

# Notes on Globalization and Strategy

Year 5 / No. 11 / 2009

## THE NEW ROLE OF SUBSIDIARIES

### Subsidiaries Can (and Must) Also Be Strategic

The role of the subsidiary should not be limited to the functions assigned to it by the multinational parent company. The subsidiary only finds its true purpose when it moves beyond the role it has been given, and helps strengthen the parent company's overall competitive advantage.

#### Carlos García Pont

Associate Professor of Marketing, IESE

In the era of globalization, multinational companies form an increasingly important part of our economy. In fact, 30 percent of global trade today is carried out by the subsidiaries of multinational companies. Moreover, it is estimated that 45 percent of production in Spain is carried out by subsidiaries of multinational companies. What we sometimes forget, however, is that multinationals are the sum total of their parts: it is the subsidiaries that make up the multinational and not vice versa. This means that each subsidiary is a key piece of the global jigsaw puzzle which is what a multinational company is.

Unfortunately, neither the headquarters nor the subsidiaries of many multinational companies pay much heed to this fact. This causes two problems, both serious. First, subsidiaries naturally struggle to gain a certain amount of independence. While this independence was entirely possible in the past, it is much more difficult to gain in the new world. Given that the value chain now has a regional and global span; it has to be monitored from the center. This need for central coordina-

tion has led to the growing involvement of the company's headquarters in the decision-making process. This in turn has clearly reduced the subsidiaries' chances of independence. The level of centralization depends on the sector and the company involved. Central control gives rise to another problem: a dip in motivation amongst top level personnel.

High-performing executives tend to be driven to take on risk and increase their decision-making authority within a company. When they begin to feel further removed from the decision-making process, these executives may choose either to seek a more active decision-making role, which would imply leaving the subsidiary and transferring to company headquarters, or to leave the company altogether and join one where there are better opportunities to get involved in making decisions.

The solution to both these problems is to make a concerted effort to give real meaning to the phrase 'subsidiary strategy.' Subsidiaries must

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Multinationals are the sum of their total parts: it is the subsidiaries that make up the multinational and not vice versa.

Subsidiaries must have their own strategy. It is only by creating its own strategy and developing a sense of mission that an organization gains real unity.

The subsidiary does not have complete freedom to decide its own future and is largely dependent upon the business model drawn up at headquarters.

have their own strategy. It is only by getting involved in drawing up its own strategy and developing a true sense of mission that an organization gains real unity in action and focus. Moreover, this would automatically give the subsidiary some decision-making independence and, at the same time, offer its executives more opportunities for career development.

## Drawing up a dual strategy

A subsidiary cannot apply a traditional business model to its strategy. Clearly, a subsidiary can never wholly own its strategy. It does not have complete freedom to decide its own future, and is largely dependent upon the business model drawn up at the company's headquarters, not to mention the specific product, market or technological systems that are imposed on it by the multinational. Moreover, the subsidiary is allocated certain roles within the value chain, and the regional or global coordination involved prevents it from expanding its field of activities without prior approval from central office.

Therefore the strategy of a subsidiary must be split into two distinct areas: the local and the regional or global. At the local level, the subsidiary must understand that its duty is to provide an excellent service in every area of activity, for example in its role as distributor or producer of a particular range of products.

At the regional or global level, where its strategy would differ, the main objective of the subsidiary is to secure the right to shape its own destiny within the multinational - that is to increase its weight within the company by stepping up its overall contribution to the organization. It is not merely a question of increasing sales within

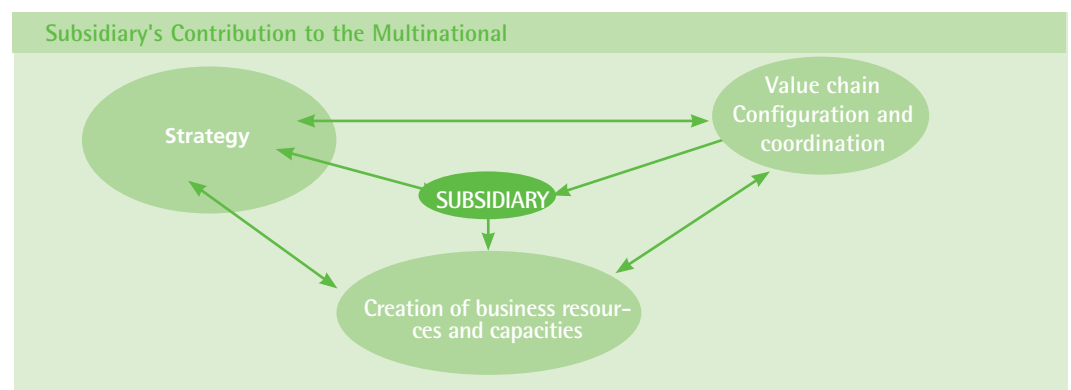
its respective country of operations, but also of contributing to the expansion of the company's activities into other areas or regions of the world. How can it do that? The subsidiary can contribute to the development of the division's global strategy through the global coordination of activities along the value chain and by adding to the corporation's global resources and skills.

## Key steps

"We are a small plant and the head office is in Europe. In Europe they could produce exactly the same products as us, so in order to survive we must be better than them at something." These are the words of the managing director of a subsidiary. They exemplify the challenge facing subsidiaries today, as they struggle to create a niche for themselves within the multinational they belong to.

To be the best in its particular field a subsidiary must, first and foremost, deliver solid results: sales and profits. It is essential to achieve good results and meet all key objectives at the local level. If not, the subsidiary risks undermining its relationship with the corporation's headquarters. After all, freedom and independence have to be earned. First, one has to be excellent in what has been assigned, and the balance sheet is the first reflection of this.

If its results do not meet or exceed expectations, its strategy will always be limited to the local level. To avoid this, it must first seek ways to improve its performance so that it can report the best possible results. Further down the line, it can start thinking about taking things further, by developing a local business development strategy.



Source: Author



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To define its own strategy, the subsidiary must begin by analyzing the business model of the multinational it belongs to and then identify its own strengths in order to develop an idea of precisely where they can outperform their fellow subsidiaries. What are the basic business processes? According to what criteria is the competitiveness of the subsidiary judged and what value chain activities do they support?

It is crucial to identify how best to carry out the strategy and to assess what resources and skills it can draw upon to achieve the highest possible standards of excellence. It would also be useful to think about how to make the subsidiary's particular market more interesting or what strategic variations it can export to other divisions of the company or its fellow subsidiaries. It is important to keep in mind the overall aim: to find a niche where this particular subsidiary can outperform its peers in the group, thus becoming a strategic leader within the multinational company.

The second way in which the subsidiary can stand out from the crowd is by adding value to the multinational beyond the local level. For this they must single out what it is that the corporation most needs. They can contribute in three different ways. The first and most immediate way would be through the coordination of value chain activities. They should strive to make any interaction with other entities as trouble-free and efficient as possible. To achieve this, they should enhance their own processes and methods as well as developing their own network of contacts. They could then add further value by harnessing this network throughout the company, helping to smooth out any of the usual complications that arise in operational processes.

Finally, a subsidiary should strategically exploit all its assets, be they value chain activities in its respective country of operations or the development of a network to coordinate value chain activities in other subsidiaries. In fact, if the

subsidiary's strategy is based around building a broader network of business relationships, it should be easier for it to find and assert its own identity. After all, the greater the number of contacts a subsidiary has, the greater will be its value to the multinational company.

Once operational excellence in all the value chain activities has been achieved, the next step should be to develop local resources and skills that yield fruitful results. Once integrated, these skills should enable the subsidiary to enter new markets and develop new products and processes. The subsidiary will then be able to benefit from the advantages of strategic integration, as it establishes itself as an essential part of the multinational company. Other subsidiaries or branches of the multinational could benefit from its skills or resources, and if so, it may be possible to transfer them to other parts of the company or adapt them to the organization as a whole.

To sum up, the strategy of a subsidiary should include:

1. The development of specific business objectives such as sales, margins, market penetration etc.
2. The development of specific strategic assets within the subsidiary's geographic area.
3. Contributing, with its strategic assets, to the development of other subsidiaries.
4. The acquisition of specific strategic assets from among its fellow subsidiaries.

## A sense of initiative is imperative

Taking the initiative is, therefore, an essential part of the whole process. If a subsidiary hopes to move on from merely carrying out orders to becoming a key piece in the jigsaw, adding value to the company as a whole, it has to abandon its passive role and be more proactive. Only by exercising its initiative will it be able to achieve the necessary independence to set its own agenda.

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If the subsidiary's strategy is built around building a broader network of business relationships, it should be easier for it to find and assert its own identity.

Initiative is the basic ingredient required for subsidiaries to abandon a passive role and adopt a collaborative role.

### Dimensions of the Subsidiary Strategy

	Local dimension	Global contribution	Global exportation
Strategy			
Value chain			
Resources and capabilities			



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## In Pursuit of a Culture of Collaboration

Prof. Carlos Garcia Pont discusses the challenges facing subsidiaries from the perspective of those working in them. He explains how working in a multinational company can affect one's career development and argues that, without a real project to focus on, managers will struggle with motivation.



**Carlos Garcia Pont.**  
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### Are subsidiaries a significant part of the economic landscape?

Subsidiaries are clearly important. Just a quick glance at some of the statistics is enough to prove this point: according to recent studies, in Spain there are roughly 8,000 multinational subsidiaries, while Germany has about 13,000. Just think for a moment how many of your friends and associates work in multinational affiliates. In fact, as many as 70% of IESE alumni living in Spain work in multinational companies.

We can also look back at the many times when, seeking to change our career paths, we have been faced with the possibility of working for a company whose headquarters are not located in Spain. The answer is plain and simple: it is very difficult for us to contemplate changing careers if we completely exclude multinational companies from the range of options. That is why it is always prudent to consider the difference between a career developed within a company whose headquarters are based locally and one whose central office is further afield. Even if the difference in terms of kilometers is not that significant, the gulf, in terms of organizational strategy and decision-making style, can be enormous.

### And what are the differences?

If you want to develop your career within a multinational company, you will have to, at some point, leave your country as well as increase your exposure to other business environments. You will also need to get used to following instructions given by people in faraway places. Yet many executives are reluctant to move country: the stress of dual careers and childraising prevent many from accepting posts beyond their country's borders. Most people believe that career opportunities are available only when one has reached a certain level professionally in

one's country of origin. This usually means that we must first spend a number of years working for the same company. Another significant concern is about the openings available to a spouse, who may have to forego their career aspirations owing to the difficulty of finding similar opportunities in other countries. Often their professional qualifications are not recognized outside their country of origin, for example with lawyers.

If one's focus is on career development locally within the corporation, one will have to focus on delivering an exceptional level of performance, above and beyond the requirements of the job description. This means having the initiative to work closely with fellow subsidiaries or with multinational taskforces entrusted with delivering this goal. This challenge is made much easier if the local subsidiary one works for is supportive – in other words, that they have a strategy of collaboration in place for working effectively with the multinational that goes far beyond simply delivering results.

Career development, like strategy development, is not merely the product of careful planning. It is also the result of identifying and pursuing any business and career opportunities that arise. One has to be alert and, just like an entrepreneur, be on the constant lookout for opportunities that add to and advance one's position.

### What risks does a subsidiary run if it is unwilling to carve out its own niche within the multinational?

The subsidiary or branch of an organization that does not exercise its own initiative risks being demoted in status and losing its value to the company. Its future will be limited to executing orders from head office, eventually resulting in a stagnant working environment staffed by unmotivated managers and workers. People,

It is always prudent to consider the difference between a career developed within a company whose headquarters are based locally and one whose central office is further afield.



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like the organizations they work in, need a project or mission. In the early stages of developing a subsidiary the main project, more often than not, consists of developing the local business: finding markets and using all the assets - both tangible and intangible - that the multinational company makes available.

Once this first phase is complete, you look around you and ask yourself, "what now?" You look for another project which could fill you with a sense of purpose; you seek not only to continue improving the bottom line, but also to be motivated by the work you do and to feel secure in the knowledge that you have a job to do and objectives to meet. Without these challenges the whole project will begin to unravel and it will become increasingly hard for you to offer your employees opportunities to grow and develop.

## How does globalization affect the role of subsidiaries and their relationship with company headquarters?

Obviously, collaboration is a give and take relationship. Subsidiaries and their employees can only add value if the multinational allows it. This is why one of the constant challenges facing subsidiaries is to empower their workers with the skills and capacity to contribute to changes that benefit the corporation as a whole.

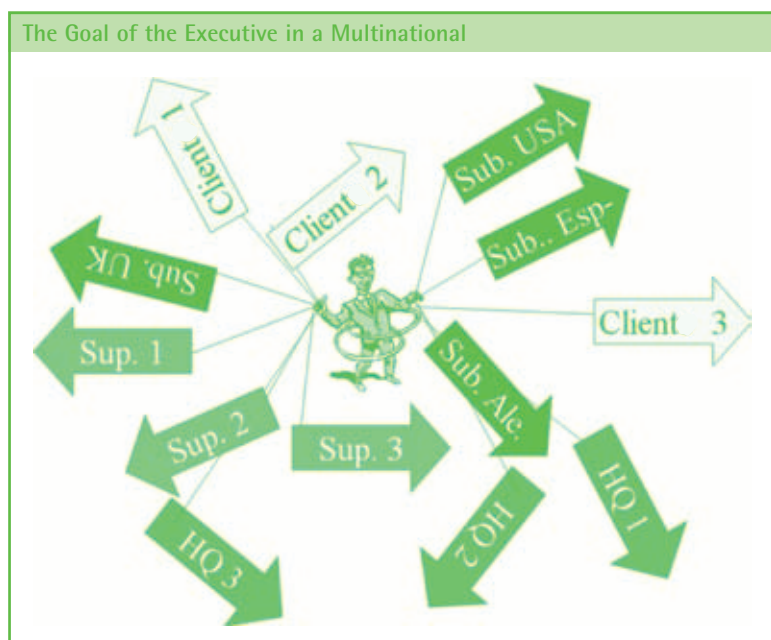
To achieve this, the general trend towards centralization must be offset by a drive to develop the skills of subsidiaries' workforces, without having to relocate them. Fortunately, there are many ways of doing this. One is to distribute responsibilities globally, either by diversifying the functions of decision-making centers, for example into areas of supply chain management or a particular division, or by modifying the roles of large global account managers. However, the most important thing is to create an ideal culture of contribution and collaboration where practices such as those above can flourish.

## Does the current crisis affect the challenges facing subsidiaries?

In the current global financial crisis the temptation to take drastic steps prevails. Although many of these steps may be necessary, we must also bear in mind, as always, that those who are closest to the problem have the most information and are, therefore, more likely to be in a position to make the right decisions. These decisions, if shared with the rest of the organization, could help bring about the creation of the culture of collaboration that we are seeking. The greatest danger during times of crisis is that we destroy the very organizations that we have worked so hard to build.

Subsidiaries and their employees can only add value if the multinational allows it. This is why one of the constant challenges facing subsidiaries is to empower their workers with skills that will benefit the entire organization.

The greatest danger during times of crisis is that we destroy the very organizations we have worked so hard to build.





# Brakes Spain: The Case of a Subsidiary That Took the Initiative

This real-life case<sup>1</sup> with fictitious names illustrates how subsidiaries can benefit from their integration within the multinational and become an essential part of it.



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**Brakes Spain felt that it had lost power and was left out of the decisionmaking process.**

Brakes Spain (from here on referred to as BS) is an affiliate of British, a multinational automotive company operating in more than 30 countries throughout Europe, America and Asia. BS belongs to the Brakes division, which is dedicated to the production of vehicle parts and supplies many of the world's leading vehicle manufacturers. In the space of just one decade, BS evolved from being a mere factory to a key player within British. How did it achieve this independence? Let's take an in-depth look at the case.

### In the beginning

BS was acquired during the mid-eighties by British. Its first years as a subsidiary were dominated by manoeuvres to integrate it within the system at British. At the same time, British made another acquisition in Spain which further complicated the whole integration process. During this period, the two subsidiaries began to truly understand what it actually meant to belong to a multinational company. Reporting systems were quickly installed and both companies were soon stocking up and supplying other companies within the Brakes division.

During the initial process, however, BS found that it was in a weaker position than many of its fellow subsidiaries. The English subsidiary benefited from the fact that the multinational was English while the advantages for the German subsidiary were that the corporation's main technological center was in Germany, and Volkswagen and Opel were important clients of the group. The French subsidiary enjoyed close links to Renault and the PSA Group, while American operations were always managed directly from the U.S. BS felt that it had lost all its power and had been completely left out of the decision-making process. In addition, its

integration within British meant that it now rarely produced complete products and depended almost entirely on parts from other factories in the division while at the same time supplying other subsidiaries of British.

Basically, it spent all its time obeying orders from the division and it was beginning to dawn on the company that its decision-making capacity had been significantly weakened, which in the long-term could pose a threat to its very existence. Further, the constant pressure to reduce costs, together with the growing threat of competition from Eastern European countries as alternative production bases, meant that BS had to sustain and develop skills that would enable it to remain highly competitive within the multinational.

### Changing strategy

BS decided to act. Its strategy was based on three central pillars. First, it decided to create a local head office and fill it with all the necessary industrial expertise to maintain competitiveness. This knowledge would be the cornerstone of all factory developments. Second, it began to provide incentives for the company's team of engineers to focus on small-scale product development in order to improve product specifications and reduce production costs. Last, it strengthened its sales team and encouraged them to build closer relations with clients, an area which previously had been managed by other departments within the company.

On the back of these changes, BS was soon able to launch its own projects and establish itself as the most prolific subsidiary of the whole Brakes division, in terms of volume of transactions. Moreover, BS was finally able to overcome



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its geographical isolation by breaking into the Asian market, a task considered by British to be of the highest priority, but which many of the other subsidiaries were reluctant to undertake due to the vast cultural and geographical differences involved. BS was beginning to gain a stronger foothold within British.

## Gaining clout

As a result of their successful management strategy, BS' executives were beginning to gain visibility and prominence within the division and were soon being summoned to fill division positions. Meanwhile, those who stayed on in Spain enjoyed increased exposure thanks to their participation in division-wide projects. Examples one could cite are their significant contribution to the group's executive resources policies or the decisive role they played in signing up a new Japanese client.

The R+D center built in Spain – the fruit of the efforts made by the engineering department years before – became a world leader in the development of certain types of products. For example, it took over responsibility for the production of braking systems, which carried relatively high margins. In addition, BS became a benchmark for a number of clients in the industry. In fact, it was able to build such a strong reputation within the multinational that soon U.S. or Japanese clients were asking to deal directly with BS. BS's growth was soon so strong that it actually became the number one subsidiary in terms of results.

## Refining the dual approach

The interesting point about this case is the two-pronged nature of BS's strategy. Evidently, BS initially drew up and carried out a traditional business strategy based on projected sales and profit figures, product development and market positioning. However it developed a parallel strategy that was purely focused on advancing its position within the multinational.

This strategy was developed by the company's senior executives, who were constantly aware of the need to pursue this two-fold strategy, which not only included developing the business and its talent from an external perspective, but also taking an internal approach which involved improving the company's positioning both within the multinational and in relation to the division's many other subsidiaries.

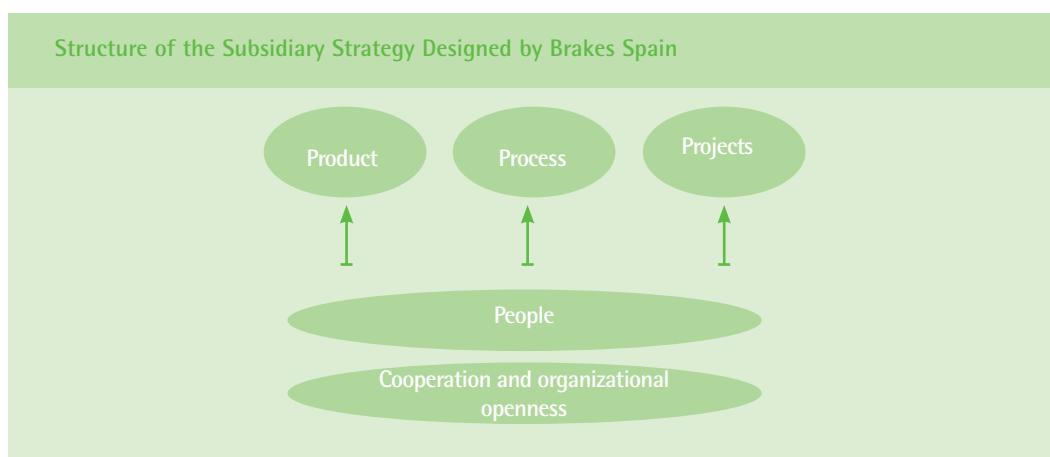
## Conclusions

The BS case is living proof of the advantages of developing subsidiary strategies. In the first place, the success of BS's strategy enabled its executives to add breadth to their professional development, benefiting from that shared identity and sense of mission that is so crucial to creating unity within a management team. In addition, the strategy helped transform what would have been a mere factory unit into an organization that was able to thrive and develop.

Within a decade, Brakes Spain changed from a mere factory to a key actor inside British.

Brakes Spain developed a parallel strategy that was focused on advancing its position within the multinational.

The success of BS's strategy enabled its executives to add breadth to their professional development, benefiting from that shared identity and sense of mission that is so crucial in creating unity within a management team.



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## THE CENTER REPORTS



**Appointments** IESE Prof. Joan Enric Ricart, who also directs the Center for Globalization and Strategy, has been named **president of the Strategic Management Society (SMS)**, one of the most prestigious academic institutions in the field of strategic management. Founded in London in 1981, the SMS, which has its headquarters in Chicago, brings together more than 2,000 experts from 50 countries specialized in the academic study of strategic management issues. Prof. Ricart will be taking over from Prof. Michael Hitt, of Texas A&M University.

**Awards** Pankaj Ghemawat, IESE professor and holder of the Anselmo Rubiralta Chair of Globalization and Strategy, has been **awarded by the Academy of Management.**



Ghemawat was presented with the highly-prestigious Irwin Outstanding Educator Award by the Business Policy and Strategy Division of the Academy of Management in recognition of his exemplary record and his prolific contribution to the academic world. It is the first time that a professor of a

European business school has received this award, which was presented during the association's annual meeting, recently held in Anaheim (California).



An article written by IESE Profs. Johanna Mair and Christian Seelos, both of whom contribute to the Center for Globalization and Strategy, has been awarded first prize in a World Bank competition.



Mair and Seelos were named **gold prize winners by the International Finance**

**Corporation (IFC) and Financial Times** second annual essay writing competition for their paper "Corporate Strategy and Market Creation in Context of Deep Poverty." The selection of this essay for the award reflects a growing interest in "Base of the Pyramid Strategies," which can generate business opportunities in low-income communities. The IFC is the private sector arm of the World Bank, whose purpose is to promote sustainable private sector investment in developing countries, helping to reduce poverty and improve people's lives.

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