

**IMPACT OF ORGANIZATIONAL ACCULTURATION ON SUBSIDIARY  
PERFORMANCE: COMPETENCE EXPLOITING VERSUS COMPETENCE  
CREATING SUBSIDIARIES**

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**ABSTRACT**

This paper proposes to examine the impact of organizational acculturation on subsidiary performance and also focus on the moderating role of the type of subsidiary on this relationship. The paper will examine two types of subsidiaries: competence exploiting subsidiaries which are miniature replicas of the parent and competence creating subsidiaries which are strategically more independent. Specifically, we look at whether the degree of organizational acculturation will differ between the two types of subsidiaries and how this difference will influence the relationship between organizational acculturation and firm performance.

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## **INTRODUCTION**

This paper proposes to examine the impact of organizational acculturation on subsidiary performance and also focus on the moderating role of the type of subsidiary on this relationship. The paper will examine two types of subsidiaries: competence exploiting subsidiaries which are miniature replicas of the parent and competence creating subsidiaries which are strategically more independent. Specifically, we look at whether the degree of organizational acculturation will differ between the two types of subsidiaries and how this difference will influence the relationship between organizational acculturation and firm performance.

There has been extensive research on acculturation (Berkson, 1969; Berry, 1980; Rudmin, 2003) in the psychology and sociology literature but relatively less research on its impact on organizations (Selmer and de Leon, 1996; Elsass and Veiga, 1994). In the past few decades the field of cross cultural management has shifted the focus of acculturation from societal groups to social organizations as they share many common characteristics (Nahavandi and Malekzadeh, 1988). However there is a major difference between the two, in societal groups the individual members do not have a choice in terms of acculturation whereas in social organizations the members can avoid acculturation by exiting the organization. This has important implications for the organization as it often faces a choice of whether to acculturate its employees or to allow the existing culture to prevail.

Prior studies have not specifically looked at the impact of culture on subsidiary performance and this paper will contribute not only to the understanding of this relationship but will also provide an insight on the difference in acculturation strategies adopted by different types of subsidiaries within the multinational organization.

According to conventional theories of international business, multinational corporations (MNCs) tend to adopt an ethnocentric orientation towards their subsidiaries (Bartlett et al., 2004) and attempt to impose their national culture on their foreign employees. But as the MNCs evolve and mature there has been a shift in the subsidiary role and status from competence exploiting to competence creating and the parents strategic orientation has also started to transition towards geocentrism.

Recent research has shown that there are significant differences between the two types of subsidiaries (Birkinshaw, 2001; Anderson and Forsgren, 2000). While the competence exploiting subsidiaries have a purely dependent relationship with the parent the competence creating subsidiaries have to balance the tension between integration pressures from the parent and local embeddness pressures. Since competence creating subsidiaries have to be dually embedded in their external and internal networks, on one hand, organizational acculturation could have a positive impact on performance by integrating the subsidiary within the intra-firm network (internal) while on the flip side it could have a negative impact by reducing the subsidiary's local embeddness (external network).

The paper will draw on three different streams of literature to develop the conceptual framework and they are organizational acculturation, subsidiary analysis and the literature on performance.

In the next section we will develop the theoretical background by giving a brief literature review and develop propositions relating to acculturation and subsidiary performance. This will be followed by an explanation of the proposed methodology and potential contributions, and the final section will concludes.

## **THEORETICAL BACKGROUND**

This section will outline the conceptual framework while developing the theory. We will first discuss the literature on organizational acculturation and on subsidiary performance. The following subsection will focus on subsidiary level of analysis and the different types of subsidiaries. The impact of the subsidiary type on the relationship between organizational acculturation and performance will be examined and propositions will be drawn based on the theory.

### ***Organizational Acculturation***

Studies in acculturation date back to the 1880s but these were mostly done by scholars in anthropology and psychology. According to the traditional definition, acculturation can be defined as the changes induced in a cultural system as a result of the diffusion of cultural elements from another culture (Berry, 1980).

Researchers in organizational studies have become interested in the topic in the past few decades due to the internationalization of the firm and its impact on inter-cultural management. In the context of an organization, acculturation takes place when the host country nationals employed in the foreign subsidiary become acculturated to the parent organizational culture (Selmer and de Leon, 1996). Thus organizational acculturation refers to the cultural changes within the organization of a foreign subsidiary.

According to Berry (1983) there are four modes through which acculturation can take place: integration, assimilation, separation and deculturation. In the case of establishment of foreign subsidiaries, most of the acculturation takes place through assimilation where one group (subsidiary) willingly adopts the identity of the other (parent).

In order to acculturate the employees of the foreign subsidiary, the parent must not only teach a set of explicit, codified rules and regulations but also integrate the employees into the subtle and complex control system. Thus according to Baliga and Jaeger (1984) acculturation involves extensive and intense training and socialization.

Previous research on cross cultural management has found that headquarters of the MNC tries to maintain the dominant culture of the parent in foreign subsidiaries (Torbiorn, 1995). The motives behind maintaining the corporate culture is to improve control, coordination and integration of the foreign subsidiaries and to maintain a uniform corporate culture throughout the organization (Schneider, 1988). Thus organizational acculturation is a mechanism for controlling foreign subsidiaries and maintaining homogeneity within the organization (Kuin, 1972; Milliman et al., 1991).

Other studies done on acculturation show that the parent tries to acculturate the foreign subsidiaries by using expatriate managers for executive positions, training of the local employees and maintaining high level of communication from the parent to the subsidiary (Jaeger, 1983). Other strategies to control the culture are to standardize the input skills, work processes and output (Mintzberg, 1979) and monitoring.

## **Subsidiary Performance**

The performance of existing subsidiaries is an important issue which impacts the overall operating decisions of MNCs, particularly with regard to growth, production structure, and the allocation of scarce resources such as capital and managerial attention. New research has emerged in the field of international business on subsidiary performance that focuses on various exogenous and endogenous factors. Some of the exogenous factors that impact subsidiary performance are country specific factors such as level of R&D and agglomeration (Thakur and Feinberg, forthcoming), taxation in the host country (Shaver and Flyer, 2000) and industry specific factors such as technological opportunity and product market demand (Levin et al., 1995).

There has been some research on endogenous factors such as multinational firm's strategy (Bartlett and Ghoshal, 1980) but there has not been any study on the impact of organizational acculturation on the performance of the subsidiary.

In general subsidiaries are formed to extend the ownership advantages of the parent firm to foreign locations (Dunning, 1978) and multinationals usually invest in those countries that are in close proximity to the parent country in terms of both distance and culture. According to the Uppsala Model (Johanson and Vahlne, 1977), firms try to establish subsidiaries in those countries where the psychic distance between the home and host country is small. Psychic distance refers to the differences in language, culture, business practices among things. Smaller psychic distance provides greater potential for growth and higher performance.

This implies that there is an underlying assumption that subsidiary performance will be greater in those countries which are similar to the parent in terms of culture.

Multinationals actively seek out countries that have greater cultural proximity to the parent culture and also attempt to acculturate their subsidiaries to the dominant parent culture.

Research on impact of acculturation on international mergers and acquisitions show that acculturation leads to greater congruence and better implementation of the integration process (Nahavandi and Malekzadeh, 1988). Subsidiary performance will be greater if there is acculturation because it will increase the level of compatibility with the parent and will also increase the focus on long term objectives. Selmer and de Leon (2002) find that MNCs should not discontinue cultural control of subsidiaries through organizational acculturation because it can foster the development of global core competences.

But on the other side, it might reduce subsidiary initiative and lead to lower innovation and local knowledge sourcing. But there is some qualification required, if the overall organizational culture is oriented towards innovation then acculturation would lead to increase in innovative activities in the subsidiaries. Accordingly, we hypothesize:

*Hypothesis 1: Other things equal, higher the degree of organizational acculturation in subsidiaries the greater the overall performance.*

### **Types of Subsidiaries**

Recent literature in international business has recognized that there two different types of subsidiaries, competence exploiting which is the more traditional type of subsidiary and the competence creating subsidiary which has evolved recently due to the organization of the MNC into an internationally integrated network (Cantwell and Mudambi, 2003; Chung and Alcacer, 2002; Frost, 2001). According to Cantwell and



Mudambi (2005) the shift towards integrated network of competence creating subsidiaries is due to the life cycle effect of the MNC which is evolving into a more mature organization. The distinction between the two types of subsidiaries is some what analogous to that between exploration and exploitation. There have been similar typologies of subsidiaries such as: home base exploiting versus augmenting (Kuemmerle, 1999) and strategic asset seeking versus market seeking (Dunning,1995) which examine the different roles of the two types of subsidiaries.

Competence exploiting subsidiaries are usually miniature replicas of the parent company and have a hub and spoke configuration with the parent. They concentrate mainly on assembly line type of production or basic adaptive R&D. Since the activities of this type of subsidiary do not involve anything novel, they would only be connected to the parent and depend on the parent for knowledge sourcing (Bartlett and Ghoshal, 1988). Thus due to the high dependence on the parent, the activities of this type of subsidiary will be highly coordinated with the parent who is more likely to adopt an ethnocentric orientation.

Multinationals with ethnocentric orientation are generally concentrate their decision making at home and also recruit people from home for key positions in their subsidiaries. They are likely to also apply home standards for performance, rewards and punishments in their foreign subsidiaries. Thus parents of competence exploiting subsidiaries are more likely to adopt an ethnocentric view towards them which will lead the patents to impose the home country culture on their subsidiaries. There will be greater organizational acculturation in competence exploiting subsidiaries which will have a

positive impact on their performance as it will improve the organizational fit with the parent.

Competence creating subsidiaries on the other hand are involved in more technologically creative activities and tend to be dually embedded within the MNC network and also the local inter firm network (Birkinshaw and Hood, 1998). These subsidiaries are different from the competence exploiting ones because they act as a pipeline between the parent and the host country (Kutscher and Schurig, 2002). The competence creating subsidiaries have relatively more strategic independence and so the parent company may adopt a geocentric orientation towards the subsidiary.

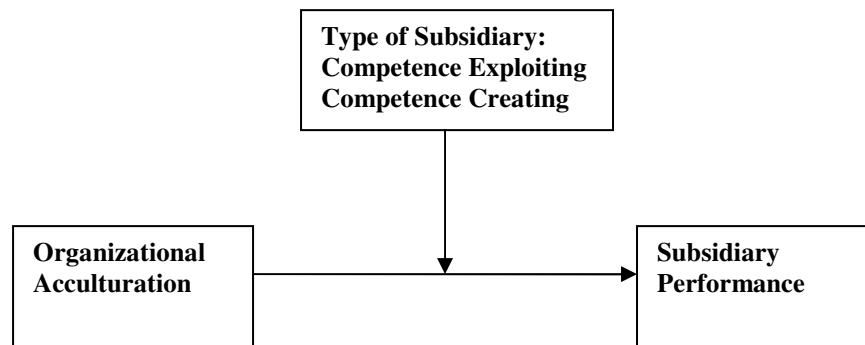
In this type of orientation the focus shifts from the parent to the subsidiary as the subsidiaries become an integral node in the network and often evolve to become centers of excellence. A geocentric organization aims at collaborative approach between the headquarters and the subsidiaries (Bartlett et al., 2004) and the heads of the subsidiary also participate in the decision making processes. Such organizations recruit people from both the home as well as the host country and thus are more likely to create a separate subculture within the foreign subsidiary. Thus parents of competence creating subsidiaries will attempt to synthesize the elements of their home culture with the dominant culture of the host country to form a separate subculture. There will be lower organizational acculturation in competence creating subsidiaries as a new subculture is likely to be created. Organizational acculturation will be less useful in the competence creating subsidiary as excess of it will reduce its local embeddedness.

Based on the above arguments we believe there is a difference in the organizational acculturation of competence exploiting and competence creating

subsidiaries and this will moderate the impact of acculturation on performance. Accordingly, we hypothesize:

*Proposition 2: Other things equal, organizational acculturation will have a greater positive impact on performance for competence exploiting subsidiaries than competence creating subsidiaries.*

**Figure 1. Summary of Proposed Relationships**



## **METHODOLOGY**

### ***Data***

The propositions will be empirically tested using a combination of primary and secondary data sources. The primary data will be gathered using internet based surveys that will be emailed directly to the subsidiaries of large multinational corporations. This study will focus on the pharmaceutical industry which is a high tech industry that depends on competence creating and exploiting subsidiaries. The list of subsidiaries will

be compiled from D&B's Who Owns Whom directory which provides detailed corporate structure of the multinational. The survey will contain questions pertaining to the acculturation strategies adopted and the role of the subsidiary in the MNC network.

The secondary data to be used in this paper will be obtained from the Orbis dataset, compiled by Bureau Van Dijk. Orbis compiles panel data on global parents and subsidiaries obtained from a large variety of international sources. To a large degree, the data quality will vary systematically by national source as the data from most countries are compiled from more common sources of publicly available data such as published data on listed firms while some have micro panel data provided by those countries' statistical agencies. In this research, our sample contains data on foreign subsidiaries of US -incorporated pharmaceutical firms between 1990 and 2005 which were incorporated on or after 1990. Useable data will be defined as having non-missing observations on at least one of the following variables: assets, sales, or employment.

This is a subsidiary level analysis and an appealing feature of the data is the distribution of subsidiary activity in a large number of both industrialized and developing countries. We will collect country level data from the World Development Indicators (WDI) and International Financial Statistics (IFS) for control variables.

## **Variables**

Our dependent variable is subsidiary performance and profits will be used as a proxy for it. This variable will be measured as the log of real gross profits of US MNC subsidiaries. We will also control for subsidiary size using real lagged subsidiary assets. Other measures of performance will also be tested as assets, number of employees but we do not anticipate any differences in the results from the use of different proxies.

The first independent variable is organizational acculturation which will be measured by the survey instrument. Using Likert scale, the instrument will examine the difference between the parent and the focal subsidiary in terms of the standard operating procedures for instance, in the rewards and punishment system. A greater similarity of rules and procedures between the parent and the subsidiary will indicate greater acculturation.

The next variable is the type of subsidiary and this will also be measured using a survey instrument. The respondents will be asked to list the top five activities performed by the subsidiary and how this differs from the parent. If the subsidiary is performing activities different from the parent then it is assumed that it is a competence creating subsidiary. Alternatively, the instrument will also examine the source of knowledge for the subsidiary. Subsidiaries which depend primarily on the parent for their knowledge are competence exploiting subsidiaries whereas those which depend on a mix of other subsidiaries, local players and the parent are competence creating subsidiaries (Gupta & Govindraj, 2000). These two measures are relatively new and exploratory in nature.

The study will control for the subsidiary level factors such as age and size, parent level factors like degree of internationalization measured in terms of total foreign employees. The study will also control for industry level factors as closeness to science and host country level factors such as GDP and R&D intensity. Since this is a panel data fixed effects will be used to control for time.

## **POTENTIAL CONTRIBUTIONS**

This study could contribute to the international business and cross cultural management literature. Since the study will use a new measure for distinguishing

between competence creating and competence exploiting subsidiaries it will add to the emerging literature on subsidiary level analysis which looks at more micro level processes.

The study will also contribute to the acculturation literature by examining it at the subsidiary level rather than at the individual level which has been the case with previous studies. It will also provide evidence as to whether acculturation has a positive impact on subsidiary performance which is an important question from the academic and practitioners view. Since subsidiary performance may be critical to MNCs' decisions about growth and resource allocation, it is important to understand endogenous influences on subsidiary performance.

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