Corporate Entrepreneurship in Network Organizations: How Subsidiary Initiative Drives Internal Market Efficiency

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Julian Birkinshaw believes that corporate entrepreneurship can play an important strategic role in the business development of large, multinational firms, and he particularly identifies internal initiatives by subsidiary companies. The growth of network organizations is relevant here, and he puts forward a framework for an ‘internal market’ to understand how they work. The internal market model is used to examine the various roles that corporate entrepreneurs can play in the large firm, with the aim of achieving network optimization. The author assesses the costs and benefits of internal initiatives, and points out the importance of arriving at an appropriate level of subsidiary entrepreneurship, agreed by head office and subsidiary, rather than applying blanket prescriptions. © 1998 Elsevier Science Ltd. All rights reserved

The concept of corporate entrepreneurship has often been hard to get across to managers who have spent their working lives in large organizations. The idea is innately appealing, but for the most part the organizational infrastructure that grows up around large firms ends up constraining and frustrating the efforts of would-be entrepreneurs. Most ideas that are conceived within large firms, it seems, either wither on the vine or come to fruition once the frustrated entrepreneur has set up on his own.

My purpose in this article is to argue that we should be more receptive to the idea of corporate entrepreneurship in large firms. Certainly, there continues to be a lot of resistance to corporate entrepreneurship, and a lot of reasons why it should be managed with care, but there are several reasons why the mid–late 1990s are seeing a resurgence of interest in the phenomenon. One is the much-discussed shift towards a knowledge society, and thus the need for firms to manage their knowledge assets more effectively. Important trends such as the empowerment movement, delayering, re-engineering and network organizations are all shifting power away from the centre and towards front-line employees. A second important change is the increasing geographical dispersal of many large organizations, and a corresponding need to take into account and act on the ideas of subsidiary managers in foreign lands. More and more corporations, it seems, are acknowledging such changes and developing organizational responses that actively encourage entrepreneurial behaviour. ABB and Cable & Wireless, for example, describe themselves as federative organizations. GE sees itself as a ‘boundaryless’ company. Volvo and many others use the term ‘network organization’.

As a first step, then, I simply want to suggest that the trend towards network organizations represents
a major opportunity for the corporate entrepreneurship movement. First, network organizations provide many of the preconditions that are necessary for corporate entrepreneurs to thrive: a license to build relationships laterally, horizontally and with external parties, as a means of getting things done; a reasonable level of discretion to pursue an idea before having to justify it; and a greater openness in head office to new ideas. Second, and more relevant for this paper, the network organization provides a ready metaphor for understanding the sorts of roles that corporate entrepreneurs can take. My suggestion is that we can use one of the key features of the network organization, namely the ‘internal market,’ to describe the way that the various parts of the large firm fit together, and to look at corporate entrepreneurship as one of the main mechanisms through which the internal market functions.

This article is in four parts. First, I provide a little background on my own research in order to explain what species of corporate entrepreneurship I am interested in. Second, I put forward the ‘internal market’ framework as a means of understanding how the network organization works. Third, I use this framework to examine the various roles that corporate entrepreneurs can play in the large firm, and fourth, I identify and comment on some of the costs of corporate entrepreneurship to large firms.

Background: Subsidiary Initiatives in Multinational Corporations

My own interest in corporate entrepreneurship dates back to 1993 (see Birkinshaw, 1995), when I began to study the plight of US-owned subsidiary companies in Canada in the wake of the Free Trade Agreement. For these Canadian subsidiaries that had been used to decades of tariff protection, Free Trade was a threat, because it gave their parent companies in the US the complete freedom to source products from their giant US factories and even to sell them out of the States. What was the use, observers asked, of a Canadian head office or a branch plant factory in such a situation? Well, not much at first glance, so the Canadian managers I studied began – some as early as the mid 1980s when Free Trade was just a distant threat – to look very carefully at their existing activities and ask themselves: what unique value-added do we provide for our parent company? 3M Canada, for example, had developed an impressive capability in small-lot manufacturing; Honeywell Canada had the engineering expertise and the primary manufacturing responsibility for two global products; and Westinghouse Canada had a standalone business unit that developed and marketed computer terminals for airline reservations systems on a worldwide basis.

But identifying such capabilities was, of course, only part of the story. The more difficult part was the selling process – bringing the Canadian subsidiary to the attention of top management in the US, and then when the moment was right, convincing them that they should make a further investment in the subsidiary. I termed this process a subsidiary initiative – it began with the identification of a new business opportunity, proceeded with a major selling process to the head office and to other parts of the corporation, and finished with the commitment of resources to the business opportunity in question. 3M Canada, for example, was able to build on its proven strength in small-lot manufacturing to push through a series of initiatives in the 1988–90 period for new manufacturing plants.

Subsidiary initiatives, I argue, are an important form of corporate entrepreneurship. Obviously the circumstances behind these Canadian subsidiaries’ actions were very context-specific, but the basic idea of identifying a new opportunity and pushing it through the levels of management to get funding is exactly the same as what Kanter and Pinchott were talking about in the mid-1980s. Moreover, it seems to me that subsidiary initiatives represent a rather rare form of corporate entrepreneurship, because they face two obstacles: (1) the usual resistance to anything new or unproven, and (2) additional resistance because the sponsoring unit is ‘foreign’. Many multinational corporations are still somewhat ethnocentric in their world-view, which results in an extra layer of scepticism being attached to any proposal that comes from outside the home country. This multi-faceted resistance to subsidiary initiative I have called the Corporate Immune System (Birkinshaw and Riddlerstråle, 1996), in that its implicit role is to reject all alien bodies that attempt to penetrate the inner core of the organization. As with all metaphors, this one cannot be taken too far. Its value is that it paints a clear picture of the challenge that the subsidiary manager faces in the pursuit of his/her initiative. It also reminds us of an important point, which is that many initiatives should be rejected by corporate gatekeepers as a means of ensuring that resources are tied to the most fruitful opportunities. But the metaphor should not be taken too literally either, because the ‘alien bodies’ in question seek to improve the corporation, not to damage it.

The second important insight I gained from this research was the observation that subsidiary initiatives can be both externally- and internally-oriented. Figure 1 illustrates this concept, in terms of the two generic forms of initiative that can be found within large multinational firms (see Birkinshaw and Fry, 1998). Externally-oriented initiatives seek to identify new customer needs, develop new suppliers or forge new alliance relationships. The rationale behind them is a simple one, namely that subsidiary companies around the world are exposed to an enormous variety of stimuli that could never be sensed by managers sitting in head office. It is therefore the
responsibility of subsidiaries to seek out and respond to those opportunities that present themselves in the local marketplace. The focus, in other words, is on Market Development. Internally-oriented initiatives, by contrast, seek to make the existing set of relationships within the multinational corporation work more efficiently. They are directed towards building new relationships, challenging existing ones, and identifying unmet opportunities, all within the confines of the existing network. I call this process Network Optimization.

The interesting point here is that while externally-oriented initiatives are well known, the internally-oriented variety seem thus far to have escaped attention. What follows, then, is an explorative account of internal initiatives – the various forms they can take, their impact on large organizations, and their costs and benefits.

Initiatives and Internal Markets

To make sense of the different types of internal initiative, it is useful to model the large network organization on an Internal Market. By internal market, all I mean is that market-like forces are recreated – to some degree – inside the firm. Consider the following examples, all of which are quite commonly seen in large firms:

- A production unit can source parts from outside suppliers if it believes that the internal supplier’s offering is not competitive.
- Two or more units within the multinational firm make competing products; it is up to each national sales operation to decide which product it will push in its own market.
- The sales unit can elect to sell a competitor’s products if it does not like the products offered by its own product divisions.
- R&D units have to ‘sell’ their services to the various product divisions before they can undertake a project.

The logic behind these sorts of arrangements is compelling. If an automobile manufacturer is compelled to buy engines from an inefficient internal supplier rather than the world leader in engines, the cars it produces will not be competitive. Such mandated sourcing relationships bear a remarkable resemblance to the old central-planning system in communist Russia, in which every company was told what to make and who to sell it to. A much better approach, one can argue, is to give the manufacturer the option of buying engines from outside. This ensures that the cars it produces will have the best engines, and more to the point, it provides the impetus that the internal engine manufacturer needs to keep its products up-to-date and competitive.

There are dangers in the internal market approach as well. An obvious concern is that internal markets create competition between units, and thus hinder the development of cooperation and resource sharing. A second concern is that internal markets lead managers to focus all their efforts on transfer pricing and internal negotiations rather than adding value to the end customer. The challenge, as always, is to design an organization that gets the maximum benefits out of internal competition whilst avoiding the worst of the costs. This involves building a system that motivates people to share ideas and cooperate, but at the same time to compete with one another. Not an easy balancing act, of course, but one several firms – including ABB, Hewlett Packard and Sharp – have come some way towards achieving.

Once one accepts the basic logic of the internal market, it becomes clear that the subsidiary’s role changes dramatically. Using the terminology of economist Kirzner (1973), the subsidiary manager becomes an entrepreneur, whose role is essentially to seek out ‘hitherto unnoticed opportunities’ in the internal market and act upon them. In so doing, the subsidiary manager helps to resolve inefficiencies in the internal market and thus gradually push it towards equilibrium. Of course, the subsidiary manager still has his or her ‘mandated’ job to do, such as selling the firm’s products in the local market, but according to Kirzner this work is done alongside the entrepreneurial work. Every individual, in other words, has a latent dual role: manager and entrepreneur.

The internal market framework, and the concept of the subsidiary manager as an entrepreneur, gives us a good theoretical foundation for looking at the types of internal initiatives I have identified during my research. While there are many ways of categorizing...
them, Figure 2 provides a simple breakdown into four groups, based on the nature of the business opportunity and the level of head-office support. The opportunity can be of two types: it can be an existing internal-market arrangement, or it can be an emerging business area. In the former case the subsidiary initiative aims to reconfigure existing activities within the firm; in the latter case it aims to enhance the allocation of new activities. In terms of head office support, the initiative is either sanctioned by head office or it is not. When it is sanctioned, that means there is an existing set of rules or procedures the subsidiary can follow. When it is not, that means head office managers are either unaware of the initiative, or they are turning a blind eye towards it. Both of these dimensions will be elaborated upon in the paragraphs below.

Reconfiguration Initiative

A reconfiguration initiative can best be understood as an effort by the subsidiary to alter the existing configuration of activities within the firm to enhance their efficiency. Consider the case of IBM in Scotland. It began manufacturing PCs in Greenock in 1982. Towards the end of the 1980s, though, plant management realized that there was a limited future in just being a final assembly operation, so they began looking for ways to extend their ‘charter’ i.e. the set of activities they were responsible for at a corporate level. In 1991 they identified a small monitor development group near London as a logical complement to their manufacturing, and succeeded in getting it relocated to Greenock. Subsequently, they identified two service functions, the order fulfillment process (whereby orders are collected, organized and sent to the factory) and help centres (e.g. for people with installation problems) as Europe-wide activities that could potentially be centralized in Greenock. Again, they were successful.

The key point here is that the initiatives all resulted in changes in the configuration of activities for IBM Europe as a result of efforts by the Scottish subsidiary. Such changes could be – and often are – initiated by head office management, but it is fair to assume that the management on location understand the implications of such changes better than the head office managers 3000 miles away. Moreover, the IBM case was not just about reconfiguration of activities. As Gordon Brown, the Greenock controller commented, “by extending the value chain and linking various activities together in one location, millions of dollars were saved, customer satisfaction improved, and market share increased”. The process, in other words, created a new vitality in the initiative-taking subsidiary, which led to a significant performance improvement.

Another important element of the reconfiguration initiative is that it typically results in a loser as well as a winner. A Honeywell Canada manager, for example, was touring the plant of a sister unit in the US back in 1972. He observed their production process for a control switch, and realized that his plant back in Toronto “could do it significantly better and much cheaper”. He proposed such a change to head office management, and it was quickly passed, with the result that the control switch production was transferred up to Canada. But of course his colleagues in the losing plant were not happy – “I was not welcome back” he admitted. Perhaps they should have had the opportunity to improve their performance, but as this manager explained, “the corporate philosophy at the time was: you could have done a better job, so you should have done before somebody took the work off you. And that’s what kept us competitive.”

The IBM and Honeywell examples are cases where the subsidiary has facilitated a reconfiguration of physical activities – production, R&D operations, and help centres. But it is important to bear in mind that many of the internal flows in a multinational corporation are of intangibles such as market knowledge, technology and organizing principles. If we extend the definition of an internal market to cover a market for knowledge, then we also open up several other forms of initiative. Consider, for example, the case of 3M Sweden which developed a high level of expertise in customer focused marketing and key account management. Gradually other subsidiaries within 3M Europe got to know about this, so that when they had questions about customer-focused marketing, they called Sweden. 3M Sweden thus emerged as a ‘Centre of Excellence’, and the individual heading up the Swedish marketing operation found himself travelling extensively and disseminating his knowledge. In addition a number of other centres of excellence were also designated within 3M Europe.

The 3M story may appear very different from the IBM and Honeywell examples, but it actually has a number of common themes: it was inspired by the subsidiary, it was sanctioned by head office, and it
resulted in the more efficient use of existing resources, i.e. 3M Sweden's excellence in customer focused marketing. The key difference, of course, is that knowledge resources can be transferred without loss to the transferor, whereas physical resource transfers tend to be a zero-sum game.

Another example that emerges from looking at the firm as an internal knowledge market is Skandia AFS, a Swedish insurance firm that specializes in unit-linked life assurance products. Skandia AFS has about 20 subsidiaries around the world which all act very independently. However it also has four subsidiaries called ISUs (International Sales Units) whose role is to identify opportunities to sell products from one country into other countries. The ISU subsidiaries, in other words, act as brokers in the internal market, continuously evaluating the existing product portfolios of sales subsidiaries, and making them available to other subsidiaries if they look attractive.

There are, then, many types of reconfiguration initiatives. They differ substantially in the type of internal market – in the IBM and Honeywell cases the market was for corporate charters, in the Skandia and 3M cases the market was for knowledge. But they all serve one critical function, namely enhancing the efficiency of the internal market without head office management having to become actively involved.

**Maverick Initiatives**

Maverick initiatives are similar to reconfiguration initiatives to the extent that they result in an enhancement in the efficiency of the internal market. However, they are also undertaken without head office sanctioning, which makes things quite tricky when the charter 'steal' involves another unit losing out. Such initiatives appear to be the least common of the four, and I was only able to identify two examples during my research, both of which requested anonymity. The first was the Swedish subsidiary of Datacom, a US-based computer manufacturer. Datacom was struggling in the early 1990s because their products were not perceived as competitive. The Swedish subsidiary, on the verge of bankruptcy in 1991, was aggressively turned around by the new managing director in part through one simple change: he began to sell and service competitors' products, not those made by Datacom. As the managing director explained,

>'the US staff concluded that we were prioritizing the sale of competitors' equipment. We were not of course – it was not a choice of A or B, it was B or nothing! To say the least, this was not understood. Many heated phonecalls, hostile video-conferences and top level pressure were applied to stop us selling competitors computers, and go back to selling what the factory could make.'

Whether Datacom Sweden was right to sell competitors' equipment is impossible to judge. But if we go back to the internal market, it is logical to give the sales subsidiary freedom to buy products from multiple sources if its competitiveness is otherwise compromised. Given that most money in this industry is made in service contracts and not in product margin, it is possible that the Swedish initiative represented an important shift in mindset within Datacom. Today, six years later, the Swedish managing director has been forgiven for his rule-breaking, and his turnaround is widely acknowledged within the firm as a success story.

The second example of this type of initiative emerged from a disagreement between Alpha, a Swedish multinational and its German subsidiary. The German subsidiary was demanding some changes to the product specifications in order to sell it in Germany; the Swedes responded that they could not make the requested changes in a cost-efficient manner. The manager of the US subsidiary came to hear about this dispute, and saw a great opportunity. He arranged to buy several hundred products from Sweden, got them shipped over to America, retrofitted them with the German subsidiary's requested changes, and shipped them on to Germany, making a tidy profit along the way. This story is a fascinating example of subsidiary initiative, undertaken directly against the wishes of head office. It is also a very good example of entrepreneurship in a Kirznerian sense, in that the internal market between Sweden and Germany was clearly failing. Through his alertness to a market opportunity (in this case an unsatisfied German subsidiary), the US subsidiary manager was able to step in and make a profit, and at the same time enhance the efficiency of the internal market.

Of course many people reading this will see the above two examples as blatantly subversive. Such actions, they will conclude, lead to internal anarchy and cause multinational firms to lose their strategic focus. My argument is more balanced. There is certainly a fine line between initiative and subversion, as the final section of this paper discusses, and only time will tell if the Datacom and Alpha initiatives crossed that line. But in the interests of organizational experimentation, these sorts of initiative are important to recognize, because they can potentially have significant benefits, as well as obvious costs.

**Bid Initiatives**

Bid initiatives are those that are directed towards emerging business areas for the multinational firm. Consider the case of Monsanto Canada, whose top management identified an interesting proposal in the corporation's long-range plan in 1991. Monsanto was developing a new formulation for its best-selling agrochemical product, with the intention of bringing it to market around 1996. Canadian management saw a great opportunity to argue for the investment to
be made in Canada because of the country’s strong agricultural industry. They persuaded corporate management to bring forward the planned investment, and they lobbied hard to ensure that a Canadian site was actively considered. After a careful analysis of the three competing sites, the Canadian one was selected.

It is important to compare the Monsanto Canada case with the IBM case described earlier. Both ended up following similar processes, in terms of identifying possible extensions to the subsidiary’s business, lobbying head office managers, and doing a careful cost–benefit analysis. But the key difference is that IBM Scotland were pushing to reconfigure existing activities, while Monsanto Canada were trying to attract a new activity. This difference is critical for one main reason, namely that reconfiguration initiatives rely exclusively on the subsidiary to identify the opportunity whereas bid initiatives are usually identified jointly by the head office and the subsidiary. In Hewlett Packard Canada, for example, I saw a couple of examples of initiatives that were originally identified by the subsidiary but which were subsequently fought out on an internal basis between the Canadian subsidiary and a couple of US-based divisions.

The best way of making sense of bid initiatives, I believe, is by thinking in terms of both the internal and external market. While the opportunity itself (such as Monsanto’s need for a new production plant) is typically oriented towards the external market, the subsidiary has to win the right to act on that opportunity through the internal market. For that reason, the process tends to resemble that seen in the reconfiguration initiatives – a lobbying process directed towards head office decision-makers as well as other influential entities within the firm.

Moreover, the internal market perspective also indicates another important dimension to bid initiatives that was not observed in reconfiguration initiatives, namely the need for both push and pull strategies. The push strategy was what was observed in Monsanto Canada, with the top management becoming actively involved in the specific initiative. The pull strategy is a little more gentle, in that it involves the subsidiary ‘broadcasting’ its capabilities to influential managers throughout the firm, in the hope that it will be approached when the right investment opportunity arises. Take the example of Motorola’s East Kilbride plant in Scotland. This is one of 16 Motorola plants around the world that fabricates silicon wafers for semiconductors. All the key performance measures such as cost, service and quality are explicitly compared on a monthly basis, and new investments are (obviously) made in the top performing sites. Because of this comparability, East Kilbride’s management do not need to think in terms of push strategies. Their approach, rather, is to stay ahead of internal competitors on the key performance metrics, and ‘pull’ new investments in as they occur.

Push and pull are by no means alternative strategies. While management at Motorola’s East Kilbride plant can focus on the pull approach, they still have to be very responsive and keen whenever new investments are planned. Monsanto Canada worked hard on the pull strategy in the late eighties by broadcasting their interest in attracting investment, and then used a push strategy when specific opportunities arose. But the point is that the relative emphasis is likely to vary, and this will be a function of the firm’s system for managing new investments as well as the individual manager’s preferred style. For example, Ericsson, the Telecommunications equipment firm, has managed its international R&D activities through an internal market process for many years. Ericsson’s corporate culture is typically Swedish, in that it places a great deal of emphasis on consensus building and group decision-making. As a result, R&D charters are handed out through a rather interactive bid process in which subsidiaries use mostly pull strategies coupled with active top-down involvement.

Finally, we can also extend the bid initiative terminology to internal knowledge markets. Here the emphasis is on emerging knowledge areas that certain subsidiary units actively pursue in order to become thought-leaders. As before, the term most firms use for such a unit is a Centre of Excellence. For example, consulting firms such as Andersen Consulting and McKinsey encourage the various units around the world to develop leading-edge knowledge in emerging practise areas or industries. Often such units are formally designated as centres of excellence, with a view to their knowledge being disseminated throughout the firm. An alternative approach is for the firm to use its information technology to make this leading-edge knowledge available electronically. In both cases, of course, it is a question of the efficiency of the internal market system (word of mouth versus electronic) whether such knowledge finds its way to the individuals throughout the firm who need it.

‘Leap of Faith’ Initiatives

The fourth and final type of initiative I have called ‘leap of faith’ initiatives because it typifies the attitudes of the managers responsible for them. Such initiatives are directed towards emerging areas of business, but they are undertaken without head office sanction. However, unlike the Maverick initiative discussed earlier this type is somewhat less contentious because there is no obvious losing party. Essentially it represents a bet by the subsidiary manager on the emergence of a certain technology or business area, in the hope that it will really take off. A well-known example of this is NCR’s Dundee operation. This plant was on the verge of closure in 1980, largely because its key product, the automatic teller machine (ATM) had serious quality problems.
Jim Adamson, the newly-appointed general manager, worked on improving manufacturing quality and restoring the confidence of major customers, while at the same time developing a vision for Dundee as NCR’s strategic centre for the ATM business. Product development responsibility officially lay with HQ in Dayton, but Adamson began directing resources towards upgrading and renewing the Dundee product line to meet the emerging demands of the big British banks, Dundee’s key customers. Faced with active resistance from the development group in Dayton, Adamson pursued a delicate strategy of co-operating with them while continuing privately to sponsor Dundee’s independent research program. A successful product upgrade in 1982 was followed 18 months later by a next-generation ATM that set new standards in functionality, reliability and serviceability. Dundee’s global market share reached 20 per cent in 1984. The following year, responsibility for the global ATM business was officially transferred from Dayton to Dundee.

In this case, the leap of faith was not so much in terms of the ATM market (which was already growing rapidly) but in terms of Dundee’s ability to compete with IBM and a host of other established competitors. Certainly, there were many within NCR who doubted that Dundee would ever return to profitability, let alone become a global leader in ATMs, yet Adamson persisted in his vision and eventually won out.

A second example of a leap-of-faith initiative is Honeywell’s Scottish subsidiary in Newhouse, which manufactures a range of control valves and related items for the European market. During the seventies and early eighties control valves were mechanical devices, but the general manager of Newhouse became aware of the impending shift towards electronic devices and he invested discretionary funds in the development of an electronic manufacturing capability. Thus, when in 1991 corporate management decided to invest in a global-scale facility for electronic fan-coils, Newhouse was the obvious location because it had already developed the necessary capabilities. This case was far less dramatic, but it emphasizes the importance of a far-sighted subsidiary manager who was willing to bet on the emergence of a certain technology. It also illustrates the judicious use of discretionary funds in the subsidiary. While not officially sanctioned by head office, it seems unlikely that such investments would have caused trouble (unlike the maverick initiatives described earlier).

In sum then, leap-of-faith initiatives represent an important fourth category in which – like bid initiatives – subsidiary managers are actively looking for opportunities in the external market while at the same time trying to get them resourced and legitimized in the internal market. The challenge in such cases appears to be one of effectively managing both arenas. In the case of the Honeywell Newhouse manager, for example, one must assume that he was conscious of the level of investment in digital systems among the other Honeywell plants, as well as conscious of emerging market demands.

To summarize, this section should be seen primarily as a descriptive account of the forms that internal initiative can take. Each initiative type requires very different tactics on the part of the subsidiary manager, from the rather Machiavellian approach in maverick initiatives, through to the by-the-book logic of bid initiatives. And moreover, each suggests a very different set of expectations on the part of head office management, such that in any given corporation there may only be one or two of these types of initiative that could conceivably be pursued. Notwithstanding the differences, it seems that the similarities are also quite striking. All four require subsidiary managers to be entrepreneurial, looking for new ways of adding value and proactively approaching head office with a proposal, and all four require a much greater level of awareness and openness on the part of head office managers to ‘foreign’ ideas than is normally the case. Clearly the sort of cultural shift I am talking about does not come easily, but it is a gradual process and one which many of the firms I have studied seem to be getting to grips with. But one of the biggest stumbling blocks is a simple and fundamental scepticism towards corporate entrepreneurship. So it is to this issue that I now turn.

The Costs of Corporate Entrepreneurship

As I observed at the outset, many managers remain suspicious of corporate entrepreneurship. They are suspicious in the first instance because it sounds like an oxymoron: perhaps an attractive idea in principle, but something which just does not happen very often. But the second reason for suspicion, and the one I want to address here, is that corporate entrepreneurship has significant and often hidden costs. Entrepreneurship is, most of us would agree, an important engine of growth and renewal whether it occurs inside the firm or in the economy as a whole. But as with most things, it is possible to have too much entrepreneurship. Below I have listed four of the principal costs of corporate entrepreneurship that I think managers need to be cognizant of, and a number of suggestions about how those costs can be managed.

**Empire building.** We are all familiar with the stories. The country manager in France, for example, convinces head office that he needs to build a local manufacturing operation to keep the government happy. A few years later he comes out with some
product changes that are ‘essential to our continued success in France’ but which cut against the worldwide positioning of the product. He then argues that a larger development team is needed to support the new product line, because the R&D people back at head office do not understand the changes that have been made. And so on.

Is the French country manager cleverly adapting the product to the unique French marketplace, or is he an empire-builder, interested only in building his own power base at the expense of the firm? Similarly, if we take the Datacom Sweden manager or the US subsidiary manager of Alpha mentioned earlier, where do their priorities lie? The answer to this question depends essentially on the preconceptions of head office management. One preconception argues that subsidiary managers are prone to act opportunistically and build their own little empires. The other is to trust subsidiary management, and to believe that they are acting in the best interests of the corporation. In my experience, the ‘facts’ of the specific case can be interpreted to reach whichever conclusion fits the manager’s preconceptions. Obviously in a few cases there is solid evidence that the subsidiary’s actions were well-intentioned or oriented towards empire-building, but most cases fall in the grey area where opinion is what matters.

So what can be done to guard against empire building? My opinion is that the head office – subsidiary relationship has to be built on trust, otherwise the strict control systems that ensue will make opportunistic behaviour a self-fulfilling prophecy. However, that trust-based relationship must also be tempered with a system for evaluating and monitoring the subsidiary’s initiatives, to ensure that they are consistent with corporate goals. And it also needs to be undergirded and reinforced by a strong corporate culture that allows head office managers to be confident about the abilities and objectives of its subsidiary managers.

Lack of focus. This problem is related to empire-building, in that it is also the result of ‘too much’ corporate entrepreneurship. Imagine that every employee takes the idea of corporate entrepreneurship to heart, and follows up on their new idea. Soon the firm is getting into new businesses in every conceivable direction, with the result that financial resources are stretched too thin and there is no coherence to the firm’s product line. Hewlett Packard reputedly found itself in this position in the late 1980s, because it had actively encouraged individual initiative but it had not put in place the necessary controls. Changes were made to reduce the autonomy of subsidiary managers, but inevitably this approach also choked off the flow of initiatives, with the result that the company probably moved too far the other way.

Corporate entrepreneurship can end up being pursued outside the firm. Ethicon, Johnson & Johnson’s Scottish subsidiary, is a good example of this: it has on numerous occasions spun off businesses that did not fit its strategy, several of which have gone on to become major firms in their own right.

Costs of administrating the internal market. Unlike the market economy which appears to work best when left alone, the internal market system needs a considerable amount of administration to work effectively. One set of administrative costs result from setting up and maintaining the internal market system, e.g. defining the conditions under which sourcing relationships can be challenged, and setting rules for transfer prices. There are also transaction costs that are accrued by the participating units every time an initiative is undertaken. Such costs are not only higher than would be the case in a ‘centrally-planned’ organization, they are also potentially higher than in an external market. In one case I studied, for example, head office management had decided against sending out a Request For Proposal to subsidiary companies because they did not want to spend the time going through all the proposals and justifying their decision to each one in turn. They chose, instead, to create their own shortlist of two or three subsidiaries, and evaluate them in detail.

As with the last point, there is a tricky balance here between maximizing the level of subsidiary initiative and keeping the cost of managing it under control. If head office managers draw up their own shortlist of subsidiaries, they keep the process under control but they may send the wrong signals to other entrepreneurially-minded subsidiary managers. Again, the rule of thumb appears to be one of keeping a very broad perspective at first, but fairly quickly selecting out those initiatives that are uncompetitive or not aligned with the firm’s needs.

Coping with internal ‘unemployment’. The final cost of corporate entrepreneurship is that it can result in unemployment, either literally or figuratively. If we think about the market economy for a second, it is generally accepted that closing an inefficient coal mine is good for the economy as a whole but results in hundreds of layoffs in the old coal town. The same can be argued for the internal marketplace. If we consider the Honeywell case discussed earlier, the decision to move a production line from Minneapolis to Toronto was good for Honeywell as a whole (because it resulted in more efficient production) but resulted in the loss of some jobs in Minneapolis. This leads to certain costs for the firm. Either the employees in question are laid off, which results in a one-time cost to the firm and more importantly the loss of some well-trained experienced people, or they are retained by the firm and assigned new responsibilities, a process which inevitably takes time.

Of course, the costs of closing down factories and reallocating people occurs in all firms, but the point to emphasize here is that a system which encourages
the use of an internal market will experience much more frequent changes in the allocation of activities to operating units, and will therefore suffer from a higher level of ‘internal unemployment’. Just as the central planning system in Russia was able to boast full employment until it all fell apart, centrally-planned firms can keep the number of unassigned workers to a minimum for a long time, and then pay the price later through massive job losses. The costs of internal unemployment, in other words, are quite substantial, but probably worth paying because they are better than the alternative. The managerial challenge then becomes one of managing the reassignment of employees to other parts of the firm, and of training them so that their skills match future needs.

Concluding Comments

This paper has focused on the perspective of subsidiary managers, both at a conceptual level, and with regard to the specific initiative strategies they can pursue. My assumption is that many ‘head office’ oriented managers will have found my approach worrying, because my implicit advice is that subsidiary managers should take more initiatives, even initiatives that go against the official sanctioning of head office. In this final paragraph I want to allay such suspicions slightly, by emphasizing that I would like the ideas presented here to be seen as descriptive of an interesting phenomenon rather than a how-to guide for subsidiary managers. The fact is that we simply do not know if subsidiary initiatives, of the type described here are really good for the multinational firm. Obviously I have chosen to focus on success stories, but for every case like NCR Dundee there are a large number of failures in which money was wasted on a poorly-thought-out investment, or precious time was spent arguing the pros and cons of a marginal idea. Rather than offering simple rules-of-thumb about what level of initiatives should be encouraged, I would prefer to argue that the appropriate level is extremely dependent on the specifics of the firm and industry. In some of the companies I have studied, head office managers have attempted to suppress the entrepreneurial endeavours of their subsidiary managers, for fear of being swamped with proposals. And in others, I have heard head office managers complain that their subsidiary managers do not take enough initiative. Getting the level of corporate entrepreneurship right is clearly a process of mutual adjustment, and one that is unlikely to be achieved without some pain.

The purpose of this article, then, was to provide a way of thinking about the different forms that internal initiatives can take, and to explain their likely impact. My hope is that it will have stimulated both subsidiary and head office managers to re-evaluate their approach to corporate entrepreneurship, and to look with fresh eyes on its possibility for enhancing the efficiency of their internal market systems.

Notes

1. There was a wave of enthusiasm for corporate entrepreneurship in the mid-1980s, fuelled by Rosabeth Moss Kanter’s book The Change Masters (1985: Simon and Schuster, New York) and Gifford Pinchott’s Intrapreneuring (1985: Harper and Row, New York). As I read the literature, we can see something of a second-wave of enthusiasm at the moment. Notable recent contributions include, Ghoshal and Bartlett (1997); Birkinshaw (1997); Block and McMillan (1996), and Ginsberg and Hay (1994).
2. On the issue of internal markets, see also the work of Halal (1994).
3. One important point of clarification is in order here, namely that initiatives directed towards new market opportunities are really ‘internal – external hybrids’ in terms of Figure 1. More specifically, while the ‘locus of opportunity’ is external to the firm, it is typically the case that head office management identifies the opportunity, so that the ‘locus of pursuit’ of the initiative is internal. Viewed in this way, such initiatives are still part of the internal initiative phenomenon.
4. Datacom and Alpha are disguised names.

References

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