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Subsidiary autonomy and performance in Japanese multinationals in Europe

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ABSTRACT

Notwithstanding the growing body of research on headquarters–subsidiary relationships, the conditions under which subsidiary autonomy leads to enhanced subsidiary performance is still a subject of debate. This study adopts a contingency approach and investigates the effects of external uncertainties and intra-MNE coordination on the performance benefits of subsidiary autonomy. The empirical analysis is based upon cross-sectional data collected from 88 European subsidiaries of Japanese MNEs. Our findings show that subsidiary autonomy has a greater impact upon performance (a) under conditions of technological uncertainty; and (b) when expatriate involvement is high, as the subsidiary can reap the full benefits of entrepreneurial capabilities and enjoy resource interdependencies through interactions with the parent simultaneously. MNC executives should aim for an appropriate balance between subsidiary autonomy and these internal and external factors so that the subsidiaries achieve superior performance.

1. Introduction

Over the last two decades, the effect of greater subsidiary autonomy on subsidiary performance has been an important theme in international business research (Gammelgaard, McDonald, Stephan, Tüselmann, & Dörrenbächer, 2012; Gomez & Werner, 2004; McDonald, Tüselmann, Voronkova, & Dimitratos, 2005; McDonald, Warhurst, & Allen, 2008; Slangen & Hennart, 2008). Much of the extant research has reported that, as value-creating activities within the multinational enterprises (MNE) become increasingly diversified and complex, the headquarters is under pressure to configure and coordinate the headquarters–subsidiary relationship by granting a considerable degree of authority and influence to overseas subsidiaries (Birkinshaw & Morrison, 1995). It is broadly agreed in the literature that foreign subsidiaries should take the initiative and play more strategic leadership roles in winning their own local markets (Birkinshaw, Hood, & Jonsson, 1998; Roth & Nigh, 1992). However, a rapid increase in global interdependence within a group of subsidiaries still calls for certain parent commitment to coordinate and mobilize unique assets and capabilities within the MNE (Bartlett & Ghoshal, 1989) and to develop subsidiaries' innovation-related competencies (Ciabuschi, Dellestrand, & Martín, 2011). In this vein, headquarters involvement in an overseas subsidiary's actions and functions remain essential for maximizing the potential benefits of multinational integration (Björkman, Barner-Rasmussen, & Li, 2004; O'Donnell, 2000; Roth and O'Donnell, 1996). For MNE executives, it is important to understand better how to appropriately align cross-border coordination mechanisms in the headquarters–subsidiary relationship with the growing dual pressures of customization for the host market (Holtbrügge, 2005) and strategic efficiency in the MNE (Ambos, Asakawa, & Ambos, 2011).

This paper addresses a simple question: does subsidiary autonomy improve the performance of MNE subsidiaries? There exists a substantial body of empirical evidence on the relationship between subsidiary autonomy and performance – see the discussion in the next section – but all these studies have assumed a simple, direct relationship. The main contribution of this paper is to propose a contingency approach, drawing upon both agency and transaction cost theory, to suggest that the autonomy–performance relationship is moderated both by environmental uncertainties and by internal coordination mechanisms within the MNE. An additional contribution is that the empirical analysis uses a sample of European subsidiaries of Japanese MNEs, whereas most of the existing research (e.g. Ambos & Birkinshaw, 2010;

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Gammelgaard et al., 2012; Gomez & Werner, 2004; McDonald et al., 2005, 2008; Slangen & Hennart, 2008) has focused on the performance benefits of subsidiary autonomy in Western multinationals. With the exception of Asakawa (2001), little is known about the performance benefits of subsidiary autonomy in Asian multinationals, despite their rapid internationalization around the globe. We show that a high level of autonomy is more favourable when technology is changing rapidly and unpredictably. The empirical evidence further indicates that the effectiveness of subsidiary autonomy in promoting the performance of overseas subsidiaries is enhanced under high levels of expatriate involvement.

This paper is structured as follows: The next section reviews the relevant literature and formulates two hypotheses for testing. In Section 3, we detail how we have collected the data for the empirical analysis, explain how we have operationalized the variables in the regression model, present some descriptive statistics, discuss the possible impact of common method bias, and outline our estimation methodology. Section 4 describes the empirical results. The penultimate section highlights the contribution and implications of the research, and also discusses the limitations of the study and identifies possible avenues for future research. Finally, we conclude in Section 6 with some brief comments about the conclusions from the study.

2. Literature review and hypothesis development

The decision about the appropriate balance between centralized parental control over MNE foreign subsidiaries and subsidiary autonomy has been one of the most challenging tasks for practitioners (e.g., Brooke, 1984; O'Donnell, 2000; Young & Tavares, 2004). This section presents a brief review of the arguments for and against subsidiary autonomy, and offers some insights into the potential performance benefits of subsidiary autonomy.

Subsidiary autonomy is a complex concept to define and measure (Young & Tavares, 2004) and many studies over the last two decades have treated subsidiary autonomy and MNE decentralization synonymously (Brooke, 1984; Nell & Andersson, 2012; O'Donnell, 2000). In this paper, we adopt the perspective of subsidiaries, and consider subsidiary autonomy as the degree to which the subsidiary possesses decision-making power vis-à-vis its parent companies in terms of strategic, functional, and operational areas (O'Donnell, 2000; Taggart & Hood, 1999). It implies that subsidiary managers have more managerial discretion for choosing the way to leverage firm-specific resources, such as technology, knowledge, finance, and human capital. Bartlett and Ghoshal (1989) assert the strategic importance of subsidiary autonomy in managing headquarters–subsidiary relationships. They claim that overseas subsidiaries relying solely on a central unit may find it difficult to exploit local market opportunities due to lack of local responsiveness. In a similar vein, Luo (2003) asserts that subsidiary independence leads to the appropriate alignment of business strategies and local market conditions (e.g., competitors, customers, legal institutions). Various authors have suggested that greater autonomy encourages subsidiaries to foster organizational learning (Luo, 2003), stimulates knowledge creation and diffusion (Young & Tavares, 2004), promotes headquarters-subsidiary cooperation (Birkinshaw, Holm, Thilenius, & Arvidsson, 2000), and fosters strategic leadership and initiatives (Birkinshaw et al., 1998) which contribute to corporate-level competitive advantage. It has also been reported that distributed decision-making authority facilitates product adaptation (Ambos & Birkinshaw, 2010) and marketing differentiation (Claver-Cortés, Pertusa-Ortega, & Molina-Azorín, 2012). Delegating decision-making power to local subsidiary managers provides an incentive for them to feel more responsible for the success of the firm (Mirchandani & Lederer, 2008) and allows companies to respond properly and reactively to changing customer needs and preferences, progressing product cycles, and intensifying competition (Bartlett & Ghoshal, 1989). Indeed, most of the extant empirical literature – see Table 1 – finds a positive relationship between subsidiary autonomy and performance.

However, several authors have challenged on theoretical grounds the contention that greater subsidiary autonomy necessarily gives rise to better subsidiary performance. Mudambi and Navarra (2004) suggest that autonomy increases the subsidiary's ability to appropriate rents, this leads to inferior performance. Birkinshaw et al. (1998) argue that autonomy serves to trigger a reduction in global integration, which may prevent the subsidiary from identifying specialized resources within the MNE network. Similarly, Keupp, Palmié, and Gassmann (2011) claim that the expansion of autonomous subsidiary activities leads headquarters to confront high control and coordination costs, and ultimately creates the risk of subsidiary isolation.

Notwithstanding the empirical evidence in Table 1, therefore, there is still debate about the exact nature of the relationship between subsidiary autonomy and MNE subsidiary performance. We suggest that this relationship is moderated by, on the one hand, the uncertainty of the external environment in which the firm is embedded and, on the other hand, the internal coordination mechanisms within the MNE.

2.1. Environmental uncertainty

To date, the environment-contingency view has provided important insights into the moderating role of environmental heterogeneity in the performance outcomes of marketing strategy innovativeness (Atuahene-Gima, Li, & De Luca, 2006), employment flexibility (Lepak, Takeuchi, & Snell, 2003), entrepreneur leadership (Ensley, Pearce, & Hmieleski, 2006), discretionary corporate responsibility (Goll & Rasheed, 2004), and organizational learning (Luo & Peng, 1999). However, the previous research has devoted little attention to the moderating effect of environmental uncertainty on the relationship between the subsidiary's decision-making autonomy and performance of foreign direct investment (FDI).

We suggest that the potential benefits of a relaxation of parental control outweigh the costs, particularly in times of environmental uncertainty (Andersen, 2004a, 2004b). Drawing upon organization theory, Andersen (2005) argues that the optimality of a non-hierarchical decision-making structure is determined by the diversity of structural and environmental circumstances. Ruekert, Walker, and Roering (1985; 14) propose a contingency theory of structure and performance in marketing, and posit that "a highly bureaucratic structure may lead to efficient, low cost orientation, but it is not likely to be very adaptive or innovative". Claver-Cortés et al. (2012) suggest that, in times of environmental uncertainty, a loosely decentralized structure could meet reactive communication and coordination needs, consequently facilitating decision-making processes. Luo (2003) asserts that, when corporate level management leave more options open to local subsidiary managers, autonomy triggers the development of self-coping mechanisms to deal with environmental turbulence.

The contingency approach has received empirical support in prior scholarly work. For example, Chang and Harrington (2000), in their computational design of a retail chain, propose a model wherein the effectiveness of units' decision-making authority increases according to the level of environmental heterogeneity. Andersen (2004a) found that firms that encourage middle-level managers to participate in strategic decisions in times of environmental uncertainty report better economic performance.