University of Reading

Value co-creation in ICT services company: a case study of a cross-border acquisition

Article

Accepted Version

Heim, I., Han, T. and Ghobadian, A. (2018) Value co-creation in ICT services company: a case study of a cross-border acquisition. Journal of East-West Business, 24 (4). pp. 319-338. ISSN 1528-6959 doi: https://doi.org/10.1080/10669868.2018.1467841 Available at http://centaur.reading.ac.uk/76713/

Value co-creation in ICT services company: a case study of a cross-border acquisition

Journal:	*Journal of East-West Business*
Manuscript ID	WJEB-2017-0014.R4
Manuscript Type:	Original Article
Keywords:	Value co-creation, Knowledge-intensive business services, Post-acquisition integration, Russia

Value co-creation in ICT services company:

a case study of a cross-border acquisition

Abstract

Post-merger and acquisition (M&A) integration is especially important for the services industry, where value co-creation between actors plays crucial role. This paper is a qualitative single case study of a multinational company (MNE) in information technology (ICT) industry, and the post-acquisition processes of its subsidiary in Russia. The main contribution of this article is the application of a value co-creation view, which until now has only been applied in the field of service industry research, to the settings of the international business. We also identify the actors and their roles and activities in the value co-creation in the Russian context.

Introduction

Firms in the service industry frequently use cross-border acquisitions as a tool to expand business to the international stage in order to generate higher value and profit (Ahlstrom 2010). However, no simplistic linear relationship has been found between cross-border M&As and value creation. As international business research is explicitly multidisciplinary, it can benefit from the complementary insights provided by theories from other fields (Doz 2011). This paper aims to integrate the value co-creation view which has been widely discussed in the marketing and IT business services disciplines (e.g. Gummesson and Mele 2010; Jaakkola and Hakanen 2013) to the discussion of post-merger performance of MNE's subsidiary in the ICT industry, and therefore to contribute to the international business literature by the application of value co-creation theory to international business settings in emerging markets. In this paper we discuss a comparative case study of two consequent acquisitions within one company and explain why first acquisition was successful, when the second one failed using a theory of value co-creation. We elaborate on a value co-creation framework, adding that actors in the network participate in the process of value co-creation. Moreover, given the fact that the integration process of cross-border acquisitions is a highly complicated activity which involves numerous participants and complex interactions, value co-creation theory (e.g. Jaakkola and Hakanen 2013), provides important explanations on how to achieve a higher performance, and will be critically discussed in this paper.

From our point of view the value creation process in the service sector of the economy differs significantly in comparison to the manufacturing sector, as the main assets of service companies, namely people and customers, are intangible by nature, and can move to competitors, thus leading to competitive disadvantages. In these transactions co-operation between *the headquarters, subsidiary, employees, local market (suppliers) and customers* can play a crucial role. In contrast, with acquisition in the manufacturing sector, MNEs gain mostly tangible assets in the form of production facilities, equipment etc. These specific features of a service sector make management of ICT companies riskier in terms of post-acquisition integration, and management of the process of value co-creation become a key success factor in performance management. This research is relevant to subsidiary management, offering a new view on why different factors can lead to the failure of the acquisition. We demonstrate that in the post-acquisition integration phase the value co-creation process can be unbalanced. We also identify the main actors in this process in the subsidiary. A case study of the acquisition in ICT industry in Russia is used as an example to illustrate it.

Literature review

Network theory and value co-creation in knowledge-intensive industries

Integrating the post-acquisition process in the cases of cross-border deals involves the issue of MNE management, leading the focus of researchers to that of understanding MNEs, through for example, understanding the factors affecting post-merger survival of the subsidiary in the long-term perspective. Important works such as the 'heterarchy' perspective (Hedlund 1986), the perspective of the MNE's inter- and intra-organizational relationships (Ghoshal and Bartlett 1990), and the differentiated network view (Nohria and Ghoshal 1997), provide the basis for the development of the network theory. Instead of the view assuming that MNEs are hierarchically structured entities with headquarters at the top and a number of dependent subsidiaries with similar roles, the network theory regards the MNE as an internally differentiated inter-organizational network (Ghoshal and Bartlett 1990). Later research conceptualized the multinational subsidiary as a semi-autonomous entity with entrepreneurial potential within a complex, competitive environment, consisting of an internal environment of other subsidiaries, internal customers and suppliers, and an external environment of customers, suppliers, and competitors (Birkinshaw and Hood 1998; Birkinshaw, Hood and Young 2005). Based on the network theory, the subsidiary is no longer a subordinate identity; rather, it should be the node in a greater network, through which it builds relationships with the internal and external actors (Rugman and Verbeke 2003). Recent studies extend the research stream, trying to identify how the interactions between the factors of autonomy, inter- and intra-organizational relationships affect performance (Gammelgaard et al. 2012). The argument also comes with the notion of embeddedness, which refers to the relationships between partners within the organizational and inter-organizational networks. On the one hand, through the embeddedness between partners including suppliers, customers and research institutions, MNEs are able to integrate the sources of innovation and create more value for the organization. On the other hand, it is a challenge for headquarters to control knowledge acquisition directly, due to information deficiencies, and this encourages the subsidiaries to be given more autonomy (Young and Tavares 2004). In conclusion, international business literature and particularly network theory apply an inter-organizational approach in investigating organizational characteristics of MNEs, explaining resource structure and different level of connectedness in different national environments. However, it fails to explain how exactly value is co-created by a sharing of resources in such networks in the service industries.

At the same time, the service industry perceives significant growth worldwide with most advanced economies dominated by the services sector. Even countries that have traditionally focused on manufacturing are experiencing growth of service industries. Service science is an emerging interdisciplinary research area that focuses on "fundamental science, models, theories, and applications to drive service innovation, competition, and well-being through co-creation of value" (Ostrom et al. 2010, p. 5).

Service science is the study of service systems and of the co-creation of value within complex configuration of resources, where value creation is seen as a core purpose and central process of economic exchange (Vargo et al, 2008). Gummesson and Mele (2010) discuss the role of value co-creation in the resource integration process, where actors access their resources, stimulating the formulation of a dynamically interactive network. Firstly, it is necessary to distinguish between co-creation and co-production. Co-creation is a more general concept that "encompasses all the specific theoretical and empirical occurrences in which companies and customers generate value through interaction" (Vargo and Lusch 2008). Galvagno and Dalli (2014) define co-creation as the interaction of suppliers and customers for the development of new business opportunities. In contrast, co-production is a component of co-creation of value and captures "participation in the development of the core offering itself" (Lusch and Vargo 2006, p. 284). In other words, co-production is the active involvement of a customer in service production and delivery (Auh et al 2007).

Recent research has also explored the importance of the collaborative process of value co-creation in the context of knowledge-intensive business services (Gummeson and Mele 2010; Vagro and Lusch 2011; Aarikka-Stenroos and Jaakkola 2012; Jaakkola and Hakanen 2013). For instance, in the context of solution network, Jaakkola and Hakanen (2013) provided a novel conceptual framework that explains the value co-creation during the interaction between actors, resources and activities. However, value co-creation has rarely been discussed in MNE management, where a considerable number of actors including headquarter, subsidiaries, local markets and their customers, are involved. Based on the network and value co-creation views, we define actors as the node in the

MNE network, including the headquarters, subsidiaries, employees, local market (suppliers) and customers. We define co-creation in MNE settings as interaction between headquarters, subsidiary, employees, subcontractors, and customers with each other for the development of new business opportunities.

A conceptual model

In this research we adopt a model of value co-creation in knowledge-intensive industries (Jaakkola and Hakanen 2013), and apply it to the circumstances of the MNE (Figure 1 below). This model considers the value co-creation process from the subsidiary's perspective as MNE's activities in the host country are organized around the subsidiary. Business value is "co-created by economic actors who exchange a variety of resources that go beyond goods and money" (Michel et al. 2008, p. 154). The actors in such a model are linked through value propositions, seeking equitable exchange from the mutually connected relationship (Gummesson and Mele 2010; Jaakkola and Hakanen 2013).

The actors in our model are of two types:

1. The intra-organizational context includes relationships within MNE structure, i.e. between headquarters, a subsidiary and its employees.
   - Headquarters and a subsidiary: headquarters provides a subsidiary with knowledge about their global products and services; the subsidiary provides headquarters with knowledge about local markets;

- Employees and a subsidiary: employees provide a subsidiary with their knowledge and skills; a subsidiary provides employees with training, projects and work;

2. The inter-organizational context includes relationships between a subsidiary, its customers and subcontractors. These actors are also placed in the settings of a local context which is defined by the local institutional context of the specific country.

   - Customers and a subsidiary: customers provide the subsidiary with knowledge about their business processes, participating in projects with their internal teams working in coordination with the subsidiary; the subsidiary provides customers with know-how and services;
   - A Subsidiary – Subcontractors: for some projects a subsidiary may not possess all the necessary resources and therefore needs to subcontract a local company. In this case a subcontractor provides a subsidiary with specific knowledge that is required for delivering services; a subsidiary provides the subcontractor with access to the world-leading expertise and participation in project.

In business networks, all the actors are both provider and user of resources at the same time, as each of them absorbs and contributes resources through their embeddedness (Cantú, Corsaro and Shehota 2012). Meanwhile, actors are bonded by "closeness, appreciation and perceived commitment, that influence and are influenced by resources and the activities through which the resources are integrated" (Jaakkola and Hakanen 2013). Therefore, from the value co-creation perspective, we make two assumptions.

Firstly, the value network is dynamic and heterarchical, which means each actor also occupies a dynamic position in the network (Jaakkola and Hakanen 2013). The position will be perceived differently depending on the position of actors who observe. Since each actor has several unique relationships with others, known as the portfolio of relationship, actors will strive to improve their position by strengthening or expanding their temporary portfolio of relationships (Abrahamsen, Henneberg and Naudé 2012). This also indicates that the organizations which insist on a fixed and hierarchically organized system can hardly achieve value co-creation, as they are not flexible enough to adopt the dynamic changes across the network. Secondly, the position will affect or determine the resources

a

c

c

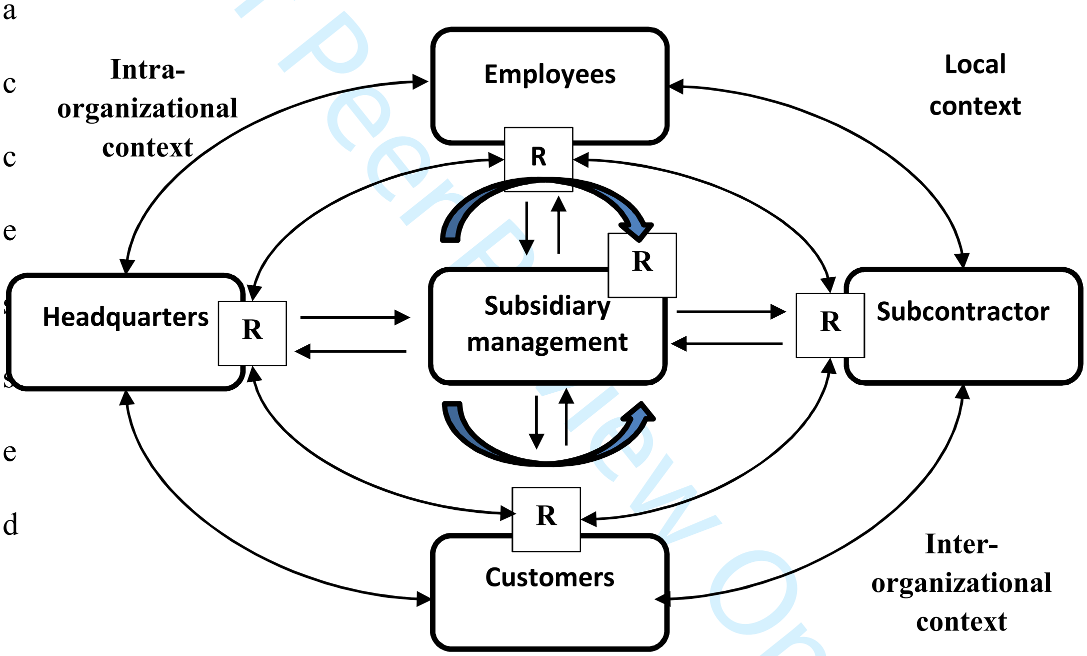
e

s

s

e

d



b

y actors, which is the reason why all actors will strive to improve their positions (Abrahamsen, Henneberg and Naudé 2012; Mattsson and Johanson 1992), since the bond is determined by the closeness between actors. Closeness, or in some cases, knowledge,

Figure 1. Value co-creation in a knowledge-intensive industry at MNE network level.

also represents the power the actor has. Concerning autonomy for example, in the network of headquarters, subsidiaries, local markets and their customers, customers are naturally connected with the respective subsidiaries, sometimes, directly with the headquarters.

In the portfolio of relationships for customers, their closeness with respective subsidiaries or headquarters determines the position in this unique network, for example, if the subsidiaries have already built a mutual trust relationship with customers, or own better knowledge of the local market. Headquarters which forcefully controls their subsidiaries will break the balance of a properly functioning network and therefore, lead to failure in post-acquisition integration, and lose its value.

To sum up, we conceptualize the value co-creation for MNEs as a value creating process occurring through dynamic interactions and changes within the MNE network, where the actors strive to improve their positions, in order to access better resources and affect others. In the post-acquisition integration process for cross-border deals, acquirers have to clearly understand their network and the network owned by the acquired subsidiaries, and cautiously integrate the network without destroying the opportunities for achieving value co-creation. This also means acquirers have to adapt a dynamic approach regarding the network and the actors within it, keep the balance of positions and grant appropriate autonomy to their subsidiaries.

Based on the literature review and value co-creation process in the MNE network (Figure 1), the research questions in this case study will be the following:

1) How value co-creation can be affected in cross-border acquisitions?
2) How unbalance in value co-creation affects subsidiary performance in the post-acquisition integration phase?

Method

Our research is based on a single-site qualitative case study exploring a phenomenon within the real-business context where the boundaries between phenomena and context are not clearly evident (Eisenhardt 1989; Ellet 2007; Yin 2009; Ghauri and Gronhaug 2010). It explores strategic change in the form of two consequent acquisitions in the MNC and its influence on the value co-creation process in a knowledge-intensive industry and therefore subsidiary performance, i.e. focuses on collecting information about specific objects, events or activities, such as a particular business unit or organization (Sekaran and Bougie 2013). This case is of particular interest because service companies have received significantly less academic attention in terms of their internationalization process (Panibratov and Latukha 2014).

A single case study is an appropriate design for the research as this case is unique: two subsequent acquisitions by the companies headquartered in the same country allow us to exclude the factor of the national culture, and the factor of resistance to change on the subsidiary side, as the first acquisition went successfully, we can assume that employees' resistance to change was at the minimal level to the date when the second acquisition took place. As it is very difficult to find similar cases in the same country settings, we want to report our findings in a single case study research design. The case study research method is particularly suited for testing and communicating a theory by showing its applicability in real business settings (Ulriksen and Dadalauri 2016). The aim of this research is to answer the research questions of how value co-creation process can be affected in cross-border acquisitions and how unbalance in the process of value co-creation can affect subsidiary performance in the post-acquisition integration phase. This will lead to the development of the model: explaining how value co-creation can be affected in the post-acquisition integration phase. In other words, we use an "explanatory "case study approach to test out propositions, revise existing theories and establish causal relationships, as well as for verification of the theory in different settings (Welch et al. 2011).

Case studies involve data collection through multiple sources such as verbal reports, personal interviews, observations and written reports, including financial reports, archives, budgets and operating statements as well as market and competitions reports. (Ghauri and Gronhaug 2009). We decided to use historical financial data because academics in international business have seen the firm as a dynamic unit, changing overtime (Rugman 1996 a, b). We used triangulation in order to facilitate validation of data received from different sources (Ghauri 2004; Ghauri and Gronhaug 2010), by checking the performance of a subsidiary claimed by the interviewee, checking annual accounts, or archives, or by interviewing another manager or company representative.

The lead author conducted nine in-depth, face-to-face interviews with key managers from the subsidiary and the headquarters. Semi-structured interviews included an outline of the topics to be covered, with suggested questions. The questions and their sequence were not strictly predetermined. Interviewees could decide which questions they would like to start with or the topic they considered important in relation to the research question, and wanted to discuss additionally in the course of the interview.

Findings

We reviewed company documentation on subsidiary development in Russia, including documents in the information database, intranet, and the information from interviews, and found the following. The subsidiary in Russia was acquired as a privately-owned company in 2005 by Company 1 (Germany, cross-border acquisition), and in 2009 – Company 1 was subsequently acquired by Company 2 (Germany, domestic acquisition). In this case study, the performance of the subsidiary dramatically weakened within five years of second acquisition (Figure 2 below).

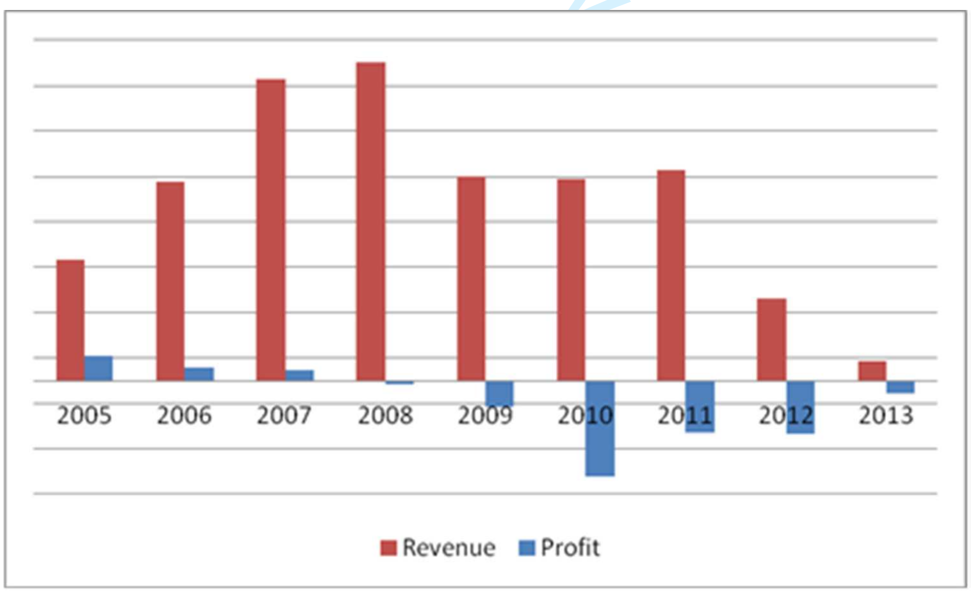


Figure 2. Subsidiary performance in Russia in 2005 - 2013.

We consider these two consequent acquisitions as cross-border in relation to the subsidiary in Russia (Figure 3 below). Before the acquisition, this privately-owned company served as a partner in the local market of Russia and CIS. A partner had about 150 full-time employees and after acquisition became the second biggest subsidiary within Company 1 in Eastern Europe. The subsidiary's main function was the sale of software licenses, consulting projects, consultation in the local market, and cooperation with other subsidiaries on global projects which took place in Russia. The principal customers for the company were oil and gas companies such as Lukoil, Rosneft, Gazprom, Tatneft, Surgutneftegas, TNK-BP as well as KazMunayGas, the Kazakhstani National Oil and Gas Company, as well as the other major companies from different sectors such as energy and banking.

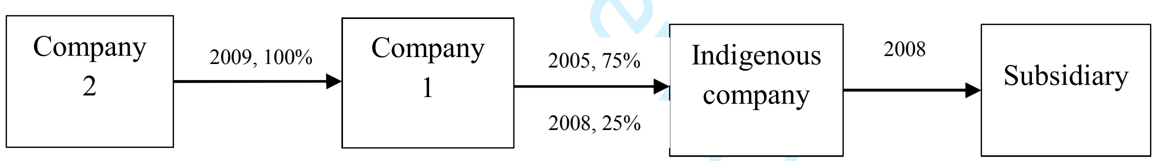


Figure 3. Acquisition's steps.

From the performance development point of view, we found that subsidiary development could be separated into two periods: development (2005–2008) and decline (2010–2013) which clearly correlates with a change of ownership at headquarters level. We asked respondents about their experience in this period of time (before and after change of ownership in 2009), in order to identify which practices and management decisions had influenced the performance of the subsidiary from their point of view. Analysis of the interview data included creating two kinds of documents: a set of spreadsheets and a list of quotations. There was one spreadsheet for each issue or question discussed; the rows corresponded to interviewees and columns corresponded to the opinion about the issue. This made it possible to instantly compute the number of respondents expressing a particular view. The list of quotations expressed the type of response with reference to the interview transcript where the quotation was found. This analysis of the interview data explored several reasons behind the performance development which all participants mentioned as critical. These findings are discussed below.

Subsidiary – Employees links

Data show that in the post-acquisition integration it is important to retain employees as they are the key actors in the process of value co-creation in knowledge-based industries. Initially, the subsidiary's managing director confirmed the intention to work further with the new owner, but as a result of many disagreements on how the business should be organized she finally decided to leave the subsidiary at the end of 2011 and set up her own company. Three months later, headquarters hired a new managing director. This appointment was not successful due to his bad relationships with the subsidiary team. As a result, a large section of employees (about 60 percent) decided to leave the subsidiary at the beginning of 2012. The new managing director resigned from the subsidiary seven months after he started, and since then there has been no fulltime managing director.

This analysis shows that initially a subsidiary management and employees had close relationships, high intensity and speed of value co-creation: the role of the local management at intra-organizational level was to coordinate activities between departments and between employees and headquarters. However, after the second acquisition the relationships with employees became more distant as management team was deprived of power, this resulted in low speed of value co-creation. Interdepartmental activities were not coordinated and this resulted in the conflict of interests between sales and delivery team - sales team wanted to sale the projects which were not feasible (see Table 1 below, Link 1).

Headquarters – Subsidiary links

Data show that in the post-acquisition integration phase it is important to keep the balance between autonomy and centralisation as this may influence the process of value co-creation in knowledge-intensive industries. Before the acquisition at headquarters level, and following the change in the headquarters team, the Russian subsidiary possessed considerable autonomy. The degree of autonomy changed considerably since the time the new HQ management team was appointed, with a clear trend towards more centralization and bureaucratization. The interviews show that there was a shift from strategic control to operational control of the subsidiary, whereas in the area of strategy it was not necessarily to make any decisions concerning the subsidiary's strategy (see Table 3 below). All the interviewees mentioned that cooperation in general worsened, the extent of control by the headquarters dramatically increased, and that performance was negatively influenced by these factors.

The following quotation from the subsidiary sales managers' interviews illustrate these findings:

"After the change of management team everything had to be approved or even decided in the HQ. The communication and decision-making process slowed down on the HQ side, answers were delayed. Strategy changed: more attention had to be given to software sales and less on consulting. From the HQ point of view consulting became unimportant. This was a mistake due to ignorance of the market. As a consequence, headquarters often did not approve project teams or project tasks, and finally contracts with customer could not be signed due to delay in the approval process or even refusal to approve. Sometimes we had un-applicable recommendations which we had to discuss with headquarters, which lead to either the loss of time or of the offer itself. After some time, employees with specific qualification started to retire and we had no specialists to execute projects or certain parts of project. Lack of communications between the subsidiary and the headquarters lead to a decrease in revenue. Headquarters as a decision-making party did not offer adequate ways of performance optimization».

<u>*Distance between headquarters and the subsidiary*</u>

Data show that in the post-acquisition phase it is important to maintain embeddedness of the subsidiary with external actors, such as for example customers and subcontractors, in order to maintain the value co-creation process.

The following quotation, a head of the project office explains that after the second acquisition, centralisation has increased and this had negative influence on the business performance:

"The business of the new owner has been focused on the large deals. This assumed long process of contracts approval. Well it is justified to minimise risks in this case. Our

transactions were smaller in terms of their size. Respectively, these long bureaucratic procedures in our case have complicated our relationships with customers… This culture of control and risk minimisation doesn't fit to the developing markets, in the countries where company wants to develop business the role of the subsidiary should be more innovative and flexible… according to the managing director all deals had to be approved by headquarters, and this in many cases has slowed down the operational processes… the managing director was in our subsidiary an owner of the key business processes and provided cooperation between sales department (contacts with customers) and project management department (contacts with local subcontractors and employees). In absence of such manager in the subsidiary and operational management and motivation in the subsidiary, the successful project delivery is not possible… Here there is a conflict of interests – sales team tries to achieve sale plan targets and sign the contract at the conditions that project delivery team cannot fulfil".

This quotation illustrates that after the second acquisition headquarters was not flexible enough in terms of their ability to combine firm-specific capabilities with local knowledge in order to co-create value on particular developing market. The embeddedness in the MNE network increased, whereas embeddedness in inter-organizational context with subcontractors and customers has decreased. This had negative influence on subsidiary outcomes (See Table 1 links 2, 3 and 4). Factors such as bureaucratic procedures, changes in subsidiary role and resignation of the managing director slowed down the operational processes and unbalanced the coordination of customers' and subcontractors' expectations from projects.

Knowledge exchange between actors in the network

Data show that in the post-acquisition integration phase it is important to maintain knowledge exchange as this may influence the process of value co-creation in knowledge-intensive industries. Knowledge about the market accumulated at headquarters level had a significant impact on the success of its activities in Russia, and therefore knowledge transfer from the subsidiary to the headquarters plays a crucial role in the performance of the subsidiary. The results of the interviews show, that important knowledge in the form of expert opinion, skills and experience, was lost at headquarters with the change of the whole headquarters' management team, as the new headquarters team had no relevant experience of business activities in Russia.

In the following quotation, a subsidiary employee comments on the importance of knowledge of the local market:

> *"Unfortunately, the HQ had nearly no knowledge about the business in Russia. For two years we tried to share it, but the head office just didn't take any notice. It queried all decisions and justifications, such as the fact that it makes no sense to dictate conditions to key customers. In order to keep this customer, we need to accept their conditions. The question of discounts: discounts weren't provided, which led to loss of customers. In every case, HQ dictated conditions which were not applicable to the Russian situation».*

However, an opinion of the HQ executive on the question of why knowledge of the local market is extremely important for good subsidiary performance which is expressed in the following quotation was quite different from those at the subsidiary side:

> *"When HQ decide that more of this or that products should be sold through the subsidiary without knowledge of the market, it becomes very difficult, especially in the Russian market. Suddenly revenues fall and you do not know why. The customers expect*

> *always complex and completed solutions. It is necessary to know many details and here it is important to cooperate with the managing director. Trusting relationships with the managing director and important sales managers should be developed in order to be able to discuss everything and not only to give orders"*

The two quotations give an overview of how the relationships between headquarters and the subsidiary were organized before and after the acquisition. In quotation 1 a subsidiary employee is talking about subsidiary-headquarters relationships after the second acquisition and in quotation 2 – before. So, we can see how the approach has changed and more tight relationships has influenced a process of value co-creation (See the Figure 1). Factors such as understanding of the local market and particularly customers' expectations and trusting relationships between headquarters and local management can improve interactions between actors and therefore facilitate development of the new business opportunities.

Finding in this study are summarised in the Table 1 below.

Table 1. Comparison of acquisition 1 versus acquisition 2. Actors in the value co-creation process and their roles.

Link	Actors relationships	Activities, Acquisition 1	Activities, Acquisition 2
Intra-organizational context			
1	**Subsidiary - Employees**	Close relationships with the local management, high intensity and speed of value co-creation: local management coordinates department activities	Distant relationship with customers, low speed of the value co-creation: department activities are not well coordinated, conflict of interests between sales and delivery departments

2	**Subsidiary -** **Headquarters**	Distant relationships, high autonomy, the intensity of interactions for development of new business opportunities high, headquarters is represented at the regional level, global headquarters does not participate in the value co-creation process	Close relationships directly with global headquarters, however, the development of new business opportunities is low, global headquarters does not participate in the value co-creation, the relationships with the subsidiary have more control function
		Inter-organizational context	
3	**Subsidiary -** **Customers**	Close relationships with customers, local management maintain resource exchange with customers on projects and resolve disputes on quality of services delivered	Distant relationships with customers, local management is excluded from value co-creation process, however headquarters did not replace this function of local management, development of the new business opportunities is slow
4	**Subsidiary -** **Subcontractors**	Close relationships with subcontractors, local management together with delivery team ensure that all necessary resources are subcontracted if the subsidiary and headquarters have no resources available	Distant relationships with subcontractors, headquarter fill the knowledge gap with their own resources that are too expensive, projects run out of budget, development of new business opportunities is limited

Discussion

This study set out to investigate the value-co-creation in knowledge-intensive business services. The framework presented in Figure 1 was useful to organise a case study and therefore served its purpose. The research outcomes indicated that understanding and interpretation of theorising was credible. As findings shows, the main actors – Headquarters, Subsidiary management, Employees, Customers and Subcontractors interact in order to meet the requirements and expectations of Customers with regards to the quality of services delivered. This is achieved through the different levels of interactions in network of relationships of multiple stakeholders. Interactions between actors are managed by the Subsidiary management to which a Headquarters delegates responsibility. Although a value is added at each stage of resource exchange, however the value is created only if it will be transferred to the next actor. In these conditions the subsidiary could co-create a value and improve performance if destructive processes would not affect the resources. These effects depend on the intellectual capacity of the network and related to the personnel as an owner and user of knowledge capital. The knowledge flows define the performance of the subsidiary in the knowledge-intensive environment.

Based on the findings in this case study we propose a framework explaining how value co-creation may be affected in the post-acquisition integration phase in the networks of the MNE (Figure 4 below). This model explains how changes in ownership at the headquarters level can lead to changes in the system of management control, the subsidiary role and the knowledge sharing process between *the headquarters, subsidiaries, employees, local market (suppliers) and customers*. This may negatively affect performance of the subsidiary.

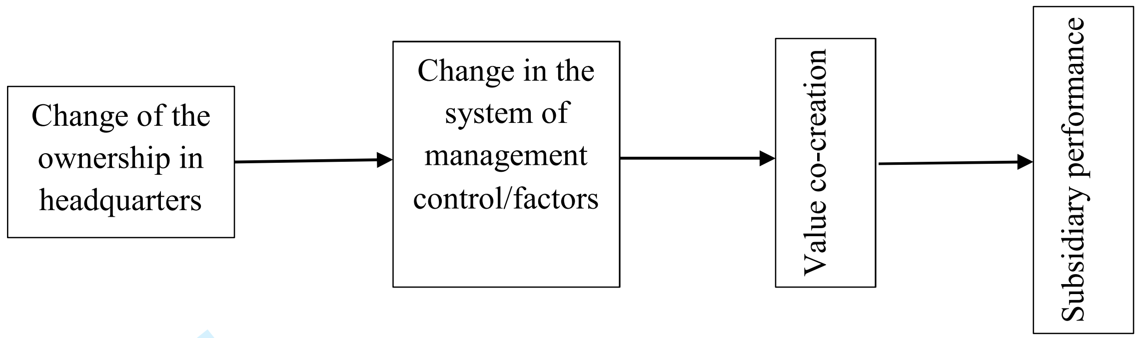


Figure 4. Value co-creation in post-acquisition integration phase in the networks of MNEs.

As a resource-based view of the firm observed, every firm constitutes a bundle of knowledge. Of all possible resources that a firm might possess, its knowledge base is probably the greatest source of sustainable differentiation, competitive advantage and therefore high performance. In the context of MNEs, the effective and efficient transfer of knowledge within intra-corporate networks (vis-a-vis markets) is the primary reason why MNEs exist.

Unfortunately, this raison d'être does not imply that such knowledge transfers actually take place effectively and efficiently on a routine basis, due to the barriers which impede this transfer, such as tacitness, motivational reasons or absorptive capacity. For example, knowledge flow depends on headquarters-subsidiary centralisation (Gupta and Govindarajan 2000). In this context, the MNE must be flexible to be able to combine firm-specific capabilities with local knowledge in order to create the value propositions which might be required in a particular market.

From the network theory point of view, the subsidiary is embedded in the MNE network as well as in the local business network. This provides the basis of the integration-responsiveness framework: MNEs adapting their strategies and organizational practices to the local context. However, it is not about creating homogeneity but about how to manage all these differences (Meyer, Mudambi and Narula 2011). It has been shown that embeddedness depends on the degree of subsidiary's' control by headquarters. For example, Anderson and Forsgren (1996) demonstrated that the more embedded the subsidiary was within its external relationships, the lower the control from headquarters was. A stronger embeddedness within corporate relationships suggested greater MNE control over the subsidiary.

Given the new ideas about how value co-creation process and subsidiary performance can be affected in the post-acquisition phase, the findings in this paper have managerial and academic relevance. From a *theoretical perspective*, it gives insight into post-acquisitions processes and the process of value co-creation between the headquarters, subsidiary, employees, local market (suppliers) and customers. It shows the applicability of the theory of value co-creation to the circumstances of the high technological service industry in international business settings. From a *managerial perspective*, the current research helps to understand how to effectively manage the subsidiary and to improve business performance in the post-acquisition phase. We recommend managers when taking strategic decisions on acquisitions to consider how their choices affect interaction between actors when creating new business opportunities.

In this paper, the development of the subsidiary in Russia was analysed, in order to explain its performance before and after post-acquisition integration. It was found that the reasons for negative development were caused by the changes within the MNE: poor cooperation between the headquarters and the subsidiary, an increase in centralization and control, less autonomy for the subsidiary, increasing embeddedness in the corporate network and a decrease in responsiveness to local demands. We demonstrated that lack of balance between the extent and type of control, within a given environment and business context, impacted the subsidiary performance and led to an imbalance in the process of value co-creation between the headquarters, subsidiary, employees, local market (suppliers) and customers. Contextual variations are particularly relevant for MNEs entering large countries such as Russia. Knowledge about local context refers here to the understanding of customers' expectations and the mentality of employees, i.e. their knowledge of how to sell more and how to motivate people. Our findings show also that in the new local context the knowledge transfer from the subsidiary to the headquarters plays a crucial role in the existing and future performance of the subsidiary. Balancing conflicting forces of local responsiveness and global integration was a major challenge for the headquarters in our case study. Change in the system of management control as a result of change in the ownership in headquarters destroyed value co-creation process at the subsidiary, and this led to the poor performance as outlined in our case study (see Figure 4 above).

The empirical findings of this case study analysis can be summarized as follows. Since 2005, headquarters implemented its gradual expansion strategy in the Russian market by combining local and global know-how in the consulting and software business at the subsidiary level. This strategy implementation, however, changed radically when Company 1 was acquired by another German-headquartered IT company. The key global competences of the MNE included a strong brand and the fact that global organizational practices and marketing strategies had been adequately implemented. After the second acquisition, from our point of view, it was not necessary to transfer knowledge to the subsidiary. However, it *was* necessary to provide knowledge transfer about local market to the headquarters, but this did not in fact happen (see Figure 1, the outward link between Subsidiary and Headquarters). As a consequence of poor understanding of the local market circumstances, more attention was given to the sales of software products than on consulting, as sale of software is a more profitable business. However, there was no consideration of the fact that most customers buy certain types of software only together with consulting (see Figure 1, the link between Subsidiary, Employees, Customers and Subcontractors). This means that the software vendor needs to provide such services itself, otherwise customers will buy a competitor's product (see Figure 1, the links between Subsidiary and Customers and Headquarters and Customers). At the same time, headquarters decreased the degree of subsidiary autonomy through limiting of decisions taken by the subsidiary itself. Even operational decisions had to be taken at headquarters level in each functional area. This led to the de-synchronization of decisions which related to all functional areas, and an increase in bureaucratic procedures. In a situation where knowledge about the peculiarities of the Russian business environment was scarce, headquarters managers were not able to find reasonable solutions for dealing with the increasing business challenges (Figure 1, the backward link between Headquarters and Subsidiary). These factors put pressure on subsidiary revenues. Since revenue was in decline, headquarters had to look for ways to reduce costs. As the main portion of subsidiary costs were personal costs, this had led to pressure on subsidiary resources. The scarcity of highly-qualified human resources on the Russian labour market had allowed the key personnel of the subsidiary to find a job very quickly (Figure 1, the links between Subsidiary and Employees and Headquarters and Employees). As a result, the loss of experienced staff again put pressure on subsidiary revenue as this meant a loss of local competencies which were highly personalised for the Russian subsidiary's CEO and key employees. This included good personal relationships between customers and subsidiary staff. These competencies were applied in order to manage and engage subsidiary personnel and to maintain the contacts with customers. With the example of subsidiary development over time, we have illustrated how the subsidiary's capabilities declined over time and that this was due to headquarters managing the subsidiary functions by trial and error. A decline of revenue in the subsidiary meant that the know-how accumulated during the first three years of its operation in Russia was later lost.

Conclusions

This case study shows the application of the value co-creation view, to the MNE network. It is first of all an illustration of the concept of subsidiary evolution. According to this model, the post-acquisition development of the subsidiary in Russia represents a combination of all three factors: first, a head-office-driven process, second, local environment response, and third, subsidiary choice. These factors led to imbalance in value co-creation process and subsequently, atrophy of the subsidiary. The head-office assignment perspective considers that the subsidiary is an instrument of the MNE and, consequently, that it acts solely with regard to head-office-determined imperatives. The subsidiary choice perspective employs the network model, which allows the subsidiary to be considered from the position of equality with headquarters or even leadership. The network model recognizes that some ownership-specific advantages belong to the subsidiary itself.

The value co-creation framework adds to this model by explaining how this network works and how the value is co-created. The decline of the subsidiary from this point of view is a process built along with the decline of the subsidiary's value co-creation. For example, it was demonstrated how key human resources are critical for the subsidiary development in Russia because the labour market is different from, for example, European countries. It is not possible to find free resources; therefore, companies develop and retain their own. Our case analysis reveals that the high capabilities held by the subsidiary did not match with the loss in the subsidiary charter assigned by the headquarters. This can be viewed as an example of subsidiary decline through parent-driven de-investment (Birkinshaw and Hood 1998). In this case, the capabilities that were associated with the old charter were drastically reduced, as a group of employees left the subsidiary. The subsidiary had superior local capabilities which were not valued by the headquarters. From this point of view, the declared growth strategy in Russia did not match with the strategy implementation: the decision of headquarters to reduce the subsidiary charter. The changes in the subsidiary's charter after the acquisition of its mother company show that the capabilities developed in the subsidiary suddenly became obsolete. Therefore, subsidiary decline was also partly driven by contextual host country factors, including constriction of the local labour market and more personalized customer relationships.

Emerging markets such as Russia remain attractive for foreign MNEs. In these markets, the organization needs to develop local responsiveness by differentiating and increasing the subsidiary's role. In order to achieve this, the subsidiary should be given a more autonomous role and managed in a less centralized way. Subsidiary development should include gradual charter establishment and capability enhancement. In this process the subsidiary' management team should play an important role in building the local team, and in local market knowledge transfer from the subsidiary to the headquarters. Trusting relationships with the local management team and key local sales managers should be developed. In the MNE's system of management control between headquarters and the subsidiary, a shift towards social control rather than bureaucratic and personal control should be the focus.

The MNE strategy determines the organizational design and control system. An effective organization is one where structure, management practices, rewards and people fit its strategy. Organizational design, strategy, organizational culture and control must also fit the environment. The strategy to grow via acquisitions rather than by the gradual development of operations meets the challenges of both integration and responsiveness. It was necessary for the organization to re-conceptualise the strategy implementation in the second post-acquisition period (after year 2009). In this regard, a view of MNE as a network of partly autonomous subsidiaries, with links between each other and to external actors, where participants share their resources in order to co-create value needs to be developed within the organization.

Limitations

The limitations of our study provide opportunities for future research. Even taking into account that the objective of our qualitative research is to test a theory, our findings must be interpreted with caution as the analysis is based on a single comparative case study. Although, our study applied the theory of the value co-creation to the settings of one country and we identified the actors and, their roles and activities in the Russian context, we expect that identical relationships can be found in any subsidiary in the service industry independent on the national context, as in the knowledge intensive industries the industry specific prevail over country specific. However, in order to confirm it more studies on how value is co-created within the MNE network need to be conducted. This is a qualitative study of *one* industry in *one* country and future research may probably seek to explore cases in different industries and different countries in order to generate a solid theory.

Acknowledgments

We thank all reviewers of this paper and participants of the poster session at 43rd EIBA Annual Conference for their c useful comments and support.

References

1. Aarikka-Stenroos, L., and E. Jaakkola. 2012. Value co-creation in knowledge intensive business services: A dyadic perspective on the joint problem-solving process. *Industrial Marketing Management*, *41* (1):15-26.
2. Abrahamsen, M. H., Henneberg, S. C., and P. Naudé. 2012. Using actors' perceptions of network roles and positions to understand network dynamics. *Industrial Marketing Management*, *41* (2):259-269.
3. Andersson, U., and M. Forsgren, 1996. Subsidiary embeddedness and control in the multinational corporation. *International Business Review, 5* (5):487–508.

4. Ahlstrom, D. 2010. Innovation and growth: How business contributes to society. The *Academy of Management Perspectives, 24* (3):11-24.
5. Auh, S., Bell, S.J., McLeod, C.S. and E. Shih. 2007. Co-production and customer loyalty in financial services. *Journal of Retailing, 83* (3):359–370.
6. Birkinshaw, J. M. and N. Hood. 1998. Multinational subsidiary evolution: capability and charter change in foreign-owned subsidiary companies. *Academy of Management Review, 23* (4):773-795.
7. Birkinshaw, J. M., Hood, N., and S. Young. 2005. Subsidiary entrepreneurship, internal and external competitive forces and subsidiary performance. *International Business Review, 14* (2):227-248.
8. Cantù, C., Corsaro, D., and I. Snehota. 2012. Roles of actors in combining resources into complex solutions. *Journal of Business Research, 65* (2):139-150.
9. Doz, Y. 2011. Qualitative research for international business. *Journal of International Business Studies, 42* (5):582-590.
10. Eisenhardt, K.M. 1989. Building theory from case study research. *Academy of Management Review, 14* (4):532-550.
11. Ellet, W. 2007. *The case study handbook.* Boston, MA: Harvard Business School Press.
12. Forsgren, M., and J. Johanson. 1992. *Managing internationalization in business networks*. Philadelphia, PA: Gordon and Breach.
13. Galvagno, M., and D. Dalli. 2014. Theory of value co-creation: a systematic literature review. *Managing Service Quality*, *24* (6):643-683.
14. Gammelgaard, J., McDonald, F., Stephan, A., Tüselmann, H., and C. Dörrenbächer. 2012. The impact of increases in subsidiary autonomy and network relationships on performance. *International Business Review, 21* (6):1158-1172.
15. Ghoshal, S., and C. A. Bartlett. 1990. The multinational corporation as an inter-organizational network. *Academy of Management Review, 15* (4):603-626.
16. Ghauri, P. 2004. Designing and conducting case studies in international business research. In Rebecca Marschan-Piekkari and Catherine Welch (Eds.). *Handbook of Qualitative Research Methods for International Business.* Ch. 5, pp.109-124. London, UK: Edward Elgar Publishing.
17. Ghauri, P., and K. Gronhaug. 2010. *Research methods in business studies.* 4th Edition. London, UK: FT Pearson.
18. Gummesson, E., and C. Mele. 2010. Marketing as value co-creation through network interaction and resource integration. *Journal of Business Market Management, 4* (4):181-198.
19. Gupta, A.K., and V. Govindarajan. 2000. Knowledge flows within the multinational corporation. *Strategic Management Journal, 21* (4):473-496.
20. Hedlund, G. 1986. The hypermodern MNC - a heterarchy? *Human Resource Management, 25* (1):9-35.
21. Jaakkola, E., and T. Hakanen. 2013. Value co-creation in solution networks. *Industrial Marketing Management, 42* (1):47-58.
22. Lusch, R. F., and S.L. Vargo. 2006. Service-dominant logic: reactions, reflections and refinements. *Marketing Theory*, *6* (3):281-288.
23. Mattson, L. G., and J. Johanson. 1992. Networks Positions and Strategic Action. In Axelsson, B. and G. Easton (Eds.) *Industrial Networks: A New View of Reality*. Ch. 11, pp.205-217. London, UK: Routledge.

24. Meyer, K.E., Mudambi, R. and R. Narula. 2011. Multinational enterprises and local context: the opportunities and challenges of multiple embeddedness. *Journal of Management Studies, 48* (2):235-252.
25. Michel, S., Vargo, S. and R. Lusch. 2008. Reconfiguration of the conceptual landscape; a tribute to the service logic of Richard Normann. *Journal of Academy of Marketing Science, 36* (1):152-155.
26. Noria, N., and S. Ghosal. 1997. *The differentiated network: Organizing multinational corporations for value creation.* San Francisco, CA: Jossey-Bass Publishers.
27. Ostrom, A. L., Bitner, M. J., Brown, S. W., Burkhard, K. A., Goul, M., Smith-Daniels, V., and E. Rabinovich. 2010. Moving forward and making a difference: research priorities for the science of service. *Journal of Service Research*, *13* (1):4-36.
28. Panibratov, A., and M. Latukha. 2014. Obtaining international results through partnerships: evidence from Russian MNEs in the IT sector. *Journal for East European Management Studies, 19* (1):31-57.
29. Rugman, A. M., 1996a. *The theory of multinational enterprises: the selected scientific papers of Alan M. Rugman.* Cheltenham, UK: Edward Elgar.
30. Rugman, A. M., 1996b. *Multinational enterprises and trade policy: the selected scientific papers of Alan M. Rugman.* Cheltenham, UK: Edward Elgar.
31. Rugman, A. M., and A. Verbeke. 2003. Extending the theory of the multinational enterprise: Internalization and strategic management perspectives. *Journal of International Business Studies, 34* (2):125-137.
32. Sekaran, U. and R. Bougie. 2013. *Research methods for business.* 7th Edition. Chichester, UK: Wiley.
33. Ulriksen, M.S. and N. Dadalauri. 2016. Single case studies and theory-testing: the knots and dots of the process-tracing method. *International Journal of Social Research Methodology, 19* (2):223-239.
34. Vargo, S. L., Maglio, P. P., and M. A. Akaka. 2008. On value and value co-creation: A service systems and service logic perspective. *European Management Journal*, *26* (3):145-152.
35. Vargo, S. L., and R.F. Lusch. 2008. Service-dominant logic: continuing the evolution. *Journal of the Academy of Marketing Science*, *36* (1): 1-10.
36. Welch, C., Piekkari, R. Plakoyiannaki, E. and E. Paavilainen-Mäntymäki. 2011. Theorising from case studies: Towards a pluralist future for international business research. *Journal of International Business Studies*, *42* (5):740-762.
37. Yin, R. 2009. *Case study research: design and methods.* 4th Edition. Thousand Oaks, CA: Sage Publications.
38. Young, S., and A. T. Tavares. 2004. Centralization and autonomy: back to the future. *International Business Review, 13* (2):215-237.