Unleash Innovation in Foreign Subsidiaries

No one has a monopoly on great ideas, least of all headquarters. Four approaches can help corporate executives jump-start new ideas and experimentation in far-flung operations.

The challenge of going global is not simply to sell products wherever customers are but to take advantage of bright ideas wherever they spring up. Indeed, growth-triggering innovation often emerges in foreign subsidiaries—from employees closest to customers and least attached to the procedures and politesse of the home office. NCR’s automatic teller business, for instance, took off only when the development team shifted activities from corporate headquarters in Dayton, Ohio, to Dundee, Scotland. Under the guidance of a charismatic leader with scrappy persistence, NCR’s Scottish operation became the largest manufacturer of ATMs in the world and brought the moribund Dundee manufacturing center back from the brink of extinction.

But as every multinational manager knows, making the most of foreign subsidiaries is tricky. Too often, heavy-handed responses from headquarters squelch local enthusiasm and drive out good ideas—and good people. Even
BEST PRACTICE • Unleash Innovation in Foreign Subsidiaries

when headquarters tries to do the right thing by democratizing the innovation process and ceding more power to subsidiaries, the results are not always stellar. (See the sidebar “A Worst-Case Scenario.”)

For the last eight years, we have studied more than 50 multinational corporations to understand what companies can do differently to encourage innovation in foreign subsidiaries—what we call “innovation at the edges.” Our observations suggest that when companies start to think of foreign subsidiaries as peninsulas rather than as islands—as extensions of the company’s strategic domain rather than as isolated outposts—innovative ideas flow more freely from the periphery to the corporate center. (We first heard the peninsula concept articulated by managers at Monsanto Canada as they grappled with the challenge of redefining their role after the 1989 Free Trade Agreement with the United States.) But even more than a change in mind-set, corporate executives require a new set of practices, with two aims: to improve the formal and informal channels of communication between headquarters and subsidiaries and to give foreign subsidiaries more authority to see their ideas through. Only then can companies ensure that bright ideas—and the smart people who dream them up—don’t end up marooned on desert islands.

**Peninsulas, Not Islands**

Fostering innovation in foreign subsidiaries is a familiar goal, but it is extremely difficult to achieve in real life. In the past, multinationals recognized the need to tap into a few select subsidiaries, but today successful corporate executives recognize that good ideas can come from any foreign subsidiary. (See the sidebar “Three Eras of the Multinational.”) The challenge is to find ways to liberalize, not tighten, internal systems and to delegate more authority to local subsidiaries. It isn’t enough to ask subsidiary managers to be innovative; corporate managers need to give them incentives and support systems to facilitate their efforts. That’s more easily said than done, of course, but our observations suggest four approaches:

- **Give seed money to subsidiaries.**
- **Use formal requests for proposals.**
- **Encourage subsidiaries to be incubators.**
- **Build international networks.**

When these practices are set in motion, we can expect far more creative and genuinely innovative ideas to emerge from the edges of the corporation. Let’s take a look at each approach.

**Give seed money to subsidiaries.**

It’s easy to argue that subsidiary companies need access to seed money, but corporate executives must strike a balance between demanding that subsidiaries meet short-term results and granting them sufficient freedom to pursue new ideas. Put too much focus on the former, and you know that subsidiaries will hide profits—not to pursue their new ideas but to protect themselves in case of a rainy day. Put too much emphasis on the latter, and there will be a proliferation of so-called strategic projects whose returns will fall below target levels. One way to achieve the necessary balance is to give subsidiaries discretionary budgets to test ideas within limits imposed by corporate headquarters. But it’s also a matter of who holds the purse strings for which types of investments. Major investments can and should be made at a corporate level. But seed money can be handled on a more decentralized basis by giving local subsidiaries discretionary budgets to test ideas.

For example, in the late 1980s, Hilary Smith, a market development manager at 3M Canada, identified a market for local subsidiaries to put together a prototype. At the American Library Association meeting where the prototype debuted, she discovered that 3M Australia had been working on a similar product. Hearing enthusiastic comments from potential customers, she...
parent company with a CEO who was fully responsible for the profits of the Canadian operating divisions. But in the 1980s, the parent company had moved to a more integrated model for North American operations. It created a dozen strategic business units, all headquartered in the United States. Thus the role of the Canadian CEO was reduced to that of mere figurehead, and the Canadian subsidiary was left to deal with mundane issues such as new legislation and tax accounting. It was only through a small business-development group that entrepreneurial activities were formally encouraged.

Soon after his arrival, McTaggart identified an opportunity to bid for a massive, government-sponsored energy management project that entailed the installation and financing of energy-efficient lightbulbs, motors, and other electrical equipment in 150 federal buildings throughout Canada. With potential revenues in the billions, energy management was a great opportunity, in McTaggart's view, not just for the Canadian subsidiary but for the entire company. Lacking a budget of his own, McTaggart convinced one division president to provide $1 million in seed money to test the market. Elated, McTaggart quickly put together a small project team and started to go after business.

That's when the problems began. A few months after McTaggart's initiative got under way, the business unit went through a dramatic reorganization. Following the abrupt resignation of the unit's president, the new president withdrew support for the energy management project. Suddenly orphaned, McTaggart found a new sponsor in another business unit after a series of emphatic presentations and 11th-hour phone calls.

Even as McTaggart scrambled for funds, the fledgling business was becoming a player in the energy management business -- several pilot projects were completed and four new contracts were secured. But again problems emerged. McTaggart and his new sponsor came to realize at virtually the same painful moment that even though energy management fit well with the existing business's product lines, the energy management business's life cycle was wildly out of sync with the rest of the division's product portfolio.

Clearly, McTaggart needed to make a number of up-front investments and take several calculated risks to grow his business. But his new sponsor, obsessed with controlling costs and intent on being involved in day-to-day decisions (or so it seemed to McTaggart), kept urging McTaggart to curb his growth expectations. Finally, matters came to a head: faced with yet another demand to scale back his projections, McTaggart decided to resign. The energy management business limped along for another 18 months but never regained its previous pace. A disillusioned McTaggart started his own company, this time better equipped, he hoped, to control its destiny.

McTaggart's experience is all too common. His idea was consonant with the company's entrepreneurial spirit and was aligned with corporate growth targets, but McTaggart faced obstacle after obstacle: lack of fit with existing businesses, changing agendas at the top, risk-averse managers, culture clashes, and time lost fighting internal resistance. He lost a great opportunity to take his ideas to the limit, and the company wasted time, money, and that precious commodity, initiative.

and her Australian counterpart agreed to work together to bring out a single 3M product. Additional funding was supplied by the U.S.-based library systems business unit, and Smith was given worldwide responsibility for the product's launch. Manufacturing was transferred to St. Paul, Minnesota, where the U.S. business unit was based. The Australian subsidiary retained product and business development rights in Australia and New Zealand. SelfCheck is now one of the main products in 3M Library Systems' portfolio -- thanks in no small part to the initial funding from the Canadian and Australian divisions.

It often happens, of course, that an idea seeded by a business unit, having developed into a viable business, is eventually abandoned because it doesn't fit well with the rest of the unit. Corporate-sponsored development projects therefore are an important alternative to business-unit-level investments. ABB, the global engineering and technology firm with headquarters in Zurich, provides both seed money at the subsidiary level and corporate funding for new ideas that cross the boundaries of existing business units. In ABB's 12 corporate
research centers, located around the world, employees are encouraged to propose "high impact" projects—those with broad, cross-business-unit applications—which are then funded from a corporate budget. One such project led to the creation of a state-of-the-art electrical transformer factory in Athens, Georgia. Dubbed the "factory of the future," the test factory is fully automated, from ordering through production to the delivery of the finished product. The results have been truly spectacular: labor costs have been cut by half, cycle times have been cut by 90%, and time from order entry to shipping has been reduced from 30 days to one day.

Use formal requests for proposals. Providing seed money to subsidiaries is a start, but funds alone won’t generate valuable innovations from a passive subsidiary manager. Executives must also find ways to increase the demand for seed money. To that end, it helps to think of subsidiaries as freelance contractors that are granted licenses to manufacture or develop certain products. When you want to make a new investment, you send out a request for proposal (RFP), which may yield three or four competing bids. Volkswagen’s decision to manufacture the New Beetle in Puebla, Mexico, for example, was the result of a lengthy review in which the Puebla site was compared with sites in Germany and Eastern Europe. It also required heavy-duty championing from executives in Mexico and the United States, who saw a local production base as essential to their plans for reviving the VW brand in North America.

An RFP approach can also stimulate subsidiaries to develop creative solutions to corporate challenges. Monsanto’s Canadian management team picked up on a tentative corporate plan to build a dry-formulation plant for its Roundup herbicide and pushed hard for that investment to be made in Canada. In preparing their proposal, they were able to shape the product’s specifications—as any contracting company knows, that’s the only way to win competitive tenders. But the members of the Canadian group knew they wouldn’t

Three Eras of the Multinational

Multinationals have evolved through three phases over the past 50 years, both in terms of their geographic scope and the roles played by their foreign subsidiaries:

Paternalism. In the first half of the twentieth century, the dominant model for multinationals was to innovate in the home country and then roll out new products across the corporate empire. U.S. companies like Caterpillar, IBM, and Procter & Gamble became masters of this model. But as foreign markets for the established multinationals became more sophisticated and as the foreign subsidiaries in those countries grew stronger, it gradually became apparent that the home country did not have a monopoly on innovation and leading-edge thinking.

Expansionism. In the 1970s and 1980s, many multinational corporations set up “scanning units” to tap into the ideas coming out of key foreign markets, and they built R&D sites abroad to gain access to scientific communities. But welcome as they were, corporate investments of this type represented but a halfhearted attempt to tap into the ideas and opportunities in foreign markets. There were two major problems. First, scanning units and foreign R&D labs were attractive in principle but difficult to manage effectively. For example, many European multinationals, including Volkswagen, Volvo, and Ericsson, established development centers in California, but in most cases the units struggled to successfully transfer and integrate their ideas with those of their parent companies. Second, by defining certain units as responsible for picking up new ideas, corporate managers were implicitly signaling to all other foreign units that they did not have to bother. Such an approach limited growth opportunities to a few select markets or technologies and dampened the initiative of subsidiary managers in other foreign units.

Liberalism. A third model, now emerging, takes a more democratic approach to the pursuit of new opportunities. It builds on two basic arguments: first, useful new business ideas can emerge from anywhere in the world, particularly those parts of the organization that are in direct contact with customers, suppliers, and other external parties. Second, the greater the distance from the center, the less constrained individuals are by the traditions, norms, and belief structures of the corporation. This is the argument that subsidiaries should be viewed as peninsulas rather than islands. As multinationals take such an approach, we can expect far more creative and genuinely innovative ideas to emerge from the edge of the corporation than from the center. The challenge becomes one of tapping into the ideas and leveraging them effectively.
get the nod based on cost alone, so they developed their proposal around such innovative practices as self-directed work teams, empowerment, and outsourcing. Their proposal focused on the competencies of the Canadian operation and demonstrated how the investment could help forestall a threat from another company rumored to be developing a competing product in central Canada. Consequently, the Canadian proposal won the contract, beating out a Monsanto site in Louisiana and an independent manufacturer in Iowa.

We have seen this approach to new investments work well in a variety of multinational companies. But we have also seen companies shy away from it because the costs of reviewing and evaluating multiple bids can be prohibitive. The best approach is to limit the list of competing proposals to three or four—as long as the narrowing process is designed to increase, rather than suppress, variance. It is best to avoid formal reviews in which two mediocre options are set up alongside the preferred candidate for the sake of appearances. This happens all too often, and it is a splendid way of killing the initiative of subsidiary managers.

Encourage subsidiaries to be incubators. Subsidiary managers often comment that their distance from headquarters makes it hard for them to attract attention. But distance can become an advantage. It allows foreign subsidiaries to experiment with unconventional or unpopular projects that would be closed down if they were more visible to headquarters. It allows them to become incubators that can provide shelter and resources for businesses that are not yet strong enough to stand on their own.

Consider the actions of Ulf Borgström, manager of the Swedish subsidiary of a U.S. minicomputer manufacturer. The company was struggling in the early 1990s because of a weak product line, and the Swedish subsidiary was on the verge of bankruptcy. Borgström was able to turn around the operation by disregarding orders from headquarters and pursuing whatever business he could find in the Swedish market. Unable to sell his own company’s products, he decided to offer service contracts on competitors’ products. Needless to say, his superiors in the home office immediately discredited his strategy, but Borgström persevered, and the service contracts proved to be a significant factor in the subsidiary’s revival. By 1997, headquarters had come around to his way of thinking, and the Swedish subsidiary was hailed as a success story.

Distance can become an advantage. It allows foreign subsidiaries to experiment with unconventional or unpopular projects that would be closed down if they were more visible to headquarters.

Or take Ericsson as another example. Outsiders know that Ericsson has successfully caught two of the biggest waves in the telecommunications business in recent years: the emergence of second-generation digital radio technology and the subsequent boom in the handsets business. Insiders admit, however, that both businesses struggled to gain acceptance while they were being developed and would have been killed if their sponsors had not been persistent. In fact, in the latter case, Åke Lundqvist, the president of the nascent handsets unit, moved himself and his team to southern Sweden, which gave him the time and space to get the business going without interference from corporate executives. More recently, Ericsson has created a new unit called Ericsson Business Innovation, whose mandate, in the words of its director, Jöran Hoff, “is to create the next core business” for the corporation. It acts as a venture fund by providing seed money and management expertise to promising new projects—not just Stockholm-based projects, but...
Columbia Executive Education

Translate learning into superior performance. We set the global standard for success—for individuals and organizations. Our approach is concrete, specific and designed for immediate results. You share challenging situations from your experience—we give detailed feedback from faculty who work at the dynamic intersection of teaching and consulting. We will give you the ideas and tools you need to power your performance.

UPCOMING COURSES AND DATES

The Columbia Senior Executive Program
[Apr 29–May 25]

Strategy Formulation and Implementation
[Jul 15–27]

Executive Development Program: The Transition to General Management
[Jun 18–29]

Emerging Leader Development Program
[Dec 2–7]

Leading and Managing People
[Jul 8–13]

E-Commerce: Creating Strategic Advantage
[Jun 4–6]

Marketing Management in the New Economy
[Apr 1–6]

Sales Management
[Jun 3–8]

Finance and Accounting for the Nonfinancial Executive
[May 14–18]

WWW.GSB.COLUMBIA.EDU/EXECED
800-692-3932 EXT. 123
212-854-3395 EXT. 123

those in places as diverse as southern California, North Carolina, and Finland.

The subsidiary-as-incubator model is promising, but as with all corporate venturing, there is a risk that a new business idea won’t find a home within the corporate portfolio. The critical success factor is typically how well the project champion is connected with other parts of the corporation. Hence the importance of international networks.

Build international networks. As every corporate executive—and entrepreneur, for that matter—knows, it’s essential to give would-be innovators access to professional and informal networks. But such networks are not easily manufactured. Some companies have tried to build international networks by creating employee rotation programs, but too often these personnel moves have been ineffective because they’ve been artificial—they haven’t been linked to practical business initiatives. If employees don’t do real work during their overseas assignments, they never become part of local teams or become integrated into networks. A number of corporations, however, now deploy talented employees on short-term overseas assignments that are tied to tangible business goals. In the short term, these assignments furnish useful resources for current projects; in the long term, they increase the number and variety of professional networks from which the next ideas are likely to emerge.

For example, when ABB acquired Taylor Instruments, a Rochester, New York-based automation and controls company, the entire management team of ABB’s automation and controls business was temporarily moved from Sweden to ABB’s U.S. headquarters in Stamford, Connecticut, to oversee the integration process and help develop a new identity for the business. After three years, the management team, which by then included a couple of Americans, was moved back to Sweden.

Similarly, Hewlett-Packard often brings in an experienced management team from corporate headquarters to get new subsidiary operations started. The team’s job is to get performance on
track, bring a local management team up to speed, and move on to another project. At both companies, the creation of strong international networks is the by-product of real work rather than an end in itself.

Multinationals also need to create roles for what we have come to think of as idea brokers. In a crowded marketplace, brokers add value through their ability to bring buyers and sellers together. For innovation at the edges to thrive, entrepreneurs in foreign subsidiaries need to be linked with sources of funding, complementary assets, and sponsors in other parts of the company. That's where idea brokers come into the picture. With their wealth of contacts and experiences, they play three important roles.

First, they link seed money with new ideas. Consider the story of Mats Leijon, an electrical engineer in one of ABB's corporate research labs who came up with a disruptive technology called the Powerformer—a high-voltage generator that allows power to go directly from the generator to overhead cables without a step-up transformer. Without the assistance of Harry Frank, the head of one of ABB's corporate research labs, Leijon's invention might never have seen the light of day, especially given that the Powerformer promised to wipe out more than one of ABB's core businesses. Frank brokered the idea by translating it into business terms, and Leijon's project received funding from the Swedish country manager, Bert-Olof Svanholm. It was launched in 1998. Today, several leading ABB customers are adopting the Powerformer, and the story of Mats Leijon's innovation has become a touchstone for other entrepreneurs at ABB.

Second, idea brokers help find the right organizational home for new ideas. In one product development group in Hewlett-Packard's Canadian subsidiary, initial funding for a new software product came from HP Canada, which was enough to get the product to market. But for the business to grow, the development group's general manager realized he needed to find a home for his product in one of HP's major divisions. He began to sound out his contacts, including several group vice presidents who were able to use their broad knowledge of the HP businesses to put him in touch with various parent divisions. After one false start, he found the right home in a small, Seattle-based division that was selling to the same customer sectors as his group. In HP, the group vice presidents are the idea brokers, and a significant part of their time is spent balancing the portfolio of businesses—splitting up large divisions, merging small divisions, shifting emerging businesses between divisions to create better opportunities for growth, and so on.

The third role idea brokers play is in cross-selling products and services among businesses. Skandia AFS, the financial services group, provides a good example. It is organized as a federation of national businesses, each of which is free to develop its own product lines for the local marketplace (they share a common business model and information system). Recognizing that a country-centered approach could restrict the transfer of new ideas across borders, Skandia created an internal brokering unit called the International Support Unit (ISU). Its role is to take new products developed in one country and cross-sell them into other countries; managed as a profit center, Skandia ISU earns its revenues through commissions on cross-border product sales.

In an era in which new business ideas are as likely to come from Stockholm as from Silicon Valley, multinational companies cannot afford to limit their creative gene pools to corporate R&D labs or a few select outposts. They must find ways to tap into the diverse and multifaceted opportunities that exist in foreign operations. Taken together, the four practices we've outlined can help corporate executives unleash innovation at the edges and fulfill, at last, the promise of going global.