Title: Subsidiary Strategy: The Embeddedness Component

Introduction

Subsidiaries are paramount to Multinational Corporations (MNCs) performance. The study of their contribution to the overall MNC has evolved from a merely passive implementation of head offices mandates, towards a more pro-active and initiative-taking strategic behavior. Underlying this stream of research it prevails the idea that subsidiaries may enact its own strategy. However, this statement has not been made operative, which highlights a gap regarding theory on the intricacies of subsidiary strategy. This paper attempts to fill this gap through a novel conceptualization of strategy as affecting embeddedness.

For that purpose we built on the literature of subsidiary embeddedness and lean on a longitudinal case study of *Brakes Spain*. Andersson and Forsgren (2000) suggest embeddedness as a good predictor of the role a subsidiary may play in the overall MNC network. However, to our knowledge no framework has been developed to describe the particulars of this relationship. Our stance is that the strategic behavior a subsidiary can play could be traced down to their embeddedness consequences.

We provide examples from *Brakes Spain* to support the notion that subsidiary strategy can be deemed as enacting subsidiary embeddedness. We further propose that there are three types of embeddedness; namely, operative, capabilities and strategic embeddedness.

The Origins of Subsidiary Strategy

Subsidiaries play an important role in the performance of MNC. Surprisingly, some authors seem to suggest that subsidiaries may only contribute to corporate performance either in terms of their financial achievements or in the fulfillment of a concrete strategic role assigned from the center (Jarillo and Martínez, 1990). Increasingly, however, subsidiaries have been seen as active units, as sources of a MNC's competitive advantage, and providers of strategic initiative (Taggart, 1999). The main motivation for this shift was the emergence of alternative conceptions of the MNC in which all subsidiaries are contributors to a complex networked firm (Ghoshal and Bartlett, 1990; Hedlund, 1986; Nohria and Ghoshal, 1997). These models proposed that MNCs cannot be conceptualized as hierarchical, but rather as a puzzle whose pieces have to fit among each other. Thus, the different elements in a MNC, subsidiaries among them, need, complement, and nurture each other. As a consequence, the term "subsidiary strategy" started to be taken into consideration. Subsidiary development through initiative-taking is a rich strand of the literature that emphasizes the shift on strategic importance of these units. Subsidiaries are encouraged to be proactive in developing initiatives that add value, not only to their local operations, but to the parent's overall business (Birkinshaw, Hood and Jonsson, 1998; Delany, 2000).

All in all, the previous literature suggests subsidiary initiative-taking and self-involvement in the MNC's strategy. What is not clear in the existing literature is how the subsidiary actually defines its own strategy. The extensive effort the literature has made in developing subsidiary typologies has tilted our conception of subsidiary strategy towards a mere fulfillment of a role imposed by HQ. However, as the literature on initiative-taking suggests, the subsidiary can also behave autonomously and develop its own strategy.

Dimensions of Subsidiary Strategy

Accepting that a subsidiary may not only behave induced by HQ mandates, but also autonomously developing its own strategy (Birkinshaw, 1997; Birkinshaw *et al.*, 1998; Delany, 2000), we use Bartlett and Ghoshal (1991) typologies to disentangle the possible dimensions where subsidiary contribution occurs. In this sense, a subsidiary can develop its own strategy in three modes. First, it can reduce its activity to merely perform day-to-day activities such as manufacturing the products to be sold to the customers (implementer). Second, it can actually try to contribute to the development of MNC resources and capabilities that will develop and sustain MNC's competitive advantage (contributor). And finally, it can try to influence the development of MNC strategy by contributing to strategic ideas and development (strategic leader).

However, any strategic initiative a subsidiary may attempt is restricted by the limits imposed by the MNC. In this structural context, one key challenge subsidiaries must face is the demand for global integration together with local responsiveness (Prahalad and Doz, 1987). Kostova and Roth (2002) suggest that subsidiaries can hardly ever attain a completely autonomous behavior as they face "institutional duality". This concept means subsidiaries must balance the need to legitimate their position on the MNC context as well as on the country where they operate (Ghoshal and Westney, 1993). This task is generally problematic since local and MNC interests may diverge (Birkinshaw, Holm and Thilenius, 2000). Thus, subsidiary strategy is constrained by a particular set of relations that determines its context, i.e., by its level of embeddedness.

Subsidiary Embeddedness

Swedish scholars have done considerable work that shows how embeddedness determines the strategic behavior of subsidiaries (Andersson and Forsgren, 2000; Andersson, Forsgren and Pedersen, 1999; Forsgren and Pedersen, 1998). For instance, it has been argued that the influence of external counterparts, i.e., the level of external embeddedness, competes with HQs' desire to exercise control to integrate the subsidiary into the overall corporate strategy (Andersson and Forsgren, 1996). Should this be the case, the subsidiary will tend to take advantage of those privileged relations, bargain against the MNC, enjoy certain autonomy, and hence have more "space" to behave strategically.

In this line of reasoning, Birkinshaw and Morrison (1995) suggest that embeddedness is heterogeneous across subsidiaries. For instance, units that enjoy higher autonomy show a more internationally configured value-chain, which would suggest a high level of embeddedness within the MNC. This argument resonates with Andersson and Forsgren (2000), who suggest that in search of factors behind a subsidiary's status as a centre of excellence, external embeddedness seems to matter.

In summary, the level of subsidiary embeddedness seems to be a good predictor of how strategically a particular subsidiary will behave. However, to our knowledge no framework has been developed to describe the particulars of this relationship. Our stance is that the three strategic modes a subsidiary can play, i.e. implementer, contributor, and strategic leader, can not only be traced down to their embeddedness consequences but that subsidiaries can act on their level of embeddedness to enact subsidiary strategy

Embeddedness as Strategy

We will develop the concept of embeddedness as strategy. For that purpose we will lean on the case of *Brakes Spain* as an illustrative example. The authors from 1998 to 2003 have studied this firm longitudinally. It is a subsidiary of a MNC that manufactures brake systems. The selected subsidiary has had the higher Return on Sales among the units of the corporation for many years, which makes it an interesting case to be analyzed.

We propose that the subsidiary can affect embeddedness as part of its strategy. Subsidiary embeddedness, as the system of dependencies with other units of the MNC and the market in general, may be a vehicle for the strategy of the subsidiary. Embeddedness, is not only determined by the external factors surrounding the subsidiary, but also as the result of the efforts of the subsidiary itself to outstand as valuable in the overall MNC. Thus, subsidiary strategy can be deemed as enacting subsidiary embeddedness. We suggest that there are three dimensions of embeddedness, which the subsidiary can affect to increase its strategic importance.

First, o*perational embeddedness* is the set of relationships between the subsidiary and other units of the MNC that concern the day-to-day activities. MNCs coordinate their manufacturing operations worldwide. The result is a network where factories in one country act as suppliers or customers of factories in other subsidiaries. Thus, the operational activities give pace to a network of relations whose end is to keep operational day-to-day activities afloat. As an illustration, consider the manufacturing process at *Brakes Spain*. Its mass production process requests coordination among different units of the MNC and customers, in order to manufacture timely the different components of a particular brake system. These operational relationships with all the actors involved in the manufacturing process determined the operational embeddedness of the subsidiary.

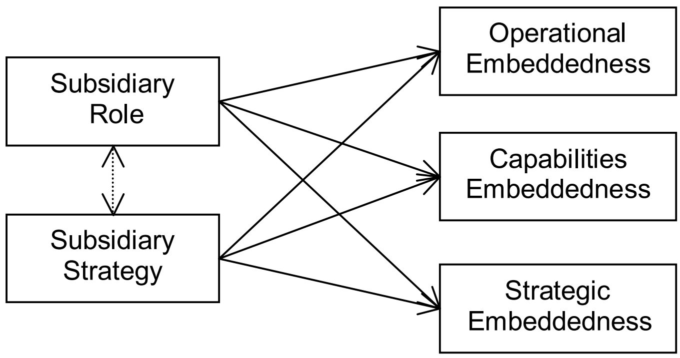
Second, *capability embeddedness* is the set of relationships between the subsidiary and other units of the MNC that refers to the development of capabilities that are relevant to the overall MNC. Unless subsidiaries do have a thoroughly defined role and responsibility, it is unlikely that the subsidiary alone is going to develop a worldwide applicable capability. However, when a subsidiary has developed a certain proficiency in some strategic capabilities it is usually called to develop those capabilities further and to contribute to the generation of company wide capabilities. The more the subsidiary develops these capabilities, the higher the chances of being called to spread them. Overall knowledge management processes will integrate the best actors to contribute to the different strategic capabilities of the multinational. For example, at *Brakes Spain* the task force to launch new products proved to outperform other subsidiaries. Its flexibility and efficiency in collaborating with other units and the customer proved to be valuable in terms of time to market. Once realized the effectiveness of this process, the MNC decided to clone it across the rest of the subsidiaries.

Third, *strategic embeddedness* is the set of relationships between the subsidiary and other units of the MNC that relates to the subsidiary's participation in the overall strategy of the MNC. Active participation of subsidiary members in the strategy process may influence the overall MNC's strategy trough a group of relations generated from the subsidiary. The more participation there is in the strategic process of the MNC, the more dependencies will be drawn between subsidiaries and HQ and between subsidiaries themselves. The more one particular subsidiary participates in this process, the more embedded it will be in strategic terms. Consider for instance the effect that *Brakes Spain* had on HQ through its involvement in the strategy of Asian expansion. In different European meetings, HQ claimed the importance of serving Asian customers. However, none of the subsidiaries of the MNC felt confident to overcome problems derived from cultural, geographic distance and language differences. At certain point in time, the strategy of expanding to Asian seemed impossible. Nevertheless, *Brakes Spain* pushed his commercial department harder and was able to start projects with one client in Japan and one in Korea, which was the first step to make the Asian expansion feasible.

Therefore, subsidiary actions are not limited to those of induced behavior from the parent. Managerial action may enact subsidiary strategy by changing its role within the corporate network. This may be particularly important when the strategy promoted by the MNC puts into danger the existence of the subsidiary itself. For example, a strategy that attempts to rationalize operations worldwide and close those units were the local labor wages are high, may find a response from the threatened subsidiary. This was the case of *Brakes Spain*. In 1998 they responded to the threat of becoming a mere operational facility by investing in a first class engineer department. This decision, made without the endorsement of HQ renewed the subsidiary into a crucial component of the MNC. From a population ecology point of view, organizational performance has been measured as survival. Consequently, organizations work in their niche for survival confronting external environmental change (Hannan and Freeman, 1977). Subsidiaries quest for survival implies the development of its own strategy within the limits imposed by the MNC. If operational activities, such as manufacturing, are subject to de-localization upheavals, subsidiaries that play a strategic role within the MNC may appear harder to be relocated, given their contribution to the overall MNC performance. These concepts are presented in schematic form in Figure 1.

Figure 1

Subsidiary Strategy and Different Types of Subsidiary Embeddedness



This scheme allows relating the strategic modes of a subsidiary and their types of embeddedness. Subsidiaries that act mainly as implementers may have a high operational embeddedness; contributors, on the other hand, may present a high capabilities embeddedness while strategic leaders would show high strategic embeddedness. Additionally, the subsidiary can enact its own strategy and change its role by affecting embeddedness. For example, an implementer may try to develop capabilities that are useful for the MNC as a whole. Then, it will alter its level of capabilities embeddedness by communicating to their colleagues how that particular capability is to be built and through coordination among different units.

The overall level a subsidiary may be capable of affecting the MNC's strategy will depend on how the subsidiary manages the three types of embeddedness. In turn, HQ can affect embeddedness in its three types through the assigned corporate role. The first can be viewed as the autonomous behavior of the subsidiary and the latter the induced behavior from HQ. The interplay between these two behaviors can explain the resultant strategy of the subsidiary.

Conclusion: Subsidiary strategy as affecting embeddedness

While traditionally the literature on subsidiary strategy has been focused on the role it plays within the multinational company. No work, to our knowledge, has operationalized the concept of embeddedness in concrete strategic and organizational issues. We introduce a new dimension on which subsidiary strategy can be enacted. The three dimensions of embeddedness that we propose correspond to three basic dimensions of subsidiary strategy. Thus, we are proposing a new dimension of subsidiary strategy that deals with managing the level of embeddedness in its operational, strategic and capability components. Although we do not claim to reduce all components of subsidiary strategy to managing its embeddedness level, aiming at parsimony we further develop the concept of embeddedness and make it a strategic variable to define subsidiary strategy.

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