UNIVERSITI PUTRA MALAYSIA

THE RELATIONSHIP BETWEEN STRATEGIC ROLES AND PERFORMANCE: THE CASE OF MULTINATIONAL CORPORATIONS' SUBSIDIARIES IN MALAYSIA

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The general purpose of the study is to investigate the roles and strategic styles of multinational corporations' subsidiaries in Malaysia. Specifically, the study aims to explore the strategic roles of multinational subsidiaries with regards to local responsiveness and integration of activities, and the level of technological capability. The strategic roles are further related to subsidiaries' performance. In addition, the study also looks at the relationship between the dimensions of the strategic roles of multinational subsidiaries and performance, and with the business environment as the moderating variable.

The methodology of the data collection is by a set of questionnaires sent out to multinational subsidiaries currently operating in Malaysia. Seventy-one (71) multinational corporations' subsidiaries participated in this study. Statistical analyses used for the study included cluster analysis, analysis of variance (ANOVA) and multiple regression.

Data analyses revealed that there are five strategic roles of multinational subsidiaries with regards to local responsiveness of activities, integration of activities and technological capability. Industry characteristics, nationalities, age and foreign ownership stake of subsidiaries are found to be dependent on the strategic roles of subsidiaries. Subsidiary performance is found to be the same across strategic styles. The three dimensions of strategic roles, namely local responsiveness of activities, integration of activities and technological capability are found not to be related to performance but business environment does appear to act as a moderating variable between the three dimensions and performance.

Results of the study present practical implications to policy makers, head office and subsidiary managers and local business players. The study also contributes to the body of knowledge in multinational subsidiaries participating in developing nations and in the area of international strategic management.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi sebahagian keperluan untuk ijazah Master Sains

HUBUNGAN DI ANTARA PERANAN STRATEGIK DAN PRESTASI: KES SUBSDIARI-SUBSIDIARI SYARIKAT MULTINASIONAL DI MALAYSIA

Oleh

ZAIDAH MUSTAFFA

Julai 2003

Pengerusi: Profesor Md. Zabid Abdul Rashid, D.Sc.

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Tujuan umum kajian ini adalah untuk mengkaji peranan dan gaya strategik subsidiari syarikat-syarikat multinasional di Malaysia. Secara khususnya, kajian ini bertujuan untuk meneliti peranan strategik subsidiari syarikat-syarikat multinasional dari segi tindakbalas setempat dan integrasi aktiviti-aktiviti perniagaan, serta tahap keupayaan dari segi teknologi. Peranan strategik subsidiari syarikat multinasional adalah seterusnya dihubungkait dengan prestasi subsidiari. Di samping itu, kajian ini juga turut melihat kepada hubungan di antara tiga dimensi peranan strategik subsidiari syarikat-syarikat multinasional dan prestasi, dan dengan menggunakan persekitaran perniagaan sebagai pemboleh ubah sederhana.

Metodologi penyelidikan ini menggunakan satu set soal selidik yang dihantar kepada subsidiari-subsidiari syarikat multinasional yang beroperasi di Malaysia. Sebanyak tujuh puluh satu (71) subsdiari telah mengambil bahagian di dalam kajian ini. Analisis statistik yang digunakan termasuklah analisis deskriptif, analisis kelompok, analisis kepelbagaian dan regresi berbilang.

Analisis data menunjukkan wujudnya lima peranan strategik yang dimainkan oleh subsidiari-subsidiari ini berdasarkan tindakbalas setempat dan integrasi aktiviti serta tahap keupayaan dari segi teknologi. Ciri-ciri industri, kewarganegaraan, usia dan hakmilik asing subsidiari-subsidiari adalah didapati bergantung kepada peranan strategik. Prestasi subsidiari-subsidiari adalah didapati sama merentasi gaya strategik. Tindakbalas setempat dan integrasi aktiviti serta tahap keupayaan dari segi teknologi tidak mempunyai hubungkait dengan prestasi. Walaubagaimanapun, persekitaran perniagaan didapati bertindak sebagai pemboleh ubah sederhana di dalam perhubungan di antara dimensi peranan strategik dan prestasi subsidiari.

Keputusan kajian ini memberi implikasi praktikal kepada pembuat dasar, pengurus-pengurus di ibu pejabat dan di subsidiari syarikat multinasional dan mereka yang berkecimpung di dalam dunia perniagaan tempatan. Kajian ini turut menyumbang kepada satu bidang pengetahuan dalam subsidiari-subsidiari syarikat multinasional yang beroperasi di negara-negara membangun dan juga di dalam bidang pengurusan strategik antarabangsa.

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LIST OF ABBREVIATIONS

AFTA	ASEAN Free Trade Area
ANOVA	Analysis of Variance
ASEAN	Association of South East Asian Nations
CEO	Chief Executive Officer
CFA	Confirmatory factor analysis
E&E	the electrical and electronics industry
EPU	Economic Planning Unit
FDI	Foreign Direct Investment
FIDA	Federal Industrial Development Authority
FTZ	Free Trade Zone
GDP	Gross Domestic Product
GFI	Goodness-of-Fit Index
HQ	Headquarters
IR	Integration-Responsiveness
JIT	Just in time
LISREL	Linear Structural Relations
MIDA	Malaysian Industrial Development Authority
MIER	Malaysian Institute of Economic Research
MITI	Malaysia's Ministry of International Trade and Industry
MNC	Multinational Corporations
NAFTA	North America Free Trade Area
NEP	New Economic Policy
R&D	Research and Development
RMSEA	Root Mean Square Error of Approximation
ROE	Return on Equity
ROI	Return on Investment
RPM	Regional Product Mandate
RPS	Rationalized Product Subsidiary
SEM	Structural Equation Modeling
SPSS	Statistical Package for the Social Sciences
TDRI	Thailand Development Research Institute
TMR	Truncated Miniature Replica
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNCTC	United Nations Centre for Transnational Corporations
UNDP	United Nations Development Program
WPM	World Product Mandate

CHAPTER 1

INTRODUCTION

This chapter sets the background for the thesis in presenting the developments and evolution of multinational corporations' subsidiaries, the strategic roles of multinational subsidiaries, the problem statement, the research objectives and the significance of the study.

Background

Strategies are vital to survive in today's highly turbulent business environment. The success of a corporation relies heavily on the strategies it is pursuing. Having operations in multiple countries, like the multinational corporations, requires synchronization and synergy of various strategies in different business locations and countries. As multinational corporations partake in international business, having financial centers in one location, whilst manufacturing premises in a country halfway across the world, strategies to be employed successfully in different operation centers are extremely important.

From chemicals to cornflakes, multinational companies continue to dominate the world economy with net worth and sales revenues exceeding the incomes of developing countries[1]. However, the competitive scenario today is dynamic. Competition in the global world is no longer about richly endowed firms competing against poorer ones. Competition is the contest to develop strategies that are inherent for survival.

[1] In 1998, the sales revenue of 196 NAFTA MNCs was almost that of the GDP of the European Union and the sales of the Global Fortune 500 companies accounted for 40 percent of the world's GDP (http://www.onlineathens com/stories/062500/bus_0625000029.shtml).

The existence of a strategy at subsidiary level is thus crucial to maintain the implementation of a globalization strategy and adapt it to the host economy's market and cultural circumstances. Strategy at subsidiary level is also important, as subsidiary has to preserve corporate missions and strategies as well as safeguard relationships with the host government and host region. The balancing of these priorities will determine whether the subsidiary is successful in performing in the global market. However, subsidiaries, especially those located in developing and less developed countries, are still, to a certain extent, subject to specifications and requirements from parent corporations. Subsidiary strategy is defined when subsidiary acquires freedom, authority and autonomy to identify its own destiny (Birkinshaw and Morrison, 1995) whilst strategic roles still denote the processes by which subsidiaries fulfill headquarters' assigned functions and responsibilities (Birkinshaw and Morrison, 1995; Delany, 2000). Thus, it is more relevant to discuss their strategic styles[2] rather than the strategic planning and management of the subsidiary units in the Malaysian context.

Multinational Corporations and Foreign Direct Investment

Multinational corporations (MNCs), throughout their existence, have been equally praised and reviled. They have been cited to be "the most effective engines of development" (LaPalombara and Blank, 1980) and "the vehicles for prosperity around the globe" (www.onlineathens.com/stories/062500/bus_0625000029.shtml). They are "the most powerful impediment to Third World development" (LaPalombara and Blank, 1980) and "instruments of core country capitalist exploitation of peripheral economies" (Mohd Nazari Ismail, 1999) and yet these

[2] Strategic styles and roles are used to denote the same meaning. Strategic styles and roles are, henceforth, used interchangeably.

peripheral economies reluctantly admit that MNCs' presence in their economies will somehow sow the seeds of prosperity. Nevertheless, multinational corporations' presence is undeniably powerful all over the world. It is probably not an overstatement to say that these corporations dominate the world economy today. Foreign direct investment by multinational corporations was estimated at US$1.3 trillion in 2000 according to the World Investment Report 2001, published by the United Nations Conference on Trade and Development (UNCTAD). Although it recorded a somewhat slower rate than in 1998 and 1999, 65 countries, including Afghanistan and Bangladesh in Central Asia, Myanmar and Vietnam in South East Asia and Finland and Sweden in the European Union, experienced more than 30 percent growth rate of foreign direct investment in 2000 (Malaysia fell in the 10 – 19.9 percent FDI growth rate). More than 60,000 multinational companies have over 820,000 foreign subsidiaries worldwide (UNCTAD, 2001). Furthermore, there are 55 countries in the world today acting as host governments to MNCs, each of which hosts over 1000 foreign affiliates. General Electric, the world's largest corporation in 1999, has sales revenue that surpasses even the GDP of the largest economy in the world, the People's Republic of China (www.ge.com/factsheet.html). Ford Motor Company, ranked fifth in the world, employs some 350,000 men and women in 200 countries and territories (www.steve-hatfield.com/dfordhq.htm). Nestlé, the world's largest food company, has operations in 479 countries with its products present in virtually every country in the world.

Certainly, multinational corporations' foreign direct investments bring favorable results, both to corporations and host governments. Corporations have access to cheap labor, cheap raw materials, investment incentives and presence in bigger, more lucrative markets. Host governments, on the other hand, welcome these multinational corporations with red carpets with hopes that these firms will finance new business expansions, create job opportunities for local citizens and bring in tax revenues that are needed for developing infrastructure. Indirectly, host governments also benefit from the "spillovers" – the accelerated transfer of superior technology, turnover of skilled labor and increased opportunities through links with multinational corporations and foreign buyers. Host governments aggressively continue to attract foreign direct investment into their countries for these benefits. Some host governments are able to create a "brand name" for the foreign direct investment in their economies like Bangalore as the software business hub, and Singapore and Hong Kong as financial services centers (Dunning, 1993). These countries rely on highly skilled labors, modern infrastructures and supportive government policies to attract such investment. Still, other developing and less developed countries gamble with cheap, unskilled labor and abundant raw materials although these are increasingly becoming less attractive, especially, when poor infrastructure and political turbulence continue to exist in these countries.

Malaysia's Experiences and Policies Towards MNCs

According to the International Chamber of Commerce and the United Nations Centre for Transnational Corporations (UNCTC) survey conducted in 1998, despite the economic crisis that erupted in the South East Asian region in 1997, multinational corporations still place optimistic views on the potentials of investments in the region, and continue to plant its resources and tap into the growing regional market, especially, for long term advantages (www.iccwbo.org/home/shared_pages/multi_confidence_full.asp). Because of the investment criteria spelled out by most developing countries, multinational corporations usually enter the South East Asian region through foreign direct investment or mutual joint venture agreement. Malaysia, similarly, has seen an influx and growing foreign direct investment and multinational corporations building their subsidiaries and affiliate companies in the country to intensify and strengthen their presence in Malaysia, and the South East Asian region. Subsidiaries and affiliate companies of these multinational corporations in Malaysia are established to further build stronger presence in the international competitive arena as well as respond to the local demands of the country.

According to the United Nations Conference on Trade and Development, Malaysia played host to 15,567 foreign firms in 1999, including Sony from Japan, Dell from the United States of America and ICI from the United Kingdom, 3000 of which were fully owned by parent corporations (UNCTAD, 2001). Malaysia has been receiving foreign direct investments since the 1970s. According to the Malaysian Industrial Development Authority (MIDA), a national body established to promote investment from foreign firms, Malaysia relies on the strength of its economy, the availability of flexible, skilled and educated work force, state-of-the-art transportation infrastructure and attractive investment policies by the government to attract foreign investments. This has made Malaysia one of the leading recipients and locations for foreign direct investment in the world (www.mida.gov.my/why.html). Besides that, Malaysia also has rich reserves of natural resources, a stable political environment and acts as the gateway to the South East Asian market. The South East Asian countries combined have the size of an economy that rivals China, and still growing, that have multinational corporations throughout the world looking for opportunities and strategic partners in the region. The design and implementation of policies specifically related to foreign direct investments by the Malaysian government, like the liberal equity policy, the employment of expatriates, incentives and allowances associated with the status of the investment, have also geared Malaysia towards building a strong strategic location for multinationals' investment.

Foreign direct investments into Malaysia have started coming in even before Independence (1957). The British colonial government is responsible for bringing in foreign capital into Malaysia. The foreign investments were from Britain and were mainly in the mining and plantation industries. According to Mohd. Nazari Ismail (1995), in the 1970s, foreign direct investments in Malaysia flourished as a result of the introduction of the export promotion strategy by the Malaysian government. The establishment of the Federal Industrial Development Authority (FIDA, later renamed the Malaysian Industrial Development Authority or MIDA) and Free Trade Zones (FTZs) in 1969 and 1970 respectively, also attracted investors mainly from the United States of America and Japan, largely in the electrical and electronics (E&E) and textiles industries. The year 1970 also saw the Malaysian government implementing the New Economic Policy (NEP) as a direct consequence to the racial riot that occurred the previous year (Mohd Nazari Ismail, 1995). The NEP was primarily enacted to balance the wealth gap among the races in Malaysia. The introduction of NEP, however, did not reduce the incoming foreign capital into the country, even though it stated that 30 percent of employment and ownership stakes should be given to Bumiputra and this did not particularly work in favor of the foreign investors. However, the introduction of the Industrial Coordination Act 1975, which actually gave powers to the Ministry of Trade and Industry to force investors to comply with the Bumiputera requirement quota before licenses were issued, did result in a decline of foreign investment into Malaysia during 1975 through 1978. FDI figures rose again from 1978 onwards. Late 1980s and early 1990s saw the Japanese investors, including the small scale Japanese companies who were predominantly suppliers to the larger export oriented Japanese conglomerates like Mitsubishi, Toshiba and Sony, investing capitals in Malaysia. This was due to the "just in time" (JIT) production system introduced by the large corporations that encouraged their suppliers to move production and facilities to Malaysia (Mohd Nazari Ismail, 1995).

In the year 2001, industries that popularly attracted foreign firms were electrical and electronics, paper, printing and publishing, non-metallic mineral products, chemicals and chemical products, scientific and measuring equipments and food (MITI, 2002). The top five investing nations into Malaysia in 2001 were the United States of America and Japan, with total investments of RM 3.3 billion each, the People's Republic of China including Hong Kong SAR (RM 3 billion), Germany (RM 2.6 billion), and Singapore (RM 2.2 billion).

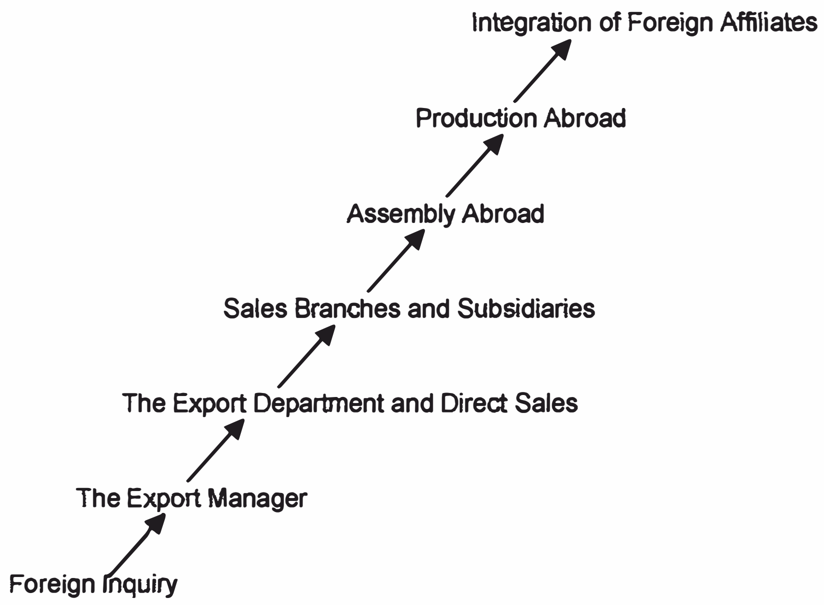
Even though Malaysia was aggressive in attracting FDIs, Prime Minister Mahathir Mohamad still expressed concern over the issue of the adverse effects of the influx of multinational corporations into developing and less developed countries. These multinational corporations also bring intense and aggressive competition that could adversely affect the prosperity of local and emerging businesses, the "mom-and-pop" stores, those that obviously have lower capital, inferior capabilities in management, technology and marketing intensities when compared to these giants. Furthermore, today's international business scenario witnesses several mega acquisitions and mergers of multinational corporations creating huge monopolies. These phenomena have heightened the worries of the developing and the less developed countries as these monopolies create entry-barriers for others to enter the market. There are then, measures taken to ensure that entries and operations of these multinational corporations still benefit small and medium locally-based companies in the form of spillovers and backward and forward linkages.

Despite talks on the dangers of globalization, developing countries like Malaysia continue to rely on foreign investments by multinational corporations to promote economic activities in their economies. The design and execution of policies related to not only attracting, but also organizing and controlling these firms' operations in the country must be specifically and meticulously implemented so that the national development agenda is not distorted by the presence of these giant firms. This suggests that the strategy of foreign subsidiaries in Malaysia is worth studying.

Evolution of MNC Subsidiaries

According to Phatak (1997), companies develop into a multinational enterprise over time. There are stages that a company journeys through in building its international presence, subsequently turning into an international empire. Figure 1, derived from Phatak (1997), depicts the stages of a manufacturing entity from a domestic company to a multinational enterprise.

Figure 1: The Evolution of a Multinational Enterprise



Source: Phatak, A.V. (1997) International Management: Concepts and Cases. Cincinnati, OH: South-Western College Publishing.

Stage 1 Foreign Inquiry

Stage 1 begins when a company, initially having domestic operations, receives inquiries about its products or goods from its foreign counterparts, exporters or importers.

Stage 2 Export Manager

When the inquiry is pursued, the company then steps into Stage 2 where it sets up an export managerial position to handle export activities and decisions pertaining to foreign businesses.

Stage 3 Export Department and Direct Sales

This stage occurs when the export manager exploits the new markets abroad and expands his or her small staff into a fully operational export department.