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**CAPABILITY AND CHARTER CHANGE: AN EXTENSION  
OF BIRKINSHAW AND HOOD'S (1998) CONCEPT OF  
GENERIC PROCESSES OF SUBSIDIARY EVOLUTION<sup>1</sup>**

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## **CAPABILITY AND CHARTER CHANGE: AN EXTENSION OF BIRKINSHAW AND HOOD'S (1998) CONCEPT OF GENERIC PROCESSES OF SUBSIDIARY EVOLUTION**

One of the most influential contributions in the research area of a subsidiary's evolution has been Birkinshaw and Hood's (1998) article that develops a model of subsidiary evolution.<sup>1</sup> The model sheds "light on the processes that drive changes in a subsidiary's activities and its underlying capabilities" (Birkinshaw and Hood 1998: 773), and consists of two parts. The first part presents a systematic review of the literature on subsidiary evolution and depicts an organizing framework for subsidiary evolution. The second part of the paper is theoretical development, where Birkinshaw and Hood define the evolution of a subsidiary in terms of capability and functional charter change, move the attention from the evolution of an entire subsidiary to the evolution of the subsidiary's value chain functions, and put forward five generic processes of subsidiary evolution.

While the organizing framework for subsidiary evolution proposed by Birkinshaw and Hood (1998) has been widely applied in empirical studies (see, e.g.: Delany 2000; Benito et al. 2003; Cantwell and Mudambi 2005; Pedersen 2006; Dimitratos et al. 2009; Dörrenbächer and Gammelgaard 2010; Gammelgaard et al. 2012; Tippmann et al. 2018), majority of those studies do not simultaneously consider changes in functional responsibilities and capabilities as a reflection of the subsidiary evolution path. In fact, even studies that concentrate on functional aspects of subsidiary evolution often focus only on changes in the performed value chain activities (e.g., White and Poynter 1984; Hood et al. 1994; Birkinshaw and Hood 1997; Dörrenbächer and Gammelgaard 2006; Egeraat and Breathnach 2012; Burger et al. 2018), or consider only evolution of capabilities (e.g., Chang and Rosenzweig 2009; Hsu and Chen 2009; Kim et al. 2011), without studying the corresponding changes in the other dimension. At the same time, numerous studies focus rather on the evolution of an entire subsidiary (Hood et al. 1994; Benito et al. 2003; Dimitratos et al. 2009; Pedersen 2006; Gammelgaard et al. 2012; Filippov and Duysters 2014), than on individual changes taking place in specific functional areas. Finally, the only studies that simultaneously refer to capabilities and charter from at a functional level are qualitative (e.g., Cavanagh and Freeman 2012; Achcaoucaou et al. 2014; Tippmann et al. 2018), and do not take into consideration the generic processes of subsidiary evolution. Because of that they also do not allow to test the proposition developed by Birkinshaw and

Hood (1998). Consequently, to best of our knowledge, the generic processes of subsidiary evolution described in Birkinshaw and Hood's (1998) paper, and the propositions built around them, have not been empirically tested in quantitative studies. This is especially surprising as Birkinshaw and Hood (1998) highlight the need for empirical studies testing the relevance of the theoretical models of subsidiary evolution, Rugman et al. (2011) emphasize that subsidiary roles can vary dramatically across value chain activities and so can their evolution paths, and Frost et al. (2002) and Birkinshaw and Pedersen (2009) argue that an entire subsidiary is too aggregate as a unit of analysis in the subsidiary evolution research.

We believe that three different issues can explain the existence of this research gap. First of all, up to recently the available operationalization of changes in functional responsibilities within quantitative studies was limited to the observations of gaining a new or losing an old value chain functions (see, e.g.: Birkinshaw 1996; Burger et al. 2018). Such an approach does not allow for a full application of Birkinshaw and Hood's (1998) understanding of the possible changes in the functional charter of a subsidiary. Importantly, the application of this understanding is a prerequisite for the identification of the generic processes of subsidiary evolution. Second, the generic processes of subsidiary evolution considered by Birkinshaw and Hood (1998) are not disjunctive and do not constitute an exhaustive typology in line with their understanding of subsidiary evolution ("subsidiary evolution is defined in terms of (1) the enhancement/atrophy of capabilities in the subsidiary and (2) the establishment/loss of the commensurate charter"; Birkinshaw and Hood 1998: 783). This makes the empirical validation of the concept in quantitative studies at least troublesome, if not impossible. Finally, the extant studies on subsidiary evolution identify the features of the subsidiary, its host environment, and the MNE as the determinants of the changes taking place at a subsidiary level (see, e.g.: Dimitratos et al. 2009; Pedersen 2006; Gammelgaard et al. 2012; Filippov and Duysters 2014). However, in Birkinshaw and Hood's (1998) paper the unit of analysis (evolutionary path) is positioned at the level of a value chain function of the subsidiary (a lower-level unit within the subsidiary rather than the subsidiary itself). Such an approach requires the application of multi-level analysis that has not been yet applied in studies on subsidiary evolution.

Our purpose is to address the above-mentioned issues by extending Birkinshaw and Hood's (1998) approach through a typology of the subsidiary's functional evolutionary paths. While there is no shortage of literature on subsidiary evolution, the lack of an established measure for the subsidiary's functional evolutionary paths makes the overall tone of this paper exploratory. Thus, like Birkinshaw and Morrison (1995), we prefer to use research questions rather than hypotheses. Similar to their study, this indicates less an absence of a priori expectations than a lack of established measures. Specifically, we ask the following:

- Which subsidiary's functional evolutionary paths can be identified based on changes in functional capability and charter?
- Which variables at the subsidiary level influence the likelihood of undergoing specific functional evolution?
- Do variables at the level of the value chain function influence the likelihood of undergoing specific functional evolution?

From the scientific perspective, an empirical validation of one of the most influential contributions in the research area of a subsidiary's evolution is an interesting research task. Even more so as Birkinshaw and Hood's (1998: 792) paper was written as a theoretical development providing grounding for future empirical studies. Furthermore, the conceptual character of the paper prevented Birkinshaw and Hood (1998) from formulating any managerial recommendations from the proposed model. However, from the managerial perspective, an identification of the possible subsidiary's functional evolutionary paths and an indication of the characteristic of the subsidiaries undergoing specific changes provide valuable information for managers coordinating the development of subsidiaries within the MNE, and those interested in conscious management of their subsidiary's evolution.

Addressing our research questions allow us to make the following contributions. First, our paper provides an extension and refinement of the Birkinshaw and Hood's (1998) concept of subsidiary evolution. In particular, while addressing our first research question we use changes of functional capability and charter to create an exhaustive classification of subsidiary's functional evolutionary paths. Such a juxtaposition allows for the identification of nine types of subsidiary's

evolutionary paths. Eight of them constitute specific cases of functional evolution. Furthermore, we apply [Dzikowska and Andersson's \(2018\)](#) concept of subsidiary strategic role to identify 729 functional evolutionary paths of 183 subsidiaries operating in the Polish manufacturing industry. All of the conceptually identified types can be observed in the empirical sample.

Finally, to address our second and third research questions, we run two-level multinomial logistic regression models with the functional evolutionary path as a dependent variable. Thus, in line with the recommendations of [Birkinshaw \(2001\)](#), and [Birkinshaw and Pedersen \(2009\)](#), our unit of analysis is at the level of an individual value chain function and not at the level of an entire subsidiary. This constitutes an important development of the extant studies on subsidiary evolution. The mentioned development brings the research on subsidiary evolution closer to the present status of operations of MNEs. Furthermore, variables like strategic autonomy, initiative, performance, inter-unit power, resource power, and environmental dynamism impact on the likelihood of undergoing a specific functional evolution. Subsidiary level control variables like entry model, age, size, cultural distance, and financial difficulties also impact on the likelihood of undergoing a specific functional evolution. Lastly, variables at the level of a value chain function (referring to the initial characteristics of functional responsibilities and capability, and variables representing the character of a value chain function) impact on the likelihood of undergoing specific functional evolution. Importantly, both the areas of differences (individual determinants) and direction of influence on the likelihood of a specific functional evolution (when compared to the lack of evolution) vary considerably depending on the path category. Hence, the influence of certain subsidiary-level factors (often considered in the literature) is specific to particular paths, and not universal in general.

### Footnotes

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<sup>1</sup> According to the Web of Science database as of the end of June 2019 the article has been cited 673 times. Google Scholar indicates its citation number as 1779.

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