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What determines MNC subsidiary performance? Evidence from China☆

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ABSTRACT

The paper challenges the view that MNC dictates a subsidiary's business strategy and operations in accordance with the integration-responsiveness (IR) framework. The paper integrates the IR framework with contingency theory to argue that a subsidiary needs discretion to craft its own effective business strategy in light of the environmental exigencies facing the subsidiary in the host country. It may do so at variance with the MNC's strategy. Evidence from China supports that subsidiary managers should take strategic initiatives in response to specific host country environment.

1. Introduction

Rapid growth of foreign direct investment is one of the most important developments in the past decades. In particular, more and more multinational corporations (MNCs) set up subsidiaries in emerging markets like Brazil, Russia, India and China and use them to implement their international strategy. A great deal of effort has been made to analyze different MNC's international strategies, and empirically investigate the impact of these strategies on the performance of MNCs and their subsidiaries (e.g., Bartlett & Ghoshal, 1987; Harzing, 2000; Prahalad & Doz, 1987; Prahalad, 1975). Research is lacking, however, on examining different subsidiary strategies at the business level, the impact of these strategies on subsidiary performance, and the dynamic interaction between subsidiary strategies and MNC's international strategies in influencing subsidiary performance.

Prior studies tended to apply the integration-responsiveness (IR) framework to the analysis of subsidiary strategy. These studies argued that subsidiary strategy is dependent on MNC's international strategy. This approach neglects the dynamic nature of subsidiary strategy and gives little discretion for subsidiary managers to take strategic initiatives in response to specific environment circumstances in the host country. To overcome this problem, we integrate the IR framework with contingency theory to allow subsidiary business strategy to respond to specific host country environment. The location-bound subsidiary business strategy interacts with strategic mandates from MNC headquarters in influencing subsidiary performance. This allows for a proactive and dynamic role of subsidiary business strategy.

Previous studies used subjective measures for MNC's international strategy, subsidiary strategy, and subsidiary performance (e.g., Birkinshaw & Morrison, 1995; Jarillo & Martinez, 1990; Johnson, Mirchandani, & Tsang, 2008; Lin & Hsieh, 2009; Roth & Morrison, 1990; Taggart, 1997, 1998; Yu, 2005). Although subjective measures have some advantages, they are prone to a variety of different types of biases, such as personal opinions and cognitive dissonance that affect the data collection process.[2] Moreover, these studies exclusively used very small samples owing to the difficulty in collecting subjective data through large-scale surveys. These biases are likely to lead to selection and estimation problems.[3] With the benefit of access to the Annual Survey of Industrial Firms conducted by China National Bureau of Statistics (CNBS), we used a data set that contains detailed input and output information of all MNC's subsidiaries that operated in

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2 Cognitive dissonance refers to an uncomfortable feeling caused by holding two contradictory ideas simultaneously. In social psychology, the theory of cognitive dissonance argues that cognitive dissonance is a source of subjective bias because people have a motivational drive to reduce dissonance by changing their attitudes, beliefs, and behaviours, or by justifying or rationalizing their attitudes, beliefs, and behaviours. This kind of biases is very likely to happen in the process of subjective data collection.

3 The sample contains, for example, 62 observations in Lin and Hsieh (2009); 351 observations in Johnson et al. (2008); 147 in Roth and Morrison (1990); 126 in Birkinshaw and Morrison (1995); 171 observations in Taggart (1997, 1998); 142 observations in Yu (2005); and 50 observations in Jarillo and Martinez (1990).

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Table 1
Typology of subsidiary strategy based on the IR framework in current literature.

Global integration	Local responsiveness	Transnational	Authors
Miniature replica	Rationalized manufacturer/product specialist	Global mandate	White and Poynter (1984)
Branch plant	Globally rationalized	World product mandate	D'Cruz (1986)
Implementer	Contributor	Strategic leader	Bartlett and Ghoshal (1987)
Autonomous	Receptive	Active	Jarillo and Martinez (1990), Taggart (1997, 1998), Yu (2005) and Lin and Hsieh (2009)
Local innovator	Global innovator	Integrated player	Gupta and Govindarajan (1991)
Implementer	Integrated	Global subsidiary mandate	Roth and Morrison (1990)
Local implementer	Specialized contributor	Global subsidiary mandate	Birkinshaw and Morrison (1995)

China and reported to CNBS. This allowed us to construct objective measures for a large sample of subsidiaries (Tian, 2010).

Our paper is organized as follows. In the next section, we explain the necessity of integration of the IR framework with contingency theory in research on the relationship between MNC's international strategy and subsidiary business strategy. In Section 3, we propose some hypotheses for empirical investigation. In Section 4, we describe the methodology and data used in hypothesis test. In Section 5, we discuss the findings of the study. Section 6 concludes the paper.

2. Theoretical analysis

Research on MNC's international strategy has been profoundly influenced by the integration-responsiveness (IR) framework that is based on two pressures faced by MNCs (Bartlett & Ghoshal, 1987; Prahalad & Doz, 1987; Prahalad, 1975). First, globalization forces MNCs to integrate business activities across national borders; and second, cross-border diversity requires MNCs to respond to specific needs of each national market. MNC's international strategies are, therefore, classified into global, multi-domestic (localization), and transnational (multifocal) strategies according to how MNCs deal with the two pressures. The IR framework was later extended to the analysis of different strategies of MNC's subsidiaries and business units. Many researchers classified subsidiary strategies into three basic categories entirely in accordance with the three main MNC's international strategies of the IR framework. Table 1 illustrates the terms that researchers have used for the three categories of subsidiary strategies and the corresponding three MNC's international strategies.

Some researchers further supplemented the IR framework with other frameworks to illustrate specific content of subsidiary business strategies. Roth and Morrison (1990) used the framework developed by Miller (1987) to distinguish between four subsidiary business strategies: complex innovation, marketing differentiation, breadth and conservative cost control. They stated that the four subsidiary business strategies are influenced by the three MNC's international strategies of the IR framework. A key argument of the IR framework is that a global strategy is adapted to achieve efficiency gains; a multi-domestic strategy is used to achieve differentiation; and a transnational strategy is implemented to achieve both (Prahalad & Doz, 1987).[4] Proponents of the IR framework have developed three theoretical predictions on the relationship between subsidiary business strategies and MNC's international strategies: (1) subsidiaries that pursue a global strategy face the pressure for global integration and therefore rely on efficiency for high performance; (2) subsidiaries that pursue a multi-domestic strategy face the pressure for local responsiveness and rely on differentiation for good performance; and (3) subsidiaries that pursue a transnational strategy rely on a mixture of efficiency and differentiation for high performance as they face these two pressures simultaneously.[5] Significant progress was made by Hanson, Dowling, Hitt, Ireland, and Hoskisson (2008), who followed the framework developed by Porter (1985), to distinguish between five subsidiary business strategies: cost leadership, differentiation, focused cost leadership, focused differentiation, and integrated cost leadership/differentiation. Although they advocated Roth and Morrison (1990)'s deterministic view, they cautiously warned that there might be a possibility that the subsidiary business strategies are only partially based on the three MNC's international strategies of the IR framework.

In this paper, we move a step further to take a clear departure from the IR perspective. We integrate the IP framework with contingency theory to explain the relationship between MNC international strategy and subsidiary business strategy. Contingency theory is a class of behavioural and organizational theory that relates organizational behaviour to external environment factors. According to contingency theory, organizations are open systems that need not only to satisfy internal needs but also to adapt to external environmental circumstances. There is no one best way of organizing. The appropriate organization strategy depends on the kind of task or environment an organization faces (Lei & Slocum, 2013). Managers must be concerned with achieving alignments and fits between their organization and environmental circumstances. Different organizational approach and strategies are needed in different types of environments. Since its birth in the 1960s, contingency theory has developed into one of the most influential theoretical frameworks in management science, and inspired such new theoretical frameworks as the dynamic capability perspective in the resource-based tradition (Sirmon, Hitt, & Ireland, 2007).

From a contingency perspective, we believe that a MNC and a subsidiary face different environment circumstances. They have to adapt their strategy to respective environment circumstances to survive and succeed. A key difference between a MNC and a subsidiary is that a MNC operates in multiple countries. It has to respond to environment circumstances in all the countries in which it operates, whereas a subsidiary operates in one country and needs to respond to the environment exigencies of the particular country. MNC's international strategies are formulated to achieve alignments and fit between the MNC and its multinational environment. MNC's international strategies at the corporate level are primarily concerned with how to address competition issues related to all MNC's subsidiaries and business units located in different parts of the world. These strategies can be analyzed with the IR framework. In contrast, subsidiary business strategies are primarily concerned with how to deal with

[4] In explaining the IR framework, Bartlett et al. (2008, pp. 199, 205) illustrate this assumption very clearly. They argue that global integration aims for "benefits that largely translate into lower costs" while local responsiveness aims for benefits "that result from the country-by-country differentiation of products, strategies, and activities." Transnational strategy "recognizes each of these traditional approaches is partial" and tries to gain all the benefits simultaneously.

[5] These were explained clearly by Roth and Morrison (1990, pp. 548–550) when they discussed business-level strategies in international business.

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