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Where Do We Go from Here?: Globalizing Subsidiaries Moving Up the Value Chain☆

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ABSTRACT

This paper studies the international expansion of local subsidiaries of multinational enterprises (MNEs). The main questions asked are why and how MNEs' local subsidiaries in developing economies undertake international expansion. Drawing from the global value chain (GVC) perspective, I argue that local subsidiaries that were initially established to undertake production activities for export-oriented industries do not want to remain at the lowest-value-added position forever. They therefore undertake initiatives to get out of that position. The literature on initiative-taking subsidiary has predominantly focused on them becoming centers of excellence via R&D and innovation in the host country. I propose a different route of local subsidiary upgrading via foreign direct investment in more advanced countries. This strategy helps not only to gain internal prominence within the MNE network, but also to improve its external position within the GVC vis-à-vis the lead firms. The paper uses an in-depth case study of a Thai subsidiary of a Taiwanese electronic MNE to explore the transformation of the subsidiary from simply manufacturing for exports to becoming a strategic international expansion arm for the parent MNE.

1. Introduction

The increasing significance of outward foreign direct investment (OFDI) from developing economies[1] is now a major feature in the global economy. Despite a 4 per cent drop in 2011, the share of developing economies in global FDI outflows remained the second highest level recorded at 27 per cent in 2011 (UNCTAD, 2012). The progressively active global participation of firms from developing economies puts more spotlights on their growth and development, and their subsequent internationalization. The literature on developing country multinational enterprises (DC MNEs) often assumes that the nationality of outward investing firms is the same as the home country of OFDI flows. As a consequence, the focus on types of DC MNEs is only restricted to private and state ownership of firms with the same nationality of that of the home country of FDI. Empirical evidence has revealed, however, that local subsidiaries of MNEs sometimes undertake direct investment out of their host countries (Chiao et al., 2008;

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[1] I follow the country groupings classification of the United Nations Statistical Office. Three main groupings are: developed economies, transition economies and developing economies. Developed economies refer to Organization for Economic Co-operation and Development (OECD) members (other than Chile, Mexico, the Republic of Korea and Turkey), plus the new EU members that are not OECD members (Bulgaria, Cyprus, Latvia, Lithuania, Malta and Romania), plus Andorra, Bermuda, Liechtenstein, Monaco, and San Marino. Transition economies refer to Southeast Europe and the Commonwealth of Independent States. Developing economies are in general all countries that are not specified above (see UNCTAD, 2012).

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Tan and Hwang, 2002). They have become another significant source of OFDI, in addition to locally-owned private and public enterprises. In my database of listed firms with OFDI activities (see Pananond, 2013), it is clear that the Thai subsidiaries of many MNEs undertake international expansion activities out of Thailand, not of their headquarters' country of origin.

The splitting up and globalization of production networks has been a key factor that integrates many emerging economies into the global economy through a variety of arrangements. MNEs from more advanced countries (AC) may set up local subsidiaries or outsource to local suppliers in developing economies to benefit from lower cost of production and to engage these firms in their global value chain (GVC). The subsequent development of local subsidiaries and local suppliers has often been attributed to benefits accumulated through interactions with AC MNEs. After having accumulated sufficient capabilities, many of these local firms undertake outward international expansion and become multinational themselves. The current IB literature has increasingly discussed the rise of locally-owned MNEs from developing countries. Not as much attention, however, is given to the internationalization of local subsidiaries, which also contributes to OFDI flows of many developing economies.

The outward investment of firms that started off as part of the MNE networks is particularly relevant to Southeast Asia. The region is well-known for its export-led development policy that has given rise to local firms that serve as subsidiaries or suppliers in many globally integrated sectors. Southeast Asian countries have long positioned themselves as export platforms for the world's leading multinationals, resulting in their success in attracting inward FDI from global players in numerous industries. This inward internationalization of the economy through inward FDI has contributed to the development of local firms and their subsequent outward international expansion. Pananond (2013) pointed out that many of the listed Thai firms that engage in OFDI started first as suppliers to or subsidiaries of MNEs from other countries. This phenomenon bears important implications on the current literature on subsidiary evolution literature and GVC, neither of which has paid much attention to possibility that local subsidiaries and suppliers in the GVC do not remain domestic-oriented forever.

This paper therefore explores the international expansion of a Thai subsidiary of a Taiwanese MNE. The main questions asked are why and how local subsidiaries of MNEs in developing economies engage in OFDI. Drawing from the GVC perspective, I argue that local subsidiaries that were initially established to undertake production activities for export-oriented industries do not want to remain at the lowest-value-added position forever. They therefore undertake initiatives to get out of that position. The literature on subsidiary evolution has predominantly focused on them becoming centers of excellence via R&D and innovation in the host country. I propose a different route of local subsidiary upgrading via foreign direct investment. This strategy helps not only to gain internal prominence within the MNE network, but also to improve its external position within the GVC vis-à-vis the lead firms. The paper uses an in-depth case study of Delta Electronics (Thailand)—DET, a Thai subsidiary of the Taiwanese Delta Group, to explore the transformation of the subsidiary from simply manufacturing for exports to becoming a strategic international expansion arm for the parent MNE.

The paper comprises five parts. The ensuing literature review sets up the research framework in the first part, while research methodology is addressed next. I then discuss the case of DET and the propositions derived from the case before concluding on the implications for future studies.

2. Literature review

Inward foreign direct investment by AC MNEs has been considered a key mechanism that allows local firms in developing countries to accumulate and upgrade their managerial and technological capabilities (Ivarsson and Alvstam, 2005). Such upgrading may result from intentional and direct transfer of technological and managerial capabilities from AC MNEs to their domestic partners or subsidiaries. Subsidiary evolution has long been a key topic in the international business literature. While the original thinking on subsidiary role may assume that subsidiary mandates are assigned by MNE headquarters (Bartlett and Ghoshal, 1986), later works have stressed the strategic importance of subsidiaries and focused more on how the role of subsidiaries may change over times (see Ambos et al., 2010; Birkinshaw, 1997; Birkinshaw and Hood, 1998).

The literature on subsidiary evolution builds on the position that subsidiaries are semi-autonomous entities that are capable of making their own decisions but constrained by headquarter demands and opportunities in the environment (Birkinshaw and Hood, 1998). Subsidiaries can undertake their own initiatives in order to enhance its strategic position vis-à-vis other subsidiaries of the MNE and other firms within the same industry (Birkinshaw, 1997; Birkinshaw and Hood, 1998). Proponents of this view commonly agree that subsidiaries enhance their position by becoming 'centers of excellence' through the process of knowledge creation and diffusion to other corporate units (Frost et al., 2002; Holm and Pedersen, 2000). This line of literature places emphasis on the contribution of subsidiaries' R&D intensity to knowledge creation, and subsequently, to the increasing power of R&D-active subsidiaries (Cantwell and Mudambi, 2005; Iguchi, 2010; Mudambi and Navarra, 2004).

Despite many insights, the above literature has been criticized for being overly reliant on data drawn from subsidiaries in developed economies, with a sophisticated level of host-country R&D infrastructure and knowledge. Chiao et al. (2008) argued that subsidiaries operating in developing countries that also have parent firms from developing countries might behave differently because of a greater autonomy DC MNEs grant to their networks of subsidiaries. Due to the parent firm's lack of sophisticated firm-specific advantages, DC MNEs may not exercise a tight control on their networks of subsidiaries the same way AC MNEs do. From their study of Taiwanese MNEs, the authors argued that subsidiaries of Taiwanese MNEs are allowed to be more autonomous in order to be more responsive to the local environment. Often, this could lead to subsidiary initiatives that are more geared toward the local market conditions. Subsidiary evolution could therefore be based on paths other than becoming R&D technological excellence centers for the MNE networks.