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FINANCIAL TIMES

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Lessons from the 1997 Asian economic crisis

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Published: January 22 2009 19:29 | Last updated: January 22 2009 19:29

In the midst of an economic downturn, there is a tendency by some to think that things have never been so bad and that extraordinary new approaches are needed. But is this true? The current downturn is neither the only economic crisis that most managers will face during their careers. Nor is it the first downturn that business school scholars have studied.

Together with Chris Chung from Florida International University and Jane Lu from National University of Singapore, I have investigated whether there are any lessons from the 1997 Asian economic crisis for the managers of multinational corporations. We conducted a series of studies using a longitudinal database on Japanese subsidiaries worldwide, and report here on the managerial implications of two of them.

First, a quick recap. In 1997, the Asian economic crisis broke out in Thailand and abruptly spread to the rest of the region. The crisis resulted in rapid contractions in which real output was severely damaged. Coming after more than two decades of high growth and frequent claims of an impending Asian economic boom, the 1997 crisis was a major shock to foreign companies operating in south-east and east Asian countries. A number of observers suggested that the extent of the damage created by the crisis was comparable only to that of the Great Depression.

In our analyses of the impact of the crisis, we considered two distinctive time periods. The first was the crisis time period (1997-99), during which Asian countries underwent more than four consecutive quarterly declines in real gross domestic product. The second was the stable time period (1993-96), during which they maintained consistent real GDP growth.

The first study compared the subsidiary performance implications of being part of a multinational network during times of economic crisis versus times of stability. The aim was to assess the value of being part of a parent-subsidiaries network, to determine whether there were conditions under which organisational links matter most.

The multinational network model conceptualises a foreign subsidiary as an equal, rather than a subordinate, of a company's headquarters that is, an active agent that becomes integrated with its parent business and other subsidiaries via organisational links that give it access to network-based resources to address dynamic environmental demands.

A multinational network model highlig¬¬hts the fact that multinational networks are able to provide their subsidiaries with a range of operating options that allow them to avoid downside risks and take advantage of upside opportunities by shifting value chain activities across networks. Can the greater flexibility inherent in a multinational network allow subsidiaries to modify and reconfigure operating routines in the pursuit of effectiveness and survival? If one geographic area is hit by economic crisis, can affected subsidiaries tap into their multinational networks and respond to adverse environmental changes by modifying their operations?

We found that strategic drivers such as multinational organisation links allow foreign subsidiaries to capitalise on the flexibility inherent in a multinational network. When local markets collapse, such strategic and operational flexibility holds the greatest positive implication for foreign subsidiary performance. Managers should, therefore, invest in the development of such networks, especially when they make investments in emerging economies whose dominant characteristic is uncertainty. Furthermore, managers should be aware of performance implications for different types of multinational networks, and configure their networks to meet specific strategic objectives.

Subsidiary profitability is more likely to benefit from a tightly linked intra-company network (ie subsidiary network) than from a distant inter-company network (ie keiretsu affiliation), since it is easier for a subsidiary to have common skills and knowledge to link various parts of value chains with sister subsidiaries within the business than with keiretsu-affiliated subsidiaries outside of it. Intra-company trade allows subsidiaries to adjust more quickly to abrupt changes than inter-business trade. This is important given that intra-company trade currently accounts for one-third of all world trade.

With respect to how performance ought to be measured during a crisis, many would argue that what really matters during times of economic crisis in host countries is survival rather than profitability. But facing unanticipated economic turmoil, subsidiaries in crisis-stricken countries have to secure their survival first before moving towards profitability.

In sum, foreign subsidiaries in multinational networks have access to resources in heterogeneous institutional environments. By taking advantage of these links, they can capitalise on the latent flexibility that resides in being part of a multinational network.

Investment mode strategy versus expatriate strategy

The second study examined the performance implications of investment mode strategy and expatriate strategy during the Asian economic crisis. We considered how these strategies, as alternatives in implementing and exercising control on the operation of subsidiaries, complemented and interacted with each other to bring about improved subsidiary performance.

In an investment mode strategy, a company can choose from a range of organisational modes: exporting, licensing, franchising, joint venture, or wholly owned subsidiary. In particular, foreign direct investment (FDI) is an important way for companies to compete internationally. FDI can occur in various mutually exclusive forms: greenfield or newly-established; wholly owned subsidiary (a greenfield operation in which 95 per cent or more of the equity is possessed by one foreign firm); greenfield joint venture (a greenfield operation in which two or more firms each possess at least 5 per cent of the subsidiary's equity); and acquired wholly owned subsidiary (the purchase of a controlling interest in an existing domestic enterprise). The choice of FDI mode strategy is likely to affect the survival of subsidiaries because each strategy differs both in expected risk level and in the importance of various co-ordination costs and resources.

Expatriate strategy refers to the utilisation of a multinational's expatriate staffing practices to achieve learning, innovation, flexibility, and corporate integration in foreign subsidiaries. The higher level of expatriate staffing in a foreign subsidiary is a means of exerting more influence on the implementation of strategy and daily operations.

Organisations tend to learn from experience and behave in a path-dependent manner. Even if acquired wholly owned subsidiaries and greenfield joint ventures attempt to integrate themselves into the multinational networks once their local markets begin to collapse, they will still fall short in terms of timing because of their structural and knowledge distance from the multinational networks. When local markets collapse, acquired wholly owned subsidiaries and greenfield joint ventures are less capable than greenfield wholly owned subsidiaries of capitalising on multinational flexibility to reap the benefits of integration through multinational networks.

Similarly, the more distant the operational structures of foreign subsidiaries are from the parent networks, the more the integration benefit could be realised by the greater utilisation of expatriates. Since the operational structure of greenfield wholly owned subsidiaries is already close to that of the parent network, the impact of an additional number of expatriates may be marginal.

By staffing acquired wholly owned subsidiaries and greenfield joint ventures with more expatriates, foreign companies can ensure those subsidiaries conform to parent goals or targets through the exercise of power, authority, or indoctrination of corporate values and norms. By doing so, they can exert more control over the implantation of strategy and daily operations.

Conclusion

We first observed that in the crisis period, both joint ventures and acquisitions were significantly more likely to fail than wholly owned subsidiaries. Overall, acquisitions were most likely to fail, followed by joint ventures and wholly owned subsidiaries in that order.

Second, the presence of a greater number of expatriates was positively related to subsidiary survival during times of crisis.

Third, a greater number of expatriates increased the survival likelihood of acquisitions the most, followed by joint ventures, then by wholly owned subsidiaries, in that order.

Our study suggests that managers of multinationals can adjust and change subsidiary staffing at each phase of a crisis to influence the typical evolutionary path of investment modes. When local markets collapse, the presence of a greater number of expatriates is more likely to enhance the performance of foreign subsidiaries that have been structured to integrate into the local markets but are distant from the multinational networks. As a parallel but more fluid strategy in exercising control over the operations of foreign subsidiaries, expatriate strategy can complement the deficiency of investment mode strategy in capitalising on multinational flexibility when local markets crash. Some managers of multinationals have paid little attention to the interaction effect of expatriate strategy and investment mode strategy on subsidiary performance to date.

Based on the results of our study, we suggest that managers of multinationals consider investment mode and expatriate strategies in a more holistic manner in order to promote value creation from the operations of foreign subsidiaries.

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