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Subsidiary strategy of emerging market multinationals: A home country institutional perspective

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ABSTRACT

We examine the effects of home country institutional factors, namely, home country government support, domestic institutional weaknesses, and state ownership on the subsidiary-level strategy of global integration (I) and local responsiveness (R) of emerging market multinational enterprises (EMNEs). We draw upon the home country institution-based view and the I/R framework to develop our theoretical model. We empirically test our hypotheses using an original new survey data collected from Chinese multinational subsidiary managers supplemented with parent-level and country-level data. We find that home country government support and domestic institutional weaknesses have significant and negative effects on global integration strategy of Chinese multinational subsidiaries. On the other hand, domestic institutional weaknesses push foreign subsidiaries to pursue local responsiveness strategy. Nevertheless, those with greater degree of state ownership in their parent firms are neither willing to disintegrate from their parent firms nor motivated to pursue local responsiveness strategy in order to deal with home country institutional deficiencies and develop new sources of competitiveness in foreign markets. Our findings have advanced the literature on subsidiary strategy in the context of EMNEs, and provide important implications for subsidiary managers and policy makers.

1. Introduction

The majority of previous studies on emerging market multinational enterprises (EMNEs) focus on parent-centric decisions in outward foreign direct investment (OFDI), such as choices of establishment modes, ownership structure, and host country locations (e.g., Cui & Jiang, 2012; Hong, Wang, & Kafouros, 2015; Lu, Liu, Wright, & Filatotchev, 2014; Meyer, Ding, Li, & Zhang, 2014). Yet, little is known about EMNEs' subsidiary strategies, which reflect a notable research gap. We aim to address this limitation in our study.

Subsidiary strategy suggests some level of choice or self-determination on the part of the subsidiary (Birkinshaw & Hood, 1998; Birkinshaw & Pedersen, 2009). The underlying premise of subsidiary strategy is that decisions are made by subsidiary managers in their marketplace, not by headquarters (HQs) managers (Garcia-Pont, Canales, & Noboa, 2009; Rugman & Verbeke, 2001; Rugman, Verbeke, & Nguyen, 2011).

Birkinshaw and Pedersen (2009) argue that a distinction needs to be made between the concepts of subsidiary role and subsidiary strategy. A subsidiary role is assigned to it by the parent firm, and the subsidiary is simply to follow orders. Subsidiary strategy involves the decision-making power and entrepreneurship of the subsidiary in its value-adding activities independently from the parent firm and other subsidiaries (Garcia-Pont et al., 2009; Nguyen & Rugman, 2015a, 2015b).

Much of our knowledge on subsidiary strategy comes from research in the context of advanced economy MNEs (Birkinshaw & Morrison, 1995; Birkinshaw, 1995, 1996; Mauri & Phatak, 2001; Nguyen & Rugman, 2015a, 2015b). The literature documents the diversity of subsidiaries driven by their specific strategic roles, the importance of external embeddedness in host country environments, and internal embeddedness within MNEs (Andersson, Forsgren, & Holm, 2002; Hoenen & Kostova, 2014; Meyer, Mudambi, & Narula, 2011). Furthermore, highly-developed institutions allow MNEs from advanced economies to build and accumulate firm-specific advantages (FSAs), especially managerial skills, integration systems of organizing, and coordinating and

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orchestrating activities of a spatially dispersed network of foreign subsidiaries (Kostova & Roth 2002; Wang, Luo, Lu, Sun, & Maksimov, 2014).

In contrast, EMNEs are latecomers in the world stage, originating from complex and weak domestic institutional environments (Luo & Tung, 2007; Luo, Xue, & Han, 2010; Pan et al., 2014). Home country institutions are a source of advantages and disadvantages for EMNEs (Rugman, Nguyen, & Wei, 2014). On the one hand, home country government support and state ownership provide EMNEs with necessary resources to embark on internationalization (Lu et al., 2014; Wang, Hong, & Kafouros, & Wright, 2012). On the other hand, domestic institutional weaknesses create disadvantages for EMNEs' foreign subsidiaries due to the liabilities of origin, which emerge as a direct consequence of the national origins of EMNEs (Bartlett & Ghoshal, 2000; Ramachandran & Pant, 2010).

The liabilities of origin can affect EMNEs and their foreign subsidiaries through a variety of processes, such as organizational imprinting and identity, image, capability development and resource scarcity (Ramachandran & Pant, 2010). Because EMNEs' foreign subsidiaries are associated with the weak institutional heritage in home countries, their corporate images and legitimacy in host countries are unfavorable (Luo & Tung, 2007; Madhok & Keyhani, 2012; Wang et al., 2014). Furthermore, weak domestic institutions have impeded EMNEs to develop traditional Western-type FSAs in technology, global brands, and managerial expertise (Hennart, 2012; Rugman, 2010; Wei, 2010). These create additional costs and challenges of doing business abroad for EMENs' foreign subsidiaries.

In this study, we argue that subsidiary strategies play an important role for EMNEs, in which home country institutions are critical factors influencing the strategic behaviors of EMNEs' foreign subsidiaries. We elaborate on the home country institution-based view and the global integration and local responsiveness (I/R) framework in developing our conceptual model and hypotheses. The central idea of the I/R framework is that on the one hand, the MNE exploits the benefits of economies of scale and scope across national borders and must balance the need to be responsive to preferences and tastes of local consumers and governments' regulations on the other hand (Bartlett & Ghosbal, 1989; Prahalad & Doz, 1987). This strategy is called "transnational solution" by Bartlett and Ghosbal (1989).

Our study addresses a key research question "to what extent do home country institutions (i.e. home country government support, domestic institutional weaknesses, and state ownership) affect the IR strategies of EMNEs' subsidiaries after they enter foreign markets?" We deem that the foreign subsidiaries of Chinese MNEs are a particularly interesting research context. The surge of Chinese OFDI has been largely attributed to China's "go global" policy and home country government's direct involvement in the allocation of firms' resources, which in turn affect their internationalization behavior (Buckley et al., 2007; Luo et al., 2010; Wang et al., 2012).

Furthermore, institutional variations in China affect subsidiary strategies of Chinese MNEs through various mechanisms. These include the characteristics of parent firms, such as the degree of state ownership, and government affiliation and political connections (Cui & Jiang, 2012; Duanmu, 2014; Liang, Ren, & Sun, 2015; Pan et al., 2014; Wang et al., 2012); regional locations in China (Hong et al., 2015); the nature of FDI projects, such as the level of compliance with government FDI policies (Hong et al., 2015; Lu et al., 2014), and the home-host political relations (Chen & Young, 2010; Duanmu, 2014).

We make three new contributions to the literature. First, we advance the extant literature on EMNEs with a specific focus on EMNEs' subsidiary strategies. We obtain subsidiary managers' insights through a survey with Chinese multinational subsidiaries for our empirical tests. We also supplement our primary survey data with secondary data from multiple sources, including parent-level data from company annual reports, and country-level data from public sources. Thus, our theoretical and empirical approach differs from Wang et al. (2014) which examines parent-centric decision-makings and autonomy delegation to foreign subsidiaries as an enabling mechanism for EMNEs; however, they use data from a survey with HQs executives of Chinese parent firms.

Second, our work advances the literature of subsidiary strategies because many of the previous studies only focus on how multinational subsidiaries adapt to host country institutional environments (Kostova & Roth 2002; Luo, 2001, 2003). Given that EMNEs originate from unique and complex institutional environments, we explicitly delineate their foreign subsidiaries' strategies as responses to home country government support, domestic institutional weaknesses, and state ownership. Furthermore, our analysis on the influence of state ownership on subsidiary strategies is a new and interesting contribution, because this phenomenon has been largely neglected in the existing literature. Our study provides insights into the role of state ownership in enforcing EMNEs' competitiveness or aggravating their disadvantages in international markets.

Third, we extend the I/R framework by analyzing it in the context of EMNEs' subsidiaries. While the I/R framework emphasizes the dual achievement of global integration and local adaptation for advanced economy MNEs, it might be challenging for EMNEs due to their lack of managerial skills in coordinating and managing a geographically dispersed network of foreign subsidiaries (Fan, Nyland, & Zhu, 2008; Morck, Yeung, & Zhao, 2008; Rugman & Li, 2007). Our study is among the first few attempts which investigate how EMNEs' subsidiaries balance integration and responsiveness as responses to domestic institutional advantages and disadvantages. Accordingly, we broaden the theoretical knowledge of the I/R framework by examining its implications on EMNEs.

2. Theoretical background

2.1. Subsidiary strategy of global integration and local responsiveness

Global integration is driven by economies of scale and scope, cost reduction, and resource intensity, in which MNEs standardize their production and distribution of homogenous products and services on a worldwide basis. In contrast, local responsiveness is the ability of MNEs to understand local market variations in consumer tastes, and demands in segmented markets, and to respond to different national standards and regulations imposed by autonomous governments and agencies (Bartlett & Ghosbal, 1989; Prahalad & Doz, 1987).

On the one hand, subsidiaries pursue global integration strategy by relying on parent-firm FSAs developed in home countries, which are internationally transferred at low cost and without substantial adaptation in host countries (Rugman & Verbeke, 1992, 2001; Rugman & Verbeke, 2008; Rugman, 2002). Global integration is consistent with the view that parent firms' FSAs are critical resources in overcoming the liabilities of foreignness, i.e. additional costs and risks of doing business abroad (Rugman & Verbeke, 2008; Rugman, 2002).

On the other hand, subsidiary strategy literature emphasizes that FSAs can be developed by both parent firms and by foreign subsidiaries (Nguyen & Rugman, 2015a, 2015b; Rugman & Verbeke, 2001; Rugman et al., 2011). Subsidiary initiatives defined as discrete and proactive undertaking of the subsidiary advances are new ways for the MNE to use or expand its resources (Birkinshaw, 1996, 1997; Birkinshaw & Hood, 1998). Foreign subsidiaries access complementary resources in host countries and create new

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