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Subsidiary capability upgrading under emerging market acquirers

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ABSTRACT

This article leverages a case study of a recent Chinese acquisition in the United Kingdom to explore the upgrading of capabilities in the subsidiaries in developed countries acquired by emerging market multinational enterprises (EMNEs). The seemingly implausible upgrading phenomenon is explained by the EMNEs' complementary assets, their GVC lead firm positions and the unique power relationship between the acquirer and acquired firms, which enable the EMNEs to 'impel' upgrading and encourage 'co-learning' in their acquired subsidiaries. The contributions to the literature on EMNEs, global value chains, and organizational learning are outlined and discussed.

1. Introduction

There has been a recent surge in research on the outward foreign direct investment (OFDI) activities undertaken by emerging economy multinational enterprises' (EMNEs), including their acquisitions made in developed countries (Buckley et al., 2007; Tung, 2007, 2017; Gubbi, Aulakh, Ray, Sarkar, & Chittoor, 2010; Hennart, 2012; Williamson & Raman, 2011). Most of the research on EMNE acquisitions in developed countries has focussed on their knowledge-seeking motives and on how parent firms acquire strategic assets to enhance their own capabilities and competitiveness (for example, see Awate, Larsen, & Mudambi, 2015; Gubbi et al., 2010; Hansen, Fold, & Hansen, 2016; Meyer & Peng, 2016; Yang & Deng, 2017). Indeed, the emergent view is that EMNEs adopt a 'light touch' approach to their western acquisitions (e.g., Liu & Woywode, 2013) so as not to disrupt the superior capabilities of the acquired targets.[1] However, we know very little about whether and how the acquired advanced firms also benefit in terms of capability upgrading and learning (Govindarajan & Ramamurti, 2011; Rui, Cuervo-Cazurra, & Un, 2016). This paper seeks to fill this void, taking advantage of a rare access to both an EMNE parent firm and its acquired subsidiary in a developed country.

The Global Value Chain (GVC) literature acknowledges that upgrading is affected by the governance structure of and power relationships in the value chains. However, in this literature, firms are largely treated as black boxes (Kadarusman & Nadvi, 2013), with little understanding of firm-level learning in the upgrading process (Morrison, Pietrobelli, & Rabellotti, 2008; Hansen et al., 2016). In addition, in both the management and GVC literatures, the empirical narrative is dominated by the subsidiaries or suppliers of developed economy MNEs (DMNEs) (e.g., Birkinshaw & Hood, 1998; Cantwell & Mudambi, 2005; Corredoira & McDermott, 2014; Ivarsson & Alvstam, 2011; McDermott & Corredoira,2010), with very little being said about upgrading in EMNE subsidiaries. Above all, the extant literature has a contextual bias towards developing country firm upgrading and provides a rather static and unidirectional view of capability upgrading, focussing on its antecedents but lacking a multidirectional understanding of subsidiary upgrading during and after the acquisition. Based on the above, this paper aims to answer the following research question: *how and why can subsidiary firms in developed countries upgrade their capabilities under emergent acquirers?*

In this paper, we cross-engage different disciplinary strands to achieve a deeper understanding of upgrading in EMNE acquired subsidiaries. In particular, we draw upon the GVC, international business and organizational learning literatures to unlock the 'black box' of the upgrading process, paying special attention to the underlying learning process and the role played by the EMNE parent firms.

This research is based on the case study of a recent Chinese acquisition in the United Kingdom (UK). The results demonstrate that multiple types of capability upgrading (product, process, functional, and inter-sector) had taken place in the subsidiary. The underlying learning process reveals a dual role played by the EMNE acquirer firm, that of an '*impeller*', which was associated with its global value chain lead firm

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position and complementary assets, and that of a '*co-learner*', which was associated with EMNE 'liability of emergingness' (Madhok & Keyhani, 2012) and with the relatively balanced power relationship between the acquirer and acquired firms.

This paper makes a number of contributions. Empirically, it responds to the call for 'phenomenon-based research' (Doh, 2015) by presenting a detailed study of the seemingly unlikely phenomenon of the upgrading of capabilities occurring in a technologically advanced firm in a developed country after it had been acquired by an EMNE. This paper contributes to the study of EMNEs in a number of ways. In particular, it reveals how an EMNE can leverage its unique capabilities, strategies, and GVC lead firm position and shape the upgrading process in an acquired, technologically advanced subsidiary in a developed country. Taking an interdisciplinary approach, this study is one of the first to examine the much needed learning effect and development impact of EMNE investments in developed countries (Buckley, Doh, & Benischke, 2017; Govindarajan & Ramamurti, 2011; Luo & Tung, 2017; Rui et al., 2016). In addition, it contributes to the study of EMNE power (Sinkovics, Yamin, Nadvi, & Zhang, 2014). The contribution made by the EMNE acquirer firm as a source of knowledge and learning in a global value chain and the power it exercised in the upgrading process challenge the conventional wisdom that sees EMNEs as mere learners and beneficiaries of knowledge transfer from developed economies. This paper also contributes to the GVC and organizational learning literatures by building a connection between firm-level learning and upgrading outcomes but also by revealing how the learning process is induced and shaped by firm strategies and characteristics.

2. Theoretical foundations

2.1. Capability upgrading

Subsidiary evolution is a persistently key topic in international business and strategy (e.g., Birkinshaw & Hood, 1998; Cantwell & Mudambi, 2005; Dhanaraj & Beamish, 2009; Enright & Subramanian, 2007). Much of the subsidiary evolution literature, however, has tended to narrowly focus on the visible mandate of the subsidiary—with an emphasis on change in the hierarchy of roles or functions such as marketing, production, and development—or a simple two stage mandate evolving from competence-exploiting to competence-creating (e.g., Cantwell & Mudambi, 2005; Collinson & Wang, 2012; Dörrenbächer & Gammelgaard, 2006, 2016; Schmid & Schruig, 2003).

The extant subsidiary evolution literature has therefore tended to reduce subsidiary development to a change in the charter or mandate of the subsidiary without much discussion of its underlying capabilities. In this study, in order to capture capability development in a more comprehensive fashion, we adopted the capability upgrading definition given in the GVC literature. This literature specifies four types of upgrading: *product upgrading,* by which firms move into more sophisticated product lines, thus increasing unit values; *process upgrading*, by which firms enhance their efficiency by re-organising their production processes or by introducing superior technologies; *functional upgrading,* by which firms climb to new functional areas in the value chain, such as design or marketing; and *inter-sector upgrading,* by which firms move horizontally into new sectors involving new production activities that exploit their existing competences (Giuliani, Pietrobelli, & Rabellotti, 2005; Humphrey & Schmitz, 2002a). We believe that the GVC literature's definition of capability upgrading enables a more comprehensive understanding and examination of the phenomenon, affording the ability to capture capability development beyond functional upgrading.

2.2. Learning, subsidiary capability upgrading, and EMNEs

In the discourse of the GVC literature, upgrading involves organizational learning to improve the positions of firms in global production networks (Gereffi, 1999). Developed against the backdrop of increasing DMNE lead firm outsourcing of peripheral and often low-value activities to developing countries, the GVC literature views the capability upgrading of firms and industries in developing countries as the result of learning opportunities exploited by local producers inserted into global value chains via DMNE lead firms that are assumed to possess superior technologies and knowledge (Gereffi, 1999; Marin & Giuliani, 2011). The idea is that both upgrading and knowledge transfer are affected by the governance structures of the value chains; i.e., the nature of the relationships that exist among the various value chain participants.

The classic GVC frameworks place governance structures on a continuum of relationships between global lead firms and other value chain participants—one that ranges from loose to very tight, with arm's-length market relations at one extreme and hierarchical ones at the other—with two or three more network-based governance structures in between. The GVC literature further argues that these governance structures dictate what, how, when, and how much is produced, offering different upgrading opportunities to local producers connecting with GVCs (Gereffi, 2005; Humphrey & Schmitz, 2002a). Lead firms may, for example, set and enforce product parameters and monitor compliance to process standards (Humphrey & Schmitz, 2002b). They may also exercise their 'normative power' by "*shaping expectations of how business should be organised, how quality should be assessed, or guidelines to be followed*" (Gereffi & Lee, 2016, 28). A key tenet of the GVC literature is that lead firm power and the way it is exercised vary in different governance structures, implying different upgrading prospects for other value chain participants. Indeed, a large volume of empirical studies has documented upgrading success and failure in different governance structures and various industries—including apparel, automotive, horticulture, and electronics (see, for example, Gereffi, 1999; Marin & Giuliani, 2011; Sturgeon, 2002; Tokatli, 2007).

The aforementioned insights notwithstanding, the GVC literature suffers from a lack of understanding of the firm-level learning processes that underpin the upgrading outcomes (Hansen et al., 2016), and the extant literature tends to "*reduce learning to the transfer of specific kinds of technological know-how or knowledge about technologies and products*" (Herrigel, Wittke, & Voskamp, 2013, 111). Above all, much of that literature has focussed on the upgrading processes found in DMNE-dominated value chains (e.g., Corredoira & McDermott, 2014; Ivarsson & Alvstam, 2011; Khan & Nicholson, 2015; Marin & Giuliani, 2011; Sturgeon, 2002; Tokatli, 2007). Little attention has been paid to the upgrading of participants in EMNE-led value chains in spite of the fact that we may, however, observe different upgrading mechanisms there because of the EMNEs' unique characteristics and of the different power relationships found in such value chains. Below, we review studies from some cognate disciplines to gauge a way of solving these issues.

In our effort to establish a link between firm-level learning and upgrading, we were particularly inspired by some recent studies. For example, in their study of technological upgrading in foreign subsidiaries in Thailand, Hobday and Rush (2007) paid particular attention to firm-level motivations, barriers, and inducements to upgrading, as well as to decision-making in subsidiaries. Investigating how a Chinese firm upgraded to a lead firm position in the global biomass power plant industry through international acquisition, Hansen et al. (2016) studied the micro-level dynamics of technological changes in firms—including the establishment of R&D units, the recruitment of engineers, and the establishment of experience-collection procedures—at the same time, observing the social conditions for knowledge transfer—including working practices, and trust and communication patterns. Herrigel et al. (2013) studied upgrading in supply chains in the automotive and machinery sectors with an emphasis on mutual learning processes in upgrading, which may involve 'communities of practice' (Brown & Duguid, 1991) and collective reflection and experiment. In the spirit of these previous studies, we floated the idea that upgrading involves organizational learning to improve the position of firms in global