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The investment-divestment relationship: Resource shifts and intersubsidiary competition within MNEs

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ABSTRACT

This paper examines the interdependencies between MNE investment and divestment decisions. We derive a conceptual framework of "segmented intersubsidiary competition" and hypothesize that the competitive pressure of new investments on existing subsidiaries varies by regional dimension. Based on a database of 3524 French MNEs, we analyse intersubsidiary competition and intertemporal adjustment processes of the investment-divestment relationship between 2002 and 2010. Our empirical findings support the theoretical notion of segmented intersubsidiary competition within MNEs: Foreign investments create competitive pressure for foreign subsidiaries to be divested in subsequent periods, where domestic investments spur divestment at home. Inversely, foreign divestments are more likely to create new investment opportunities in the foreign than in the domestic arena. Our differentiations between investments/divestments in EU countries and in non-EU countries shows that the competitive pressure of new investments on existing subsidiaries is mainly limited to the same region.

1. Introduction

Global competition and faster business cycles require MNEs to continuously adapt their corporate strategy and structure. From a portfolio perspective, MNEs benefit from their flexibility of reallocating resources across their subsidiary network to increase the firm's efficiency and competitive advantage (Boddewyn, 1983; Feenstra & Hanson, 1997; Hamilton & Chow, 1993; Helfat & Eisenhardt, 2004). Thus, MNEs react to changing market opportunities by engaging in investment and divestment of subsidiaries to optimize their portfolio (e.g., Berry, 2010). From a subsidiary viewpoint, however, a portfolio restructuring causes competition with the subsidiary network. Additional subsidiaries can make existing subsidiaries partly sub-additive and redundant (e.g., Belderbos & Zou, 2009; Birkinshaw, Hood, & Young, 2005; Nachum & Song, 2011), thereby increasing the risk of subsequent divestment. Similarly, the divestment of a subsidiary can increase the intersubsidiary competitive pressure as resources are freed that might then be partly redeployed in existing or new subsidiaries (Helfat & Eisenhardt, 2004). Hence, in this paper we focus on the intersubsidiary competition by examining the interdependencies between investments and subsequent divestments as well as between divestments and subsequent investments.

According to Birkinshaw et al. (2005), MNE subsidiaries face both an external (outside firm boundaries) and an internal (inside firm boundaries) "competitive arena," in which subsidiaries need to defend their position and compete for survival. We build on Birkinshaw et al.'s (2005) notion of competitive arenas and propose further splitting the internal MNE environment into a domestic arena and a foreign arena because competition can vary within and across those arenas. For example, although MNEs are now more fact-based in their management of investments and divestments, domestic subsidiaries might still be expected to have a home turf advantage, due to closer HQ distance, different functions, and managerial ties (e.g., Boddewyn, 1983; Bouquet & Birkinshaw 2008; Davies, 2005; Sewing, 2010). Thus, domestic and foreign subsidiaries may constitute two distinct groups that compete with other. Applying our theoretical concept of *segmented intersubsidiary competition* allows us to empirically test whether competition between subsidiaries is larger within or across the foreign and domestic arena. The theoretical notion is further empirically tested in alternative operationalizations of arenas to provide a broader understanding of the type and extent of intersubsidiary competition.

There is a long stream of papers examining the internationalization process of MNEs. The traditional approach in the international business literature is to view these investment (or divestment) decisions as

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discrete, independent, and static (e.g., Head, Ries, & Swenson, 1995). In order words, each single event is examined without taking the repercussions and interdependencies within the MNE network into account. More recent approaches stress the need to view MNE decisions as continuous, interdependent, and dynamic as well as to consider the characteristics of the MNE's portfolio of subsidiaries (e.g., Nachum & Song, 2011) plus its capabilities explicitly (e.g., Song, 2002). However, empirical papers examining the link between an investment (or divestment) and subsequent portfolio changes are rare and the pioneering work of Berry (2010) is an exception. She finds that foreign investments result in domestic divestments, but she neglects intersubsidiary competition within the domestic or foreign arenas.

Our paper strengthens the portfolio perspective that investments and divestments are linked to each other and contributes to the literature on firm internationalization in three ways. First, building on the notion that subsidiary are in competition with each other, we present a more integrated framework that splits the competitive internal MNE environment into domestic and foreign arenas. Second, we apply this framework of the segmented intersubsidiary competition by examining the investment-divestment relationship within the subsidiary network. In a first step, we analyse to what extent previous investments can lead to subsequent divestments and whether the linkage is stronger within, rather than across, respective arenas. In a second step and analogously, we examine whether divestments entail more investment opportunities in subsequent periods within or across both arenas. The analyses enrich our understanding of the intertemporal direction of the investment-divestment relationship, thereby answering calls to examine MNEs' investments and divestments as a series of interconnected moves (e.g., Belderbos & Zou, 2007, 2009; Berry, 2010; Nachum & Song, 2011; Song, 2014). We provide robust evidence that the investment-divestment relationship is bidirectional, such that divestments can follow investments and vice versa. Third, given that MNEs and their foreign subsidiaries concentrate most of their sales and assets within the home region, we can assume that the competition between subsidiaries might be more pronounced within a region or within bloc of countries with similar factor endowments (Banalieva & Dhanaraj, 2013; Nguyen, 2015; Rugman & Verbeke, 2004).

2. Background and theory development

Investment and divestment decisions can be analysed from a flexibility and corporate portfolio perspective. A company can be viewed as a portfolio of assets, operations, and interdependent sub-units that is continuously assessed and restructured according to strategic, financial, and market considerations (Benito, 2005; Chow & Hamilton, 1993; Nachum & Song, 2014). In contrast to the portfolio of domestic firms, MNEs operate a global network of subsidiaries that provides greater flexibility and capabilities to respond to international market opportunities and cost arguments by shifting resources across their affiliates in different countries (Zou, 2007, 2009; Zou, 2007, 2009; Chung, Lee, Beamish, & Isobe, 2010; Kogut, 1985; Song, 2014). Resource shifts can range from an intersubsidiary relocation in functions, assets, employees, and operations within the current subsidiary network to an investment in new subsidiaries and the divestment of existing subsidiaries (Birkinshaw & Lingblad, 2005; Birkinshaw, 1996). The ability of MNEs to relocate resources within their portfolio, known as multinational flexibility, allows them to secure their competitive advantage and to maximize their overall efficiency (e.g., Allan & Pantzalis, 1996; Fisch & Zschoche, 2012; Kogut & Kulatilaka, 1994; Mata & Freitas, 2012).

For the HQ, it is not the absolute attractiveness of a single market or location that matters, but rather the relative attractiveness with respect to all other markets (e.g., Arregle, Beamish & Hébert 2009; Benito & Welch, 1997). HQs engage in an optimal resource (re)allocation that, however, can trigger competition for those resources within the subsidiary network i.e. an intersubsidiary competition. Any investment enlarges the subsidiary portfolio and overall capacity for the MNE, thereby simultaneously increasing the risk of redundancies within the subsidiary network and, hence, the likelihood of subsequent divestments (Belderbos & Zou, 2009; Haynes, Thompson, & Wright, 2003). New investments often employ modern machinery and equipment as well as more efficient technologies, production processes, and services, thereby threating the operations of existing subsidiaries.

The headquarters induces part of the intersubsidiary competition. In particular, the relationship between the HQ and its subsidiary can be characterized as follows: First, the HQ decentralizes activities and grants subsidiaries the autonomy to respond to local market conditions. However, HQ also designs and decides on the corporate global strategy, structure, and processes to guarantee an efficient (re)allocation of resources (Ghertman, 1988). Consequently, the resource allocation of the HQ might be suboptimal for a particular subsidiary. Second, the HQ-subsidiary relationship can trigger the principal-agent problem whereby the HQ (principal) has to realign the (conflicting) interests of its agents (subsidiaries) in order to maximize the company's overall efficiency and profitability (e.g., Kostova, Nell, & Hoenen, 2016). Third, the HQ functions as an internal capital market where earnings from the subsidiaries flow to the HQ, which in turn are partly redistributed within the corporate network (Birkinshaw, 2000; Haynes et al., 2003; Williamson, 1975). Finally, if subsidiaries have overlaps in operations, they become sub-additive and partly substitutable (or redundant) to the corporate portfolio (Belderbos & Zou, 2009). In sum, the HQ-subsidiary relationship evokes intersubsidiary competition for corporate resources, information, and support so that subsidiaries can defend their position within the MNE network (Lou, 2005).

For a better understanding of a firm's competitive environment, we draw on Porter's (1980, 1990) theory of competitive strategy. He shows that the competitive environment is not limited to immediate competitors but also includes suppliers, customers, and potential rivals. Birkinshaw et al. (2005) apply Porter's competition theory to the subsidiary level: Subsidiaries can be understood as semi-autonomous entities within the MNE, which face and respond to an external host-country environment and an internal firm environment. Birkinshaw et al. (2005) refer to these environments as the "external competitive arena" and the "internal competitive arena," respectively. The external competitive area consists of customers, suppliers, and competitors in the local and other markets. The internal competitive arena consists of subsidiaries that act as intrafirm customers, suppliers, and competitors. For example, a subsidiary becomes an internal customer (supplier) if it buys (sells) intermediate products or services from (to) other subsidiaries of the same MNE. The intersubsidiary relationship within an MNE is characterized to a varying extent by both cooperation and competition (e.g., Birkinshaw et al., 2005; Maurer, 2011).[1] Birkinshaw and colleagues refer to competitive arenas because subsidiaries, "fight to establish and defend advantageous positions, and ultimately secure competitive advantage" (Birkinshaw et al., 2005, p. 228; Birkinshaw, 2000; Young, Hood, & Peters, 1994), which in turn give rise to an intersubsidiary competition.

Building on Birkinshaw et al.'s (2005) concept of competitive arenas, we take a deeper look at the internal competitive arena and intersubsidiary competition. The MNE's subsidiary network can be quite large and heterogeneous in terms of geographical scope. Additionally, a further differentiation of the internal competitive arena might be necessary due to the dominance of the HQ and a potential home bias, expressed through lower physical distance and stronger cultural, linguistic and social ties with domestic subsidiaries (Boddewyn, 1983; Bouquet & Birkinshaw, 2008). For example, Bouquet and Birkinshaw (2008) emphasize that subsidiaries close to the HQ are

[1] *Competition* and *cooperation* are the two most fundamental forms of (intrafirm) relationships. Intermediate forms comprise *coopetition* and *independence*, which imply, respectively, the combination and the absence of competition and cooperation (see e.g. Maurer, 2011).