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International Business Review 15 (2006) 53–67
INTERNATIONAL BUSINESS REVIEW
www.elsevier.com/locate/ibusrev

Roles of foreign owned subsidiaries in a small economy

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Received 15 September 2004; received in revised form 16 June 2005 and 21 September 2005; accepted 29 September 2005

Abstract

This study explores the roles and characteristics of foreign owned subsidiaries in a small economy within a trading block. Four role types of foreign owned subsidiaries are identified: local satellite, truncated miniature replica, export platform, and the regional or world mandated hub. Evidence is provided on the sales focus of foreign owned subsidiaries in the Dutch electronics and electrical applications industry. We find that almost half of the foreign owned subsidiaries focus their sales on more markets than just the Netherlands. These subsidiaries use the Netherlands as an export base. They supply the European market with products that are produced in one location, instead of using multiple production plants. The results show that these subsidiaries with a non-European parent are relatively young and focus also on manufacturing activities.
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Keywords: Sales foci; Subsidiaries; MNE; Small economy; EU; Electronics industry

1. Introduction

The developments in the international economic environment have induced many multinational enterprises (MNEs) to adopt new approaches to competing worldwide. These changes have major implications for the roles played by their subsidiaries in individual host countries. As competition in many industries becomes increasingly global, managers have found that import-substituting subsidiaries—focussing on the supply of national markets—have

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0969-5931/$ - see front matter © 2005 Elsevier Ltd. All rights reserved.
doi:10.1016/j.ibusrev.2005.09.005

become less viable. Instead, in most industrial sectors, especially in electronics and pharmaceuticals, marketing and sales activities are now located in one particular host country to serve a broader market, for instance the European market (Calliano & Carpano, 2000). MNEs that want to stay competitive in the regionalizing or globalizing markets have to make the most effective use of their worldwide assets. Consequently, ownership-advantages are no longer solely developed at the corporate headquarters and leveraged abroad to a network of subsidiaries (Birkinshaw & Hood, 2000; Taggart, 1998). Instead, as these foreign owned subsidiaries grow in size and develop their own unique resources, they themselves become important sources of competitive advantage for the MNE. Therefore, subsidiaries are no longer seen as pipelines to move products. Their own special strengths can help to build competitive advantages for the entire MNE (Bartlett & Ghoshal, 1986). Consequently, the role of the subsidiaries in host markets has frequently shifted from import-substitution towards an export-oriented strategic position in the MNE group's global network (Birkinshaw & Hood, 1998; Papanastassiou & Pearce, 1994). Some subsidiaries even develop into centres of excellence, controlling vital resources that other parts of the MNE depend upon (Holm & Pedersen, 2000).

In recent years increasing attention has been focused on the relationship between the MNE's headquarters and its foreign subsidiaries, particularly on how the subsidiaries evolve from both a conceptual and empirical perspective (Birkinshaw, Holm, Thilenius, & Arvidsson, 2000; Hedlund, 1986; O'Donnell, 2000; Prahalad & Doz, 1987; Roth & Morisson, 1992). This research provides an understanding of how international activities have subsequently developed. Due to globalisation, regional integration and technological developments, foreign owned subsidiaries are taking on an increasing variety of roles. Whereas foreign owned subsidiaries began as 'market access' operations for selling the MNE's products in the host country, most now also perform a geographically-dispersed set of value adding activities (Birkinshaw et al., 2000). Instead of only supplying products to a host market, MNEs increasingly have the option of allowing individual subsidiaries to make positive use of the potential of export orientation to supply a much wider regional or global market (Pearce & Papanastassiou, 1997; Yip, 1994).

Given this background, this study aims to classify foreign owned subsidiaries in terms of the degree of the value added scope of activities and the market scope under which they operate and to evaluate the typology against a number of key characteristics of foreign owned subsidiaries including the location of the parent, the overall strategic choices of the parent, and the age and size of the subsidiary. In the literature, it is well established that the roles of foreign-owned subsidiaries vary according to such contingencies as the identity of the parent and the structural context imposed by the parent (Bartlett & Ghoshal, 1986; Birkinshaw & Morrison, 1995; Hedlund, 1986; Porter, 1986). However, studies are inconclusive on the impact of the subsidiary's age on its role within the MNE. And there is continuing debate concerning the influence of subsidiary's size, although the balance of evidence indicates a positive relationship between subsidiary size and international sales focus.

In this study, we take a closer look at the role and the characteristics of the foreign owned subsidiary in a relatively small host market. It involves the classification of foreign owned subsidiaries according to the value added scope of activities and the market scope. Evidence is provided from the Netherlands, a small country that is part of a larger regional economic entity, namely the European Union. Although small and therefore potentially unattractive as a location for MNE subsidiaries, the Netherlands has managed to attract considerable FDI flows, amounting to an inward FDI stock of 351 billion Euro by 2003 (DNB, 2004). This makes the Netherlands the fifth largest recipient of FDI in the world behind US, UK, China, and Germany, but ahead of most small developed economies. Due to its favourable location and active role

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