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Subsidiary redefinition: Charter loss in a German-owned subsidiary in Hungary

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Subsidiary Redefinition: Charter Loss in a German-owned Subsidiary in Hungary

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Abstract

Based on a literature review and a single case study approach, this paper provides insights into the actors, interests and dynamics of charter losses. It reports the results of interviews with 20 managers at different units of Siemens ICN (Information & Communication Network division) in Germany, Hungary and Austria, including the Hungarian subsidiary where the charter loss occurred, the German headquarters, and the main competing subsidiaries. Furthermore, the paper sheds light on the questions: to what extent and by what combination of host country, subsidiary-related and MNC structural and organizational factors do situations develop in which a subsidiary loses its charter. Our findings show that there is no single reason for a charter loss, but multiple interdependent reasons subject to divergent interpretations, reflecting the micropolitical interests of the key actors. The case study further elucidates that there is room for strategic action at the subsidiary level to avert a charter loss, whereby anticipatory adjustment of the subsidiary towards more balanced internal and external embeddedness as well as constant interpersonal networking with the headquarters office are two important prerequisites.

Zusammenfassung

Dieser Beitrag beschäftigt sich auf Basis einer Fallstudie mit der Frage, warum Tochtergesellschaften multinationaler Unternehmen Mandate verlieren. Mandate sind zeitlich und inhaltlich befristete, von der Unternehmenszentrale eines multinationalen Unternehmens verliehene oder von einzelnen Tochtergesellschaften errungene Kompetenzen bzw. Verantwortlichkeiten, die die konzerninterne Arbeitsteilung in einem multinationalen Unternehmen definieren. Es werden Ergebnisse aus Interviews mit mehr als 20 Managern der Siemens-Sparte für Vermittlungstechnik (Information and Communications Networks oder kurz ICN) in Deutschland, Ungarn und Österreich präsentiert. Der Beitrag verdeutlicht, dass es verschiedene interdependente Ursachen für Mandatsverluste gibt, die je nach den mikro-politischen Interessen der wesentlichen Akteure unterschiedlich interpretiert werden. Die Fallstudie verweist zugleich auf Spielräume für strategisches Handeln auf der Tochtergesellschaftsebene. Wesentliche Ansatzpunkte sind dabei eine strategische Ausbalancierung von interner und externer Eingebundenheit der Tochtergesellschaft sowie eine stark auf interpersonelle Kontakte abstellende Vernetzung der Tochtergesellschaftsmanager mit der Konzernzentrale.

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1 Introduction[1]

The present paper examines the case of a charter loss at a German-owned subsidiary in Hungary during the first 15 years of transition and investigates the reasons for subsidiary charter losses in multinational corporations. Former surveys, often conducted in a West European context, have focused on positive development of the subsidiaries' strategic responsibilities and how those entities have extended their activities over time with regard to market, product and value-adding activities (Birkinshaw & Hood, 1997; Delany, 1998; Egelhoff et al., 1998; Hood et al., 1994; Jarillo & Martinez, 1990; Pearce, 1999; Taggart, 1998, 1999; Williams, 1998). Only a few studies, like Galunic & Eisenhardt (1996); Birkinshaw (1996) and Hood and Young (1982) have paid attention to the reasons for subsidiary business area demotion. The paper investigates the reasons for subsidiary charter losses and further contributes by examining this topic in an East European context. Our data, acquired through 20 interviews with managers in the German headquarters of Siemens ICN its Hungarian subsidiary and other (competing) subsidiaries provides a detailed picture of the reasons, dynamics and different interests related to charter losses. We begin by summarizing the reasons for subsidiary charter losses, as ascertained by reviewing the literature on subsidiary roles. Next, we proceed to discuss methodological issues and examine the case. In the final section, we conclude and discuss implications for management practices.

2 Literature Review

A multinational corporation (MNC) is a corporation which owns or controls production or service facilities located outside of the country in which it is based. Headquarters organizes its activities by decentrally delegating business areas and strategic responsibilities to its subsidiaries. Therefore, various subsidiaries are “chartered” to look after a certain business area. Galunic & Eisenhardt (1996, p. 256) define a *charter* as: "the businesses (i.e., product and market arenas) in which a division actively participates and for which it is responsible within the corporation"[2]. By this definition, a charter defines a subsidiary’s product or service line and the markets on which these product or services are to be

1 Special thanks to Sigrid Quack and Frank McDonald for their critical comments and helpful suggestions for revisions.

2 Galunic and Eisenhardt's level of analysis is the division of an MNC, but in this paper, the concept of charter is used at the subsidiary level.

sold. On the other hand, a charter also stipulates the strategic responsibilities granted to a subsidiary, often deciding its level of autonomy, i.e., the degree to which the subsidiary can make strategic or operational decisions without consulting headquarters (O'Donnell, 2000). Additionally, a subsidiary is characterized by the role it plays in the MNC, i.e., by the activities it carries out. White & Poynter (1984) grouped the roles of foreign-owned subsidiaries into five main categories, and this classification has since been a central reference point for several subsidiary development studies (Hood et al., 1994; Delany, 1998; Taggart, 1999). According to White & Poynter (1984), *marketing satellites* are subsidiaries that market single products or whole ranges of products in the host country (with some limited customer service provided too). *Miniature replicas* not only market single products in the foreign country, but also manufacture single products, ranges of products, or varieties of products for the parent company. *Rationalized manufacturers* produce individual products or product ranges for the world market. Other MNC units carry out R&D, marketing or necessary production steps. *Product specialists* have comprehensive responsibilities for a product within an MNC since they develop and manufacture the product and sell it worldwide. Finally, *strategic independent units* have the additional freedom to develop and manufacture new products and to set up new markets. Beyond these five roles, Schmid (2000) has shown the existence of a large number of role typologies. However, newer subsidiary role descriptions tend to include very advanced characteristics of organizational sub-units related to strategic importance and influence, such as centers of excellence (Holm & Pedersen, 2000).

Several researchers have focused on changes in subsidiary roles over time, emphasizing the extent and reasons for charter "wins", here defined as situations where subsidiaries have extended their business areas within markets, product and service lines and strategic responsibility. Hood et al. (1994), Delany (1998) and Taggart (1999) all used White & Poynter's (1984) terminology to analyze role changes, i.e. the transformation of the subsidiary from one role to another, and mostly reported positive changes in terms of charter wins. Utilizing different concepts, extended charters were also a general phenomenon observed in surveys carried out by Pearce (1999), Egelhoff et al., (1998), Williams (1998), and Walsh et al. (2002), the latter reporting that 56% of 66 North American or Asian-based subsidiaries in China have extended the scope of their market activities. Meyer & Lieb-Dóczy (2003) recently provided a specific insight into the improvement of acquired firms in the former German Democratic Republic and in Hungary, but did not look into role changes *per se.* Of the nine Hungarian cases, only one subsidiary had been promoted to be a global center of excellence for R&D.

Researchers have rarely carried out surveys on subsidiary demotion, though Galunic & Eisenhardt (1996) carefully described charter losses in 9 multinational divisions. Birkinshaw (1996) reported 31 cases of charter change in

six subsidiaries, which led to charter loss in six cases[3]. Most surveys have reported only a few cases of charter loss. Taggart (1999), for example, observed 9 charter losses in a sample of 131 US and European-owned UK-based subsidiaries. Other surveys have only embraced status quo situations, like in Egelhoff et al. (1998), whose sample included 7 non-changing subsidiaries out of 16. Other descriptions of charter losses are often anecdotal in nature, as in the case of Hood & Young (1982).

What causes subsidiary charter loss? Only a few surveys have pointed out reasons, and most explanations to subsidiary developments need to be revealed from charter win situations; these arguments have to be turned around when explaining charter losses. Nevertheless, in the survey by Birkinshaw (1996), it turned out that the engine for positive subsidiary development was the possession of distinct capabilities, and that charter losses occurred either in situations where such capabilities were lacking or in cases of where there was a mismatch between subsidiary resources and the remaining corporation's business activities and interests. Galunic and Eisenhardt (1996) likewise found the mismatch between divisional charters and corporate core business areas as a reason for demotions. Secondly, they focused on loss of charters due to failures in operating new business areas, and, finally, they paid attention to situations where a division lost its charters to other divisions due to the internal competition within the MNC. Conversely, charter loss is not necessarily negative. Galunic & Eisenhardt (1996), for example, showed how radically growing divisions lost peripheral business areas in order to concentrate on their new charters.

From these prior surveys, a pattern emerges where explanations to subsidiary charter development were to be found in *host country factors*, i.e. the local market economy and the actors related to this market, *subsidiary resources,* i.e. resource-based characteristics of the subsidiary and, finally, *MNC organizational and structural factors,* which included specific circumstances regarding both the configuration of the MNC and headquarters behaviors. Birkinshaw & Hood (1997) also found evidence for this tripartition. Rugman & Verbeke (2001) likewise described three drivers of subsidiary evolution, namely, the degree of parent company assignment, subsidiary choice, and local environment determinism. Crookell and Morrison (1990) operated with a similar concept defining the competitive conditions in the industry, headquarters strategy toward international markets, and finally subsidiary initiatives to position themselves within the corporation as factors influencing the charter of the subsidiary. It is therefore relevant to establish the reasons for subsidiary role development (also in relation to charter loss) in a) the host country environment, b)

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3 Birkinshaw (1996) used the word "mandate" instead of charter, and defined mandate (p. 467) as a "business, or element of business, in which the subsidiary participates and for which it has responsibilities beyond its national market."

within the subsidiary, and c) in the MNC. These three factors are discussed in the following three paragraphs.

The stage and the development of the local economy affect subsidiary evolution, and extension of business areas is an outcome of spillover effects from local market opportunities. One 'classic' example is the development of foreign-owned subsidiaries in Canada, which underwent what White & Poynter (1984) described as a transition from market-oriented units to more production-oriented and strategically independent units. This development was a spillover effect from the Canadian government's efforts to improve the level of development to avoid negative effects of a high proportion of US ownership in the Canadian industry. Similar effects have been shown to occur in Ireland (Egelhoff et al., 1998) and China (Walsh et al., 2002). Government-initiated development programs targeting, for example, infrastructures and universities have generally been supportive of subsidiary development (Rugman & Douglas, 1986; Egelhoff et al., 1998); so has direct subsidizing (Birkinshaw & Hood, 1997). Furthermore, improvements of the host country's economic level of development typically improved market conditions, thus offering subsidiaries more opportunities to establish autonomous business relationships (Ivarsson, 2002) and, as shown by Egelhoff et al. (1998), to start up research processes. Holm et al. (2003) showed how access to skilled personnel combined with pressures from local competitors and customers had a positive effect on a subsidiary's ability to develop capabilities, especially when tapping into leading edge clusters (Birkinshaw and Hood, 2000) through highly embedded relationships (Andersson et al., 2002). In general, these positive externalities speak for charter wins, whereas negative externalities argue for charter losses.

The position a subsidiary holds in the MNC is a reflection of its strengths and weaknesses (Luo, 2005). According to a resource-based view, a firm's – in this case a subsidiary's - stock of resources and capabilities determine its evolution (Amit & Schoemaker, 1993). This way of thinking initiates from Penrose's (1959) pioneering work, which demonstrated how the growth rate of a firm is constrained by its reservoir of resources and how these resources are managed. Following this line of argumentation, capabilities such as specialized technologies (Egelhoff et al., 1998), product portfolios (Hood et al., 1994), managerial expertise (Rugman & Douglas, 1986), entrepreneurial efforts (Birkinshaw & Hood, 1997; Crookell & Morrisson, 1990) and especially internal R&D processes play a central role in subsidiary development processes (Pearce, 1999; Florida, 1997; Taggart, 1998). Conversely, lack of resources is a strong predictor for charter losses. Egelhoff et al. (1998) exemplified this situation by referring to lack of pursuing technology-based initiatives. Birkinshaw (1996) further showed how non-progressing subsidiaries lost charters to those competing corporate affiliates that have had developed new generations of products or services. Demotions are, so to say, the outcome of an increasing

mismatch between the subsidiary charter and the MNC's core areas of business (Galunic & Eisenhardt, 1996).

The development of distinct capabilities is paradoxical, since these often are unique and – thereby - different to the capabilities and resources held by the remaining MNC. This brings about a knowledge gap between other corporate entities (Rugman & Verbeke, 2001) and lowers absorptive capacity (Lane & Lubatkin, 1998). Besides, studies of knowledge flows within the MNC have indicated that transferring knowledge has been far from easy. Szulanski (1996) identified two sets of factors that hinder internal knowledge flows: motivational factors and knowledge-related factors. The latter emanated from the character of knowledge (e.g. tacit, context-specific and ambiguous) that has made it difficult to transfer knowledge from one location to another, while the former is more related to the lack of incentive structure of the MNC. Consequently, this will slow down subsidiary developing processes. Therefore, distinctive capabilities advocate charter wins but simultaneously can bring the subsidiary in a more isolated and demoted position.

Finally, the role of a subsidiary is determined not only by environmental influences and the capabilities available to the subsidiary, but also by strategic decision-making at the headquarters level and the degree of autonomy of the subsidiary (Morrison & Roth, 1993). To provide a few examples, Egelhoff et al. (1998) showed that headquarters' assignments were central to the evolution of subsidiaries, and Lou (2005) explained how subsidiaries compete for parent resources and support, and how more resources from headquarters will reduce the subsidiary's dependency to local resource possessors. The concept of resource dependency (Pfeffer & Salancik, 1978) can also be applied internally in the corporation, where the degree to which headquarters depends on the subsidiary will influence its decisions concerning subsidiary charters (Holm & Pedersen, 2000). Furthermore, one must remember that an MNC is also a political organization (Forsgren, 1989) and, as Birkinshaw & Ridderstråle (1999) have suggested that the *corporate immune system* is a reason for the absence of assignments. In this case, headquarters may oppose proposals from the subsidiaries because of strict funding criteria, bureaucratic inertia or political reasons. However, the willingness of headquarters to allocate the subsidiary the resources and to delegate the strategic responsibilities needed for charter changes also depends on more economically rational motives. When the home market of an MNC matures or its technological advantages disappear, a need for corporate resource reallocation then arises (Prahalad & Doz, 1981; Birkinshaw & Hood, 1998). In this regard, Delany (1998) observed that the closure of one subsidiary sometimes resulted in the upgrading of another. Altered market conditions, poor management, and other factors elsewhere in the MNC may therefore prompt an MNC headquarters to reconfigure the resources and strategic responsibilities of its subsidiaries. These strategic redeployments may be either parent-driven (Birkinshaw & Hood, 1998), where headquarters urges

subsidiaries to compete for mandates on market-alike conditions, or subsidiary-driven (Birkinshaw and Hood, 1997), where subsidiaries act as "incubators" that autonomously start up activities like R&D that later qualify them for strategic responsibilities.

A subsidiary's charter reflects simultaneous influences from local environmental factors and internal corporate requirements, both of which determine the nature of the subsidiary' resources. It is a paradox that the variation between the different subsidiaries external networks within the MNC, which can be seen as an advantage for the development of new knowledge, will turn into a disadvantage when the MNC wants to transfer the knowledge among the MNC units (Forsgren, 1997). In terms of institutionalization theory (e.g., Hawley, 1968; DiMaggio & Powell, 1983; Rosenzweig & Singh, 1991 Scott, 1995; Kostova & Zaheer, 1999), foreign subsidiaries are subject to simultaneous isomorphic pulls both from their local environment and from their MNC, which bases its actions on its own institutions, rules, norms, values and cognitive mindsets. Subsidiaries therefore exist in a world of institutional duality (Kostova & Roth, 2002), caught between their MNC institutions and local institutions. Subsidiaries choosing to be highly externally embedded (Andersson et al. 2002) might be downgraded to narrowly defined activities and markets unless the subsidiary is able to produce resources upon which other corporate units depend. Highly internally embedded subsidiaries might face difficulties in tapping into the local market, which, again, will decrease performance. An imbalance between internal and external embeddedness might then lead to charter loss.

Closing this discussion, charter loss manifests in terms of closure of certain activities (sales, production, R&D), the loss of product or service lines, and decreased market operations. Furthermore, the subsidiary might lose strategic responsibilities within the above-mentioned areas, and decision-making would take place at headquarters instead.

3 Methodology

Given the scarcity of direct knowledge about charter loss in the literature, a single case study approach is used to provide more data on this subject. The case study is designed as being both descriptive and explanatory (Yin 1989). It aims to provide insights into the actors, interests and dynamics of charter losses as well as to explain to what extent and by what combination host country, subsidiary and MNC structural factors lead to situations in which a subsidiary loses its charter. The latter is basically done by matching the case study results with the theoretical propositions developed by inverting the reasons for upgrading in

Chapter 2. Case study[4] data was collected in more than 20 interviews carried out between 1999 and 2003 at different Siemens units in Germany, Austria and Hungary, both at the headquarters and the subsidiary level. The semi-structured interviews based on an interview questionnaire usually lasted an hour and a half. Most of the interviews were conducted at the interviewees' offices. Because of confidentiality obligations, no interview partner is mentioned by name. An anonymous list of the interview partners is given in the footnote below.[5] Interviews at the German headquarters and with German or Austrian Expatriates in Hungary were conducted in German. Interviews with Hungarian managers and Hungarian Stakeholders were conducted in Hungarian with the help of a Hungarian associate who simultaneously translated the interviews. Access to interview partners was first eased by a sponsor at the headquarters. After conducting a few interviews, we decided to use a snowballing approach in which the interview partners were asked to name other relevant interview partners (Welch et al. 2002). This helped us to include all relevant actor groups (in line with the basic provisions of policy network analysis, cf. Marin & Mayntz 1991) and ensured a multi-facet view on the rather conflict-burdened issue of charter losses. All interviews except one were taped and transcribed. Triangulated with document data, a summary report was produced and sent to the interviewees for approval to eliminate mistakes, misunderstandings and analytical error. In addition, we had two intense feedback meetings with interview partners to improve data interpretation.

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4 The case study was undertaken in the realm the project: "Exogenous influences in path dependent transformation processes: The effects of German FDI on work organization and labor relations in Hungary". The project was funded by the Volkswagen Foundation and hosted by the Free University, Berlin.

5 1 top manager at the divisional headquarters in Bruchsal/Germany; 1 middle manager at the divisional headquarters in Bruchsal/Germany; 1 middle manager at the Siemens headquarters, Munich/Germany; 1 representative of the general works council (Konzernbetriebsrat) and member of the supervisory board at Siemens AG, Munich/Germany; 1 middle manager for corporate personnel at Siemens AG, Berlin/Germany; 4 middle managers at Siemens Österreich AG, Vienna/Austria, working as expatriates at Telefongyár, 3 top managers at Telefongyár, Budapest/Hungary; 7 middle managers at Telefongyár, Budapest; 1 middle manager at Sysdata, Budapest/Hungary, a software spin-off of Telefongyár; 2 representatives from the labor side at Telefongyár, Budapest/Hungary, 1 representative from the Hungarian Investment Promotion Agency (ITD), Budapest/Hungary, 1 representative from the Hungarian Ministry of Economics dealing with foreign direct investments, Budapest/Hungary. A few of the interviews were group interviews; some people were interviewed several times while drafting this study.

4 The Case: Charter Loss at Siemens Telefongyár, Hungary

Siemens Telefongyár is the Hungarian subsidiary of the Siemens telecommunication switching business. In socialist times, it was a model company at national level, producing information and communication hardware on its own technological basis with more then 3,000 employees (1989). Telefongyár today is merely a peripheral location fully dependent on company supplies. Its basic task is to market Siemens switching equipment and some other Siemens telecommunications hardware in Hungary. Siemens' original motive in taking over Telefongyár in 1991 was to gain access to the Hungarian market. The first big tender to serve the local telecom operator (MATAV) was won in the early 1990s, the second one (extending till 2001) in the mid-1990s. Both tenders encompassed a formal obligation to maintain local production. Thus, initial transitional restructuring of Telefongyár only extended to sharply downsizing its different functions (production, R&D, sales), transforming the company into miniature replica of the Siemens switching division.[6] This change, which basically meant implementing Siemens standards throughout Telefongyár, was by and large translated into action through a broad transfer of know-how from other Siemens switching units in Germany and Austria. Production was completely modernized, e.g., by transferring state-of-the-art production lines for the fitting and soldering of printed circuit boards from the Siemen's Viennese switching plant.[7] Workers as well as the new management team of Telefongyár were trained by a large number of German and Austrian expatriates(15-20 at peak times). Training extended to all functional areas and lasted up to three years. Young employees of Telefongyár were generally given preference with some of the old top management - especially those that had good contacts to the national Telecommunications operator MATAV were also kept.

This strategy of modernizing the company via intensive cross-border transfers while maintaining established political relations proved to be very successful. A long period of positive business development and high dividends followed. For many years the profit rate of Telefongyár clearly exceeded the profit rate of other Siemens' subsidiaries in Hungary as well as the profit rates of Siemens switching subsidiaries elsewhere in Europe. However, the situation changed after 10 successful years, finally leading to the closure of production at Telefongyár at the end of 2002. This charter loss downsized the subsidiary to approx. 250 employees and altered the role of Telefongyár from a miniature replica to a marketing satellite. What caused this charter loss? Following our theory, reasons for charter losses can be found in the host country environment, within the subsidiary or within the MNC. As we will see in greater detail below,

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6 The more then 3000 employees were downsized to 1.200 before Siemens took over Telefongyár in late 1991. This number steadily decreased over 700 in the mind 1990ies to 400 at the turn of the century and 350 in 2001.

7 Different kinds of printed circuit boards are the main components of switching systems.

reasons for the charter loss at Siemens Telefongyár touch upon all these analytical categories. Furthermore the reasons are highly interrelated and are subject to divergent interpretations that reflect the micro-political interests of the key actors.

One important reason for Telefongyár's charter loss can be found in the *host country environment*. Following ten years of constant investment, Telefongyár's main customer , MATAV, finalized the basic modernization (digitalization) of its telecommunications network in 2001, with no funds left for a further upgrading of the network (by e.g. broadband applications or voice over IP technologies). This came close to a complete market collapse, since MATAV in 2002 still had about 85% of the fixed network business in Hungary. Given the transitional status of the country, Telefongyár had only a few other local customers in the telecommunications industry to whom it could sell its printed circuits. These rather scare opportunities to establish local business relationships were also highly contested. For one, due to the foreign-led transition strategy of Hungary, many of the potential customers were subsidiaries of (other) western MNCs sourcing largely from captive markets or from well-established external suppliers. Secondly, some big contract manufacturers such as Flextronix were producing printed circuits on a much larger scale in Hungary.

The rather small scale of the production site at Telefongyár also turned out to be an important *subsidiary-related reason* for the charter loss at Telefongyár. Imposed by a clause in the tender, Siemens only established a very small production unit just to satisfy local demand. Once it turned out that a new tender (with the rather favorable conditions of the two pervious tenders) was not in sight, the Telefongyár production site as it existed then became obsolete. Prompted by warnings from the headquarters office to close down production, the local management started to look for new orders from other Siemens' divisions as well as from external customers in the late 1990s. These initiatives secured a second wave of modernization at the production site - one that was strongly desired by the local management but already heavily criticized by some headquarters managers, yet the orders gained were not sufficient to justify an enlargement of the production to a competitive scale. According to some voices from the headquarters office, the failure to manage the new situation was due to a lack of entrepreneurial effort and experience. The local Hungarian management, however, more or less blamed it mainly on the rather uncooperative behavior of other Siemens divisions[8] as well as on the ethnocentric attitude of the headquarters office (see below). A second, rather complementary subsidiary-related reason for Telefongyár's charter loss is its scarcity of R&D resources. After spinning off some of its R&D activities to Sysdata, a newly

8 This refers to Telefongyár's attempt to "rent out" the whole production capacity to another division of Siemens. However shortly before a formal agreement was reached, the management at this other division changed, with the new management canceling the plan.

founded Siemens software subsidiary in Hungary, Telefongyár's remaining R&D resources were closely tied to local product adaptations. Thus, there were no R&D resources left to pursue technology-based initiatives that could eventually lead to highly popular new products (requiring an upscale of production).

Apart from host country and subsidiary related factors, there were also *MNC structural and organizational factors* contributing to the charter loss at Telefongyár. The main background here is an internal restructuring program of Siemens' switching division. Released in 1996, this program should cope with some major structural changes in the telecommunications industry.[9] It contained two basic provisions: Firstly to drastically lower the number of about 50 Siemens switching plants all over the world (1996), and secondly to build a more hierarchical production structure. The final structure, which was originally scheduled to be fully implemented in 2004, only foresaw three centers of competence (one in Europe, one in Asia and one in the Americas), which were to handle all production and innovative R&D, as well as a system of about 7 regional logistic centers (depending on the business volume of the world region) and as many configuration satellites as needed (basically serving as assembly points and customer interfaces). Faced with this strategic reorganization plan and realizing that the existing production site was too small to survive, the local management of Telefongyár endeavored to promote their location as the center for the planned concentration of European production. Using the strategy "offense is the best form of defense", they argued that Siemens should enlarge the production site in Hungary rather than closing because of it had well-qualified but inexpensive workers, adequate space for expansion, good transport routes and, last but not least, the favorable tax provisions that Siemens had negotiated at the take-over of Telefongyár but had previously only taken limited advantage of. This undertaking placed Telefongyár in immediate competition with other plants of the same division, particularly with a factory in Southwest Germany which, up to that point, was the biggest factory and the largest R&D center in Europe for these types of products.

Following some negotiations, the headquarters of the switching division took the decision to close production at Telefongyár, to relocate production to

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9 Since the early 1980ies, political liberalization, technical change and increasing transnational standardization of networks have eroded the close relationship between national telephone operators and their preferred equipment suppliers. The introduction of competition in their former monopoly markets forced the service operators to lower the prices for their services and to increase demand-led investments in their networks. Most of the operators abandoned their former policy to require local production. In addition, 'squeezed' by competition, they put more pressure on prices leading to a dramatic fall of the price per subscriber line (from 1995: 200 US dollars to about 50 US dollars in 2001). For the equipment manufacturers, these changes translated into a strong rationalization potential, due to the fact that once there is no more political requirement for local production, small plants such as the one of Siemens in Hungary turned out to be relatively inefficient.

the factory in Southwest Germany and to promote this factory to the European center of competence. It remained controversial, which factors finally influenced this decision. Representatives of the parent company referred to the more advantageous scale of production and R&D at the factory in Southwest Germany, with a geographical separation between production and R&D generally considered as disadvantageous. On the level of the subsidiary management opinions ranged from “information problems in the international matrix structure” to the accusation that the divisional headquarters was pursuing an ethnocentric policy of “location protectionism contrary to all economic reason”. The somewhat hash reactions among the subsidiary managers are easily to understand, no matter whether their arguments hold true or not. Their initiative to gain a European mandate for the production of switching components was turned into the opposite. By order of headquarters, production was closed and Telefongyár was downgraded to a marketing satellite. It is very likely that Telefongyár will remain within this role in the foreseeable future. With new headquarters assignments very unlikely, the loss of the productive base at Telefongyár, more or less also forecloses future subsidiary initiatives to upgrade in role. A further carter loss however is rather unlikely too, given the daily need for service and maintenance in the switching business.

5 Discussion

"To what extent is the case of Siemens Telefongyár typical for subsidiary business area demotion?" is a question that remains to be answered in quantitative studies. However, this single case study made it clear that our theoretical postulations developed by inverting the reasons for upgrading do have a strong potential for explaining charter losses. Beyond that, the case study stresses that there is no single reason for charter loss, but multiple interdependent reasons. In the case of Telefongyár, subsidiary-related weaknesses, such as the lack of R&D resources, small production size and the lack of entrepreneurial experience only became a problem after significant changes in the host country environment occurred, such as a drop and later the collapse of the incumbent market. Nonetheless, charter loss still was not completely unavoidable. Drawing on MNC structural factors, such as the existence of a world-wide reorganization program, as well as strengths of the host country environment (low labor costs, skilled workers) and the subsidiary (the favorable tax regime that Siemens had negotiated for Telefongyár), the local management of Telefongyár was able to draft a proposal that not only aimed to avert the charter loss, but even implied a charter win.

As we already know, the headquarters refused this proposal. The Hungarian production was relocated to a competing subsidiary in Germany, which at the same time was promoted to the European of center of competence in

switching where all production and most R&D was concentrated. This sheds light on the pivotal role of strategic decision-making at the headquarters level, not only for new mandates at the subsidiary level, as Egelhoff (1998) has pointed out, but also for charter losses at the subsidiary level. To what extent strategic decision-making was based on ethnocentric rationale in our case study is hard to say. Even though claims of ethnocentric behavior in the strategic decision-making of the headquarters (closing down production in Hungary and promoting competition from a German plant) seem to echo the strong disappointment of some managers at Telefongyár, they do have some plausibility. Closing production and laying off workers seems to be much easier and cheaper in weakly institutionalized countries such as Hungary than in strongly institutionalized countries such as Germany (Tempel 2001). Moreover, trade union power is especially high at Siemens in Germany. In addition, the headquarters claim that separating production from R&D is generally disadvantageous is not a unanimous assessment within the telecommunications industry. The French competitor Alcatel or Cisco of the US, for instance, are successfully following a strategy to outsource considerable parts of their production to contract manufacturers (Jürgens & Sablowski, 2004).

No matter how strongly political reasons figured into the decision to close down production at Telefongyár, the sheer fact that the closure happened indicates an underlying change in the degree of headquarters' dependence on the Hungarian subsidiary, as the resource dependency theory suggests (Pfeffer & Salancik, 1978). Considering the fact that Siemens in 1989 sold its switching systems in more then 100 countries of the world, and further considering the modest size of the Hungarian market, it is obvious that headquarters was never absolutely dependent on the Hungarian subsidiary. However, not to miss profitable business opportunities in the emerging Central and East European infrastructure markets meant getting on the market quickly and having effective access to local infrastructure providers – something that was best realized by joining forces with well-established local partners. In our case, Siemens joined forces with Telefongyár, whose top management had very good relations with the big national telecommunications operator MATAV. Winning the first tender, the so-called systems selection tender, however, already weakened the power position of Telefongyár's management. Once the decision for a certain switching system is made, a path for future investments is created. This materialized in a second tender won by Telefongyár in the mid 1990s. The only reason why the Hungarian production did not became obsolete at that time was the fact that Hungarian forces succeeded to include a production clause into the second tender, too. Thus, around the same time as Siemens' divisional headquarters released its plan to concentrate switching production in three plants worldwide, it was forced to further maintain the small-scale production site in Hungary. But a few years later, the privatization of Matav (now belonging to the Deutsche Telekom) and a downturn in the market from the late 1990s onwards, weakened the position of local subsidiary vis-à-vis the headquarters. With the second ten-

der expired in 2001 and no other big tender in sight, the headquarters office could have decided to close down production at Telefongyár by the end of 2002 without fearing negative repercussions from the main customer or the local management.

6 Implications for Management Practices at the Subsidiary Level

What does this case tell local subsidiary managers? A rather self-evident point draws on the interrelatedness of the different reasons for the charter loss. If a lack of subsidiary resources and capabilities only turns into a problem when factor endowments or the markets of the host country are deteriorating, the times of favorable host country conditions have to be used to improve subsidiary resources and capabilities and to readjust the business of the subsidiary.

To make charter losses less likely, these readjustments should aim at a somewhat more balanced internal and external embeddedness, as Andersson et al. (2002) proposed. In addition, both the external and the internal embeddedness should focus on more than one big customer, as our case clearly points out. While struggling for a deeper internal embeddeness, the local subsidiary management must, above all, sell the locational advantages of the host country. This implies a solid knowledge of investment promotion programs, market opportunities, and innovative sources, etc. The local subsidiary management struggling for a deeper external embeddedness has to sell firm-specific advantages to new customers. This implies not only a good sense of identifying new potential customers and creative ways to build relationships, but also a solid knowledge of the product and service range of the MNC.

Needless to say, readjusting the embeddedness of a subsidiary is a difficult task, even if the headquarters is giving the subsidiary some room to at least try it, as in the case of Telefongyár. For the headquarters office, it is often more convenient and less risky to decide to let a subsidiary lose a charter than to give credence to solutions that promise profitability in the future. This is especially the case if the charter in question does not fit into the headquarters' blueprint of inter-company division of labor, as in our case study. In such situations, which rather seem to be the rule than the exception, it is important for the subsidiary management to have access to headquarters in order to have at least a chance to influence development. This access must be effective, i.e. a purely formal right of access normally is not sufficient. In order to actually be able to influence processes that might lead to a charter loss, the management of the subsidiary must know how relevant to themselves any changes in corporate strategy are; they must also know what the essential decision-making criteria are, what alter-

natives are under discussion, and which factions support which positions. As a lot of this information is very sensitive from an organizational policy standpoint, it can only be available when there is a regular confidential exchange between the management of the subsidiary and those persons who are responsible for the decisions (either in the parent company or in other units of the MNC). Thus, constant interpersonal networking (Ghoshal et al., 1994) is a key prerequisite to avoid charter losses or to soften the negative repercussions of charter loss.

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