Subsidiary Power and Role Development: Three Cases from the Chinese Coatings Industry

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Abstract:

This paper reports the findings from 3 case surveys of foreign owned subsidiaries and joint ventures in China in the Coatings industry. Through these three cases a new research agenda is established in order to establish the relationship between subsidiary power and subsidiary role development. Apparently, subsidiaries run by expatriates are better to utilize their power in negotiation processes with divisional or corporate headquarters. One major reason is the subsidiary manager's ability to fit in the institutional duality of the subsidiary, matching the formalized control systems of West European MNCs and acting in the local context simultaneously. Further, the host country effect, in this case China, seemingly brings power to the subsidiary, due to the present and future prospects of this market. However, the latter is proposed to be effective in resource dependency situations.

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Introduction

This paper examines foreign-owned subsidiaries in China and questions how far and for what reasons the subsidiaries are in a position to develop their role in the multinational corporation (MNC). Former surveys, conducted in a West European context, have revealed that some subsidiaries positively develop their role over time with regard to market, product, value-adding activities, along with strategic and operational autonomy, and in relation hereto, the power associated to the subsidiary.

Despite the fact that China plays a decisive role in today's world economy, surprisingly little attention has been paid to the development of subsidiaries in this part of the world. Most writings about China look into effects of inward and outward Foreign Direct Investments (FDI) and, therefore, conceptually and empirically, surveys have been executed on the macro-economical level. This study investigates the effect of Western European FDI at a micro-economic level, and discusses effects of structural and managerial processes of the MNC in a Chinese context. These analyses will, in this chapter, depart from three case studies within the coatings industry, which is a seemingly under-researched industry. The empirical context for this examination includes two Danish companies (Hempel and Flügger), the Swedish and Dutch conglomerate Akzo Nobel, and indirectly, the case investigated the former Danish company Sadolin & Holmblad.

The empirical findings demonstrate different facilitators for subsidiary role development. First, changes in the organizational structure of the MNC—and the economical importance of China when distributing new roles because of these changes—were important. Second, the subsidiary managers' ability to act in an institutional "dual world" (i.e. being a West European affiliate located in China) when requesting more resources and mandates from headquarters' managers is decisive to role change. Beyond these two indirect effects, the market opportunities associated to the coatings industry in China were, in general, proven to positively affect the power and role of foreign-owned subsidiaries.

The paper is organized as follows: First, a literature review on power in association to subsidiaries is provided; next this discussion is related to subsidiary roles and subsidiary role developments. Thereafter, the research methodology is described, followed by a presentation of the empirical survey. Finally, the last Section includes conclusion and discussions.

Literature Review

Subsidiary Power

Another stream of literature describes the role of the subsidiary in relation to its power position vis-à-vis the headquarters, often manifested in the subsidiary's ability to influence headquarters in its strategic and operational decision making procedures (Dörrenbächer & Gammelgaard, 2006). The departure for the conceptual discussion, which will depart from the behavioural description of organizations (e.g., Cyert & March (1963) seminal work), is that organizations do have to allocate scarce resources within a context where optimal allocation criteria do not exist: hence power enters into all important decisions (Fligstein, 1985). On this point Pfeffer (1981, p.2) emphasised: "power affects outcomes ranging from the allocation of budgets to organizational subunits, to succession of executive and administrative positions, to the design and redesign of formal organizational structures". However, the perceptions of power are multiple. Most often referenced is the concept developed by Dahl (1957) being that power is the ability to force others to do what they would otherwise not do. Though, this type of power is to be associated with legitimate power, where power is expressed through a lawful authority. In the case of the MNC the headquarters emphasizes hierarchical power towards its subsidiary through its ownership structure. In French & Raven's (1959) classical description of power, this type of command, together with reward and coercive power, will typically be the sort of authority possessed by headquarters. Instead, subsidiaries have the opportunity – in relation to French & Raven's framework—to exert power either through being "experts" (i.e. where the subsidiary possesses some special knowledge or expertise) leading to resource-dependency situations of the headquarters (Pfeffer & Salancik, 1978; Forsgren et al., 2005). In this light, the reputation, being an outcome of historical performance of the subsidiary (Pfeffer, 1992) impacts the negotiation position, as Birkinshaw & Ridderstråle (1999) p. 152-153, citing Beerlew & Hall (1966), "A subsidiary unit with a strong reputation will have its suggestions listened to with more respect by other corporate units and will typically be favourably treated in resource allocation decisions.

Other types of power refer to the subsidiary manager, like "referent power" where the subsidiary's power in relation to headquarters is a function of how attracted headquarters is to the subsidiary, a situation where the subsidiary manager can utilize e.g., his or her lobbyist or charismatic skills (Dörrenbächer & Geppert, 2006; Mudambi & Navarro, 2004). Cantwell and Mudambi (2005) has here argued that in order to win competence-creating mandates, subsidiary managers have to "exercise a voice" in the organization, and influence parent-driven investment strategies through lobbyism. Mudambi and Navarra (2004) further add that low performing subsidiaries depend to a higher degree on lobbyism then well performing subsidiaries. Ling et al. (2005) argue more or less in the same direction by stressing that one of the pertinent tasks of key subsidiary managers is "issue selling" i.e. directing headquarters' attention to particular issues and helping them to overcome related "perception gaps" (Chini et al. 2005) between headquarters and subsidiaries.

French and Snyder (1959) have here associated power with leadership by emphasizing the potential social influence on one part of the group over the other. To connect the work by French and Snyder to the headquarters-subsidiary relationships, the power of the subsidiary and its ability to utilize this power for role developments is primarily two-folded an contains both a social and a economically rational side. The question is, using French and Snyder's wording, to which degree headquarters *accept* the subsidiary, which depend on simultaneously a social based "we like them" effect, *and* the probability of success (within a manifold of performance criteria), the latter being influenced by the certainty of this success, combined with the uncertainty of this success, if the headquarters does not paid sufficient attention to the subsidiary, i.e., neglecting positive Net Present Value project suggested by the headquarters. At the end of the day, power is finally an outcome of the subsidiary's *attempts* to influence headquarters decision, where persevering and enterprising units in most case will obtain more power. In a further perspective, the work by Bachrach and Baratz (1962) is worth mentioning, where power is demonstrated by an actors ability to exclude others from being part of decision-making processes – a likely outcome of the intra-firm competition within the MNC (described among others by Luo (2005) and Cerrato (2006). Therefore, as Surlemont (1998) has noted, it might be of higher relevance to use the concept of "influence" since the subsidiary can cause changes in headquarters' decisions by persuasion, initiation, advices or manipulations. Yukl and Tracey (1992) have here examined the different tactics by which negotiators can gain influence.

Consequently, the question that is going to be investigated in this chapter is what factors create subsidiary role development, as in what cases the subsidiary sees changes in its scope of activity or in the level of autonomy. The more narrowly defined research questions analyzed here is;

RQ: what brings power to foreign-owned Chinese subsidiaries in the coatings industry and how does it influence subsidiary role development.

In the next Section, the literature on subsidiary role development will consequently be examined

Subsidiary Role Development

Immense variations exist in the scale and scope of subsidiary activity and mandates. Typically, subsidiaries operate within a narrowed set of the value-chain (Roth and Morrison, 1992) as headquarters typically allocates different mandates and set of activities to its various subsidiaries. Therefore, some subsidiaries will focus on manufacturing activities whereas other affiliates solely act as sales outlets. Furthermore, headquarters establishes unique, particular, and dyadic relationships to each of its subsidiaries. Next, subsidiaries organize their activities in order to meet local competitive pressures, which in some industries produce different ways of operations. As an outcome of these circumstances, Nohria and Ghoshal (1997) have characterized the MNC as a differentiated network: a concept which encapsulates both a decentralized structure and a variation of role and power of the subsidiary. Furthermore, subsidiary role variety is a result of structural developments towards the transnational MNC (i.e. a company responding simultaneously to pressures of local adaptation and global integration (Bartlett & Ghoshal, 1989).

Several surveys have analyzed the reasons for subsidiary role development, though they have not directly touched upon the concept of subsidiary power. For example, increased market opportunities—often as an outcome of improved host country economy, or the effect of supranational institutions like the EEC—have proven to positively affect the position of subsidiaries in the corporation (Jarilo & Martinez, 1990; Pearce, 1999; Egelhoff et al, 1998; Delany, 1998; Dörrenbächer & Gammelgaard, 2006). One survey by Walsh et al (2002) focused on 66 Chinese subsidiaries or equity joint ventures of North American and Asian MNCs. The survey results showed a general change from production unit-based to more market-oriented activities due to an improvement in the Chinese economy, which in turn caused both higher employment costs (making production inefficient to other countries) and at the same time led to an increase in the local demand for the subsidiary products and services.

Another common reason for subsidiary development has been the entrepreneurial efforts within the subsidiary. This is often manifested through R&D processes that have been shown to positively create a situation of resource-dependency, which ultimately brings more power to the subsidiary (Taggart, 1998a; 1998b; Pearce, 1999; Egelhoff, 1998; Hood et al, 1994).

Two surveys (Delany, 1998; Birkinshaw and Hood, 1997) pointed out the effects which managerial ambitions and lobbying activities have on subsidiary role development.
Subsidiary role development depends on location factors (e.g. market opportunities offered by the host country) and the subsidiary's relative strength compared to other host country market prospects of other subsidiaries within the corporation (Benito et al., 2003; Egelhoff et al., 1998, Holm et al, 2003). In addition, Birkinshaw & Hood (2000) demonstrated how location in leading edge clusters affected subsidiary development. Both factors can lead to better performance which, in turn, leads to power. Finally, the personal power of subsidiary management—his/her ability to influence strategic decision-making processes in the headquarters—have an effect on subsidiary role development.

On subsidiaries in China

Some surveys focus on foreign-owned subsidiaries in China. Walsh et al's (2002) study on small- and medium-sized enterprises documented a shift from wholly-owned subsidiaries which served export markets to a subsidiary focus on the development of firm-specific capabilities (rather than solely concentrating on utilizing low cost labour advantages). Buckley & Meng (2006) found that inward FDI in the Chinese manufacturing industry was typically oriented toward the local market. Ambidextrous MNCs are able to focus on exports via Chinese affiliates as well. Cheung and Leung (2007) reported that MNCs in the Chinese advertising industry typically followed the internationalization process stage model, although operational changes were client-driven rather than a result of reduced market certainty.

Researchers like Hong et al (2005) analyzed knowledge transfer issues; in this survey the authors investigated how Japanese manufacturing firms transferred organizational learning systems to Chinese subsidiaries. Wilkinson et al. (2005) studied the human resource barriers to the establishment of local partnership arrangements through a survey of 47 UK-owned subsidiaries in China. Lou (2003) examined the performance of 196 MNC subsidiaries in China, and proved how the parent firm's control flexibility, resource commitment, and focus on local responsiveness positively influenced performance. Sanyal and Guvenli (2000) also observed a relation between control and performance in their sample of American firms and their subsidiaries in China.

Subsidiary performance was the focal point in another survey by Lou (1997). This study showed factors such as product quality, sales force marketing, industry selection and timing of entry, and in general the interaction between business strategy and investment strategy as influential factors of subsidiary performance. A recent survey by Xu et al (2006) showed that both private foreign-owned firms performed better than the state-owned firms. Only the survey by Walsh et al (2002) directly investigated changes in subsidiary role.

Methodology and delimitation

Three cases--Akzo Nobel, Flügger, and Hempel—are based on semi-structured interviews with one manager in each of the respective companies. Interviews were conducted in the Danish headquarters of Flügger and Hempel, and in a Danish subsidiary of Akzo Nobel. Interviews lasted 60-90 minutes, and were subsequently transcribed. Further information was collected from annual reports, newspapers, and journal articles.

The Coatings industry

The coatings industry is the supplier of colours and decorative surfaces which surround us in almost every area of life. Nearly every commodity we use in our daily lives—including the houses we live in and the infrastructure we utilize—have been coated. Coating can be defined as a film-forming substance which protects a substrate from damaging elements in its environment. A report by Akzo Nobel (2005) provides insights of this industry. In this report coatings are categorized into 1) architectural/decorative coatings (i.e. paints, lacquers, and varnishes that protect and decorate surfaces like walls, doors, window frames, etc.), 2) industrial coatings, which include all consumer durable products and all types of industrial equipment, and finally, 3) special-purpose coatings including subgroups like protective coatings (i.e. for steel and concrete structures, car refinishes, marine coatings, and aerospace).

The report reveals that in 2005 the global coatings market was worth US$ 85.7 billion which is analogous to 26.5 billion litres. Since 2001, the annual average growth rate has been 2.7 % in constant value terms and 4.2 in terms of volume. The value growth rates for Asia Pacific were 26.3%. Western Europe diminished by -3.5%. Eastern Europe had the highest growth rate of 42.8%. These substantial differences are caused by the shift from US and Western Europe's status as the primary centers of manufacturing to the current state of production off-shoring and outsourcing to Asia and Eastern Europe. In 2005, the USA was still the world's largest market (US$18.8 billion). China, however, approaches this value; with a growth rate from 2001 and 2005 totalling 92%, the Chinese market ended 2005 with a value of US$ 7.3 billion.

China has grown extensively in both the property sector and within industrial coatings (i.e. especially appliances, automotive, and electronic industries.) Wang (2006) reported that the Chinese coatings industry increased by 14 % in 2004 (based on a report from China National Coatings Industry Association). Since China hosts the 2008 Olympic Games, further growth is estimated for the architectural sector, and it is, therefore, not surprising that Phillips (2007) clams that China is to be the "spearhead" of the Asian Coatings market.

Three Cases

Hempel

Hempel was founded in 1915 as a wholesale business of ready-mixed paints for the Danish maritime industry. Since its establishment, Hempel has been a supplier to the Maersk Shipping Company. Hempel began its export activities as early as 1920 (Bernhard, 1988). Throughout the 19th century, related businesses have been added to the product portfolio, such as coatings for containers, bridges, and yachts, as well as protective and decorative paintings. In 2005, Hempel's turnover was 980 million DKK (71 million litres) and the company employed 400 staff members in Denmark. Hempel is present in 83 countries, represented by 20 factories, 47 sales offices, three R&D centres, and more then 130 stock points (i.e., whole-sales units in ports.)

China became a market for Hempel in the mid-1950s, primarily in order to supply to the Maersk Corporation. The market entrance took place through a sales agent; later the market was accessed through a subsidiary in Hong Kong. Local production advantages and market opportunities were the initial reasons for the direct investment. A licence agreement with Hai Hong Chemicals, a division of China Merchants Group (CMG) (a state-owned conglomerate), has over time transformed into a joint venture Hempel-Hai Hong (HHH) that includes three factories (Yantai, Kunshan, and Shekou), six sales offices and nine stock points. Complementary strengths were the strategic motivation for the joined activities of the Hempel subsidiary and the China Merchants Group affiliate, since Hempel gained access to manufacturing facilities, and China Merchants Group accessed the high value brand of Hempel, though the CMG brand (Seagull) is still offered to the local market. CMG has for a long time being a sleeping partner, but has recently, due to the growth and success of HHH, taken a greater interest in the business, which has resulted in the replacement of some of the Danish managers. The CEO of HHH is Danish, but to cite the interview respondent:

"it is important that the Danish Management remains loyal, keeps the contact to Denmark, pays attention to Hempels' interest, and simultaneously services a Chinese partner that takes more and more control in the company"

In 2004 HHH employed 750 persons in China. Hempel has, furthermore, a clear segmentation strategy, operating within the following product lines 1) Containers; 2) Bridges; 3) Harbour installations (e.g. cranes); 4) Road markings; 5) Tanks for oil and gas; and 6) Pipe lines. The selection of segments depends on both local and global market opportunities, but with the Chinese market strengths within these segments, HHH becomes an important player in the Hempel Corporation. For example, HHH has been able to win several important contracts in a growing property market where Hempel supplies to the two largest real-estate contractors. Secondly, the company delivers paint to bridges, and HHH recently won the contract for what will be the world's longest cable-stayed bridge: the Sutong Bridge that connects the cities of Suzhou and Nantong. Finally, Hempel supplies coatings to containers, 95% of which are currently produced in China. The recent move of most of the world's container production from Europe to China has given HHH a lucrative position in the corporation. Finally, HHH's presence (i.e. three factories) in China enables HHH to deliver large quantities with short lead times, ensuring its competitive position in the container market.

HHH’s market mandate is geographically focused on China. However, in cases where the Singaporean unit—a wholly-owned subsidiary paint producer for the subsidiaries in Korea and Taiwan—lacks capacity, the Chinese production capacity is utilized for this purpose. The Singaporean unit possesses this production mandate because of Hempel’s full ownership, which directly minimizes the power of HHH (since it is a joint venture) and its ability to obtain mandates serving other markets outside China. Regarding autonomy, the distribution of production and market mandates is solely made by headquarters. Previously, the Chinese subsidiary possessed high operational autonomy, but this has decreased over the years, and is today more centralized. Product development issues are also primarily centralized, though subsidiaries are here consulted regarding this issue.

The joint venture has its strengths through its low cost production, but this is considered by management in Denmark not to be a situation of resource dependency. The establishment primarily gains its power through its current performance and the high likelihood of a significantly positive future performance. The size of the subsidiary, furthermore, produces negation power, since the Chinese entity takes 1/3 of turnover, volume, and number of employees. HHH is, therefore, the biggest subsidiary entity in the Hempel corporation and has for that reason relatively more power than the other subsidiaries in the corporation. Also the downturn of ship and container production in Europe, and China’s future importance for these markets, together with the prospect within building constructions, place HHH in a very influential position in the corporation.

Flügger

Flügger is a Danish company within the decorative sector. The Danish company was established in 1890 as a subsidiary of the German company J.D. Flügger. The Danish affiliate was nationalized following World War II, and later the German founder closed down its production in 1973. In 2004/05 Flügger had a turnover of 750 million DKK and it employed 548 persons. Today Flügger has nine subsidiaries: seven are located in the Nordic countries, one is located in Poland, and one is located in China (i.e.Flügger Coating (Shanghai) Co Ltd.) The business model of Flügger is to sell directly to both professional decorators as well as to customers via retail shops. One third of business is wholly-owned and the remainder operates through franchise agreements. This retail shop structure is implemented in the Nordic countries, where the company’s products are offered through 750 retail shops. However, in China, decorative coatings are sold directly to building contractors or professional decorators.

Flügger's internationalization process followed the track described through the Uppsala internationalization model (Johanson & Vahlne, 1977), with incremental steps of geographical representation. Following the Oil Crises in 1973/74, the company saw the need to expand its activities and, therefore, Flügger established its first subsidiary in 1975 in Norway. Throughout the 1990s, the company made a series of acquisitions in Scandinavia. The addition of the Polish subsidiary was a take-over of a business relationship that faced financial problems. The investment in China broke the logic of the incremental internationalization process, and rather fit into the description offered through the Born Global literature that surveys the reasons for companies leapfrogging the Uppsala development. One explanation given for this break in process is the international background and mindset of the founder/manager (Knight & Cavusgil, 2005), which was relevant in this case, due to the background and interest in China of one of the company's CEO's. Initially, Flügger secured a license agreement with a governmental-owned, but highly autonomous producer of combat aircraft, in order to supply coatings to the plant buildings. Flügger decided not to produce locally but rather decided to transport the paint from Denmark due to low shipment costs.

The Chinese subsidiary was established in 2005 as a wholly-owned unit employing 20 people. In 2007 the subsidiary employed 35 people. The role of the subsidiary is to market the corporate products, including paint and wallpaper. Due to the demand in the Chinese market for Danish design, wallpaper gained a strong market position. Over time, Flügger's subsidiary has extended its geographical mandates, and today it exports products to other Asian markets. The second role of the subsidiary is to purchase related products—such as paintbrushes—for resale in the Nordic countries. In this case, China demonstrates its advantages due to its access to cheap raw materials and low labour costs.

Flügger plans to expand the role of its subsidiary by establishing a production plant as a greenfield investment, which is going to be controlled by the Chinese subsidiary. Reasons for this change include high Chinese tariffs on imported goods, long delivery times on paint shipped from

Denmark, cheaper raw materials, and a new European regulation demanding approval of all chemicals, which demands substantial resources in order to produce the needed documentation.

There have also been changes in the level of autonomy of Flügger's subsidiary. The subsidiary is managed and controlled by a Danish expatriate, whereas all mid-level managers are Chinese. Most employees have been job-rotated to the Danish headquarters. Beyond the financial control, the expatriate exercises social control, and supervises legitimacy issues like corruption and the use of child labour. Initially, the subsidiary was assigned a high degree of autonomy, as the interview respondent revealed:

"bureaucracy is a killer in the start-up phase"

When the subsidiary reached a critical mass of 30 employees, it became more controlled by headquarters. The subsidiary still possesses a high level of operational autonomy with respect to its purchasing activities – a typical example of a resource dependency situation as the result of local expertise and the establishment's direct link and relationships with local suppliers.

Flügger further plans to change its corporate structure from the functional-based form to the multi-divisional form, which is a typical path of MNCs when entries into new geographical markets or new product lines create further complexity and ambiguity, thus making the functional form inefficient to control and manage the company (Chandler, 1962; Stopford and Wells, 1972). This change will certainly impact the role of the Chinese subsidiary, becoming a divisional headquarters of the corporation. Today, functions like marketing, finance, and the like are exercised through the Danish headquarters but a change of structure will imply strategic and operational decision making power to the Chinese unit.

The decision to turn the Chinese unit into a divisional headquarters is directly linked to the current and future market opportunities, and the profit that the subsidiary already is able to produce. The purchasing expertise, the market strength, and the future economic prospects of China brings power to this subsidiary.

Akzo Nobel

The Danish paint producing company Holmblad was established 1777. In 1912 it merged with a paint producer Sadolin (established in 1907) to form the Sadolin & Holmblad Corporation. In 1945, the company established its first subsidiary abroad: Sadolin Färgfabrik and in this period Export activities to the Far East began (Bernhard, 1988). Following World War II, the company acquired firms in the Far East. In 1987, Sadolin & Holmblad was acquired by the Swedish MNC, Nobel, which in 1994 merged with the Dutch corporation Akzo—hereafter renamed Akzo Nobel. The former establishment of Sadolin & Holmblad—today named Akzo Nobel Decorative Coatings—belongs to the division of coatings, and produces and markets paints, varnishes, and wood care products.

In 2005, Akzo Nobel closed down production in Copenhagen, primarily due to environmental reasons, since the plant was located in the centre of Copenhagen, and would needed heavy investment in order to meet new environmental regulations. The turnover of 91 million DKK in 2005 was, therefore, half of the turnover from the previous year, though the company managed to increase its revenues. In 2005 the Copenhagen unit employed 75 people. Increased competition in the industry has created a need for further rationalizations, leading to divestment of other European factories, and a stronger focus on the Asian market, since Headquarters viewed Asia as a future growth market.

The 2006 revenues of Akzo Nobel were 13.7 millions Euros, and the MNC employed 61,900 people. Akzo Nobel operates with three divisions: Health Care, Chemicals, and Coatings. The latter produces 45 % of revenues, which are distributed over four sub-divisions: Decorative (36%), Industrial coatings (31%), Car Refinishes (15%), and Marine & Protective Coatings (18%). In total, 11% of revenues are produced in Asia (compared with Europe’s 61%) and 17 % of the staff is employed in Asia (compared with Europe’s 51%).

Since the 1980’s Akzo Nobel has been active in China. Originally, the firm exported its products through five representative offices. Today, the company has 20 establishments in China, which include both joint ventures and wholly-owned subsidiaries. In China, Akzo Nobel operates within the following businesses: Car Refinishes, Decorative Coatings, Industrial Finishes, Industrial Products, Marine and Protective Coatings, and Power Coatings.

This paper focuses on the subsidiary Akzo Nobel Decorative Coatings, which is headquartered in Shanghai, and which also maintains offices in Beijing and Guangzhou. Before the establishment of this wholly-owned subsidiary in 1998, Axzo Nobel formed two joint ventures, which both failed. The main products offered by the subsidiary are interior and exterior decorative paints.

Initially, the subsidiary was assigned the mandate to market the corporation's products, whereas production was carried out by another subsidiary. Products are sold through small retail shops offering a high variety of national and international brands, though with high preferences for local brands. A goal to sell 5 million litres was set for the subsidiary in order to obtain a production mandate; this goal was reached in 2003.

Akzo Nobel aims to be one of the largest players in this market, which today is led by Nippon (with a market share of 11%) and ICI (with a market share of 6 %). The remaining producers take less than 1% of the market respectively, and in total, the interview respondent estimated there are more than 8,000 plants in China.

Because of Akzo Nobel's growth strategy, the subsidiary has been able to obtain acquisition mandates from headquarters, in order to grow in production capacity, to obtain local brands, and to secure a geographically appropriate spread of plants in China. Geographical proximity is needed in the construction industry, where the final product order is often placed late in the construction process. As the interview respondent explained:

"The contract is made with the architect or with the contractor, you negotiate throughout the planning period, and suddenly when the concrete is dried – then you have to deliver within a very short time period – so you have to be close by".

Akzo Nobel decorative coatings decided to acquire a small local producer (10 million litres) in South China, following a negotiation period of more than 2.5 years. In Northern China, Akzo Nobel has established a Greenfield plant, and plans a future establishment in Central China.

Embeddedness into the local market is a key factor for success, as emphasized in the citation above, showing the long negotiations with contractors throughout the construction period. This high degree of local responsiveness is, furthermore, relevant in relation to the subsidiary's R&D activities. Often, local adaptations of paint formulations are needed in order to meet specific customers' requests. Factors like building materials, weather conditions, product applications, and the degree of pollution can create specific product needs, making corporate formulations obsolete. The R&D department further controls the quality of raw materials and finished goods. These varying conditions bring the subsidiary the power to obtain R&D activities.

Akzo Nobel organizes its activities via the multi-divisional structure, and the complexity the company faces in terms of product diversity and cultures has initiated centralization processes, and decisions about which geographical markets subsidiaries should serve, and strategic decisions concerning Human Resource Management, Corporate Social Responsibility, and financial practices are solely made in headquarters. Operational decisions concerning sales are the only value-chain activity to be decentralized. Furthermore, the use of controls, which include documentation and throughout descriptions for projects approval, have been increasing. Subsidiary-driven initiatives need careful descriptions of the project and budgets to be presented for a committee in the Swedish regional board, which often requires further clarifications and specifications in order to accept the application. The Swedish regional board will then present the application to the board in headquarters in Holland. One example here was the acquisition of the Chinese coatings factory. The subsidiary easily got the approval to search for acquisition targets, but the subsidiary manager—a Danish expatriate—had to negotiate the screening criteria with the board members in Sweden. He must continually write descriptions of market opportunities, technologies, environmental issues, taxes, legal affairs, and especially risk assessments.

What brings power to the subsidiary is first and foremost its location in China, and secondarily the fact it is managed by an expatriate. Today the media and the public pay attention to China, and naturally headquarters' managers also watch China closely—manifested in yearly or quarterly visits from the corporate headquarters. As in the other cases, geography brings power, and for that reason alone the subsidiary is strong. It can more easily develop its role (e.g., gaining production mandates, building plants, making acquisitions) compared to other subsidiaries. As our interview respondent stated:

"It's easier to be subsidiary manager in China than in Bulgaria"

However, subsidiary role development depends on the allocation of resources from headquarters. Akzo Nobel is organized as an "internal market", where the subsidiaries compete for these resources. The expatriate manager plays a key role in this game, since he or she often has a competitive advantage – compared to local managers – in terms of ability to communicate and to formulate the detailed report requirements from the West European headquarters. Our Interview Respondent expressed it in this way:

"An expatriate manager is a key actor that can match and translate local business opportunities into project descriptions that is approved by headquarters – here I see myself as a intermediary between two worlds"

Subsidiary development, especially for those subsidiaries that culture-wise are far away from headquarters, therefore, depends on expatriate managers with ambitions and cleverness to translate local market opportunities to projects of interest for headquarters managers. The interview respondents gave several examples of subsidiaries that were started up with local management: managers who lacked the communicative competences, were too embedded in the local context, and who preferred managerial principles that did not fit the internal corporate competitive forces. Our interview respondents viewed expatriates as outsiders (beyond the management and control functions they served) who could change the underperforming subsidiary into a success, and who could pave the way for subsidiary development. Subsidiary power in Akzo Nobel, therefore, relates to a combination of local expertise: in this case knowledge of how to operate in Chinese context, but also to position the subsidiary in the corporate Western European context. As the interview respondent stated:

"You have negotiation power when you can formulate and sell your message to the Board. You need to be embedded in the culture of writing of concrete executive summaries, to make budgets, etc., this is the way to convince. Secondly, performance counts. However, it is also important with the network – whom to make phone calls to. I can call informally the Business Unit CEO in Stockholm. I have known him for many years.

The lobbying effect and the strength of personal networks are emphasized here. At the end of the day, the development of Akzo Nobel Decorative Coatings depended on its ability to convince headquarters management to allocate the needed resources and mandates for that purpose. Convincing management was achieved through lobbying power, gained via its position in China, but also the manager's ability to minimize the cultural distance between Holland/Sweden and China.

Conclusions and perspectives for further research

The size and the profitable prospects of China without doubt bring power to the Chinese subsidiary. Foreign-owned entities of MNCs are likely to develop the subsidiary role, measured as changes in activity and autonomy. However, the performance aspect is certainly the mediator between market opportunity and role development. In the case of the coatings industry in China, the ability to win contracts is of utmost importance: i.e. contracts in real estate, bridges, ships, etc. This often creates resource dependency situation, since winning these contracts demand both local connections and cultural knowledge. China is the "hot spot" these years, since much of the production of containers, ships, and furniture now takes place in China,. This positions the Chinese subsidiary relatively stronger than other subsidiaries in the coatings industry. China is, furthermore, under pressure from countries like Vietnam—also a low cost area—where companies can access cheap labour and raw materials for coatings production and related by-products.

This investigation generates new explanations about subsidiary development. First, changes in organizational structures impact the level of autonomy assigned to the subsidiary. One the one hand, implementation of multi-divisional structures extends the level of formalized control mechanisms. On the other hand, converting a subsidiary into a division, as in the Flügger case, absolutely expresses autonomy and decision-making power. In these cases where geography is the ordering principles for divisions (alternatively it could be product/industry), China is likely to host the divisional centre for the Asian market, given the country's size and relative importance in this region.

Furthermore, the Chinese subsidiary of—in this case—a West European MNC, can be viewed as caught between two worlds. In terms of institutionalization theory, the subsidiary will be subject to isomorphic pulls from the local environment and, in a wider context, it will not always come across legal controls, norms, values, and cognitive constraints (Scott, 1995). As described by Zaheer & Mosakowski (1993), firms must learn how to operate in the local market in order to develop relationships with local counter partners. Connections between the subsidiary and its local counter partners refer to transactions tying organizations to each other: from contractual-based arrangements to personal relationships. Isomorphism refers to firms imitating or resembling other firms which face the same set of environmental conditions (such as cultural expectations in the society (DiMaggio & Powell, 1983)). However, this creates a problem in relation to headquarters and the subsidiary's ability to attract resources and mandates. The subsidiary can be "over-embedded" into the local context which can create a lock-in effect, which constrains the subsidiary's ability to utilize relationships, knowledge sources, and market opportunities outside the small community in which the subsidiary operates (Woolcock, 1998) – a situation faced by subsidiaries run by local management in the Akzo Nobel case.

Simultaneously, the MNC has its own institutions with rules, norms, values, and cognitive pillars from which to act. At the same time as subsidiaries are forced to adapt to the local environment, they are subject to isomorphic pulls internally in the MNC where they also must adapt to rules, norms, and values, and share the social context with other MNC-units in order to build strong internal relationships.

Subsidiaries, therefore, exist in a world of institutional duality (Kostova & Roth, 2002), caught between the MNC institutions and the local institutions. The cases presented here clearly placed subsidiary management as the mediator between these two worlds, and their ability to make the needed translations of local specific knowledge and the ability to follow the internal norms and rules for application descriptions. This concept builds on Cohen and Levinthals (1990) famous concept of absorptive capacity, which in this case can be seen as the Chinese subsidiary's ability to acquire local knowledge, to translate it, and to make use of this knowledge in other corporate units: a skill that produces resource-dependency situations and power.

The staffing of the subsidiary, therefore, seems to be important for its power and its role development. Many textbooks that address IHRM issues and in particular issue of staffing policies put the overall MNC strategy in the first place. Drawing on to the seminal work of Perlmutter (1969) and Perlmutter and Hennan (1979) almost all of them distinguish between an ethnocentric, a polycentric and a geocentric approach to staff foreign subsidiaries (e.g. Griffin and Pustay, 2007). Following Banai and Reisel (1999) "…the ethnocentric staffing policy endorses the assignment of parent country nationals (PCNs) to key positions in the subsidiaries and affiliates. The polycentric staffing policy proposes that all key managers in the subsidiaries should be host country nationals (HCNs) whereas the geocentric staffing policy seeks the best people for key jobs throughout the organization regardless of their nationality" (ibid. 478). A related but somewhat different link between MNC strategy and foreign subsidiary staffing is presented by Griffin and Pustay (2007). According to their view, MNCs with a decentralized decision making philosophy mainly use host country nationals (inpatriates) while MNCs with a centralized decision making philosophy use home country nationals (expatriats). Irrespective of their nationality, foreign subsidiary managers have to fulfill three different roles: They are sensors and interpreters of local opportunities, builders of local resources and contributors to and active participants in the global strategy of an MNC (see e.g. Ferner, 2000; Birkinshaw, 2000). However, following the incumbent literature on subsidiary staffing, they do so in different ways, with expatriates, inpatriates and third-country nationals ascribed different orientations according to their nationality. Thus expatriates are seen as strongly following a headquarters orientation due to their familiarity to the MNCs overall goals, policies and practices. Very often they are seen as most efficient in exercising headquarters control over the subsidiary. Inpatriates on the other hand are seen as basically having a local (subsidiary) orientation, due to their socialization in the host country and their familiarity with the social, political and economic environment of the host country (Harvey et al., 1999).

Birkinshaw et al (2005) have recently argued for the MNC as an internal market place, where subsidiaries fight for power. However, seemingly, this competition does not take place based on pure market forces, based on e.g., performance, but rather political issues are present too. What differentiates this sample might be the size of the corporation, two of them being small of medium sized MNCs, and the far distant institutional context of China. In respect to this finding, micro-political issues have recently been associated with subsidiary role development (Dörrenbächer & Geppert, 2006; Taplin, 2006). Earlier Forsgren et al (1995) have proven how the location of divisional headquarters was an outcome of sequential bargaining processes within the MNC. Another example has been provided by Cantwell and Mudambi (2005) where subsidiary managers influenced the distribution of specific mandates through lobbyism. Again, the personal relationships of the subsidiary manager, and his or her negotiation skills, advocate for the expatriate manager in cases of cultural distances like in the case of West European headquarters and Chinese subsidiaries. However, the concept of intra-firm competition brings further aspects into this discussion. The fact that subsidiaries can gain or lose 'weight' (Bouquet and Birkinshaw 2007) in intra-firm competition shows that intra-firm competition has an intrinsic conflict potential. Moreover, it pinpoints that keeping pace in fierce intra-firm competition is of prime strategic importance for subsidiaries. This is not only to avoid job losses at the subsidiary – an issue that often dominates the public debate - but also to secure future influence and reputation of the subsidiary as well as of its key subsidiary managers. Organizational impacts to intra-firm competition are assumed to exist on the overall MNC level, the subsidiary level as well as on the level of headquarters-subsidiary relations. With regard to the overall MNC level, Phelps and Fuller (2000) argue that intra-firm competition is especially high in multi-domestic MNCs, where large overlaps with regard to products, markets and technologies exist among subsidiaries. Birkinshaw and Lingblatt (2005) as well as Ceratto (2006) stress the impact of a decentralized decision making in MNCs, arguing that the more decentralized decision making in MNCs, the more subsidiaries are free to contest the mandates or charters of fellow subsidiaries. According to Birkinshaw and Lingblatt (2005) this however will be mitigated in MNCs where a normative integration by some common norms, values and rules exists. Next to overall MNC factors, several subsidiary level factors are assumed to impact intra-firm competition in MNCs. Luo (2005) for instance suggest that especially subsidiaries with a high local responsiveness face intra-firm competition because they strongly rely on scare headquarters resources to overcome their liability of foreignness. A second subsidiary level factor brought forward by Luo (2005) stresses the fact that subsidiaries which lose competitive advantage fuel intra-firm competition in the same breath as they ask for headquarters resources. Birkinshaw and Lingblatt (2005) assume that subsidiaries with fungible capabilities might spur intra-firm competition much more then subsidiaries whose capabilities more or less only allow to fulfill the given mandate. Impacts from headquarters-subsidiary relations are finally emphasized by Ceratto (2005), who maintains that frequent and open headquarters-subsidiary relationships breeds trust and thus allows for more intra-firm competition. Power, gained through resource possession or host country attractiveness, combined with individual characteristics and abilities of the managers, is, therefore, utilized in this internal competition, that at the end of the day causes the transfers of resources and mandates to the subsidiary.

Localization advantages are obvious for Chinese subsidiaries, though cultural and contextual differences towards the West European management might be sincere obstacles for further development of those subsidiaries. Managerial skills to balance this institutional duality are, therefore, the key factor for creation of power and for extension of activities and autonomy for these subsidiaries. Localization advantages do, therefore, not bring power to the subsidiary if there do not exist a resource dependency situation. Low cost opportunities did not bring power to the Hempel joint venture. In cases where the host country is strong, but other existing subsidiaries, or new established is assessed by headquarters to bring exactly the same advantages, localization advantages will not bring power to the subsidiary. Only in cases where resource dependency situations exist, power is gained by the subsidiary. We, therefore, see the link between subsidiary power and subsidiary role development as a *combination* of 1) subsidiary managers ability to act in an institutional dual world – being effective in the micro-political system of the MNC, and 2) the host country advantages playing an essential role in the intra-firm competitive system of the MNC.

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