example by looking at country-specific advantages and its impact on national competitiveness (Smith, 1776; Ricardo, 1817), later studies applied a more microeconomic approach. Many scholars (e.g. Buckley, 2009; Kapler, 2007) view Stephen Hymer's work (1960, 1976) on the international firm as the starting point for modern IB research as it explicitly sought to provide answers to why and how firms internationalize. In addition, Hymer (1960, 1976) truly focused on the firm as the unit of analysis, which differentiated his work from previous macroeconomic perspectives. Rugman, Verbeke and Nguyen (2011: 756) emphasized this contribution of Hymer as he "pioneered a fundamental change in the unit of analysis adopted in IB studies: he positions the MNE and its FSAs at the core of his analytical approach". Moreover, his work significantly influenced subsequent IB research across the globe and set the breeding ground for two major research streams of firm internationalization: transaction-cost-based and internalization theories of the MNC (Kapler, 2007). Despite its existence for more than fifty years, his work will therefore be explained in detail in the following pages.

2.3.2.1. Monopolistic advantage theory of the MNC

In his PhD thesis on the international operations of national firms, Hymer (1960, 1976) provided a new explanation for how firms benefit from foreign production and why firms choose foreign production over relatively simpler selling or licensing of technology. With regard to the first question, Hymer (1960, 1976) argued that firms can develop certain proprietary or monopolistic advantages that eventually allow the firm to more than offset locational advantages enjoyed by market participants in a particular host market. These proprietary advantages therefore serve as a means to overcome barriers to international business operations. Extending Bain's (1956) work on national barriers of competition across different sectors, Hymer (1960, 1976: 45) stated that "there are as many kinds of advantages as there are functions in making and selling a product. The firm's advantages may be that it can acquire factors or production at a lower cost than other firms. Or it may have knowledge or control of a more efficient production function. Or the firm may have better distribution facilities or a differentiated product."

Regarding his second research question, Hymer postulated that firms opt for foreign direct investment rather than selling or licensing technology in order to lower or even eliminate competition. Competitive strength can be achieved by acquiring foreign firms and by maximizing the exploitation of aforementioned proprietary advantages. His argumentation is based on the existence of market imperfections like uncertainty. Through foreign asset ownership



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