Conflict and Development: A Headquarter Intervention View of IT Subsidiary Evolution

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Abstract:
In this paper, we examine the impact that headquarter interventions have on how subsidiaries evolve in the Indian IT offshoring industry. We analyze how a subsidiary evolved in the presence of a rare phenomenon: a negative headquarter intervention. Such an evolution has nuances and theoretical implications that existing frameworks cannot fully explain. Although researchers have often studied the relationship between a subsidiary and its headquarters through a headquarter-intervention lens, they have not employed it to examine how subsidiaries evolve. In this paper, we present a generalized model of subsidiary evolution using three constructs: value potential, headquarter intervention, and headquarter control of the subsidiary. In line with our study’s exploratory nature, we conducted an in-depth case study of a multinational firm and its Indian subsidiary over several years. We found that, in the presence of high potential value in the subsidiary ecosystem, certain headquarter interventions can lead to a conflict between the headquarters and the subsidiary. If not aligned with the subsidiary’s interests and values, a headquarter intervention can negatively affect the subsidiary’s growth even if the headquarters has good intentions.

Keywords: IT Services Industry, IT Offshoring, Headquarter Intervention, Subsidiary Evolution, Case Study.

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1 Introduction

Many multinational information technology (IT) companies have long offshored work to low-cost hubs such as India, the Philippines, and China. However, offshoring practices have also led many companies to set up subsidiaries in such locations to take advantage of both worlds (i.e., lower labor costs and better control over and ability to monitor service quality). While the extant literature has well researched and documented such outsourcing practices and their related implications (both positive and negative) (Contractor, Kumar, Kundu, & Pedersen, 2010), we know much less about the offshore firms themselves.

Over the years, many of these offshore firms have experienced problems such as low employee motivation, a high turnover rate, and low work quality (Budhwar & Debrah 2009; Sealock & Harmon 2013). Some industry experts and researchers have even predicted these firms’ doom (Taylor & Bain 2005). However, these firms have endured the test of time by evolving in their role and offerings. In India, the largest offshoring hub, IT services giants such as Tata Consultancy Services, Infosys, and Wipro have also evolved and set up research and development (R&D) units and new product development teams to provide high-quality services and move from a “bodyshop” image (Agrawal, Goswami, & Chatterjee, 2010). These companies needed to undergo such an evolution to establish their presence as major software developers globally and, thus, to generate more revenue, lower employee turnover, and raise employees’ motivation (Kaiser & Hawk 2004).

While standalone IT service firms typically evolved from performing low-value, low-skill outsourcing jobs to high-value, high-skill product development, subsidiaries of large global firms did not. Most large global firms set up offshore subsidiaries to lower costs. Most of these firms already had successful product development centers, R&D units, and highly skilled employees. Thus, offshore subsidiaries faced a difficult situation in evolving along the same tracks as standalone IT outsourcing firms. They had to design new organizational paradigms. The issues that these subsidiaries grappled with in their initial years did not differ too much from the ones that the standalone IT services firms dealt with. However, the solution to those problems for the subsidiaries came with the additional constraint that they had to redefine their relationship with their headquarters (HQ). Traditional literature on subsidiary evolution has seldom accounted for the unique characteristic of IT subsidiaries in the offshoring setup whereby a HQ creates an offshore subsidiary with little to no independent market standing of its own for support. Offshore IT subsidiaries have much less flexibility to change course and adapt to changing local and international requirements and, hence, have typically faced many issues that we raise above.

In this paper, we examine how a HQ’s interests and vision impact the way its subsidiary evolves. Extant research has discussed HQ-subsidiary relationship from a governance perspective (Roth & Nigh 1992; O’Donnell 2000). We extend the organizational perspective of HQ-subsidiary relationship and use it for examining the evolution of the subsidiaries. We create a framework to analyze the impact that such an evolution has on both the subsidiary and the HQ. We conducted an in-depth case study on an Indian subsidiary of a large U.S.-based multinational as it went through a major transformation from 2013 to 2016. Since the IT service industry represents one of the biggest industries to practice offshoring as an integral business model, this research can help organizations in this industry to better understand and evaluate how their subsidiaries evolve. However, our research pertains to other industries as well since, while we focus on IT subsidiaries, our framework has immense generalization potential. For example, many offshore manufacturing subsidiaries of Western manufacturing firms have also faced difficulties in evolving amid changing HQ requirements due to higher automation, global trade policies (Albertoni, Elia, Massini, & Piscitello, 2017).

This research provides not only a framework to analyze such interventions but also insight into the HQ-subsidiary relationship as a negotiation emerges between them. The narrative of negotiation between subsidiary and HQ, as we discuss in this paper, is counter to the HQ’s parenting behavior (Gates & Egelhoff, 1986). We extend the framework for subsidiary evolution that Birkinshaw and Hood (1998) propose by introducing three additional constructs: HQ intervention (HQI), HQ control, and value potential. We propose that the subsidiary’s value potential defines how it evolves. Different HQI impact the evolution by supporting or reducing the pace of such an evolution. This research contributes to three distinct streams of management research: offshoring and outsourcing, subsidiary development, and HQI. The framework adds a missing link to the literature on outsourcing (Fürstenau, Rothe, & Sandner, 2017) by providing a basis for analyzing and managing how global IT firms’ subsidiaries evolve.
2 Theoretical Background

We draw the theoretical grounding of our work from three major streams of research: offshoring, subsidiary development, and HQI.

2.1 Offshoring in the IT Industry

While offshoring itself is not a new phenomenon (Loh & Venkatraman 1992), offshoring and outsourcing in IT-related fields started in 1990s and gained momentum after the dot-com bust in 2001 (Lewin & Peeters, 2006; Marrone, Gacenga, Cater-Steel, & Kolbe, 2014). Offshoring refers to sending a job to another country (generally a cheaper country or a country with more resources), while outsourcing refers to assigning a task to another company (Contractor et al., 2010). A firm may outsource to either cut costs or to prevent it from engaging in non-core operations (Murthy, 2004; Olsen, 2006). A firm may outsource in its own country by assigning non-core operations to other company or it may send some of its activities to another country to gain from abundantly available labor or cheap raw material through its own subsidiary.

Many large IT firms outsourced work by establishing their own offshore subsidiaries (Evaristo, Nicolas, Prikladnicki, & Avritchir, 2005). They did so either by opening a new development center (i.e., a greenfield investment) or by acquiring offshore companies. Such offshore enterprises’ success relied on economics of scale that they attained by performing huge volume of repetitive jobs (Kaiser & Hawk, 2004). Such jobs, though they induced profit, did not serve as the best motivators to engage high-performing employees or to raise the enterprise’s profile.

One can view offshoring decisions in IT as a multi-stage process with each stage having its associated complexities for the unit. Carmel and Agarwal (2006) proposed a stage model for IT offshoring that elicits the different stages that an offshoring model needs to go through: 1) offshore bystander, 2) offshore experimenter, 3) proactive cost focus, and 4) proactive strategic focus. Figure 1 explains these different stages in more detail. Most firms in India and other such emerging markets tended to use the proactive cost focus strategy in order to gain from these markets’ cost efficiencies. However, to gain a true and full competitive advantage from investing in these markets, a firm should transition to a proactive strategic focus in which it focuses on extracting maximum strategic advantage rather than only a cost advantage from its subsidiaries. While standalone outsourcing firms could extract such an advantage since they made the strategic decisions themselves, subsidiaries had to rely on their HQs to move to strategic work.

Managers and academics alike have always found the way in which such offshore IT subsidiaries evolve as a grey area. Many IT subsidiaries have perished at the slightest change in economic conditions or change in HQ priorities (Fabriek, van den Brand, Brinkkemper, Harmsen, & Helms, 2008). Offshore IT firms do not display many of the characteristics that other subsidiaries exhibit, such as independent market access and independent strategic planning. Since subsidiaries exist only to serve their HQs’ requirements, they do not generally have the capability or the opportunity to nurture their own market and develop local expertise. As such, these organizations have a major disadvantage since they cannot respond quickly to changing market dynamics. As Fama (1980) articulates, at a fundamental level, any firm needs to survive and grow to exist. As such, we cannot overstate the need for a framework that allows firms to visualize how their IT subsidiaries can grow independently.

2.2 Subsidiary Development

While the IT sourcing style that large multinational firms adopt impacts their subsidiaries’ business model and, thus, how they evolve, the literature on subsidiary development has also found several other aspects
that influence and impact their evolution. (Prahalad & Doz, 1981; Hedlund 1986; Wiesmann, Snoei, Hilletofth, & Eriksson, 2017). The primary factor concerns why a parent firm operates the subsidiary to begin with. For instance, many global multinationals have created subsidiaries to rise up the value chain and create more sophisticated products. However, some multinationals have created subsidiaries as a distant cousin (particularly in highly regulated markets) that slowly came closer to the parent firm over time. Another approach has involved starting a subsidiary as a closely related offshoot that grows stronger over time with a higher value-creation capability (Geroski, Machin, & Van Reenen, 1993).

Studies have found that three other factors impact a subsidiary as well: head office assignment (the role or work delegation that the HQ assigns to the subsidiary), subsidiary decisions (the internal unit-level decisions that the subsidiary’s management takes to refine its growth and prospects in its ecosystem, such as building up specific expertise or targeting new markets), and local environment determinism (issues beyond the firm’s control; for an offshore subsidiary focused on saving costs for its parent company, environmental factors include changes in the cost structure and local workforce pressure to perform more meaningful tasks). These three factors affect a subsidiary’s final role, which, in turn, affects the three factors (see Figure 2). As such, a subsidiary’s role continually evolves. The framework considers leadership in both the HQ and subsidiary via the two factors head office assignment and subsidiary decisions. Most extant models (including the one we present here) have not represented the variables for subsidiary’s actions and its leadership separately but considered them a constituent of the variable “subsidiary decisions”.

![Figure 2. Framework for Subsidiary Evolution (Adapted from Birkinshaw & Hood, 1998)](image)

### 2.3 Headquarter Intervention (HQI)

The management literature has long attempted to study the relationship between multinational companies’ headquarters (HQ) and their subsidiaries. HQs routinely attempt to influence their subsidiaries via designing their activities and policies in order to generate higher firm synergy (Foss 1997; Pehrsson, 2017). However, HQs—especially HQs further away (geographically and culturally) from their subsidiaries—often do not fully understand the issues, context, and problems that the subsidiaries face, which can negatively impact the subsidiaries (Goold & Campbell 1998). HQs might influence their subsidiaries through various acts and decisions (also known as interventions), such as direct interventions or indirectly via changes to organizational infrastructure, organizational policies, and so on (Foss, Foss, & Nell, 2012).

Foss et al. (2012) argue that a HQI and the way in which a subsidiary perceives it have an important role to play in how the relationship between a HQ and subsidiary develops. They list four types of interventions: 1) when the HQI serves a good cause and the subsidiary perceives it as such, 2) when the HQI serves a good cause but the subsidiary does not perceive it as such, 3) when the HQI serves a bad cause and the subsidiary perceives it as a good cause, and 4) when both the HQ and the subsidiary perceive the HQI to serve a bad cause (Foss et al., 2012). The extant literature has generally interpreted and analyzed a HQI’s type and quality from subsidiaries’ perspective, and we adopt the same convention. As one can see from the classification that we mention above, one can see the first HQI type as a positive HQI. For example, a positive HQI would include a HQ that provided domain experts and funding that aligned with a subsidiary’s expectations, which would enable the subsidiary to grow and adapt to its local environment. In developing...
their subsidiaries throughout the world, Unilever and Amazon have followed a pattern wherein they have provided the necessary support and autonomy to the subsidiaries for them to take charge and grow locally.

Extant research has predominantly focused on interventions in which researchers consider both the HQ and its subsidiary as one entity and in which both the HQ and its subsidiary understand any HQ intervention in a similar way. While Benito and Tomassen (2010) and Foss et al. (2012) proposed the idea that a HQ can act opportunistically rather than benevolently, no extant study has presented a clear picture about how the relationship between such a non-benevolent HQ and its subsidiary plays out in the long term. In the taxonomy that we provide in the preceding paragraph, we can generally classify the second and fourth intervention types as negative interventions from a subsidiary’s perspective, though the fourth type generally represents a more problematic situation since it refers to the classic case of a non-benevolent HQ. As Foss et al. (2012) elucidate, situations that lead to a negative HQI might arise when a HQ suggests new products or withdraws old products from a subsidiary’s local market based on information it has even though the subsidiary believes such an act lacks justification and/or evidence. HQs can often also overestimate the potential synergy between themselves and their subsidiaries, which can force subsidiaries to do things for their HQs that strain the former’s resources and lead to their downfall. A classic case of negative intervention involves a situation in which a HQ, due to its lack of focus or resources, decides to curtail a subsidiary’s autonomy or discretionary power to cut costs.

In cases of IT subsidiaries’ development/evolution, a HQ and subsidiary might even have conflicting rather than simply different aims. Such conflict can lead to strange situations in which either the HQ knowingly intervenes negatively with the subsidiary’s functions or the HQ tries to optimize the activities across the whole firm that might hinder a specific subsidiary. Even though the extent literature has rarely studied such a situation, it occurs relatively frequently in practice. In such cases, the negative HQI influences the subsidiary’s decisions and, hence, the subsidiary’s decisions do not remain an exogenous factor as Birkinshaw and Hood (1998) have postulated.

In examining these different literature strands together, we note that the existing literature has not adequately explained and theorized subsidiary evolution under different HQI. Neither the literature on subsidiary evolution (which Birkinshaw and Hood’s (1998) seminal model typifies) nor the literature on HQI (which Foss et al.’s (2012) study typifies) cogently explain the phenomenon. Thus, we conducted an exploratory case study to better understand how subsidiaries evolve in relation to interventions from their HQ.

3 Research Method

To examine how subsidiaries evolve in relationship to interventions from their HQ, we used an in-depth case study (Benbasat, Goldstein, & Mead, 1987; Yin, 2011). Research suggests that researchers use the case study method to conduct exploratory analyses for novel phenomenon in situations where they face difficulty in accessing data due to either the phenomenon’s novelty or the activity’s restricted/confidential nature (Yin, 2014). Though all research methods come with their advantages and disadvantages, exploratory case studies provide benefits not available in other methods. For instance, the method ensures one can understand a scenario in depth via accessing specialized data, and it allows one to create complicated theories that one can later test and generalize for a large population (Berg & Lune, 2004; Eisenhardt & Garebner, 2007). As such, the method has good internal validity. On the other hand, the method lacks external validity. However, as research has noted, the method’s enhanced internal validity somewhat offsets this limitation (Eisenhardt & Garebner, 2007).

Our research design concurs with the widely accepted principles for conducting case studies that Yin (2011) and Yin (2014) propose. Further, we satisfied the criteria in the literature for choosing a setting to examine (Benbasat et al., 1987; Patton, 2005). Specifically, we examined an organization called Powertech1 that had undergone a novel transformation. Through detailed interviews, we collected detailed data and triangulated it via independent sources.

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1 We use Powertech as a pseudonym for the firm we studied. Since the information related to the case study has a strategic nature, we anonymize the firm’s and interviewees’ names to protect the firm’s privacy and the strategic interests. We describe the firm in more detail in Section 3.3.
3.1 Data Collection

To ensure we obtained reliable and valid data and to retrieve as much data as possible, we triangulated data from various sources (Patton, 2005; Yin, 2014). We followed a three-step process. Specifically, we 1) conducted preliminary interviews to ascertain facts and familiarize ourselves with the case background, 2) organized in-depth interviews with all stakeholders during field visits, and 3) analyzed secondary data from non-interviewee sources. We conducted in-depth interviews with senior management from both the organization’s HQ in the US and its subsidiary in India. We conducted preliminary interviews with the members from the subsidiary’s strategy team prior to visiting its India office. We prepared and distributed a questionnaire to the firm’s leaders to give them a general idea about the questions we would ask in the face-to-face interview sessions.

At the firm’s India office, we conducted semi-structured interviews with senior management team members, which included several interviews with the firm’s managing director (MD). We conducted the interviews to understand top management’s vision for the firm. We also conducted semi-structured interviews with the stakeholders from the firm’s HQ in the US. We conducted these interviews over Skype after we had distributed the questionnaire to the interviewees.

As we state above, we first interviewed the strategy team because they initiated and implemented the strategic transformation. We used these initial interviews to identify important divisions and, thus, interviewees to analyze for the strategic transformation (Yin, 1981).

Our work’s exploratory nature dictated that we had free-flowing flexible conversations to collect information. Accordingly, we considered semi-structured interviews to be the ideal method (Eisenhardt, 1989; Yin, 2011). We also followed up with some interviewees for clarifications and further information in few cases when needed.

<table>
<thead>
<tr>
<th>Interviewee</th>
<th>Location</th>
<th>Number of individuals</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chief strategy manager</td>
<td>HQ (San Francisco)</td>
<td>1</td>
<td>Former colleague of Powertech India’s MD and the strategic link between the chief technology officer (CTO) of Powertech US and Powertech India.</td>
</tr>
<tr>
<td>Head of the finance division</td>
<td></td>
<td>1</td>
<td>General managers of different operations with direct relationship and role in Powertech India’s assignments. They reported to the CTO.</td>
</tr>
<tr>
<td>Head of engineering</td>
<td></td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Chief human resource officer</td>
<td></td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Head of process alignment</td>
<td></td>
<td>1</td>
<td>Responsible for maintaining standardized business processes. Reported to the CTO.</td>
</tr>
<tr>
<td>Managing director (MD)</td>
<td>Subsidiary (Bangalore)</td>
<td>1</td>
<td>The subsidiary’s managing director.</td>
</tr>
<tr>
<td>Strategic planning team</td>
<td></td>
<td>3</td>
<td>Members of the strategy team reported to the subsidiary’s MD. The strategy team actively participated in assisting the MD in designing and implementing the transformation.</td>
</tr>
<tr>
<td>Chief human resource officer</td>
<td></td>
<td>1</td>
<td>Responsible for staffing decisions across all Powertech India units.</td>
</tr>
<tr>
<td>Function director (FD)</td>
<td></td>
<td>4</td>
<td>New positions created in the Indian unit. They did not report to the MD but to the CTO at the HQ.</td>
</tr>
<tr>
<td>Chief managers</td>
<td></td>
<td>4</td>
<td>New position created as a part of the reorganization. They reported to Powertech India’s MD and liaised with FDS.</td>
</tr>
<tr>
<td>Associate vice presidents</td>
<td></td>
<td>3</td>
<td>Led the discipline-specific tracks such as testing, development, and so on.</td>
</tr>
<tr>
<td>Team leads (of various function lines (FLs))</td>
<td></td>
<td>4</td>
<td>Heads of specific programs. Reported to Powertech India’s MD and to FDS through a dotted line².</td>
</tr>
</tbody>
</table>

² The term dotted line reporting refers to a reporting structure where a manager has some but limited formal right for an individual’s time and attention. This is a very prevalent reporting structure in a matrix organization where an individual can have two reporting
We also examined the managing director’s emails and blog messages to employees. The managing director sent these emails to all subsidiary employees; as such, one could regard them as policy or indicative announcements from the senior management team. Further, we analyzed numerous internal company presentations that laid out the firm’s strategic roadmap and publications and press releases available from the media in detail. As a result, we could validate whether the senior management team recalled the events accurately and could form a basis for asking more details in interviews about issues that seemed important but that the company’s presentations scarcely or did not cover. Table 1 lists the key players we interviewed along with their role and affiliation (i.e., whether they worked in the subsidiary or HQ).

3.2 Robustness and Validation

To enhance our study’s robustness, we took steps to ensure its credibility, generalizability, dependability, confirmability, and integration, which we adapted from Wallendorf and Belk (1989) and Beeler, Zablah, and Johnston (2017).

3.2.1 Credibility

Credibility refers to the extent to which we derived our results from our data. To ensure our study had good credibility, we conducted multiple rounds of interviews with the participants. We also engaged stakeholders with different and often opposing viewpoints to gather evidence from all quarters.

3.2.2 Generalizability

Generalizability or transferability, which often represents the Achilles heel of qualitative research, refers to the extent to which researchers can generalize results to settings beyond the ones that they cover in a study (Yin, 2014). To ensure our study had good generalizability, we built the framework from consistent concepts in the data that we collected from multiple stakeholders. We have also described the case setting and our data in the paper for future researchers so that they can test, transfer, and adapt our results to different settings.

3.2.3 Dependability

Dependability refers to the extent to which the study’s findings are consistent and repeatable. To ensure our study had good dependability, we required consistent and unique descriptions of the events in the firm. We achieved such descriptions by collecting data from multiple participants about each unique event. Thereby, we could ensure that data collected through the interviews consistently reflected the actual situation in the firm. We also used secondary data and internal company communications to triangulate data.

3.2.4 Confirmability

Confirmability refers to the extent to which a study suffers from researcher bias (Gerring, 2006). To ensure our study had good confirmability, we used unstructured interviews in which we asked open-ended questions. We recorded and re-examined all interviews after the site visit. We also provided documents in which we described our findings from the interviews to the company members to confirm that we did not bias them.

3.2.5 Integrity

Integrity refers to the extent to which research participants presented unbiased and truthful accounts of their and the firms’ activity. To ensure our study had good integrity, we ensured participants’ anonymity in all research we published. Further, we conducted the interviews with participants alone (i.e., without their reporting officers) and in places they found comfortable, such as their offices.

3.3 Case Background

Powertech, a publicly traded large multinational software firm, had various business groups that each focused on one kind of business activity, such as business groups for IT, products and solutions, research managers: first solid line reporting managers (i.e., managers who they report to for day-to-day activities frequently) and second dotted line reporting managers who are responsible for a few the individual’s activities.
and development, and so on. The business groups acted as smaller independent firms for greater growth and autonomy purposes. The management board tied these groups together to achieve overall synergy. Powertech IT refers to one business group in the firm. The Powertech IT business group delivered IT support to all Powertech business units and other groups through three primary subsidiary locations in the US, Bangalore, and Singapore and received support from smaller centers in Russia, South America, and South Africa. However, unlike other IT organizations, Powertech IT served the parent firm’s (i.e., Powertech’s) different subsidiaries (business groups). Among its responsibilities, Powertech IT tested products before the company launched them in the market.

Powertech started its India operations though the Powertech India subsidiary in mid-2000s. Powertech fully owned Powertech India and they both followed the same organizational structure in terms of business groups as its HQ. Though all Powertech’s subsidiaries in all of its locations worldwide followed the global business group division, the relative size and role of different business groups in different subsidiaries varied according to the HQ’s focus, local requirements, and the subsidiary’s available skills. Powertech India operated out of Bangalore in India. Many refer to Bangalore as the Silicon Valley of India because it houses some of the largest IT firms and their subsidiaries outside the US. The Powertech IT business group had a large presence in the Indian subsidiary called Powertech IT India. In other words, Powertech IT India served as a direct subsidiary to Powertech IT. In the case, we examined how the subsidiary Powertech IT India evolved and its relationship with its HQ from 2013 to 2016.

We considered 2013 as the start date because, in 2013 and 2014, the subsidiary Powertech IT India began to evolve due to various HQI that involved reorganizations, changes in leadership, and so on. Before that time, the subsidiary functioned without significant change for an extended period. We chose 2016 as the end date because initial results about its evolution became visible at that time.

4 Case Description

4.1 Powertech India Prior to Its Evolution

Powertech India followed an organizational scheme based on function lines (FLs). The FL heads reported directly to the FLs in the US. The HQ assigned projects to the Indian FL based on the Indian unit’s capabilities. The assigned work included non-strategic projects, while the HQ performed most strategy development work. At Powertech India, employees could not easily move from one FL to another, which limited employees’ learning opportunities. As a result, the firm had a silo-like structure, a high employee attrition rate, and a diamond-like organizational structure with too many middle managers and little fresh talent infusion at the lowest levels rather than the ideal pyramidal structure. Further, employees did not report to Powertech’s India head, and the leadership often rotated, which changed the subsidiary’s focus from time to time. These factors cumulatively led to low employee morale in the organization. The teams in India were unhappy that they had no say in the work that the HQ allocated to them. Also, the communication channels in India and also to the HQ lacked consistency and transparency, and employees perceived a lack of leadership in general.

In 2013, a new MD began to lead Powertech India. Among his first tasks, the MD commissioned a survey to gauge employee perception. Over 80 percent of the employees who responded to the survey believed that things needed to change at the company. Responses ranged from “Powertech India employees have no defined career paths or growth opportunities” to “The overall culture is to follow instructions without thinking—there is no roadmap for where we want to be, so how can we be successful this way?”. The new MD reflected: “I knew things were bad, but didn’t realize it was so bad. When I shared the data internally, there was denial and a lot of pushback from the Indian leadership team.”.

4.2 The Evolution of the Subsidiary

To enhance the deflating morale and improve Powertech India’s productivity, senior management realized that the business needed to undergo a transformation to align it with local aspirations. As such, senior management planned multi-step process to move from the low end of the value chain to the higher end of the value chain by creating a flexible structure for managing the workforce at the Bangalore center.

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2 Function lines refer to the major lines of businesses to which Powertech provided its services. They included banking and finance, maintenance, communication, manufacturing, and so on. The different functional lines catered to software projects in these domains.
However, the MD stated that the firm faced difficulties in doing so movement up the value chain was not so straightforward:

*One of the key reasons for employee dissatisfaction was the ‘holy grail’ that they wanted to go for – which was to ‘build-it end-to-end’, to have an Indian charter. But there was a trap there. It was a chicken and egg dilemma, because what the HQ was going to say was that how do we know that you can do it? First prove it, and then we will give you the charter. And here the people were saying, give us the go-ahead, and then we will go and get the talent and deliver it. So how was I going to break this dilemma?*

The first attempt to come up with a flexible solution resulted in a failure. The MD recollected:

*I said that, going forward, let us structure the firm as follows. Give one of these different FLs at the HQ to India - because if we do this, I will own a clean end-to-end charter. However, the proposal was shot down. My bosses and my peers said that they would not be able to subscribe to this, as they did not have the confidence that we could deliver, they did not believe we had the people, and it was too big a gamble.*

These were the first signs of conflict between the subsidiary and the HQ. While the subsidiary wanted to expand its value portfolio, it did not fit into the HQ’s overall plans. The subsidiary saw the HQI of disallowing a more flexible structure for expanding its portfolio of products being developed as a mechanism to control how the subsidiary evolved, and the subsidiary risked antagonising the HQ if it made moves to expand its portfolio on its own.

Subsequently, Powertech India underwent an organizational transformation to move towards more high-value development work and change its relationship with its HQ. Figure 3 shows the transformation model that Powertech India management called Flexalent. The term Flexalent synthesized “flexibility”, “excellent”, and “talent”.

![Figure 3. Flexalent: The Flexible Talent Structure Transformation Model](image)

As Figure 3 shows, Powertech India’s earlier structure built on the FLs’ needs. The FLs each had their own resources for developing, delivering, and managing projects. As such, the firm found it extremely difficult to leverage firm-wide capabilities since FLs could not use other FLs’ resources even when they needed to do so. Also, the firm did not adequately use the skills of the employees in the FLs, and the employees felt demotivated due to the lack of diversity in their work. The new structure organized the employees according to their expertise. Also, any of the FLs could use employees from the talent pool for their projects. As such, Powertech India gained much-needed flexibility to better use its available human resources. Not only that, employees gained the opportunity to work on diverse projects and develop their skills.

The new MD and other senior managers at Powertech India believed that the subsidiary’s issues were so profound that they demanded a radical approach rather than a slow transformation. The transformation comprised the following steps:
A flexible talent structure would replace the original organization based on function lines. The new structure would combine engineering activities and put them under the leadership of three associate vice presidents: delivery, development, and management.

A change in the reporting structure would occur. Earlier, employees at Powertech India reported to Powertech US through the FLs, with only a dotted line reporting to the Powertech India Head. Now, all discipline leads would report directly to Powertech India’s MD. The firm created this new reporting structure after multiple trials. The final model entailed 80 percent of the FLs’ workforce reporting to the India office as a part of Flexalent structure. The final 20 percent would report to the HQ through function directors (FD) who reported directly to the HQ and acted as the single point of contact for the FLs in India.

The subsidiary also had to convince HQ in the US about its need to change and the benefits the transition would have. At the HQ, the head of process alignment articulated the concern as follows:

*There were many concerns raised by the leadership team, and the biggest one was on lack of control. In the old model, I had a team in the US and in India, and I had control. Now we were moving from a culture of control to one of trust, believing that a service provider [model] like the Flexalent could provide the right level of skills and can deliver on time—when they don’t report directly to me. And that was the biggest thing that slowed down the implementation. I would say that don’t underestimate the amount of effort it takes to change the way people work.*

In order to convince the HQ that it would fulfill its requirements with the same level of efficiency and expertise after the transition, Powertech India:

- Organized workshops at the HQ to convince stakeholders to agree on the evolution’s aspirations, needs, and possibilities.
- Tested out multiple organizational models to see what suited both parties best and also to consider the suggestions and desires of the senior leadership team at the HQ.
- Ensured that the transition did not affect the existing work that it performed and that it would deliver ongoing projects just as well as it had before.

[Senior Management at Powertech India created two new positions—functional directors (FD) and chief managers (CM)—at the India center to enable the transition. These new positions ensured that the new structure did not overly break from the current and cause turmoil. The FDs had responsibility over their FLs and directly reported to the HQ. They maintained the link between the engineering teams in the US and India (through the CMs). For any specific project, they would liaise with the Indian team to create the best possible talent team from the available personnel. These resources would directly report to the CM responsible for the program. The CM ensured that the project stayed on track by continuously engaging with the FD for the concerned FL.

It took a year for the HQ to approve this new model. The MD said:

*This went on for almost the entire year, and finally we got to the stage where both, the US stakeholders and I, agreed that experiments worked, it was now only a qualitative argument, and HQ needed to make the final decision one way or the other.*

Finally, in the long term, Powertech India sought to form a flexible talent structure that would give the firm a flexible talent pool to effectively allocate resources. The Flexalent model diverged from the usual talent-management practices at other Indian subsidiaries or even at any other Powertech unit around the world. The new talent management model led to results such as an increase in leadership rating from 51 to 99 percent in its 2016 survey of Powertech India employees. One of the Team Leads at Powertech India commented:

*The major advantage of moving to Flexalent is that we were earlier seven separate delivery teams, but now we better understand each other, where the talent is, how to integrate together. The second (advantage) is that I have grown from just a delivery leader to a Powertech leader. It has also brought in a lot of global best practices together.*

The head of engineering based at the HQ in the US commented:

*The results and delivery from the Flexalent has been pretty impressive. I think five years from now, a much bigger chunk of work that is being done now in the US, can be done in India. My*
division earlier was at 50% offshore and 50% onshore - and now it is already 75% off-shore and 25% onshore, and I can only see that increase.

5 Analysis and Discussion

To the best of our knowledge, this study represents the first study to examine a subsidiary’s evolution despite a negative HQI. Indeed, one can find many such instances in practice, especially in the IT domain where subsidiaries evolve to gain more meaningful roles. Like Powertech India, many subsidiaries (at least in their initial years) primarily exist to support their HQs and their HQs’ customers in onshore locations (Vang & Overby 2006). In most traditional non-IT sectors, a subsidiary that serves its HQ’s primary goals and clients constitutes a secondary firm. In most such cases, the subsidiary focuses on turning into a major competitive player in its own right in its sector/location, having its own clients, and developing its own governing mechanisms that either relate to or operate independently of the HQ (Birkinshaw & Hood 1998).

However, most assumptions in the literature about subsidiaries’ role and function, such as that a subsidiary should have a significantly local clientele and vision (which holds true in most sectors), do not work well with IT subsidiaries. As we show in this study, most IT subsidiaries start from having no local clientele and exist solely to support their HQ. HQs—not subsidiaries—conduct HQI from their own point of view and to fulfill their own aims. Such interventions require a fine balance between the roles and responsibilities that a HQ assigns to its subsidiary and the subsidiary’s own evolution plan, which may not fully align with the HQ’s overall strategy. Figure 4 shows the evolution plan that Powertech India prepared.

![Figure 4. Powertech India's Plan of Evolution](image)

This evolution plan was formed as a way to maintain balance between their needs and the HQ’s requirements. The figure also reflects Powertech India’s planning strategy as it realized that it needed both short- and long-term goals. Success in achieving in achieving short-term goals such as enabling career planning for its employees allows a subsidiary to show itself and its naysayers that it can achieve long-term goals in future. We map the strategies that Powertech India followed on a two by two matrix. As one can see in the figure, Powertech India categorized some strategies such as revamping how the firm trained employees, as an investment (i.e., a strategy that will likely take a long time to show results and will have a low but definite impact). In comparison, a firm can more quickly develop local leadership since it typically has already available talent. However, this strategy will likely hugely impact local employee motivation because it will motivate the employees and show them a clear way they can progress their careers. The MD of Powertech India commented:

*While evolution itself is a long term process, [the] absence of short-term goals has the potential of making employees disillusioned. Short-term successes prime the players to invest time and effort in long-term goals.*
At a basic level, we can see that a subsidiary’s evolution represents a negotiation exercise between the subsidiary and its HQ. In Section 5.1, we elaborate on the process through which a subsidiary evolves based on our findings.

5.1 A Generalized Framework for Subsidiary Evolution

While classical subsidiary evolution frameworks focus factors that relate to subsidiaries’ decision making and how HQs assign work, they cannot explain the transformation at firms such as Powertech India. Birkinshaw and Hood’s (1998) classical subsidiary evolution framework cannot fully explain such a transformation since it lacks factors that deal with the HQ-subsidiary relationship and resultant interventions. Therefore, we propose a generalized framework for subsidiary evolution that accounts for HQI and subsidiaries’ resulting evolution. From analyzing our data, we identified the following factors that one may need to include in any tangible and generalizable framework on subsidiary evolution: 1) value potential, 2) HQI, and 3) HQ control.

First, we use value potential, a compound variable, to represent the potential value a subsidiary can create. The term differs from local environment determinism in Birkinshaw and Hood’s (1998) framework because it encompasses all resources available in the subsidiary (i.e., knowledge capital, technology capital, and human capital). Prior research that has adopted the resource-based view of the firm (Wernerfelt, 1984) has showed that one can view a firm as a set of resources that provide the potential for value generation (Peteraf, 1993; Lin & Wu, 2014). One can theoretically see value potential as a firm’s (or its subsidiary’s) untapped resources that can give it a competitive advantage. The literature on subsidiary evolution has often pointed out that a subsidiary’s resources and capital at its disposal constrain its ability to create value (Roth & Nigh, 1992; Hood & Birkinshaw, 2016). A subsidiary needs to recognize that resources are limited and that improperly using resources may lead to inter-firm conflict for dominance over the resources (Grant, 1991). Competing firms may poach each other’s employees and, thus, reduce the value potential that they left untapped. We can see from Powertech that conflict arose because the HQ failed to realize the value that the subsidiary possessed. Powertech had other subsidiaries in locations such as South Africa and Russia; however, those subsidiaries had a lower value potential, which meant they did not evolve in a way similar to Powertech India.

Second, HQI directly impact the resources that a subsidiary has available (Foss et al., 2012). A positive intervention can turn a subsidiary into a potent force in its market via providing resources, capital, intellectual capital, and/or leadership as when Tata Motors revived Jaguar Land Rover (Becker-Ritterspach & Bruche, 2012). However, firms that rely on offshoring primarily focus on optimization from their own (and not their subsidiaries’) perspective, which negatively impacts their subsidiaries’ capabilities. As we can see in Powertech’s case, negative interventions can cause a subsidiary’s employees to become unsatisfied with their work.

Third, HQ control refers to the amount of control a HQ has over a subsidiary. We did not find evidence for this factor in our case study. Prior literature has showed the impact that varying levels of control can have on a firm’s ability to project and protect its interest (Roth & Nigh, 1992). Various regulatory conditions change the landscape for a HQ to control and run its subsidiaries for its own benefit. The Indian IT sector was one of the first sectors in India that the Indian Government lightly regulated and provided with ample relaxations as it was a major contributor to the country’s export revenues (D’Costa, 2002; Agrawal et al., 2010). As a result, local players such as Tata Consultancy Services, Infosys, and Wipro had the opportunity to expand and grow and multinational companies’ HQs could more tightly control their subsidiaries.

Accordingly, we modified Birkinshaw and Hood’s (1998) framework on subsidiary evolution to account for HQI. While Birkinshaw and Hood’s (1998) original model proposes that three factors determine a subsidiary’s final role, their model does not connect these factors to HQI. Via analyzing the Powertech case in depth, we found that HQ control and HQI played a central role in determining Powertech India’s final role.

We show our modified model in Figure 5. The model includes bi-direction paths. The solid lines denote the interventions and decisions that lead to a subsidiary’s final role. The dotted lines denote how a subsidiary’s role at specific points in its evolution (for a subsidiary does not evolve instantaneously but rather over time) to subsequent HQ assignments, decisions, and so on that, in turn, influence how the subsidiary evolves. In this respect, we follow the numerous research studies on subsidiary evolution that have discussed and articulated such a feedback system by articulating the forward and backward paths with solid and dotted lines (Birkinshaw & Hood, 1998; Foss et al., 2012).
As we can see from our discussion on HQI, HQI directly results from how much control the HQ has on a subsidiary, and HQ control and HQI together determine the assignments the subsidiary will receive from the HQ. For instance, these two factors together ensured that Powertech India received only low-value work from Powertech. The exogenous variable HQ control results from an organization’s structure and governance mechanisms that the operational decision-making variables in the framework do not generally affect. HQ control directly impacts HQ assignment in terms of the kind of projects that the subsidiary receives. HQ control also directly impacts HQ intervention because the amount of control the HQ has defines its ability to apply different kinds of HQI measures. These two factors also directly impact the decisions that a subsidiary takes because subsidiaries with substantial HQ control have less flexibility to make independent decisions compared to subsidiaries with limited HQ control. One can see these decisions as a single or series of negotiation steps between the two parties to achieve their goals. The relationship between HQI and a subsidiary’s potential value emerged as another factor from our analysis. While subsidiaries inherently include several components that constitute their potential value, HQI by their design and definition changes it to a great extent. In the case of Powertech India, one can argue that, by instilling a highly energetic and visionary MD in the subsidiary, the HQ intervened in the subsidiary by providing high-caliber leadership that increased the subsidiary’s potential value.

The other factor—namely, environment determinism—remains as important in our modified model as in Birkinshaw and Hood’s (1998) original model. This exogenous factor defines environmental conditions such as labor or macroeconomic factors. One cannot overstate leadership’s importance as a variable that impacts a subsidiary’s evolution. However, while extant models of subsidiary evolution have treated it as an effect that other variables reflect (as we explain in Section 2.2), we explicitly bring the variable to the forefront by highlighting its relationship with other key variables. Based on our analysis, we found that subsidiary leadership has a significant impact on a subsidiary’s value by putting in place strategies to enhance and use the subsidiary’s capabilities. We found as much in our case since Powertech India’s leadership actively attempted to enhance the subsidiary’s value by obtaining high-value projects and boosting employee motivation. Its leaders also took strategic decisions and negotiated with the HQ about implementing a new model for work allocation that enabled it to further grow as a firm.

The framework includes an important relationship between HQI and the subsidiary’s original value potential (OVP). OVP refers to a subsidiary’s value potential prior to a major evolution. Building on Foss et al.’s (2012) work on HQI and the resource-based view of the firm (Barney, 1991), we propose Figure 6 to depict the intended relationship. Foss et al. (2012) propose that different kinds of HQI might lead to different reactions from a subsidiary, such as revolt in cases of extreme negative HQI or enhanced subsidiary value in cases of positive HQI. Based on analyzing the case and introducing OVP as a variable, we expand on the relationship between OVP and HQI and make a proposition for a subsidiary positioning framework. The term "subsidiary positioning" refers to a subsidiary’s state relative to its ecosystem (Foss et al., 2012).
We argue that a subsidiary has the most ideal position in situations with high OVP and positive HQI since this state has the most stability. As such, the subsidiary will grow the most with support from its HQ, and the HQ-subsidiary relationship will not need to evolve. In situations with low OVP and positive HQI, the multinational enterprise would have faith in the subsidiary. Such a subsidiary would have low strategic positioning, but any change in value potential might quickly send it up to high value position. In situations with low OVP and negative HQI, conflict can arise in that the subsidiary does not have the resources and the potential to oppose the HQ or grow on its own and resists the HQ’s decisions. However, situations with high OVP and negative HQI potentially represent the most dangerous situation for any HQ-subsidiary relationship. The presence of such relationship may lead a firm to lose much potential. For instance, Powertech India had high OVP, which its high-quality employees and growing local market in the Indian IT hub evidenced. It also had negative HQI that drove it to act not in accordance with its capability to develop locally. Such a situation led it to somewhat revolt in that it resisted its HQ and developed plans to build on its strengths that could benefit its HQ as well. Without such a shakeup, both Powertech and Powertech India may have experienced much loss.

5.2 Implication and Limitation

This study has significant implications for theory and practice. With the changing economic and political situation around the world, organizations can no longer rely on being a cost leader via sheer arbitrage as a sustainable business model. Business units become competitive where they operate by following sustainable and efficient strategies and devising policies to compete on their own—especially in the IT sector. Our study provides a framework for managers to understand how such business units evolve. A subsidiary that effectively learns to compete on its own will increase both its own and its HQ’s overall value. We help managers better understand the relationship between HQI and the subsidiaries’ potential value. Correct HQI can lead to a much more robust value realization from the subsidiary. In such circumstances, a better-planned and -negotiated evolution can lead to a more networked and decentralized enterprise (Malnight, 1996). While the ideal role of a HQ and subsidiary in realizing the true value of the subsidiary shall remain a matter of debate, our framework allows managers to unravel the factors that impact the evolution and their implications. With our case study, we also highlight the need for HQs to manage their IT outsourcing centers better so as to ensure that both entities continue to benefit. While a HQ might perceive that an offshore center will face difficulties in evolving independently, such an evolution will invariably allow the subsidiary to perform better in its local market and create more value for the parent firm.

From a theoretical perspective, we enhance three theoretical paradigms with this study (i.e., HQI, outsourcing, and subsidiary evolution). Our work provides a lens to view the complex HQI problem through a case study on negative HQI. Researchers have rarely studied negative HQI (Foss et al., 2012), though it occurs much more commonly in practice (especially in the IT sector where HQs and subsidiaries often have different goals). We provide a theoretical framework to develop and study such interventions. Second, we contribute to the literature on outsourcing. Outsourcing research has mostly focused on the issues and challenges that the outsourcing firms and their clients face in generating higher value, which both represent independent firms that gave a much higher control on their actions and decisions (Carmel & Agarwal 2006). The outsourcing industry continues to expand, and cost-cutting centers have evolved into much bigger entities over time (Marrone et al., 2014). Through analyzing Powertech India, an offshore IT center, in detail,
we present a theoretical view about how IT offshoring activities expand and the role that various factors have in shaping whether the subsidiary can realize its potential value. Third, we extend the literature on IT subsidiaries by adding a new dimension to how we understand subsidiary evolution. Extant subsidiary evolution frameworks have had a limited scope and ability to explain different factors that affect subsidiaries. With our enhanced framework, researchers can analyze and theorize about complex subsidiary evolution, which occurs often in the IT industry, with greater ease. We also extend past research and explore one quadrant that Foss et al. (2012) highlight in detail by better explaining the HQ-subsidiary dynamics involved in negative HQI.

With that said, as with any other study, our study has some limitations. Although we have accounted for various robustness principles in our case study (see Section 3.2), the method we chose still limits it. Case study-based research allows one to more richly understand a phenomenon but also introduces bias (Yin, 2014). Researchers could extend our work by conducting multiple case studies or other large sample-based statistical studies to test and validate our framework. Further, researchers could analyze the possible interactions among the variables in the subsidiary evolution model. Such a study would provide deeper insights into how variables such as environmental determinism and subsidiary decisions interact with each other and enhance or diminish their mutual effects. While we conducted rigorous methodological checks and balances to ensure our results’ validity and their applicability to a wider setting, in the tradition of case study-based research, we acknowledge that we can claim only analytical and not statistical generalizability (Yin, 2014), the latter of which we leave to future research projects.

6 Conclusion

In examining Powertech India, we shed light on numerous factors that govern the relationship between a HQ and its subsidiary. In this paper, we delve into the understudied area of offshore IT subsidiaries and answer questions related to how such entities evolve. Through an exploratory case study in which we collected and analyzed data from both the subsidiary and the HQ, we identified the impact that factors such as HQI, the subsidiary’s potential value, and HQ control have on how a subsidiary evolves. The framework that we propose in this paper can help both practitioners and researchers better understand and explain how subsidiaries evolve under negative HQI. Further, it theoretically advances different research fields. Our study shows that a global HQ that optimizes only its own operations may hinder both itself and also its subsidiary from maximizing their value. The best policies should entail a carefully planned balance between the subsidiary’s and the HQ’s interests.
References


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