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**Utilizing Location advantage to develop a contributing subsidiary role**

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ABSTRACT OF THE MASTER'S THESIS

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Abstract <p>Location advantage is an importance incentive for a multinational enterprise (MNE) to set up subsidiaries in a foreign country. However, whether such location advantages are fully utilized during the subsidiary operation?</p> <p>The purpose of this study is to analyse how the subsidiary can make use of the changing location advantage and continue to grow. It tries to find out whether the subsidiary succeeds to meet its original expectation during its development. And if not, what should be done to make sure the previous location advantage is actually converted to the MNE's competence.</p> <p>The research method is qualitative by doing a case interview with the headquarter of an MNE based in Finland. The qualitative empirical study helps to provide deeper understanding of the eclectic paradigm and subsidiary development as well as the analysis made in this study. As the study emphasizes the continuous development of both location advantage and subsidiary competence, the qualitative research shows different events in the subsidiary's history.</p> <p>The finding made in the study shows that there is a continuous cycle between subsidiary development and the configuration of location advantage, headquarter-subsidiary relationship and the subsidiary character itself. In particular, the normative integration is the key in achieving a suitable configuration. Location advantage is the important link in making sure the subsidiary development will continue, therefore, the location advantage should be perceived as changing and dynamic to seek the growing subsidiary role.</p> <p>The finding suggests the MNE to pay more attention on recruitment and training to achieve high normative integration, which will prevent lots of potential conflicts. In addition, the location advantages should be consistently monitored and evaluated to be prepared to respond timely.</p>			
Keywords Location advantage, normative integration, subsidiary development			
Additional information			

## CONTENTS

1. THE INTRODUCTION .....	3
1.1 Introduction to this study .....	6
1.2 The study Goal and research questions .....	8
1.3 Key concepts .....	10
1.4 Previous research .....	12
1.5 Research method .....	14
1.6 The expected contribution of the study .....	16
1.7 The structure of the study .....	16
2. UTILIZING LOCATION ADVANTAGE IN SUBSIDIARY DEVELOPMENT .....	18
2.1 The eclectic paradigm .....	18
2.1.1 The classical OLI model .....	18
2.1.2 The importance of location advantage .....	20
2.2 Factors influencing subsidiary development .....	21
2.2.1 The contextual environment .....	21
2.2.2 The structure of headquarter-subsidiary relationship .....	25
2.2.3 The subsidiary itself .....	27
2.2.4 Configuration to promote subsidiary development .....	31
2.2.5 The relationship from the view of both headquarter and subsidiary .....	33
2.3 Developing subsidiaries by location advantage .....	35
2.3.1 Applying eclectic paradigm in subsidiary development .....	35
2.3.2 Utilizing the location advantage .....	37
2.4 Theoretical framework .....	43
3. METHODOLOGY .....	46

3.1 Case study as a research strategy .....	46
3.2 Selection and description of the case .....	49
3.3 Methods of data collection .....	51
3.4 Methods of data analysis .....	56
4. EMPIRICAL STUDY .....	59
4.1 Introducing case company .....	59
4.2 Case study about the headquarter and subsidiaries in China .....	61
4.2.1 Location advantage in Chinese offices .....	64
4.2.2 The headquarter-subsidiary relationship .....	69
4.2.3 The subsidiary itself .....	73
4.3 Findings on utilizing the location advantages in China .....	75
4.3.1 The changing location advantages .....	75
4.3.2 Building the suitable headquarter-subsidiary relationship .....	78
4.3.3 Choosing the suitable subsidiary manager .....	82
4.3.4 Understanding the utilization of location advantage through case study .....	85
5. CONCLUSIONS .....	91
5.1 Conclusion of the study .....	91
5.2 Theoretical implication .....	95
5.3 Managerial implication .....	96
5.4 Limitation of the study and the suggestion of the future study .....	97
REFERENCES .....	100
APPENDICES	
Appendix 1 Framework for interview .....	106

## FIGURES

Figure 1. Roles for national subsidiary (Bartlett & Ghoshal 1986) .....	28
Figure 2. A framework for a differentiated fit between subsidiary context and structure (Nohria & Ghoshal 1994) .....	32
Figure 3. Subsidiary development flow .....	45
Figure 4. Three dimensions of research (Dubois & Gibbert 2010) .....	46
Figure 5. Organization structure of Company T (company website) .....	61
Figure 6. Revised subsidiary development flow .....	86

## TABLES

Table 1. Strength and weakness of interview and documentation (Yin 2003, 86) ..	53
Table 2. Secondary data summary .....	55
Table 3. Detailed description of the secondary data .....	55

# **1 THE INTRODUCTION**

## **1.1 Introduction to this study**

The Multinational Enterprises (MNEs) have played an increasingly important part in the world economy as the globalization is progressing, leading to a sharp increase in foreign direct investment (FDI). FDI has risen from \$ 7.5 trillion in 2001 to \$ 20.4 trillion in 2011 worldwide, almost triple in ten years (UNCTAD's report of Inward and Outward foreign direct investment stock, annual, 1980-2011). With the development of MNEs, theories also evolve correspondingly from mere criticism to thorough analysis. Initially the MNEs were believed to function upon structure imperfection, which leads to inefficiency. Later on, the transaction cost theory pointed out the market imperfection and claimed the MNEs will actually more efficiently transfer the valuable assets, especially knowledge, inside the firms (Forsgren, 2002). Thus the critical analysis toward MNEs began to decrease and overall research from different perspectives of MNEs began to prosper.

Subsidiaries, as a member in MNE's network, controlling part of MNE's resource and its interdependency with other relevant partners, largely decide the performance of MNEs, thus attract many research interests from subsidiaries' role, the subsidiaries' relationship with headquarter to the subsidiaries development (Forsgren & Holm. 2002).

To set up the local unit in a foreign country is a very committed way to participate in the

internationalisation with the aim to fully obtain the location advantage residing in the specific environment. The great investment and the higher risk consequently mean the decision and strategy related to subsidiary is of great importance to the MNEs' performance. With the increasing complexity of environment and MNE's internal structure, the focus of studies on subsidiaries already shifted somewhat from the location selection and entry mode to relationship between headquarter and subsidiary and its dynamic development. Mostly explained in the network theory, in order to get access to the external resource, the MNE needs to establish a position in the market network while a subsidiary would be important foothold for headquarter to build connection with local counterparts. Consequently the relationship between headquarter and subsidiary influences whether the network of subsidiary and local industry can be efficiently incorporated into the global network of MNE.

Dunning (1980) argued that the location advantage combined with MNE's ownership advantage will decide the MNE's advantage to serve the foreign market and overcome the cost of foreignness. And the form of involvement is especially dependent on the location advantage. To set up a subsidiary, the equity-intensive involvement, implies that the location advantage is especially attractive for MNE. Then whether the subsidiary has made the full use of location advantage and contributed to the MNE as supposed initially? Researchers have reached consensus that the local environment, headquarter-subsidiary relationship and subsidiary itself will largely decide the subsidiary role and development (Enright 2007, Birkinshaw 1998, Birkinshaw 1995). To develop a more contributing role of subsidiary requires a fit between local environment, headquarter-subsidiary relationship and subsidiary itself. With the combination of compatible

headquarter-subsidiary relation and subsidiary character itself, the environment, especially the location advantage deriving from the environment will be fully explored to promote a contributing subsidiary role.

Specially speaking, several location advantages received more attention from previous studies, namely the linkage to key resource or embeddedness to local network (Frost 2002, Benito and Groggaard and Narula 2003, Gammelgaard 2011), the local competition (Birkinshaw 1998, Holm 2005, MILLER & EDEN 2006) and the innovation or local R&D capability (Cuervo 2003, Ghoshal 1988, Pan 2007). However, the previous research about the subsidiary development is mainly about how to adjust the headquarter-subsidiary relationship to match different environments and subsidiaries without detailed analysis on these location advantages that are especially important for MNEs recently. Thus it would be interesting to study how the subsidiary can benefit by trying to utilize the location advantages.

## **1. 2 The study Goal and research questions**

The goal of this study is to analyse the relevant factors that can help to develop a contributing subsidiary role. The subsidiary role and initiatives are jointly influenced by the configuration of environment, headquarter-subsidiary relation and the subsidiary itself with more attention paid to environment recently due to the complex and dynamic local market (Benito and Groggaard and Narula 2003, Birkinshaw 1998, Paterson 2002, Cuervo 2003). In eclectic paradigm, the location advantage, combined with ownership advantage and internalization advantage, explains the MNE's incentives to go internationalisation

while location advantage may give rise to further ownership and internalization advantage (Gaspar 2011). Consequently when the location advantage is fully explored, the change in the environment may lead to change in the subsidiary role in return by enabling or inhibiting certain capability development (Enright 2007), resulting in more contributing subsidiary role.

The researches mentioned above have covered the influence of the configuration of environment, headquarter-subsidiary relationship and subsidiary itself on the subsidiary role and initiative. Empirical studies have been made to support that the subsidiary role and initiative will be determined by such configuration and subsidiary performance will be promoted when there is a fit between the environment, headquarter-subsidiary relationship and the subsidiary itself (Nohria & Ghoshal 1994). Environment, especially location advantage specific to certain location is definitely an essential factor in deciding subsidiary development. Eclectic paradigm also attributes the location advantage as one of the incentives for MNE's internationalisation. Special focus would be given to location advantage when trying to find out the compatible configuration of headquarter-subsidiary relationship and subsidiary itself in order to achieve the fullest utilization of location advantage and consequently leads to a more contributing subsidiary role. Thus the research question in the paper should be:

How the location advantage could be effectively utilized through configuration of headquarter-subsidiary relationship and subsidiary itself to develop a more contributing subsidiary role?

To break the research question into more specific questions, three sub-questions should be addressed in this study, ie:

Sub-question 1: What kind of headquarter-subsidiary relationship can help to utilize the location advantage?

Sub-question 2: What kind of subsidiary character is desirable to better utilize the location advantage?

Sub-question 3: How a better utilization of location advantage can lead to a more contributing subsidiary role?

### **1.3 Key concepts**

Several concepts need to be clarified before more detailed analysis is carried out. Location advantage refers to the advantage that is specific to certain location and can be available for all the local actors (Dunning 1980, Gaspar 2011). A tradition categorizing of location advantage include market size, natural resources, aspects of the infrastructure, the education, system, governance structures, and other aspects of political and government activity (Rugman 2010). The common early motivation for MNE's internationalisation related to location advantage is to secure the key supplier or to search for new market. However, the new motivation turns to be the access to new technology, scarce information and diverse geographic portfolio (Bartlett & Ghoshal, 2002).

It is worth mentioning that the operation in different locations will give rise to new ownership advantage and MNEs' way to react to location advantage may influence the attractiveness of internalizing foreign operations (Gaspar 2011). Such a facilitating effect of location advantage can be readily seen in MNE's increasing bargaining power with host country government due to its flexibility in allocating activities in different countries. Generally a broad view of location advantage is recommended to include not only the location-bound resources but also the location factors' influence on MNE's ability to acquire and exploit the ownership advantage (Dunning 2001). One perfect example of such kind is the local embeddedness, which will be analysed in detail later.

Another concept that requires further explanation is the contributing subsidiary role. Researches related to subsidiaries have evolved from headquarter-subsidiary relationship to subsidiary development and to subsidiary role in 90s. In this study, the contributing subsidiary role is not the role of contributor defined by Bartlett (1986). Instead, the contributing subsidiary role is more related to subsidiary initiative and consequently the subsidiary's performance and contribution to the MNE as a whole. While the performance may be more easily measured in financial terms, the contribution to MNE as a whole also involves its role of learner and contributor of knowledge accumulation through MNE (Pan 2007) . However, the subsidiary role theory will be discussed briefly as well because the different subsidiary roles actually epitomize different configurations of external environment and subsidiary competence, also representing various level of subsidiary development. The black hole and implementer subsidiary are usually less contributing subsidiaries while the contributor and strategic leader subsidiary are usually able to

contribute more to the MNE. Under no condition the contributing subsidiary role should be limited by the typology of these four kinds of subsidiaries.

Several criteria should be present in identifying the contributing subsidiary role. First, the subsidiary should have a strong capability or specialized resource. Second, such higher than average competence should receive formal recognition from headquarter. That is to say the subsidiary competence should be in line with the MNE's overall strategy. In practise, expected profitability, sales volume and market shares can be used as the measurable index (Andersson 2002).

#### **1.4 Previous research**

The eclectic paradigm, built upon the international market failure, draws on the three sets of advantages of MNEs, the ownership advantage (O), the location advantage (L) and the internalization advantage (I) to explain the MNE's incentive as well as the form to go internationalisation. Location advantage, which include various factors ranging from the natural endowment to political environment, is especially influential to the form of MNE's involvement in the foreign market (Dunning 1980, Dunning 2001, Gaspar 2011).

The eclectic paradigm is especially good at analysing the location advantage not just because it covers a wide range of factors in Location advantage, but also because it views the location advantage in a dynamic way. In the eclectic paradigm, the ownership advantage (O), location advantage (L) and internalization (I) advantage will be influenced

by each other. In particular, the location advantage will give rise to new ownership advantage by providing access to key resource in related firms in coalition (Dunning 2001). On the other hand, the location advantage will also have positive influence on the internalization advantage through its broad geographic portfolio. One such example is the flexibility in allocating its activities globally, leading to a high bargaining power with host government (Forsgren 2002). By taking such a developing view toward location advantage, the changing condition in the subsidiary development process can be monitored and adjusted continuously, ensuring a thorough research of the benefits a foreign location can provide to the subsidiary.

Another popular stream in the International Business field is about the relationship between headquarter and subsidiary and combined with the environment and subsidiary itself, jointly decides the subsidiary development (Enright 2007). The analysis on the environmental influence more or less coincides with the location advantage in the eclectic paradigm, providing the link to analyse how the location advantage can promote a more contributing subsidiary role. On the other hand, the analysis of headquarter-subsidiary relationship and subsidiary character itself lead to a comprehensive framework to study the subsidiary development. In particular, the headquarter-subsidiary relationship worth careful examination due to the emergence of new organizing way in MNEs. Besides, the headquarter-subsidiary relationship and subsidiary character are elements that are under the control of either headquarter or subsidiary, making it practical for MNEs to take corresponding steps to utilize the location advantage.

When such relationship is examined, hierarchy and heterarchy are commonly used to

describe the two types of headquarter-subsidary relationships. In traditional hierarchy structure, formal regulation is used to guide the behaviours of both headquarter and subsidiaries while in heterarchy structure, normative integration is repeatedly used in organizing the MNE's activities (Ghoshal & Bartlett 1988, Bartlett & Ghoshal 1986). Autonomy is an key factor that is deemed to be influential in distinguishing hierarchy and heterarchy, but empirical studies fail to reach consensus on the relationship between autonomy and subsidiary performance (Frost 2002, Ghoshal 1988, Scott & Gibbons 2011, Majcen 2009). Some new researches turn their attention to headquarter's investment to subsidiary, which claims to have a direct boost on subsidiary performance (Frost 2002). No matter how the headquarter-subsidary relationship varies, some research argued that the quality rather than the type of control matters (Birkinshaw 1995). These are all the main aspects that need to be covered in analysing the headquarter-subsidary relationship.

The emphasis on subsidiary is relatively new in this stream of research as researchers will tend to ignore or underestimate the role played by subsidiaries in the MNE. With the increasing emphasis on the local environment, subsidiaries are also believed to be able to grow the organization itself without the support of headquarter (Paterson 2002). Entrepreneurship is an critical element in subsidiary development (Birkinshaw 1998 & 1997).

### **1.5 Research method**

A case company will be interviewed to carry out qualitative research. The three factors in

deciding subsidiary roles, namely the environment, the headquarter-subsidiary relationship and subsidiary itself will be examined in details by interviews. Due to the background of the author of this article, a subsidiary located in China will be chosen so as to obtain deeper understanding of the host country environment and closer contact with the subsidiary managers. According to Rugman (2011), one subsidiary may have different roles based on the different value chain activities, thus the empirical research should not simply base on subsidiary level. In case of different subsidiary roles and development in different functions or product lines, the sub-subsidiary level study should be carried out to provide a context-specific result.

Ideally, interviews will be carried out with both headquarter and subsidiary to get complete and deep understanding about each's view on the headquarter-subsidiary relationship. The utilization of location advantage should be mainly a headquarter consideration at the formation of subsidiary, however, during the development of subsidiary competence, the subsidiary will also form many ideas regarding the location advantage. When talking with subsidiary, special focus should be made to the subsidiary's perception about their relationship and how the subsidiary takes initiative. Only the interview with subsidiaries will give the first-hand information about the subsidiary's character itself and subsidiary's view on the headquarter-subsidiary relationship. However, difficulties can be predicted for both headquarter and subsidiary to talk frankly about the shortcoming in their relationship.

## **1.6 The expected contribution of the study**

This study will draw strength from two important theory streams in International Business, the eclectic paradigm and the subsidiary development. Both of the theories attribute great weight to the environment when explaining the MNE's internationalisation and performance. The location advantages are important impetus for MNEs to go internationalisation, especially in setting up subsidiaries with such high investment and risk. Meanwhile, the environment is also deemed to be an essential factor in deciding the subsidiary's contribution to the MNE as a whole. The study tries to find out how the location advantage can be fully used to obtain the largest possible subsidiary contribution. Specially speaking, the result is expected to be the deeper understanding of the fit between environment, headquarter-subsidiary relationship and subsidiary itself that can boost the utilization of location advantage and eventually lead to a more contributing subsidiary role.

Theoretically speaking, to make use of both eclectic paradigm and subsidiary development researches, the environment's importance and the measures to make better use of location advantage will be studied in a new angle, leading to supplement to both of the theories and a thorough understanding about the location advantage.

## **1.7 The structure of the study**

The next chapter will introduce the theoretical background of this topic. Previous research will be summarized to give a general understanding about what has already been proven in this sector. First comes the eclectic paradigm, laying the foundation for the research in

geographic importance. Then the subsidiary development and headquarter-subsidiary relationship will present the configuration of environment, headquarter-subsidiary relationship and subsidiary itself as the determinants for subsidiary performance. The key part of this study is to analyse how to better utilize the main location advantage by achieving the optimal configuration with the headquarter-subsidiary relationship and subsidiary itself.

Chapter 3 will introduce the methodology of this study, to qualify the use of the qualitative research approach and the case study method. The character of this study is listed in the chapter to explain why it is proper to employ such research method. In addition, it describes the case company and its compatibility for the aim of this study. The summary of data collected in the case study is shown as well.

Chapter 4 will present the empirical study. The case study will be carried out through interviews with both headquarter and subsidiary. The approach of qualitative research will be employed to gain in-depth understanding on the relationship of subsidiary performance and location advantage utilization. The first-hand experience will help to understand the assumption reached in the previous chapter better.

The last chapter will summarize the result of the study and possible contribution in both theoretical and managerial fields. The future research direction will be suggested based on the weakness of this study.

## **2. UTILIZING LOCATION ADVANTAGE IN SUBSIDIARY DEVELOPMENT**

### **2.1 The eclectic paradigm**

#### 2.1.1 The classical OLI model

The eclectic paradigm, drawn upon several related researches in foreign operation, such as the market failure, enlisted the ownership advantage (O), location advantage (L) and internalization (I) advantage to explain the incentive and form of MNEs' foreign operation. The boarder between different national markets impedes the market's function to exchange goods and services. The emergence of knowledge economy enlarges such inefficiency in international market due to the nature of public good and intangibility of the technology (Forsgren, 2002). As a result, MNE emerges as an alternative way to integrate horizontally the different national markets and virtically the various value chain activities into the organization.

According to Dunning (1980), the level of ownership advantage possessed by MNE and the location advantage in the foreign country decide the inducement of the MNE to engage in the international operation. Ownership advantage measures the assets that MNE can create for itself, most obvious of which is the size of the large MNE and the economy of scale as a result. The core ownership advantage, somehow, lies in the intangible asset, such as the patent, technological knowhow and the managerial experience.

Location advantage refers to the advantage that is specific to the location, but is available

to all players in the location. A broad definition of location advantage was given in the eclectic paradigm, including market size, natural resources, aspects of the infrastructure, the education system, governance structures, and other aspects of political and government activity (Rugman 2010).

The last strand of eclectic paradigm is internalization advantage. Instead of the contractual activities, the MNE choose to exploit the ownership advantage and location advantage on its own so as to secure complete control and achieve the scale economies and higher integration while avoiding the mistrust and risk with external players. Only when such three advantages (OLI) are present will the MNE choose to engage in the international production. Meanwhile, the configuration of ownership advantage, location advantage and internalization advantage explains the form and extent of MNE's foreign production in a context-specific condition (Dunning 2001). Thus the set of OLI advantage functions is based on different industries and countries, which is also a location-specific element.

Four motives of FDI are identified in the Eclectic paradigm, namely the resource-seeking, market-seeking, efficiency-seeking and strategic asset-seeking (Rugman 2010). Both resource-seeking and market-seeking FDI are largely explained by the strong location advantages, in particular the natural resource, the cheap labour force, favorable host country government policy, the access to local market and the special cluster network. Efficiency-seeking FDI is organized to rationalize the foreign operations in order to achieve the cost efficiency. In this case, the location advantage in host country, such as factor endowment and government policy are important. The asset-seeking FDI concerns the knowledge-related assets in particular, which will largely concentrate in the developed

countries, thus presents an obvious geographical character.

Owing to the reduction of spatial transaction cost, the market-seeking FDI is in sharp rise, pushed by subsidiaries that rooted firmly in the host countries. Meanwhile, the asset-seeking FDI shows rapid growth as well. Though considered to be a weak form of FDI as acquisition of desired asset is out of MNE's control (Rugman 2010), the emergence of intellectual capital has made it necessary for MNE to develop new competence from new assets rather than exploiting old asset (Dunning 1998).

### 2.1.2 The importance of location advantage

Not just the location advantage alone attracts the MNE, but also its reinforcing effect with the ownership advantage appeals to MNE. Though time lag exists, the present location advantage will lead to new ownership advantage in the future. For example, ownership advantage can be generated by MNE from international present, such as the price transferring or bargaining power of MNE with host country government due to its flexibility in allocation operation between countries (Forsgren 2002). The ownership advantage, even if considered alone, depends not only upon those internally generated, but also upon MNE's competence to seek out, harness and influence the innovation, price and quality of assets of other institutions with which they have an ongoing cooperative relationship (Dunning 2001). Therefore, the location advantage deserves more in-depth researches.

In addition, new development in the global economy also demands a closer look at the

location advantage. Until 1950s, most studies attributes the motives of FDI to market-seeking and asset-seeking. Now more attention has been given to clustering activities, which will lead to concentration of economic activities in certain country. Consequently the role of government has been acknowledged by providing a favorable institutional framework and facilitate such network (Dunning 1998). Knowledge-intensive assets and learning experience, which usually concentrated in advanced industrial countries, are highly valued by MNEs as an important way to augment their existing ownership advantage.

As it can be shown, the location element covers a broad range of variables, has reinforcing effect on the ownership advantage and further on the internalization advantage, and provide the contextual environment to apply the eclectic paradigm as well (Bartlett & Ghoshal 1986). Given the latest development of global economy, the location configuration of MNE's activities can itself be an ownership advantage or be able to augment its existing ownership advantage. Thus the structure and content of an MNE's location configuration is critical for its global competitiveness (Dunning 1998).

## **2.2 Factors influencing subsidiary development**

### **2.2.1 The contextual environment**

The range of MNE's operation expands from adjacent countries to the distant countries both geographically and psychologically. Previously, subsidiaries' influence was assumed to be limited to local environment when headquarter plays a global role in deciding the MNE's worldwide operation. But it is not the case anymore (Mahlendorf 2012). As the

dual pressures for local responsiveness and low cost become eminent, such center-for-global structure is increasingly invalid and a stronger subsidiary role is needed (Bartlett & Ghoshal, 2002). Some subsidiaries began to take a more strategic role while others still remain their implementer function depending on subsidiary's specific environment and own competence and resources.

Some MNEs, even though are aware of such differentiated role of subsidiaries, still employ the unified formal administration system and allocate same autonomy and authority to subsidiaries in decision making. As subsidiaries are increasingly interdependent and global dispersed and each subsidiary's external link with host country varies, the headquarter-subsidiary relationship need to be tailored to match such difference. Failing to realize this point and instead treating all the subsidiaries in a uniform manner as a mere implementor will largely affect the efficiency in the MNE's international operation and increase conflict between headquarter and subsidiaries (Mahlendorf 2012, Schmid & Schurig 2003).

Environment is crucial in differentiating subsidiaries because the role of subsidiary is seen as a function of local environment (Birkinshaw 1998). Many studies regard environment as a critical element in deciding the subsidizing performance and roles (Frost 2002, Benito & Groggaard & Narula 2003, Enright 2007, Paterson 2002), which can be analyzed using many variables. Environmental complexity explains the interdependency and interaction in the network of related players in a national market as well as the development pace. A high environmental complexity will typically have rapid technological growth and fierce competition (Ghoshal & Nohria 1989 ). Similarly, the local density were used to describe

the competition in the host country (Holm 2005, MILLER & EDEN 2006). A high local density means the intense competition and the liability of foreignness and the obstacle MNEs face in their foreign operation will decrease. In such a dynamic and competitive environment, the global learning may not be that important anymore while the global efficiency and differentiation matter (Grewal Chandrashekar & Dwyer 2008, MILLER & EDEN 2006). This result coincides the idea that the increasing environmental complexity will cause higher interdependency within MNE as each unit alone is more vulnerable (Ghoshal & Nohria 1989).

Another feature of the environment shows the attractiveness of the specific market, such as the local resource (Ghoshal & Nohria 1989; Ghoshal & Bartlett 1988), and the local importance (Bartlett & Ghoshal 1986, Nov/Dec 1986). Such attractiveness are categorized as the location advantage in the eclectic paradigm. At macro level, the resource endowment and institutional condition will define a location's advantage while at micro level, the cluster effect has positive influence on firm's performance (Frost 2002). Actually such linkage to key actors and scarce resource in the specific location has drawn much attention from researchers ( Frost 2002, Benito, Groggaard and Narula 2003). Such linkage will provide access to the valuable resource or information, so that MNE can gain additional advantage without necessarily own new asset. Besides, such advantage obtained through network is relatively inimitable and unsubstituable (Andersson 2002).

The rich local resource is proven to facilitate the creation and diffusion of innovation within MNE (Ghoshal & Bartlett 1988). On the other hand, it causes the interest of headquarter and subsidiary to diverge, resulting in more conflicts when both parts try to

attain more power in its own interest (Scott & Gibbons 2011). Interestingly, many studies treat the abundant local resource as a challenge rather than an opportunity, probably because the benefit of local resource is self-evident, while how to handle the relationship with such local units is an even tougher question. How to deemphasize the direct control, how to empower the local unit and allow them to participate in the whole organization's decision making are repeatedly studied by several articles (Bartlett & Ghoshal 1986; Bartlett & Ghoshal, 2002; Hedlund 1986; Bartlett & Ghoshal, 1997). Such subsidiary abundant in local resources is usually strategically important subsidiary, facing higher level of coordination and control as headquarter deems them critical for the MNE's whole operation (Rao 2012). Therefore, when considering the location advantage of the subsidiary, more attention should be paid to the managerial challenges that come as a consequence.

Special interests are paid to the development in the environment that calls for greater involvement of subsidiaries in the strategic formulation (HEDLUND 1980, Stephan 2011, Mahlendorf 2012). For example, the increasing local government involvement, especially in the developing countries, leads to their great influence in shaping the environment. As the subsidiary's contact with local government becomes important, to formulate the strategy from the top is less viable. On the other hand, the emphasize on the local response may lead to another extreme, the polycentrism, when each subsidiary has enough autonomy to make own decision. It would become problematic once the strategic field of different subsidiaries overlap without the central coordination from headquarter. MNE's advantage comes from wide geographical presence to gather resource and more importantly new knowledge; subsidiaries, acting as means to assimilate dispersed

resources and knowledge embedded in the local market, the location advantage, will take a more influential role in the headquarter-subsidiary relationship (Schmid & Schurig 2003).

### 2.2.2 The structure of headquarter-subsidiary relationship

In response to the various environment a subsidiary is located, MNE develops new characters of headquarter-subsidiary relationship instead of retaining all strategic functions in the headquarter and treating the subsidiary as an implementer only. The hierarchy and heterarchy represent two major types of headquarter-subsidiary relationship. Hierarchy exists from the origin of MNE. The organization in hierarchy mode is organized by bureaucratic control and headquarter retains most of decision making authority. In contrary, heterarchy is characterized by the dispersed resource and decision making authority, lateral linkage among subsidiaries and normative integration as the main measure to secure control over the organization (Birkinshaw 1995).

Hierarchy and heterarchy were different in many aspects, the most common one is normative integration (Ghoshal & Bartlett 1988; Ghoshal & Nohria 1989). Other dimensions that are used to capture the characters of headquarter-subsidiary relationship include the formalization, centralization in managerial structure (Ghoshal & Nohria 1989), which defines the boundaries for managerial discretion, and affects employee's behaviour (Mahlendorf 2012), and the dispersal and specialization in the resource distribution among subsidiaries (Ghoshal & Bartlett 1990).

The headquarter-subsiary relationship's influence on the subsidiary role and performance is also supported by many studies. For example, according to Birkinshaw (1998), the headquarter-subsiary relationship will direct the behaviour of subsidiary managers and imperative of whole company. Enright (2007) went even further by arguing that some subsidiary role may not reflect the quality and capability of subsidiary, instead, it is the result of internal power coalition between headquarter and various subsidiaries.

It is worth pointing out that the most suitable headquarter-subsiary relationship under given condition is decided by the trade-off between cost and efficacy (Ghoshal & Nohria 1989). Normative integration, though will bring lots of benefits in encouraging innovation, pooling talent of all subsidiaries and respond to the external changes more quickly, is also the most expensive mechanism to achieve. It is mainly achieved through normative control and secondly through bureaucratic regulation (Hedlund 1986). Large investment should be made on people so that shared value is built among staff across subsidiaries, information flows timely between different locations and conflicts are handled with the version of whole organization. Personnel rotation between different subsidiaries and between headquarter and subsidiaries and the use of expatriate managers would also be common measures to maintain normative integration (Lovett, Pérez-Nordtvedt & Rasheed 2009). Thus when trying to achieve normative integration, MNE should consider firstly whether they have the slack resource and competent managerial expertise.

### 2.2.3 The subsidiary itself

Another factor influencing the subsidiary performance and development is subsidiary itself, mainly referring to the subsidiary initiative and the entrepreneurship behind such initiative. Especially in the adverse environment with limited resource, the subsidiary entrepreneurship is extremely vital for a subsidiary to develop its competence by taking initiatives and seeking continuous progress (Birkinshaw 1997, Bartlett 1997, Birkinshaw 1998).

In detail, the subsidiary entrepreneurship will help to build the relationship with parent managers, increase subsidiary managers' credibility and eventually help subsidiary to gain more resources. The capability-building investment from headquarter to subsidiary is an especially beneficial element for subsidiary development (Frost 2002). A series of decision makings and new strategies need to be followed up with new business activities, requiring the headquarter to provide tangible resources in particular. When the elementary progress has been made, the entrepreneur selling is necessary for a subsidiary to communicate its contribution and furthermore, manage to earn more resource and higher degree of influence in decision making process (Bartlett & Ghoshal 2002).

To have a thorough understanding of subsidiary's condition, the subsidiary role may be used as an simplified parameter. Several typologies propose different dimensions to summarize the subsidiary conditions, such as capability creation level, capability utilization level, product scope and geographic scope (Enright 2007). In this paper, the typology suggested by Bartlett and Ghoshal (1986) will be applied to distinguish different



trivial importance to the whole organization. Therefore, headquarter should try to incorporate the Contributor's expertise in the organizational goal.

3) Implementer: this type of subsidiary is weak in both location importance and own capability. In spite of these, they are equally important as the previous two types because they provide the leverage to afford the competitive advantage and room to achieve the scale of economy.

4) Black hole: this type of subsidiary refers to important local market with weak competence. It is an unacceptable role for MNEs, which will try to find way out of this situation. Even setting up sensory outpost to give feedback to headquarter, the lack of local connection and real operation will prevent the local unit from obtaining important progress. Another way is to form strategic alliance via different levels of cooperation, requiring a higher level of coordination and integration.

According to the definition earlier, a more contributing role of subsidiary doesn't relate to the roles categorized by the Bartlett&Ghoshal framework, instead it refers to the contribution and development of subsidiary. However, out of the three determinants of subsidiary development, namely the environment, headquarter-subsidiary relationship and subsidiary itself, the subsidiary role typology summarizes the two out of three, thus provide a combination of various environment and subsidiary itself to analyse. That is why even though the analysis is not based on different subsidiary types given by Bartlett & Ghoshal (1986), the concept of some of the types will be used as an example to briefly illustrate some subsidiary situation.

Special attention should be paid to the level of analysis. Although Bartlett & Ghoshal

(1986) carried out the research in the subsidiary level initially, the subsidiary's contribution shouldn't be gauged in the subsidiary level alone. Specialized contributor performs significantly worse than the other types of subsidiaries in terms of return on investment (ROI) and profits, possibly because such kind of subsidiary is highly integrated vertically and horizontally in the value chain and therefore serves more as a cost center instead of profit center (Birkinshaw 1995). Thus the comprehensive approach should supplement the understanding of contributing subsidiary role, taking into account of factors such as organizational learning or information linkage. Taking a more logical approach, the subsidiary's contribution can be analyzed from local, internal and global level (Birkinshaw 1997). In the local level, the direct contribution a subsidiary can make is the enhanced service to customers, possibly leading to new business opportunity. In internal level, subsidiary can contribute by promoting the internal efficiency of the whole MNE. Lastly in global level, when subsidiary builds the relationship with external actors other than their own market, the global integration and global learning were achieved.

Meanwhile, thanks to the development of information and communication technology, the internal integration is promoted and thus the subsidiaries are able to find-slice the value-chain activities (Rugman, Verbeke & Yuan, 2011). Sub-subsidiary level analysis should be carried out if necessary, likely based on different divisions or business units (Birkinshaw 1997, Bartlett & Ghoshal 2002). Subsidiaries will usually show different roles in functions of production, sales, innovation and administration. Thus specific contextual condition should be included in analysing subsidiaries.

#### 2.2.4 Configuration to promote subsidiary development

The combination of environment, headquarter-subsidiary relationship and subsidiary is believed to decide the subsidiary development. Furthermore, some studies argue that once MNE reaches the fit between these three factors, the optimal performance of subsidiary will be achieved. Birkinshaw (1995) claimed that once such a set of configuration is identified, the closer a subsidiary comes to match such fit, the better it will perform. Nohria & Ghoshal (1994) gave a detailed framework to achieve such fit with special emphasis given to headquarter-subsidiary relationship. As shown in figure 2, given different subsidiary environmental complexity and subsidiary resources, the most suitable headquarter-subsidiary relationship is suggested.

Environmental complexity	High	Centralization: Moderate Formalization: Low	Centralization: Low Formalization: Moderate
	Low	Centralization: High Formalization: Low	Centralization: Low Formalization: High
		Low	High
		Local subsidiary resources	

**Figure 2: A framework for a differentiated fit between subsidiary context and structure (Nohria & Ghoshal 1994)**

The problem of such framework is the ignorance of environment, or location advantage in particular. As mentioned earlier, the location advantage is extremely important for MNE's motivation for internationalisation, and whether a subsidiary can make good use of the location advantage as expected by headquarter will largely decide its performance. On the other hand, the environment is dynamic and multi-facet. The single element of environmental complexity (Nohria & Ghoshal 1994) or strategic importance of location (Bartlett & Ghoshal 1986, Nov/Dec 1986) isn't good enough to capture all the factors in location advantage. That is why this paper try to analyze the location advantages in a dynamic and developing way rather than using this framework to simplify the location

advantages.

The difficulties in treating subsidiaries differently don't usually happen when subsidiaries are in a subordinative role as headquarter can comfortably fulfill their traditional formulation and control role. The biggest challenge lies in the situation that small role is given to the subsidiary which is not matched with the subsidiary's capability and leads to unproductive conflict. To empower the subsidiaries, include them in the decision-making and provide the proper support is a painstaking process. In the subsidiary with high entrepreneurship or faced with great location advantage, such a situation is likely to happen. The types of strategic leader and contributor subsidiaries are such examples.

#### 2.2.5 The relationship from the view of both headquarter and subsidiary

What is the actual viewpoint from both the subsidiary and headquarter toward their relationship, the subsidiary initiative and the subsidiary contribution? Whether the problem is indeed as serious as the previous study suggested? The answer lies in the article by HEDLUND (1980). Though HEDLUND's research is based on the Sweden companies in the industrial products rather than consumer goods, the phenomenon seems to be widespread. Anyway, further studies will be made in the empirical study to show whether it is the same case in other conditions.

According to him, there are actually quite contradictory ideas from headquarter and subsidiary's view. The most common complain from subsidiaries is the exclusion from

strategic matter, which is typically shown as lack of understanding in the overall strategy, the strategy for their own subsidiary as well as rigidity of strategy and uncertainty. Besides, the subsidiaries' view is not treated seriously when the local country does have important influence on the corporation. In general, the subsidiary feels isolation and remoteness without an adequate role in the decision making.

On the contrary, the headquarter usually thinks that subsidiaries don't need to know the overall strategic thinking. And it is normal for subsidiaries to complain because they are subordinate to the headquarter and thus have less resource and power. Even when the overall strategy need to be communicated well with subsidiary, the headquarter don't think they can contribute much in the formulation.

Another discrepancy of understanding from headquarter and subsidiary view is the subsidiary's contribution. Adding to the difficulty of defining the contribution of a subsidiary mentioned earlier, formal recognition by the organization is also required to evaluate a subsidiary's performance (Frost 2002). The performance of subsidiary should be viewed by headquarter as significantly greater than average and thus can derive addition value for the whole organization. In addition, it is vital for such contribution to be aligned with MNE's strategy priority, otherwise, such subsidiary contribution driven by subsidiary entrepreneurship will be taken as self-interested behaviour (Birkinshaw 1998). The entrepreneurship in subsidiary will be hurt if its contribution cannot get the recognition it deserves from headquarter, and subsidiary managers may thus fall back to the comfortable zone and only carry out the implementer role.

## **2.3 Developing subsidiaries by location advantage**

### **2.3.1 Applying eclectic paradigm in subsidiary development**

The eclectic paradigm, especially with its OLI parameters, is usually used to explain the MNE's motive to go internationalisation and its entry mode. However, the OLI parameters may not only be used to justify the MNE's internationalisation, but also the process of the subsidiary to develop its competence. The OLI parameters provide an advantage configuration for a subsidiary to exploit both from internal and external environment. After the subsidiary is set up, the OLI parameters should not cease to take effect, instead, the OLI parameters can function as a criteria for the subsidiary to check whether its development fulfill the original expectation to make the best use of OLI advantages.

Thus this paper will extend the application of eclectic paradigm and try to analyse the subsidiary development with OLI parameters. As pointed out earlier, out of the three advantages, the location advantage is more interesting to study not only because of the increasing complexity of the environment, but also the location's reinforcing effect on ownership advantages and internalisation advantage. Moreover, to exploit the location advantage is the most direct reason for the MNE to establish a subsidiary in the host country. The subsidiary's competence is actually the function of the location advantage a host country can provide (Benito and Groggaard and Narula 2003). Thus it is necessary to evaluate after the establishment of subsidiary that whether the initial goal of setting up a subsidiary in the host country is met, which will allow MNE to improve its international operation.

The eclectic paradigm not only serves as a standard to evaluate the subsidiary performance, but also adjusts to the changing situation. As the subsidiary evolves, the situation may change as well. New location advantage may emerge, such as the industrial cluster or favorable institutional environment supported by host government while the old location advantage may cease to exist, such as the increasing labour cost in the host country. Therefore the eclectic paradigm is not stable but dynamic and needs to be adjusted from time to time in order to remain responsive.

Of the four types of motivation of FDI in eclectic paradigm, the market-seeking FDI is more aggressive in recent years due to the rapid reduction in the spatial transaction cost (Dunning 1998). As one of the traditional MNE's motivations for FDI, the market-seeking investment aims to access the location advantage at the output side, usually concerning the factors that can foster sales (Rugman 2010). As a result, such location advantage related to sales, for example the business embeddedness, would be an important factor to track (Andersson, Forsgren & Holm 2002).

Another significant change in the motives of FDI is the rapid growth of strategic asset-seeking FDI (Dunning 1998), aiming at the acquisition of new asset, such as the technical knowledge and management expertise. Innovation and R&D level of the host countries decide the technical attractiveness of the certain market. The network and cluster effect represent the learning opportunities and information exposure a subsidiary can obtain from the host country. These location advantages are examples that are typical to influence the strategic asset-seeking FDI.

### 2.3.2 Utilizing the location advantage

The configuration of environment, headquarter-subsidiary relationship and subsidiary itself have been proved to decide the subsidiary development and subsidiary initiatives. Furthermore, interaction of these three factors have been studied and different combinations have been studied to reach the optimal performance in the subsidiary. For instance, Nohria & Ghoshal (1994) gave a framework to find the suitable headquarter-subsidiary relationship based on environmental complexity and subsidiary resource.

Such researches would be helpful in guiding MNEs to structure the headquarter-subsidiary relationship given the different subsidiary resources and environments. However, the increasingly complex and dynamic environment cannot be simply summarized in the environment complexity dimension. Meanwhile, the factor of subsidiary itself includes more than the subsidiary resources, but also the subsidiary entrepreneurship and so on. The subsidiary role is also evolving according to the changing environment, requiring an dynamic model to provide the up-to-date guidance. Therefore, the Nohria & Ghosha's framework mainly presents a relationship between headquarter-subsidiary relationship, environment and subsidiary itself but in a stable and simplified way. This paper will try to analyse the location advantages and its corresponding headquarter-subsidiary and subsidiary condition itself in an evolving view.

As stated earlier, the recently emergence of market-seeking FDI heavily relies on the local embeddedness. The connectivity to the key actors and resources allows the subsidiary to

actively participate in the relationship building activities. The relationship development has been proven to have direct effect on the MNE's competence development. Such relationship building will be accelerated in the competitive environment (Holm 2005). Specially speaking, the sales related performance, especially to a regional trading block, will be obviously boosted if the subsidiary can be more embedded in the host country (McDonald 2011). Local customers are the most important network partner and will influence with their needs while the suppliers and competitors have similar roles in facilitating innovation (Frost 2002, Schmid & Schurig 2003).

Spatial cluster is an location advantage under two situations. First case includes the high transaction cost of traversing distance or great transaction benefit of spatial proximity for intangible asset. The attractiveness of such cluster advantage can be witnessed by the geographic concentration of business activities in particular regions and countries. Another case happens when the presence of foreign investors serves as the investment-stalk or signal to other foreign firms which are not very familiar with the market. Consequently the access to external economies of knowledge creation and learning opportunities are benefits a subsidiary can derive from local cluster (Dunning 1998).

Learning opportunities are increasingly vital in MNE's international operation in new ear and subsidiaries can gain competitive advantages by forming learning network and knowledge-sharing routine (Holm 2005). With the rapid growth of strategic asset-seeking FDI, the location advantage a subsidiary is supposed to achieve expands from the traditional natural resource endowment to learning experience, which can augment MNE's

existing ownership advantage. Innovation is the major source of such learning opportunities, requiring the dispersal of organizational resource and decentralization of authority (Bartlett & Ghoshal 2002). Transferring ambiguous knowledge will carry out more efficiently with the normative integration when different units share similar organizational goal (Lovett, Pérez-Nordtvedt & Rasheed 2009).

In making use of any of location advantages mentioned above, the subsidiary entrepreneurship is a necessary factor. Especially at the initial stage of subsidiary development when subsidiary managers are faced with constrained resource, the subsidiary managers' entrepreneurship will urge them to make the better use of location advantage in host country and do more with less. The subsidiary, even if in adverse condition, can initiative business activities for continuous growth, such as the case in the type of contributor subsidiaries (Bartlett & Ghoshal 1997).

The headquarter-subsidary relationship and location advantage utilization has a reinforcing effect. To fully use the location advantage requires the subsidiary managers to hold high credibility in headquarter while headquarter allows more autonomy and big investment to subsidiary. Only in such condition can the subsidiary timely respond to the local incentives, take effective actions and launch long-term projects. On the other hand, a full utilization of the location advantage in the host country will directly boost the subsidiary manager's credibility, winning him bigger autonomy and more investment from headquarter. In reality, there isn't such obvious division. Both utilization of location advantage and headquarter-subsidary relationship will influence each other simultaneously and each of the elements will have incremental increase.

Consequently such beneficial circle will lead to a more contributing subsidiary role. Not only the measurable index such as the sales volume, the profit or return on investment will improve, but also other aspects will have significant progress. The contribution will be easily recognized by the headquarter. Likewise, the learning result from the local subsidiary will be more readily introduced throughout the MNE international network, not to mention that the investment from headquarter would be on a rise. Typically when subsidiaries obtain a more contributing role, they may evolve from the implementer to contributor or from black hole to strategic leader.

Subsidiary's development process will carry on, keeping the old location advantage and more importantly discovering and exploiting the new location advantage. The previous location advantage discussed would still play an important part while new location advantage may emerge due to the rising competence of the subsidiary. For example, the increasing bargaining power of a subsidiary will probably earn a more favorable institutional condition supported by the host government. The bundle of new and old location advantages are the impetus for subsidiary's sustainable growth. In such self development process, the subsidiary entrepreneurship is always the necessary condition for the subsidiary managers to step out of the comfort zone and seek continuous progress by reform and risk-taking (Bartlett & Ghoshal 1997).

Headquarter-subsidiary relationship certainly has a role to play in the further development of subsidiary competence. The subsidiary managers' credibility in headquarter and investment from headquarter obviously still positively influence the competence

development in subsidiary. When it comes to autonomy, not consensus has been reached yet. Among the general researches about headquarter-subsidary relationship, there is an increasing emphasis on autonomy and reduction on centralization, standardization and control (Paterson & Brock 2002). The monitor is believed to impede the subsidiary's responsiveness (Scott & Gibbons 2011) and the parental control is negatively related with subsidiary's performance (Lovett, Pérez-Nordtvedt & Rasheed 2009). Autonomy is also suggested to differentiate according to varying activities; autonomy is higher for marketing and personnel decision than R&D and financing, largely because of local responsiveness (Gammelgaard 2011). There are also studies believing that the increasing investment from headquarter and the formal recognition will inevitably lead to decreasing autonomy (Frost 2002). To be more detailed, at initial stage, the autonomy would be necessary for subsidiary to respond to the local market without headquarter's interference while it can be a burden at the advanced stage of subsidiary development (Birkinshaw 1997). However, there is also conflicting studies showing the control's positive influence on subsidiary's performance in production area (Majcen, Radosevic & Rojec 2009).

Thus the problem lies in what kind of headquarter-subsidary relationship would be more suitable to exploit the location advantage further after subsidiaries have made some achievement in the competence development. The conflicting ideas concentrate at whether the autonomy should increase or decrease. One possible answer is the time frame for the analysis. When studies are based on the initial subsidiary development without substantial progress yet, the subsidiary hasn't reached the milestone when increase in autonomy will become problematic. Therefore, those studies claiming the subsidiaries should be allocated more autonomy are valid in this sense. Besides, most subsidiaries are

still in the adverse condition with relatively low competence and few recognition from headquarters, which explains the trend asking for more autonomy and less control. On the other hand, when the whole subsidiary development cycle is studied, autonomy will not always play a positive role. Researches about center of excellence, the world mandates and strategic leader will usually argue more control instead of autonomy is desired. Therefore, the most suitable autonomy level to match the utilization of location advantage is a context-specific problem that needs to be put to the subsidiary circumstance to consider.

Another possible solution to seek the optimal autonomy level lies in the specific subsidiary activity. For activities such as manufacturing, which is highly integrated vertically throughout the MNE, more control would be required to achieve the global efficiency and economy of scale. Except such activities, other subsidiary activities, including marketing and personnel, may generally desire more autonomy to remain local responsiveness and adapt to institutional multiplicity.

In contrast to autonomy, normative integration is always required in each stage of the subsidiary development. No matter whether the hierarchy or heterarchy model is applied in the subsidiary, all subsidiaries of large MNEs are likely to exhibit significant levels of normative integration (Birkinshaw & Morrison 1995). Normative integration is proved to facilitate the creation, diffusion and adoption of innovation (Ghoshal & Bartlett 1988, Lovett, Pérez-Nordtvedt & Rasheed 2009), developing the sustainable competence in subsidiaries. Especially when the environmental complexity and local resource are on the rise, the normative integration is significantly productive (GHOSHAL & NOHRIA 1989).

The shared value achieved through normative integration is claimed to be equally important as the differentiated fit between headquarter-subsidiary relationship and environment (Nohria & Ghoshal 1994). Therefore, it is reasonable to believe that the normative integration is desired in the headquarter-subsidiary relationship throughout the subsidiary development process.

## **2.4 Theoretical framework**

The study builds on two academic pillars, the eclectic paradigm and the subsidiary development theory. The eclectic paradigm relies on OLI model to explain the advantage of MNEs in internationalisation (Dunning, 1980 & 2001). This study paid special attention to location advantage as in the knowledge economy, a broader range of location advantage (Rugman 2010) influences the MNEs' competence not only by its own effect, but also through its relation with ownership and internalization advantages. In particular, in the four types of FDI categorized in eclectic paradigm, the market-seeking and strategic asset-seeking FDIs are on the rise (Dunning 1998), drawing our attention to the related location advantages, such as local embeddedness and learning advantages.

This study doesn't limit the OLI model of eclectic paradigm to the decision of establishing subsidiaries overseas. Instead, the study tries to use OLI model, in particular location advantage, to evaluate the process of subsidiary development and combine with the related theories in subsidiary development domain. The subsidiary has increasingly taken an important role in the MNEs due to the higher integration in the global market, requiring

corresponding changes in the headquarter-subsidary relationship (Birkinshaw 1998, Enright 2007). The environment of the subsidiary also plays important role in deciding subsidiary performance (Paterson 2002). The last element in influencing subsidiary performance is the subsidiary character itself (Birkinshaw 1997, Bartlett 1997, Birkinshaw 1998).

The configuration of the three elements are believed to influence the subsidiary performance. Some research (Nohria & Ghoshal 1994) tried to find out suitable headquarter-subsidary relationship given the environment and subsidiary character. In this study, a different angle is taken to analyse the suitable configuration based on different environments, ie. important location advantages in the current economy. The subsidiary entrepreneurship is always desired in developing a more contributing subsidiary while the headquarter-subsidary relationship presents a more complicated case. Normative integration is beneficial throughout the subsidiary development while the autonomy may be problematic after a subsidiary grows too important.

The location advantages and the headquarter-subsidary relationship should be in constant change and affect each other. In larger scale, the configuration of the three elements and the subsidiary development will also form a beneficial circle when the progress in one side will lead to improvement in the other. To keep this reinforcing circle continue, this study has been trying to find out the match in different conditions. The summary of the theoretical analysis is shown in the figure 3 below.

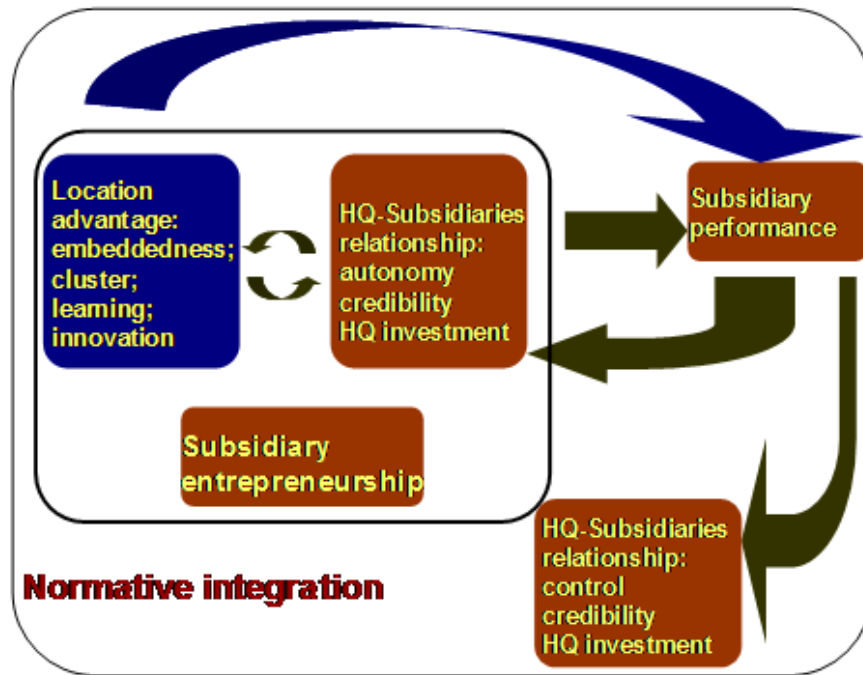


Figure 3: Subsidiary development flow

### 3 METHODOLOGY

#### 3.1 Case study as a research strategy

Theory, method and empirical phenomena are three cornerstones of research while more attention has been called for the interplay between theory and method recently. The relationship between the three elements supporting the research can be shown in the Figure 4 below (Dubois & Gibbert 2010).

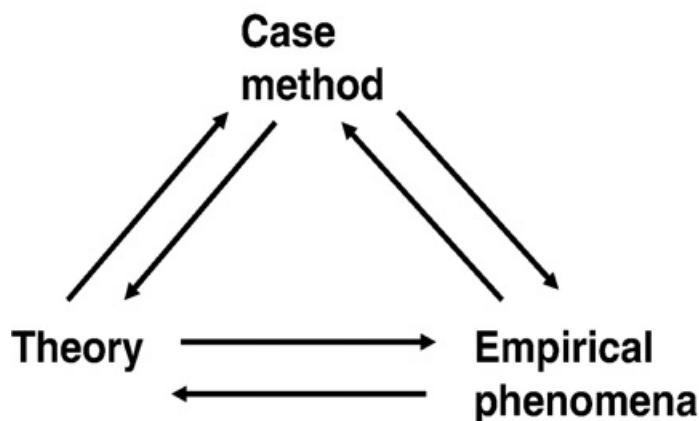


Figure 4: three dimensions of research (Dubois & Gibbert 2010)

This study employs the abductive approach to link the theory, method and empirical phenomena. By abductive approach, it means when theoretical framework evolves simultaneously and interactively with empirical observation (Dubois & Gibbert 2010). Different from inductive and deductive research approaches, the abductive approach doesn't focus on generalizing new theories. Instead, it tries to find out which part of a phenomena is generalisable and which only pertain to the specific situation itself (Kovács & Spens 2005). This study doesn't aim to invent a completely new theory about location advantage and subsidiary development, nor does the study totally rely on the existing

theory and try to confirm the theories. In fact, the study tries to draw strength from both eclectic paradigm and the subsidiary development streams while looking for new development on the basis on existing theories to explain the phenomena. Therefore, this study applies the adductive approach to manage the link between theory, phenomena and method.

Abduction also works through interpreting or re-contextualizing individual phenomena within a contextual framework, and aims to understand something in a new way, from the perspective of a new conceptual framework (Kovács & Spens 2005). It is also highly in line with this study to understand how the location advantage is still taking effect from the new angle of subsidiary development point of view. Therefore, this study expects to generate new insight to the phenomena by examining from a new angle as a result of its abductive research approach.

In particular, the abductive research approach should not be simply defined as a mixture of inductive and deductive approaches. One major difference is the role of framework. In abductive studies, the theory framework is successively modified, partly as a result of unanticipated empirical findings, but also the theoretical insight gained during the process (Dubois & Gadde 2002). In this study, such character of abductive research is shown in the structure; firstly the theoretical framework is built by referring to existing theories, then the empirical study represents a process of looking for findings both confirming the theory framework and challenging it, lastly new discoveries are made by developing the theory framework. As the research question of this study is how to utilize the location advantage to develop a more contributing subsidiary, the existing phenomena is best

analyzed by looking from new angle, suggesting new development based on the previous theories, so the abductive research approach is most suitable.

It is argued that case study and action research are generally used in the abductive research ( Kovács & Spens 2005). The case study is believed to be most desirable when answering research questions of "how" and "why" as such questions deal with operational link to be traced over time rather than with frequency and incidence (Dubois & Gibbert 2010). Reviewing the research question of this study, it is found that the case study would be very suitable in this case. As put by Yin (2003, 6), "how" and "why" questions are most explanatory and likely to lead to the use of case studies. Consequently defining the research question is probably the most important step in doing research.

The use of case study in this research is not just justified by the nature of research question, but also by the case study's ability to analyse a real-life event difficult to separate with its context and with a variety of evidence (Yin 2003, 6). This study aims to do research on an MNE and its subsidiary overseas; different evidence will arise during the study in various forms and the MNE itself is contemporary phenomena which is hard to totally distinguish from its environment especially when the study's research question is related with location advantage. Thus the case study is a suitable method in getting the research result as expected.

As said by Gerring (2004), a case study is best defined as an in-depth study of a single unit where the scholar's aim is to elucidate features of a larger class of similar phenomena. In this definition, the focus shifts from the suitable target of case study previously to the

effect of case study. It is expected to summarize applicable rules for general condition from a deep examination of a single case. That is what this study would like to achieve through a single case study.

### **3.2 Selection and description of the case**

This study employs a single case to gain insight into the research question. Single case study used to be thought as less valid in presenting the general rule and risk mistaking the particular situation as the common result. However, such situation specificity in the single case study is objected recently. According to Dubois & Gadde (2002), the learning from a particular case should be considered a strength rather than a weakness. The interaction between the phenomena and its context is best understood through in-depth case studies. Meanwhile, researching greater number of cases usually means greater width but less depth. By focusing on one single case, the study can gain deep understanding about various evidence and examine their relationship.

The single case study can be suitable when it is representative or typical (Yin 2003, 41). Such a representative or typical case will ensure the findings gained in studying the case will be applicable in general condition and the necessary interaction between all the players will be covered in the research. The MNE in this study is believed to be a representative case. It has long internationalisation history, not only in target host country but all over the world, the development of subsidiaries is fast and healthy. However, the problem still remains to prove the case is representative and the theory is generalized. One

solution suggested by Eisenhardt & Graebner (2007) is to clarify the purpose of the research is to develop the theory, not to test it, so theoretical sampling is appropriate. In theoretical sampling, the case is chosen because it is particularly suitable for explaining the relationship between several variables. In this study, the single case is also used to develop the theory about location advantage and subsidiary development. The MNE chosen as the case company will show how its subsidiary develops by utilizing the location advantage in the local market. Therefore, the case is a suitable theoretical sampling for research.

Another reason for choosing a single case is because it is a longitudinal case (Yin 2003, 42). By examining all the events happening in a period of time, the single case study will offer an evolving view and include wider factors in a deeper analysis. In this study, the case presents both the period before the establishment of subsidiaries in China as well as the one decade history of Chinese subsidiary development. The longitudinal case enables the continuous review of the relationship changes in the larger scale. In spite of the single case study's merits, the careful screening and interpreting of case should still be carried out to reduce the risk of misinterpretation.

In detail, the case chosen in this study is an IT MNE based in Finland and the subsidiary studied is located in China. The MNE itself is well developed and quite experienced in internationalisation after its entry to global market in 1990s. The company nowadays is still expanding, especially its business in China, presenting a good chance to study the development in the subsidiary. The choice of an MNE based in Finland is because the author's understanding in Finnish company through her study here. In addition, the

Finnish company also represents a Nordic style of management, which is interesting to study as well. The subsidiary location is chosen in China is mainly because of the booming Chinese market. As this study focus on the subsidiary development, subsidiaries in a rising market will be a suitable candidate to show the growth pattern. Besides, the author, being a Chinese, will have a better understanding about Chinese business practise, adding strength to the correct interpretation of the case.

### **3.3 Methods of data collection**

According to Yin (2003, 97), there are three principles for data collection. First of all, multiple sources of evidence should be used. Any findings or conclusions from the study would be more convincing and less likely to suffer from bias if the data are collected from multiple sources. It is especially important in this study because the single case is employed to gain new understanding about the phenomena. The multiple data resource will not only serve to provide a deeper understanding from all aspects, but also prevent the bias or wrong attribution.

Secondly, a database should be created to process the data. Different from quantitative research when the need for database is more obvious to process numbers, the importance of database in qualitative research is often ignored. A good database will significantly increase the validity of the study because the database allows other researchers to view the study objectively (Yin 2003, 102). For a case study in particular, the most common way to construct the database is to use notes. No matter what forms it is, all the notes should be organized, categorized, complete and available for later access. Special attention should

be paid to avoid the data from being too tightly summarized to save the rich qualitative details. Instead, it should be presented as a complete narrative of the story in concern (Eisenhardt & Graebner 2007). Such a narrative part should be treated as part of database instead of the final report. Actually the note should be not over edited to look presentable, otherwise, it may lose its essence as a database.

To describe a case deeply also requires careful selection of events to include. Some researchers may describe everything and in the end describe nothing. A solution to such a problem would be to rely on the theory to set control on the case description; theory will improve the explanatory power of the case while the evolving theory will be directed to the consistent empirical data as well as the unanticipated part (Dubois & Gadde 2002). Besides, another important decision a researcher should make is how far back needed to be traced in the process. The boundary of the sample should include the related events from the case, especially in the longitudinal study. In this study, the case is considered not only in the decade's history of its Chinese subsidiary development but also the whole internationalisation process so as to gain a comprehensive view about the company structure and management style.

By forming such a database, the validity of the study will be improved because the database is an objective reflection of the data collected from the case study, serving as an important link between various stages of argument, clearly illustrating the interplay between the theory, case and method (Dubois & Gibbert 2010). Similarly the 3<sup>rd</sup> principle suggested by Yin (2003, 105) in the data collection is to maintain the chain of evidence. In his words, by maintaining the chain of evidence, you are able to move from one part of the

case study process to another, with clear cross-referencing to methodological procedures and to be resulting evidence (Yin 2003, 105). As a result, it can construct validity and readers of this research will be able to follow the development of theory. This study tries to achieve the chain of evidence by presenting the theoretical analysis based on the empirical data and connecting the finding with the new theoretical framework.

In particular, a case study typically combines data collection methods such as documentation, archives, interviews, questionnaires and observations (Eisenhardt 1989, Eisenhardt & Graebner 2007). Among them, interview is highly efficient to gather empirical data about the contemporary event, especially when it is episode and infrequent (Eisenhardt & Graebner 2007). Yin (2003, 86) summarized the strength and weakness of interview in the Table 1 below.

**Table 1: Strength and weakness of interview and documentation (Yin 2003, 86)**

	Strength	Weakness
Interview	Targeted: focused directly on case study topic Insightful: provides perceived causal inference	Bias due to poorly constructed questions Response bias Inaccuracies due to poor recall Reflexivity: interviewee gives what interviewer wants to hear.
Documentation	Stable: can be viewed repeatedly; Unobtrusive: not created as a result of the case study; Exact: contains exact names, references, and details of an event; Broad coverage: long span of time, many events and many settings	Retrievability can be low ; Biased selectivity: if collection is incomplete; Reporting bias: reflects bias of author; Access: may be deliberately blocked

According to him, the interview is an essential part of case study evidence because the interviewee can interpret and report the human issue while the well-inform respondents can provide useful insight to the issue. Despite the obvious advantages of interview in giving insightful and targeted information, the main concern is the bias. How to mitigate the bias happening in constructing questions, interpreting interviews and even from the respondent's side remains a tough job in carrying out interview. One suggested solution is to employ various data collection approaches (Eisenhardt & Graebner 2007). Numerous and highly knowledgeable informants would be a precious resource to provide insight from various perspectives. If it is not achievable, other sources of data, such as the documentation or observation would also help to mitigate the possible bias rising from interviews. Such view is echoed by Yin (2003, 76) that even if the data from interviews mainly builds up the database, the conclusion cannot be based entirely on the interview.

In this study, the interview is the main method to gather date from the case because of its advantages mentioned above. To mitigate the risk of bias, the study incorporate documentation as another way of data collection. The pros and cons in using documentation as a data resource can also be found from table 1 given by Yin (2003, 86). The company website provides rich information about the company history, management structure and internationalisation stage. In addition, there are lots of news reports in Finland about this MNE and increasingly about its business in China recently. These resources provide important supplement to the information given by the interviewee.

Even though the interview of this case study only took less than 2 hours, the interview is still a guided conversation than a consistent line of inquiries as required by Yin (2003, 89).

The fluid conversation will ensure an open-ended conversation which will reduce the bias of both interviewee and interviewer while encouraging the new information unanticipated in the previous theory building.

There is another particular problem in this study: the case company would like to remain anonymous. Therefore, the documentation data either from the company website and the news report cannot be clearly marked in the reference. To improve the validity of the study, rich secondary data was included in the data collection. The information from the company website offers the general and long-term information regarding the company internationalisation. On the other hand, the news reports also frequently cover the company's business, providing an outsider's view on the company. Though the interview is only done with one person in the headquarter, the vast amount of secondary data helps to reduce the risk of bias. The number of the secondary data obtained from the company website and the news report is summarized in table 2 below and the table 3 provides a breakdown of the information from company website and news report.

**Table 2: Secondary data summary**

	Company website	News report
Number	1	10

**Table 3: Detailed description of the secondary data**

	Summary	Related topic
<b>Company website</b>	Company history	Company structure; Main business area
	Company internationalisation	Management style in internationalisation

Sales and staff number overseas	Company's internationalisation level Geographical distribution
Vision and core value	the competitive advantage
<b>News report</b>	
China attracted the company to open a third office	Location advantage in China
The greenfield startups in Hangzhou office	The organic growth way
Company's personnel and structure change	The company structure
The information bank and the problems	The knowledge sharing way
Company's strong status in China	The contribution of Chinese offices; Importance to the whole company
The wage inflation in China	The potential change in location advantage
The fierce price competition of IT industry and company's solution by offshore operation	The location advantage; The environment
The rotation of staff within company's different offices	The knowledge sharing mechanism
The increase of staff in Asia and decrease in Europe	The environment; The company strategy
Company's main customer benefited from its offshore operation	The contribution of Chinese offices; The company advantage

### 3.4 Methods of data analysis

The last step to analyse the data is most difficult, however, treated with least importance (Yin 2003, 109). It is especially tricky in case study with the qualitative data instead of

quantitative data. As explained earlier, the data from case study will largely take a narrative form and include many different sources either from interview or documentation. The close interaction of the event with the context also makes it necessary to consider not only the event itself but also the general environment as a whole. Besides, this study took the longitudinal research by tracing back the process of case company's internationalisation, especially the decade's history of Chinese office's development. In a word, the case study form a huge database with evidence of both width and depth, asking for review carefully.

The most common way to analyse the data is to rely on theoretical proposition (Yin 2003, 111), when the theory acts as a criteria to guide which data to focus and which data to ignore. It is especially true in this study when the abductive approach is employed. The abduction research tries to re-contextualizing the individual phenomena with a contextual framework and aims to understand the phenomena in a new framework (Kovács & Spens 2005). As a result, the theory actually goes with empirical data hand-in-hand when the researcher needs to check the empirical data against the original theory framework to either confirm it or develop it. This study tries to maintain the continuous check of theory to ensure the simultaneous development of theoretical framework and empirical findings.

For the detailed technique to analyse data, Yin (2003, 116) advised to use patten matching to compare the empirically based pattern to the predicted theory framework. It is still in line with the abductive approach to closely connect the empirical data and theory. A tight and evolving framework is suggested by Dubois & Gadde (2002) to make sure the researcher have articulated the preconceptions while the the theory will develop together

the new empirical findings and deeper theoretical understanding. The theory's importance should not be ignored as most of the case studies will be carried out in a narrative form, which will not be very accurate and hence the theoretically significant proposition will largely decide a good case study (Yin 2003, 120).

However, the analysis of the data should still reflect all the evidence (Yin 2003, 137). Though distinction should be made about related and unrelated evidence from the case study, the unanticipated evidence should not be confused with the unrelated evidence. In contrast, the unexpected evidence actually pushed the researcher to develop the theoretical proposition and eventually offer a new insight to the phenomena. This study paid great effort to formulate the theoretical framework in the first half of the research, and during the case study, such theoretical framework was consistently reviewed to seek the understanding of empirical data as well as the improvement in the theoretical proposition.

## **4 EMPIRICAL STUDY**

### **4.1 Introducing case company**

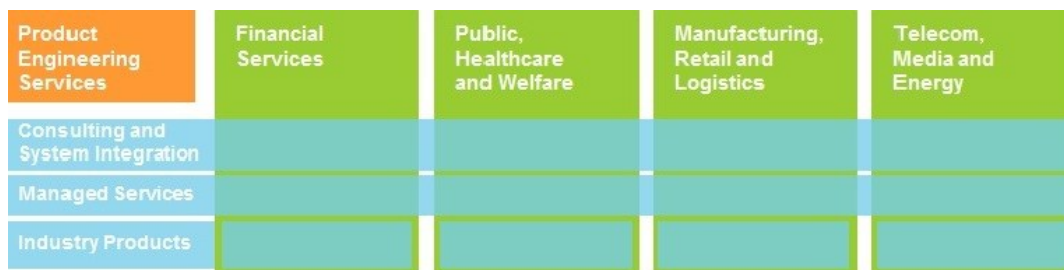
According to its company website, case company T is the largest Nordic IT service company providing full life-cycle services for both private and public sectors. Founded 1968, headquartered in Helsinki, the company nowadays operates in over 20 countries with net sales at approximately EUR 1.8 billion. The wide geographic coverage, high sales volume and deep integration among all steps in the life-cycle service mark the company T as a truly multinational enterprise (MNE). In 2011, its net sales from international market accounted for 24%, while its sales in Finland and Sweden, the company's base, reached 45% and 31% respectively. Among its overseas subsidiaries, China held three subsidiaries, in Beijing, Qingdao and Hangzhou respectively, serving different functions, thus company T is a very suitable case company for this study on location advantages.

The history of company T began in 1968, when it mainly served as a computer center and provided IT service for customers, largely including the local banks and forest industry companies. The company grew mature and expanded its customer base during the whole 1970s. The introduction of personal computer in 1980s helped the company to expand its operation to mainframe computer services and software as well as development of IT systems. Meanwhile, the company continued to expand its customers to various industries.

Together with the 1990s IT boom, company T experienced a rapid growth period through a series of merge and acquisition. Several large merge and acquisition in Nordic countries consolidated company T's position in the telecom area. At the end of 1990s, company T has become an industry leader in IT service based on Finland and Sweden and became powerful enough to begin its international expansion.

The globalization of IT service industry and the emergence of Indian companies in the international market urged company T to accelerate its globalization in 2000s. Offshore production was started in 2004, and has become an important value driver for company T ever since. Till 2013, the offshore sales has doubled within 5 years to over 40% of the whole sales with centers located in East Europe and Asia.

As company's position in several major industries and the life-cycle services is consolidated, the company began to replace its original industry-based structure by a matrix structure based on the industry groups and service lines. The Industry Groups include financial services, public sector and healthcare, manufacturing, retail and logistics, telecom, media and energy. And the Service Lines are managed services, consulting and system integration (CSI), industry products. Subsidiaries in various countries will have different functions and do business in different industries. Depending on the subsidiaries' specific condition, subsidiaries need to report to various directors in industry group and service. With the complete matrix structure, the company T is able to serve the customers by offering the cross-selling potential from various steps and industry and being close to customers. The company structure can be found from the figure below.



**Figure 5: Organization structure of Company T (company website)**

## 4.2 Case study about the headquarter and subsidiaries in China

This study did an interview with the person in charge of the product engineering service group to gain understanding about the business operation of product engineering service between the Finnish headquarter and its Chinese subsidiary. At the company's request, the company's name is mentioned as T, but the events during the international development are discussed thoroughly during the interview to help understand the previous theoretical analysis.

Product engineering service provides product development to customers. It is operated globally in the structure of company T. In China in particular, around 99% of the business is from product engineering service, thus doing the interview with the person in charge of product engineering service will offer a comprehensive understanding on the globalization of company T in China.

Regarding the matrix structure, subsidiaries in China served various functions from sales

to service delivery in several industries, therefore, the site manager in each subsidiary needs to report to many directions, most of which located in Europe. Besides, there is one China manager in general, serving as the company representative and completing legal infrastructure. During the interview, the importance of site manager is especially emphasized. They are the spokesman of the subsidiaries, responsible for all the activities happening in the site and report to the rest of company T. Company T had bad experience before by not having a site manager but several low-level managers in each subsidiary as they did in some European subsidiaries. The lack of supervision and coordination made the report to higher level very difficult and inefficient. On contrary, the national manager in China is more of a functional role and serves as the legal representative.

In particular, the first subsidiary in China was built in Beijing about 10 years ago. The decision to enter Chinese market was mainly pulled by their existing customers in Finland. To meet the customer's need, company T need to have office in China to serve their customers' offices in China. And Beijing was chosen because it was also the location of their customers. The establishment of first Chinese office is actually a passive reaction to the customer's need and faced less risk because of the existing customer base, as stated by the interviewee:

*"Our business in China started in forest industry. Our customer in forest industry had some paper mill in China and they would like us to provide IT service to their office in China, so we followed them to set up office in China. When we thought of China, the first choice was Beijing because most of our customers' offices were located in Beijing."*

At first, the Beijing office's function was limited to only provide maintenance to the customers in forest industry and its importance was not very remarkable in the group strategy. However, situation changed very fast. By being in the Chinese market, company T soon discovered that there were huge opportunities in telecom sector, which was also their competitive advantage lied in. Since then, Beijing office was given more importance and business developed very fast, as the interviewee said,

*"Soon after we built the Beijing office, we found that China's telecom market was really big and we began our business in telecom by delivery. We got the first contract from testing maintenance, then we proved our server quality and was able to upgrade our service. Things developed very fast. It was all because we were in the right place in the right time."*

Compared with the Beijing office, the building of the second office in Qingdao presented a more initiative process with confidence and knowledge in company T. Some time after the Beijing office was built, company T found out that the cost was high compared with other cities in China and the competition for talents in Beijing was very fierce. After careful consideration, they chose Qingdao to set up the second office where the cost was much lower and there were plenty of IT talents locally. From the passive establishment of Beijing office to the initiative building of Qingdao office, the growth of competence and knowledge in company T about the Chinese market and the internationalisation is obvious.

Later, the Hangzhou office was built. Again the decision was made because one of their

customers would like company T to be in the same place to provide service for its Chinese office in Hangzhou. In fact, even after 10 years' development in China, most of company T's business is done with customers based on Europe. They provide service to either the European customers directly or to the European customers' Chinese offices. That is why to meet the customer's need plays such an important role in deciding to set up a subsidiary.

After the three Chinese offices are built, the Beijing office in particular has undergone some changes in the role and importance. Though Beijing office is downsizing and more staff are moved to Qingdao and Hangzhou offices where the service is mainly delivered, the Beijing office is actually increasingly important. Now it turns to be a front-end office with more responsibilities to hunt for own business. The other two Chinese offices located in Qingdao and Hangzhou are more like implementer.

#### 4.2.1 Location advantage in Chinese offices

When asked about what is the location attraction that drew the company to set up an office in China at the first beginning, the interviewee mentioned the customer in the forest industry. In this case, it is more like a market-seeking FDI, when the MNE entered the Chinese market to get access to the customer's local office there, supporting the Rugman's claim (2010) that market-seeking FDI is on the rise. In addition, the low cost and availability of talents are also among the advantages that attracted company T to set up subsidiaries in China, which represents the resource-seeking FDI, a very traditional types of FDI.

The location advantages that existed at the beginning were closely related to the local environment, but required less global integration. The strategic asset-seeking and efficiency seeking were not identified from the initial purpose. It is due to the slow internationalisation of company T in China. In this sense, company T showed the characters of Uppsala internationalisation model when the company underwent gradual internationalisation and developed the subsidiaries after gaining local knowledge. The subsidiaries set up in China weren't integrated to the whole organization deeply at first, mainly served as a delivery site to local customers. The expansion in Chinese market is also in controlled pace, after the previous Chinese office is well functioned.

Because the customers served by the Chinese offices were old customers that already had connection with their Finnish offices, the local embeddedness was less important at the beginning for the sales of Chinese office. Besides, the Chinese offices mainly focused on the functions of delivery and sales, less much on R&D, so the location advantages such as industry cluster and innovation, which will improve the research activities, were also not very relevant here. Though the location advantages that attracted company T to build Chinese offices at beginning were not the same as the location advantages that were specially studied earlier in the theoretical part, it would still be interesting to track any changes during the subsidiaries development.

Regarding local embeddedness in particular, the Chinese offices of company T actually haven't built strong connection with local business community yet. As mentioned earlier, most of their business in China is done with the European customers. However, as China

became increasingly important for most of MNEs, the local connection strengthens in another way. As European customers' Chinese offices generally have increasing authority to decide the procurement themselves, company T's business in China also began to rely more on the local connection to sell their services and products to the European customers' Chinese branches. As the interviewee put it,

*"it depends. Some customers are highly centralized in European headquarters, so we mainly deal with their European offices and Chinese offices are merely delivery site. Other customers operate globally, so our Chinese offices have more connections with such customer's Chinese branches."*

Even though the Chinese offices don't serve the R&D function yet, the learning advantage is not only restricted to technology. The learning about the local market, especially in cultural aspect is highly important and emphasized during the interview for several times. In particular, company T learnt how to operate in the multi-cultural environment and how to wrap up and grow organization in a controlled but quickly way in such an environment. Chinese market presents a chance for MNEs to learn how to do business in a different culture. However, it is interesting that the interviewee also mentioned that China is not the only place that they can learn such knowledge. In India or any other possible market with a different culture, they will still learn the same thing. In the interviewee's words,

*"In IT industry, I think we are the leader to manage multi-cultural environment in software development. We learnt a lot in China and with China, such as how to wrap up and grow organization in a quick but controlled way. But it is not necessarily in China. It is the*

*things that have been done matter, how to grow business fast and maintain the consistent quality. If we have done the same thing in India, we would have probably learnt the same."*

It is an interesting idea because in the case, the learning opportunities are not necessarily unique to the location. Even if the subsidiaries fail to utilize such learning opportunities in the specific location, the MNE can easily remedy the loss by learning from some other locations. It is different from location advantages such as market size or customer base, when subsidiaries fail to utilize them, the MNE will suffer absolute loss from sales; for location advantage such as learning opportunities in the case study, the utilization of them will contribute to the whole MNE but the failure to utilize them won't be too big a disaster. If so, whether the incentive to learn and to share with the rest of MNE are still strong? The interviewee's answer is yes,

*"The learning is shared in the internal training. How to manage cross-culture environment and cross-culture communication are largely based on their experience in China. Such training has been given to thousands of people. Another learning is about how to run distribution. Learning about distributing multiple sites software projects and the people who have experience working in China is useful when they are considering to opening a new office."*

The Chinese market itself is so dynamic and different that the site managers themselves are motive to learn the proper way of doing business in it and feel obliged to share with the rest of organization. The other units of organization also think highly of such learning. According to the interview, lots of training has been made for the learning from Chinese

market. And one of their site managers have around 10 years' experience in China and he is usually asked for help when others face problems related to China. The possible explanation to such phenomenon is that even though the learning from several locations may be similar, the increasing resource of such learning is still of value for MNEs, especially by developing more staff with hands-on ability to deal with the different cultures.

Such learning is shared in an informal way rather than a formal way. Actually in the company there is a system called information bank in which the company gathers information on personnel's skills, experience and willingness to develop. Therefore, staff members make their own profile in the system and company T uses the profiles when it seeks project workers. The enthusiasm to create the profile has varied: 95% of the Indian employees immediately created a profile, while in Finland and Sweden the development has been slower. Such different attitude toward the information bank was echoed in the interview. The interview didn't even use this system, but only vaguely heard of something about it.

It drew our attention to the sharing of knowledge learnt. The big variety in the geographic coverage and staff nationalities did bring vast opportunities to learn, but at the same time posed challenges to share such learning. The different learning habits, even the different ages require tailored programs to prompt the learning. The information bank system carried out in company T universally proved to be inefficient because it tried to share learning in a standardized way. That is why the interviewee thought the learning is more shared in an informal way, when proper way can be chosen to make sure the learning is

well understood.

#### 4.2.2 The headquarter-subsiary relationship

The relationship between headquarter and the Chinese subsidiaries is still typical Nordic style of loose management. In their Chinese staff's words, company T is a very different place to work compared with other Chinese companies. However, necessary adjustment has been made according to the specific Chinese business practise. Company T thought a bit more hierarchical structure need to be employed in China. As the interviewee put it,

*"The way we operates in China is a compromise between the Nordic decentralized and informal style to hierarchical way of doing things. From the beginning, they introduce lots of Nordic style of management to Chinese employees. Meanwhile, they need to remember their culture. We cannot become Chinese and they cannot become European, so we meet half-ways."*

Such compromise in the management style turned out to work well. Company T is quite global and its decision-making is highly distributing. In China, things are done in Chinese way but at the same time embody the company character. In building such relationship, some subsidiary managers who have long time working in China serve as the bridge between China and the rest of organization. Consequently the credibility of subsidiary manager is high because he had the experience and knowledge of working in China which is valued in the organization.

Similarly, China is a booming market for company T owing to its big telecom market and low labour cost which is only a fraction of that in Nordic country. In 2011, the Chinese employees doubled to 1100. Even though the wage inflation in China is estimated to be 8-10% annually, it is still moderate and China will remain a low cost center considering the high quality service it provides to customers. Therefore, the investment from headquarter to China will go on increasing, making the Chinese subsidiaries more important.

During the 10 years' operation in China, the role of subsidiaries, especially the Beijing office has undergone some changes. As mentioned earlier, the Beijing office was first set up to serve customer's local offices. Later, when the other Chinese offices are built, more delivery service was transferred to them where the cost is even lower while Beijing took more front-end responsibilities, such as sales. As the interviewee put it,

*"Beijing is a more frontier office to customers' Chinese branches, which are most often located in Beijing. It is not losing importance, but going through evolution. The same thing happened in Europe many years ago. When China and India are discovered, the development and maintenance are moved from Europe to China while Finnish and Swedish offices are frontiers, serving functions of sales, presales and consulting. Now same changes happen within China. Beijing office may be smaller in size, but it is more important."*

The Beijing office in the past decade evolved from a implementer toward a contributor or

strategic leader when the importance of the local market is fully realized and the competence of Beijing office is improved and recognized during the development. Such change in the subsidiary role provides a good chance to study the developing headquarter-subsidiary relationship in a dynamic way.

The normative integration is repeatedly emphasized during the interview. The interviewee was proud of the particular way of company T doing business and regarded it as the success factor. Such high degree of integration is achieved by organic growth in the greenfield FDI in China. During the company T's history, over 200 merge & acquisition were done to grow the company into a giant organization covering various industries and diversified countries. However, the majority of such transactions were done among Nordic countries, and gradually to German and East European companies in the recent decade. Surprisingly, very few M&As were carried out toward Asian companies when M&A is thought to be an effective way to quickly understand the local market and build local connection.

When asked about the reason for greenfield investment in China, the interviewee quoted the company value as the main reason,

*"We only have organic growth in China, because of some M&A transactions in Asia before didn't succeed, and you don't know what you actually buy. It is easier and more secure to grow organically in Asia by recurring. If we buy a company, it is more difficult to integrate to the whole company. By organic development, we can train people and introduce the company value."*

The emphasize on the company culture and value overweight the importance of getting to know local culture faster. It is partly because the local connection is not that much important at the establishment of a Chinese office. As mentioned earlier, the building of Chinese offices are to serve the existing customer's local branches; even now, a decade later, the vast majority of Chinese business is done with either European companies or their Chinese offices. However, the main reason for company T to give up such easier way of growing in a distant market and build everything out of scratch is to safeguard the company culture. Because the Nordic decentralized working style is different from Chinese traditional hierarchical style as well as the common American way of doing business, company T found it more effective by training people from the very beginning than integrating an existing company to its whole organization.

It is because company T always grows organically in market with high psychological distance, less effort is needed to maintain such normative integration later. When asked about how the company makes sure the goal and value are shared through the organization, the interviewee could not even name any particular measures at first. In his words,

*"It is built in, partly because of introduction and training, partly because how we make decisions and what goals we set. It is natural way of doing things, our way of doing things. In general, it is what kind of behavior we allow and what is not allowed. Value and principle are showed in different activities. It is difficult to give conclusion on how it is done."*

It presents an interesting discrepancy with the theory where the normative integration is believed to be an effective but expensive mechanism to organize offices in various locations. In the case of company T, not much extra effort is required to maintain such high degree of integration, even at a time when the company went internationalisation fast and had 30% of employees working in low-cost countries in Asia and East Europe. The controlled way of organic growth is critical in achieving such normative integration by recruiting the right people and giving the proper training at the beginning. Such organic way of growing also contributes to a better relationship between the headquarter and Chinese offices as foreign offices are more likely treated equally.

#### 4.2.3 The subsidiary itself

The organic growth of company T in China decides the subsidiary managers are expatriates at first. Because the first subsidiary manager needs to build everything from scratch, he needs to show high level of entrepreneurship. Being an aggressive and initiative leader will help the new office make business and build relationship as fast as possible while being able to gain more support and investment from headquarter. However, the subsidiary manager's role changes with the development of subsidiary itself. And consequently, the requirement for a suitable subsidiary manager changed to a more functional and operational level. It was explained in the interview,

*"During different phases, the subsidiary managers are different. The people who open and start business need to be entrepreneurial in tough situation. He needs to build things from scratch. It is not 8 hours work every working day, but 24\*7 job. After things get mature, he*

*may get bored. When things are up and running, we need a more operational guy. When we start to build a new site, usually it is an expatriate, a Finnish manager and a Chinese assistant. But expatriate is too expensive, so when subsidiary is mature, new subsidiary manager can be promoted from inside or hired from outside."*

The subsidiary manager did change with the development of the subsidiary itself. However, opposite to the theory that a more contributing subsidiary requires an entrepreneurial subsidiary manager who can fight in the headquarter to earn recognition and more investment to subsidiary, company T actually choose to replace entrepreneurial managers with more operational managers when subsidiaries grow mature.

It is partly because of the high expense to keep an expatriate in China. Another reason would be the high normative integration in company T. As explained in the previous part, the organic growth enables company T to share the same value and way of doing business all over the organization. As different offices operate under the same code, there are less obstacles in evaluating subsidiary performance and making decision on further investment, therefore, an entrepreneurial manager may not be that important when business has been established. One important finding from the interview is that the normative integration can not only bring values such as innovation and fast response, but also partly replace the necessity to hire an entrepreneurial subsidiary for the development of subsidiary. Besides, the recruitment of local staff from the very beginning of subsidiary operation allows company T to train their own talents locally and provides the pool for future promotion internally.

On the other hand, such less importance of entrepreneurial manager lies in the low connection with the local business. As the majority of local business in China was done with European companies or their local offices, there are less requirements for building long-term and close relationship with the local customer and other business partners. The continuous subsidiary development may as well be brought about by the headquarter's sales while the Chinese offices just carry out the function of delivery. It is not that vital for subsidiaries in China to engage in the tough and time-consuming relationship building yet, and an operational manager and an entrepreneurial manager may well perform similar in such situation.

### **4.3 Findings on utilizing the location advantages in China**

#### **4.3.1 The changing location advantages**

Just as the theoretical part claimed, the location advantage is not still and only used for the decision making of opening a new office. Instead, accessing and evaluating the location advantage is a dynamic process that will last throughout the subsidiary operation. The case study illustrated how the location advantages changed during the years of subsidiary development.

At the beginning, the main location advantage that drew company T to open subsidiary in Beijing was geographic closeness that enabled it to better serve the customers in forest industry. Not long after they entered Chinese market and got some understanding of the local situation, their knowledge improved and discovered vast opportunities in the

telecom industry and thus successfully opened up a new business sector in China. The location advantages that attracted company T to open two more offices and employ more staff in China are not the same from the beginning. Even other minor location advantage underwent changes as well. Low cost, for instance, was found out to be more available in other Chinese cities and nowadays it is not even sure how long the low cost advantage will maintain as the labour cost is on the rise all over China.

To better utilize the location advantages needs to understand the location advantages first, and then take the necessary steps, just as company T did in China. They were not satisfied in providing IT service to customers in forest industry, but reacted positively to the vast market in telecom industry. After getting the first contract in testing maintenance, they need to prove the value of their service and consequently win customer's trust to provide more service. In this process, company T managed to develop competence of its staff and find suitable expatriate from its talent pool in the whole organization. Even though the expatriate is always a temporary strategy, it did help the Chinese subsidiary to seize the new location advantage.

Except the expansion on business area, another location advantage that appeared recently is due to the decentralization of company T's European customers. As more and more customers gave authority of decision making and procurement to local offices, company T's Chinese offices faced a new business area that was not just delivery, but also included sales, presales and consultancy. Such new changes were again recognized and followed by the Chinese offices. As the interviewee explained how they responded to the new location advantages,

*"We have adapted to the changes happening in the outside environment. Part of the change is customers' Chinese branches have own decision-making and procurement authority. At first 99% of revenue in China is done through European offices. But now for some customers, we do local business towards local branches. We anticipate it, we are able to convert a delivery site to a front end site. It is something happening in the outside world.*

*On one hand, we have been able to hire people from outside, meanwhile, we have been growing people and developing their competence internally, especially by expatriate. Expatriate is only temporary, who starts up a business with a new customer, builds, educates and grows the local organization. We have different skills in the company, we might choose expatriate, but always temporary."*

The changes in location advantages may come from external environment or the company's own development. In this case, the new telecom market is discovered due to company T's deeper understanding about Chinese market by their presence here; the higher demand from the European customers' Chinese branches is due to the external changes. An MNE need to examine both internally and externally so as to be alert of the new location advantages and prepare to make use of them.

The interviewee didn't mention any changes in the learning opportunities. Though ten years is not a short time, company T still found new knowledge continued to appear during its operation in China. At first, it may be some basic understanding about Chinese culture, later some deeper understanding about business opportunities in various

industries and recently, the knowledge about managing multiple sites software project as more cooperation between Chinese offices and other offices. However, whether such learning advantages will maintain after a long time when company T is already well aware of the Chinese market and experienced in operating multiple sites project? It is possible that when company T becomes more mature and skillful in internationalisation, the learning advantage in China nor learning advantage in similar locations may not longer exist. Some location advantage, such as learning advantage is less strong for mature MNEs. On the other hand, other location advantages, such as the higher demands in full life-cycle service, would be more obvious for larger MNEs who have the knowledge to perceive such chances and ability to provide required service. In this sense, the location advantages are subjective and influenced by the MNE's own competence.

#### 4.3.2 Building the suitable headquarter-subsiary relationship

The relationship between headquarter and offices in China seems to be suitable to promote the subsidiary contribution. The company T applies a typical Nordic countries' decentralized style when the operation between many offices are coordinated by the shared values and same way of doing business rather than by regulation and bureaucratic control. In Chinese offices, the relationship is tailored based on the Chinese condition and more hierarchical control is added by keeping site manager for each subsidiary. Difficulties in evaluating subsidiaries' contribution and communicating company's strategy are seldom found in company T's Chinese offices. Such harmonious relationship is largely due to the high normative integration throughout the organization.

Normative integration is believed to bring benefits such as encouraging innovation and responding to external changes more quickly. However, some suggest the normative integration should be chosen with caution because it is also a very expensive mechanism considering the high investment in sharing information and rotating personnel. In the case, the normative integration proved to be a very powerful tool in ensuring a smooth operation between headquarter and Chinese offices. At the same time, not heavy investment is identified to maintain such high level of normative integration in company T. The possible answer lies in the organic way the company grows in the market with high psychological distance.

Among the huge number of M&As during the company T's expansion history, very few were done in Asia. The reason for them to give up a faster way of knowing local market but to use a slower way to build business in a distant market is to make sure the new office will be easily incorporated into the whole organization. Knowing that their culture is quite different from the common company culture in China, company T decided it would be easier to recruit and train staff from the beginning than to convert an existing company to adopt their company culture.

Such organic growth and expatriate subsidiary manager at the establishment of subsidiary can largely explain why the normative integration is relatively high while there are little additional costs for achieving such high integration. Surprisingly, the normative integration not only brings the benefit to MNE's performance, such as innovation or fast response as mentioned before, it also served to improve other aspects of the

headquarter-subsiidiary relationship.

Autonomy in subsidiaries in China, for example, is changing with the development of subsidiary, but in a natural and smooth way. For company T, the ideal is always to localize the management and allow the subsidiary to have its own decision making authority. How much autonomy the Chinese subsidiaries have is decided by the opportunities the local market provides and the subsidiary's own competence. In other words, the location advantage and the subsidiary itself will influence the headquarter-subsiidiary relationship, echoing the theory that the location advantage, headquarter-subsiidiary relationship and the contributing subsidiary role are in the reinforcing cycle.

In company T, the increasing autonomy in subsidiary level is less due to the entrepreneurship of subsidiary manager. Actually, when the Beijing office discovered more business demand, earned more responsibility and became more mature, the expatriate subsidiary manager should be about to leave and another more operational manager either recruited from outside or promoted from local office will replace him. It is a time when the new subsidiary manager is supposed to have less credibility and power to fight in the headquarter for more autonomy. On the contrary, the subsidiary then would be deemed to be experienced enough to have the suitable ability to burden more responsibility and the autonomy is naturally given.

*"Our idea is always to localize the management and enable the Chinese management to run their own organization, so certain level of autonomy is expected. But we need to make sure rules are followed. As Beijing became a front-end office, it is their responsibility to*

*hunt for new business. They need to take more responsibility and act more sales function. They are autonomous within certain parameters, but need to comply with local legislation and follow strategy. I don't think being more autonomous is the result of role change, but you learn to do things on your own and manage things. Instead of autonomy, we talk about role activiness. You need to hunt your own business, need to become sales site, more active, make sure there is enough work for everyone in your location."*

When it comes to autonomy, the theory cannot reach a conclusion on whether the autonomy should be increased or decreased as a subsidiary grows more important. In the case of company T, the autonomy is raised when the Beijing office becomes a more contributing subsidiary. Just as this study pointed out earlier, the Beijing office hasn't reached the threshold to become too important for the whole organization when the increasing autonomy will become problematic. The majority of business in China is done with European companies or their local branches instead of local Chinese companies. In this sense, the Beijing office still largely took the role as an implementer or contributor. Therefore, the headquarter won't expect any inconsistency on strategy or conflict on management when it gives more autonomy to Beijing office. On the other hand, the Beijing office developed to have more responsibility in sales, which requires localization and quick response. Compared with functions such as manufacturing, sales functions requires higher degree of autonomy to perform its task better. As the interviewee put it, they need to hunt for new opportunity and bring work to its staff. The major functions Beijing offices fulfills also decide that more autonomy instead of less autonomy should be given as it grows.

However, in the case of company T, there may be another reason that the increasing autonomy is desired instead of problematic in its Chinese office. Again, the answer lies in the high normative integration. The worry about too high a level of autonomy in the subsidiary is largely because too much freedom will risk the subsidiary pursuing business that is not consistent with the company strategy. It can be a disaster for an MNE especially when the subsidiary is important and the investment to subsidiary is huge. The precaution for such result is not just to reduce autonomy and put more control, but also to improve normative integration to ensure the subsidiary business is in line with the organization's whole strategy.

As company T and its Chinese offices did, the organization value and goal are well recognized among all staff by the training. Meanwhile, the way of doing things is well shown by everyday operation; the strategy is clearly communicated between the subsidiary managers and the various directors based on industry group. All these details in normative integration will help to prevent the risk of inconsistency between whole strategy and subsidiary operation. In a word, the case showed that the proper autonomy level in the subsidiary should be also considered based on the normative integration. The higher the normative integration there is in the MNE, the higher autonomy a headquarter can provide to a subsidiary.

#### 4.3.3 Choosing the suitable subsidiary manager

Subsidiary managers are responsible for all the activities happening in the site and under

the matrix structure in company T, report to various directors in Europe. In the interviewee's opinion, the subsidiary manager is more important than the country manager, who is more a representative and spokesman under the legal infrastructure. Just as the theory argued, the factor of subsidiary itself refers to the subsidiary initiatives and the entrepreneurial behaviour, which will positively influence the recognition and investment from headquarter as well as the subsidiary's local performance.

In the case, expatriate manager from Finland plays an critical part at the establishment with his initiative character and experience. The biggest challenge is not to fight for support from headquarter, nor to have local connection, but to build everything from scratch. The organic growth decides the expatriate manager's role and major responsibility. In spite of the high cost of keeping the expatriate manager in China, the company T needs the expatriate manager for his dedication and experience in dealing with tough situation without any previous foundation. Besides, an expatriate manager is well aware of company culture and value, which will make sure the recruitment and training is done to safeguard the whole organization's normative integration.

However, company T has a different consideration about expatriate manager when the subsidiary grows mature. They worry the smooth operation in subsidiary will make the expatriate manager get bored and therefore not fully motivated. On the other hand, a more operational manager promoted internally or hired externally would be more suitable and more cost-efficient. The practise in company T is different from the theory which claimed an entrepreneurial subsidiary manager is always beneficial for subsidiary development.

In Chinese offices, keeping an entrepreneurial expatriate manager after the subsidiary becomes mature is not productive for the whole organization as well as to the expatriate manager himself. Initiative character is still a must especially when the subsidiary took more responsibility of sales, looking for business on their own. However, the improved situation when things get up and running means the focus of subsidiary manager's work is not longer to contact with headquarter and ensure everything is built according to headquarter's expectation. Instead, the subsidiary manager is more supposed to take care of the daily business in the local market.

The normative integration is taking effect again to prevent the potential conflict between headquarter and subsidiary when subsidiary is growing. That is why a subsidiary manager is able to shift more of his attention to the local business instead of focusing on the time-consuming argue with the headquarter. The normative integration enables a local manager to replace the expensive expatriate manger and the entrepreneurship of subsidiary manager to some extent is not that vital as a result.

If so, what kind of character a subsidiary manager should have based on different development phases in the subsidiary? Theoretically speaking, the entrepreneurship is always desired to fight for more support and investment from headquarter. However, in the case of company T, the entrepreneurship is not that much emphasized when the subsidiary is up and running, provided that there is high normative integration in place so that the subsidiary manager needn't bother about it. The finding from the case study is that the normative integration can partly replace the importance of having an entrepreneurial subsidiary manager while initiative character is still important in exploring new business

opportunities.

#### 4.3.4 Understanding the utilization of location advantage through case study

The case study provided a good opportunity to understand the theory and the conclusion made earlier in the research. The company T is a truly multinational company with high percentage of international sales and oversea staff. The long time of operating in China and experience of opening up several Chinese offices made it even more qualified to illustrate how the location advantage in Chinese market is utilized in the development of several Chinese offices in real-life business.

In the interview for more than one hour, the interviewee provided information covering various aspects of subsidiary operation, including the MNE structure, location advantage analysis, headquarter-subsidiary relationship and subsidiary situation. Because of the interviewee's long experience with the Chinese offices, he was able to explain the whole process in a dynamic way, making it possible to compare situations in different phases. Though the company name is not disclosed in this study to protect the company secrecy, the case study presented in this research is still able to provide a better understanding about the previous theory.

The connection between the location advantages and the headquarter-subsidiary relationship is not that obvious at first glance because the beneficial circle is so natural that the interviewee will take it for granted. After careful analysis, it is clear that the

suitable headquarter-subsidiary relationship does improve the subsidiary's ability to discover and utilize more location advantage, however, the circle needs to include the subsidiary performance improvement. That means the beneficial circle is comprised of the headquarter-subsidiary relationship, the subsidiary performance and the location advantage as shown below in the Figure 5. Take the early expansion of Beijing office for example, the support and investment from the headquarter enabled the Beijing office to serve the forest customer in China, grow its competence and then Beijing office were good enough to recognize more opportunities in telecom market. By making use of such new location advantage, the Beijing office developed itself and earned more support and autonomy from headquarter.

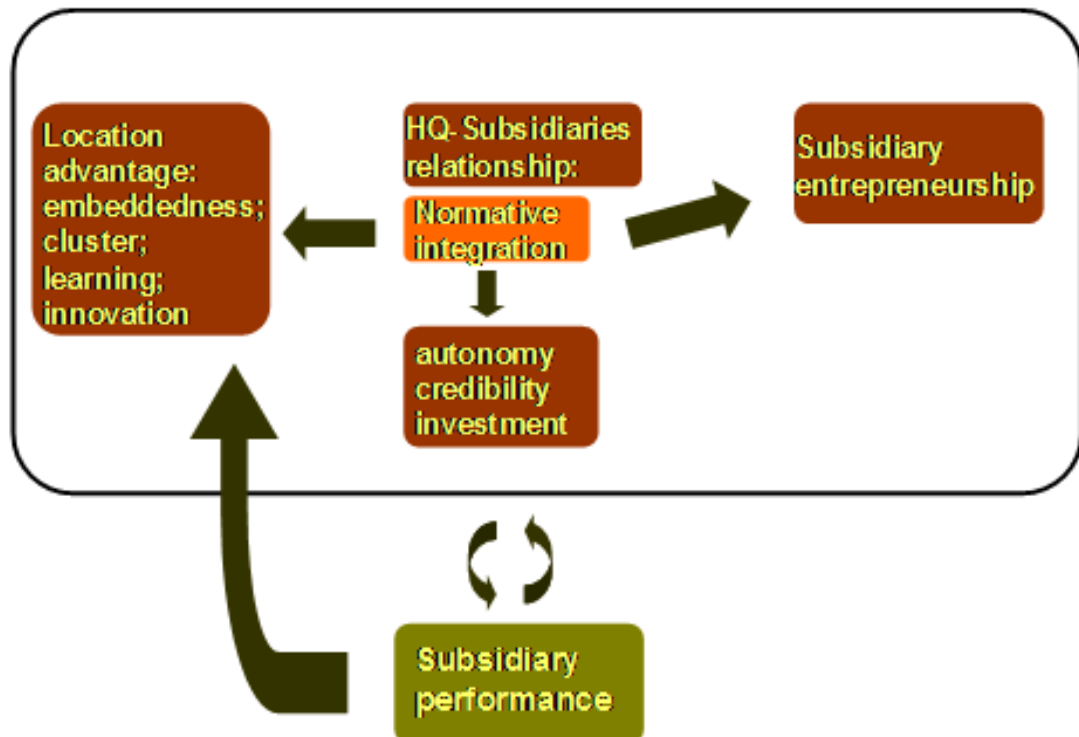


Figure 6: Revised subsidiary development flow

The emphasis on the dynamic character of location advantage is also shown in such case. The subsidiary's ability to discover and utilize the location advantage is influenced by the headquarter-subsidiary relationship as well as the subsidiary competence itself. That is just internal factors that cause the changes in location advantage, not to mention the external changes in the environment, such as the rise in labour cost or economic development. That is why this study emphasizes the location advantage is not still and not only useful when making the decision about opening a new site. It is always changing and therefore an MNE needs to keep alert to it so as to respond timely.

The subsidiary manager plays an important role in ensuring the growth of subsidiary. The requirement for the entrepreneurship in the subsidiary is more due to its organic growth than to the fight with the headquarter. When a Chinese office is just built, the subsidiary manager's biggest challenge is to start a whole new business. Such a tough situation requires a subsidiary manager to be tireless, initiative and experienced. However, as in company T, subsidiary managers seldom face the pressure to fight with headquarter for more investment or support thanks to the harmonious headquarter-subsidiary relationship. Such entrepreneurship is not that important after some time when the subsidiary is up and running, while in theory, more mature a subsidiary is, more important an entrepreneurial manager is for the subsidiary development.

The inconsistency between the theory and the real case on the subsidiary manager character is probably due to the high level of normative integration in company T. The suitable headquarter-subsidiary relationship, largely characterized by high normative

integration, made it less necessary to fight for proper recognition and investment from headquarter, thus the main task for subsidiary manager is to run the local business well. When the first connection with new customer has been made and the subsidiary mainly needs to prove their value and quality to upgrade the service, the subsidiary manager would pay more attention internally to develop its own competence.

The emphasize of normative integration has been repeatedly mentioned during the interview. The case study showed the high degree normative integration plays a larger role than this study firstly thought. Regarding the headquarter-subsidiary relationship alone, the normative integration is not just an important parameter in describing the relationship, but also largely decides the rest parameters, namely the autonomy in subsidiary, credibility of subsidiary manager and investment from headquarter to subsidiary. The normative integration seems to be a key in building a harmonious relationship; once such high integration is achieved, there will be less trouble in developing other aspects of the headquarter-subsidiary relationship. In particular, the suitable autonomy level in subsidiary, where the theories cannot reach a consensus, is a natural decision without too much conflict thanks to the high normative integration.

The positive influence of normative integration is not only restricted in the relationship between headquarter and subsidiary alone, but also to the utilization of location advantage. In this case, the learning opportunities in particular is benefited from the high normative integration. The close connection between different offices made the sharing of knowledge more efficiently while the formal and standardized way is proved to be not working.

Normative integration works in selecting the suitable subsidiary manager as well. While the theory believes the entrepreneurship of subsidiary manager is vital for subsidiary development in gaining credibility from headquarter and winning support, the case company didn't recognize it as very necessary. The normative integration makes the communication with headquarter a smooth and efficient process requiring less misunderstanding and conflict. Therefore, the subsidiary manager needn't waste time in the battle with headquarter. Instead, the main character should be initiative to hunt for business. Instead of promoting the development of subsidiary manager's entrepreneurship, the normative integration actually makes it less necessary for a subsidiary manager to be aggressive and tough.

In general, the combination of location advantage, headquarter-subsidiary relationship and subsidiary manager will decide the development of a subsidiary. In growing a more contributing subsidiary, a suitable configuration should be achieved based on these three elements while the normative integration plays a core part by influencing other factors in the configuration. However, such growth flow won't stop when subsidiary achieves the first development. It is a reinforcing cycle. That means after the subsidiary improves its competence and becomes a more contributing subsidiary, its ability to discover and utilize the location advantage in the same market grows as well. As this study suggests, the location advantages are actually subjective and dynamic. The increase in the location advantages will promote changes in other two factors in the configuration, namely the headquarter-subsidiary relationship and the subsidiary manager, and jointly a new configuration will be achieved, resulting in continuous subsidiary development.

As shown in the figure 5, the circle for continuous subsidiary development lies in the critical link from subsidiary development and the utilization of location advantage. On one hand, it helps to make subsidiary keep growing. On the other hand, the MNE should be aware that the location advantage is a dynamic factor that needs to be monitored all the time. Only after the subsidiary recognizes the new location advantage will the mechanism of location advantage, headquarter-subsidiary relationship and subsidiary manager take effect and jointly lead to a more contributing subsidiary. In the mechanism, normative integration is obviously a core element in ensuring other parts of the configuration work properly.

## **5. CONCLUSIONS**

### **5.1 Conclusion of the study**

The study was first initiated due to the curiosity that whether the subsidiaries built in the foreign market are successful enough to utilize the location advantage locally. With some theoretical analysis, the research goal is related factors that will lead to better utilization of location advantage and contributing subsidiary. To find the answer to this problem, the research question was broken down to three sub-questions, namely what headquarter-subsidiary relationship can help to better utilize the location advantage, what subsidiary character can help to better utilize the location advantage and how the better utilization of location advantage can lead to a more contributing subsidiary role.

The study was carried out in two steps. First, related theories are reviewed to draw strength from previous result and gain deeper understanding about the research question. Two research streams are covered in this study, the eclectic paradigm and the subsidiary development. The eclectic paradigm provides a comprehensive definition on the location advantage and the importance of contextual environment. The subsidiary development theory includes the related elements in influencing the subsidiary capability development. The link between these two theories is the location advantage or the environment. The location advantage is one of the three advantages in eclectic paradigm that provide an MNE with extra competence to overcome the cost of foreignness in a new country while in the subsidiary development theory, it influences the subsidiary development jointly with headquarter-subsidiary development and subsidiary character itself. That is why this

study emphasizes the environment and views the internationalisation process as a dynamic process. In the end, a flow of subsidiary development is summarized. It shows the three elements of the configuration, the location advantage, the headquarter-subsidiary relationship and the subsidiary character itself will influence each other, and jointly they will affect the subsidiary contribution. In return, the new subsidiary competence will require changes in the headquarter-subsidiary relationship.

Then in the second part, an empirical study was presented. The qualitative research method is used so that the case study can provide a deeper understanding on the theory this study includes in the first part. The qualitative research also helps to understand various elements in the internationalisation process, especially the interaction between each of them. As the study emphasized the utilization of location advantage is a dynamic process, the qualitative research describes the whole process of subsidiary development, presenting the full picture of changes of elements from the beginning. The object of case study is also carefully chosen. Company T is a truly mature MNE judging by its international sales volume, staff outside headquarter and the long history in internationalisation. Meanwhile, the subsidiaries in China are selected as research objects because the researcher herself is from China; more knowledge about Chinese market and business practise will make it easier to understand the situation of subsidiaries in China. Besides, Chinese market underwent radical changes in the last decades, evolving from a manufacturing site to big market and potential R&D center. Such substantial changes in the macro environment are supposed to affect the subsidiary development in China, presenting a more obvious growth in the subsidiary role.

The case study provides both new and deeper understanding on the research question. Some of the previous theoretical findings are confirmed in the case study. In real-life business, some rules may not be that obvious and absolute as in the ideal theoretical analysis. However, the careful analysis still finds the configuration including the location advantage, headquarter-subsidiary relationship and the subsidiary character, will jointly influence the subsidiary contribution. At the same time, the pattern of subsidiary continuous development is also identified by adjusting to changing location advantage. In a word, once a suitable configuration of location advantage, headquarter-subsidiary relationship and subsidiary character is built, it will trigger the reinforcing cycle, leading to more contributing subsidiary and then requiring the adjustment in the configuration accordingly.

On the other hand, the case study represented some interesting discrepancy with the theoretical analysis, adding value to this study by supporting the research with real-life business situation. One finding is about the expanding definition of location advantage. Previously, the location advantage is thought to be unique to the specific location; only the companies present in the area can benefit from such location advantage. However, in the case study, the learning opportunities, one kind of important location advantage in knowledge economy, isn't only available in China. The learning opportunity about how to manage multi-cultural environment isn't necessarily related to China. Company T may well learn the same thing when they do business in India. When several locations can provide the same learning opportunity, the importance of learning opportunity in each location may be reduced because failing to learn in one location won't necessarily lead to the absolute loss in the whole organization. However, that doesn't imply the utilization of

such location advantage is not important. Though the learning result would be the same, a subsidiary that grasps the learning opportunity still can contribute by providing more staff with hands-on experience in dealing with such situation.

The location advantage is also subjective, depending on the MNE's knowledge and competence. The growth in the MNE's competence and knowledge will surely lead to a recognition of more profound location advantage in the foreign market, just as the Beijing office found the telecom market. Meanwhile, for a more mature MNE, some previous location advantage may even disappear due to the internal changes. For example, the learning opportunity mentioned in the last paragraph may be less valuable after the MNE is more international. However, it does not exclude the changes in location advantage brought by the external environment, such as rise in labour cost. In a word, the location advantages are consistently changing due to internal and external situation. Keeping this in mind will help the MNE to be alert to respond timely. That is why in the new flow chart for subsidiary development shown in figure 5, the critical link to achieve the continuous subsidiary development moved from the headquarter-subsidiary relationship to location advantage.

Another new finding from the case study is the way to determine suitable autonomy level in subsidiary. The theories have no consensus on whether the autonomy should be increased or decreased when a subsidiary is more important. The study used different time frame as well as different subsidiary functional division to explain the difference. However, in the case study, it emerged that the autonomy level should also be influenced by the normative integration. The theory calling for more control for contributing subsidiary

is due to the risk of inconsistent strategy between subsidiary and the whole organization. It can not only be solved by placing more control on the subsidiary, but also on pursuing higher normative integration, so that the shared goal and strategy will be well communicated between headquarter and subsidiary. Likewise, when integration is low, more control is desirable because there are higher risk that the subsidiary will develop own business strategy regardless of the general strategy.

In summary, the figure 5 presented the revised flow for subsidiary development. There is reinforcing cycle for subsidiary to utilize location advantage to develop itself as long as there is suitable configuration of headquarter-subsidiary relationship, location advantage and subsidiary character. The normative integration is the key in such a configuration by influencing the other elements. Location advantage served as a changing factor that will drive a continuous subsidiary development.

## **5.2 Theoretical implication**

The study is built on the two pillars, eclectic paradigm and the subsidiary development theory. The location advantage in the OLI parameter is one of the important incentives for MNEs to set up subsidiaries in foreign countries. In this study, the location advantage is not only limited in the decision making for opening a new site. It is an ongoing process throughout the subsidiary history. After the location advantage attracts the MNE to build subsidiary in the local market, it is still helpful for MNEs to evaluate the environment as well as its own performance in the market. This study starts from location advantage in

eclectic paradigm and combine its usage with the subsidiary development theory.

The subsidiary development theory grows fast from 1980s. Its emphasis on environment provides the link between the eclectic paradigm and the subsidiary development theory. By drawing strength from eclectic paradigm, the subsidiary development theory can have a better understanding about the environment where a subsidiary operates. Meanwhile, such dynamic location advantages lead the subsidiary development to a reinforcing cycle for continuous process.

By combining the eclectic paradigm and subsidiary development through the link of location advantage, this study is able to examine the utilization of location advantage from a new and comprehensive angle. The eclectic paradigm helps to analyse the location advantage in a logic way in the increasingly complicated environment. The subsidiary development theory provides a comprehensive view on what factors are related to subsidiary development. The study combines the merits from both theories, showing how to develop subsidiaries by utilizing the location advantage.

### **5.3 Managerial implication**

The managerial implication of this study is to guide MNEs on how to develop the subsidiary by drawing strength from local environment. First of all, the study calls the MNEs' attention to the location advantage, not just at the beginning of subsidiary's establishment, but also throughout the subsidiary development. Knowing the location

advantage will change all the time, the MNEs will keep an eye on the location advantage of foreign market and thus being prepared for the changing environment. Specifically speaking, the constant monitor on the local environment should be carried out in subsidiary level and any discovery should be communicated with headquarter to discuss whether any actions are needed to respond. At the same time, the certain level of autonomy should be granted to subsidiary for monitoring the local environment and taking pilot project to react fastly.

Secondly, the study points out the importance of normative integration. It is believed to be a beneficial mechanism by many studies before. But in this study, the focus of normative integration's benefits is on the positive influence on the subsidiary development. Besides, the cost of normative integration is not as high as the theory previously thought. As long as the MNE is growing in a proper way and carries out recruitment and training properly, the normative integration is achievable without huge additional cost. Both managers in MNE's headquarter and subsidiaries should pay more efforts on nourishing high normative integration. Informal way may be as effective as formal way of training or personnel rotation. The way of doing business, what is allowed and what is not, will all help to build a unified company culture and characteristic way of doing things.

#### **5.4 Limitation of the study and the suggestion of the future study**

The study is limited in both theoretical and empirical aspects. Theoretically speaking, the analysis is general without further separating the industry, function or subsidiary development phase. Therefore, the finding is only applicable in the common situation.

Besides, the study only covers the reinforcing cycle when the subsidiary keeps on growing, but doesn't explain the situation when one of the elements fail to work and the cycle cannot continue.

As the study emphasizes the whole development process of subsidiary, especially the evolution of subsidiary role, it would be ideal to investigate a subsidiary going through radical changes in the environment and own competence. Even though in the case study, the three Chinese offices represent different functions and are driven by different location advantages, it still cannot fully illustrate all the changes during subsidiary development. Even though Beijing office in particular has went through big changes in role, it still hasn't reached the threshold to become too important to cause trouble for headquarter.

Meanwhile, even though the company T has a 10 yeas' history running subsidiaries in China, the Chinese business is still mainly restricted to European customers and their local branches. The lack of close connection with local community made it impossible to analyse some location advantages, such as local embeddedness or cluster effect. In addition, the lower requirement for building deep contact with local business partners may help to prevent the potential conflict between balancing local response and bureaucratic regulation, resulting a more simplified case than reality.

At last, only interview with headquarter is carried out, presenting the opinion from only one side. Without the opinion from subsidiary, it is difficult to understand the situation objectively. For topics such as headquarter-subsidiary relationship or subsidiary character, the view from subsidiaries will definitely bring new perception to the studies. Besides, it is

impossible to know more details about the subsidiary's operation in China from the subsidiary's view.

Based on this study's finding, more researches can be done from subsidiary's view to provide new understanding about the conclusion. In addition, as only part of location advantages are covered in this study, more researches can be made toward other location advantages. It would be interesting to see whether other researches will come to similar conclusion. Finally, a deeper study can be made by focusing on one particular industry or one particular subsidiary function.

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**Appendix 1****FRAMEWORK FOR INTERVIEW**

1. What is the company's business and its internationalisation history?
2. How the subsidiaries in China were built?
3. Why among so many M&A in company history, there are so few transaction done in China?
4. What is the advantage in China that attracted you to build the office here?
5. Whether the subsidiary has close connection with local business community, and whether such relationship is helpful for the subsidiary performance?
6. What the whole organization has learnt from the subsidiaries in China?>
7. Whether such learning has been effectively shared among different offices and how?
8. What kind of the person is the subsidiary manager in China, how he is promoted to such a position?
9. Whether the importance of subsidiary changes after its establishment?
10. What kind of relationship is between headquarter and offices in China, formal or informal?
11. Whether there are shared value and goal throughout the whole organization, if so, how it is achieved?
12. In so many years of subsidiary development, do you find new advantages in the Chinese market?
13. In so many years of subsidiary development, do you find any old advantages not longer exist in China?

14. What measures the company has taken to deal with the changing environment in China?
15. As the subsidiary becomes mature, whether the autonomy is increased or decreased?