

Subsidiary survival: a case study from the Portuguese electronics industry

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Abstract

Purpose – The existing literature suggests that multinational corporations (MNCs) divest subsidiary units whenever they cease to enjoy the advantages of ownership, location or internalization. However, not all MNCs divest under these conditions. This paper aims to explore the factors that contributed to the survival of a particular subsidiary and prevented it from being divested.

Design/methodology/approach – The analysis focuses on an individual subsidiary of a large foreign MNC in the electronics industry, which divested other subsidiaries from Portugal. Data were collected using semi-structured interviews.

Findings – The subsidiary's diverse customer base, specificity and high level of efficiency, the local advantages, the existing governmental agreements and the parent MNC's previous unsuccessful relocation experiences seem to have contributed to the survival of the subsidiary.

Research limitations/implications – Although the results of the case study are not generalizable to the entire population of firms, the featured case study is a rare survival success story in the Portuguese electronics industry.

Practical implications – The proposed framework may offer public authorities measures to create conditions to encourage firms to retain their investment in a particular site. For corporate strategists, new perspectives on subsidiary survival are provided.

Originality/value – This paper is one of the few qualitative studies in the field of subsidiary survival. The results offer an integrative framework on which factors contribute to the survival of a subsidiary located on a comparatively unfavorable labor cost location and support the role of the organizational learning and of previous failed relocation experiences and relocation barriers when a parent MNC decides whether to retain a unit.

Keywords Foreign direct investment, Electronics industry, Foreign divestment, Subsidiary survival

Paper type Research paper

Introduction

Multinational corporations (MNCs) make frequent decisions on market entry and exit, i.e. investment and divestment. Foreign divestment (FD) involves the sale or closure of units in foreign locations (Benito, 2005). Divestment and survival are an important current topic for various reasons.

First, an increasing number of firms seek to internationalize, but, with the tougher competition in international markets, it is more difficult to compete successfully abroad (Sousa and Tan, 2015). Second, MNCs are increasingly important in international markets and there is a need to understand how they restructure their global operations



(Norbäck *et al.*, 2015). Third, divestment has severe socio-economic impacts for all stakeholders. Benito (2005) highlights the negative implications of FD, especially the loss of jobs for individuals and of employment opportunities for towns and regions. Fourth, attracting and retaining foreign direct investment (FDI) is of the utmost importance for host countries' economies (Benito, 1997).

The literature on FD has used the Eclectic Paradigm (Dunning, 1980) to explain MNCs' decisions to divest. Boddewyn (1983) proposed the theory of FD, arguing that MNCs would divest subsidiaries when they cease to have an ownership, location or internalization (OLI) advantage. However, evidence shows that MNCs may not divest their subsidiaries when losing OLI advantage.

This article reports an exploratory case study of a subsidiary that "should" have been divested but is still operating in an apparent unattractive labor cost location, unlike other units that were divested in the same country and industry by the parent MNC.

This paper addresses gaps identified in the literature. First, there is the need for more research dedicated to the survival of subsidiaries (Demirbag *et al.*, 2011). Second, the call for more in-depth exploratory studies dealing with divestment (Brauer, 2006; Moschieri and Mair, 2008; Silva and Moreira, 2019) and analyzing anomalous cases (Christensen *et al.*, 2003). Finally, the need "of learning why firms do not divest" to gain new theoretical insights on extant findings (Brauer, 2006; p. 775; Lampón *et al.*, 2015).

This article contributes to the literature by providing a holistic view of the divestment phenomenon, from FDI motivations to the main reasons that contribute to the survival of a subsidiary, by highlighting the role of organizational learning theory and previous relocation experiences on the decision to retain a unit, and by drawing MNC managers' attention to how relocation barriers may offset the expected gains of relocating a unit.

The article is structured as follows. After this introductory section, we review the literature on divestment and survival. Next, the research method is presented, including the selection and description of the case and the collection of data. Then data are analyzed and a conceptual framework of reasons behind the decision to retain the unit is presented. Finally, the results are discussed along with the theoretical contributions of the study. The article ends with the concluding remarks, limitations and the potential future avenues of research.

Theoretical background

There are several theories that explain why MNCs internationalize or engage in FDI but Dunning's Eclectic Paradigm (1980) is among the most widely accepted theories (Ribau *et al.*, 2015). Theories of FD are less developed (Kotabe and Ketkar, 2009; Silva and Moreira, 2019). This is mostly attributed to difficulties in obtaining quantitative and qualitative data on divestment.

In one of the earliest theoretical approaches to the topic, Boddewyn (1983) drew on Dunning's Eclectic Paradigm and proposed the theory of FD. FD was conceptualized as the reversal of FDI and would occur whenever the MNC ceased to have a competitive advantage, no longer found it profitable to internalize its advantage, or no longer found profitable to internalize its competitive advantage in a particular host country. Boddewyn (1983) argued that while the Eclectic Paradigm demands all three OLI conditions to be satisfied simultaneously, the FD theory requires only one of them. The theory of FD applies particularly to MNCs that have room for locational flexibility and the ability to adjust their resources among various countries, exploiting their advantages as well as those of external markets and economic policies (Benito and Welch, 1997).

The research on subsidiary survival is less well developed. [Demirbag et al. \(2011\)](#) argues there is no comprehensive literature on the determinants of survival of MNCs' subsidiaries, but there is empirical research investigating the various factors that lead to termination. Several studies focused on the determinants of FD ([Benito, 1997](#)), while others examined the survival (longevity) or the failure (mortality) of foreign entrants ([Håkanson and Kappen, 2016](#); [Mata and Portugal, 2000](#)). [McDermott \(2010\)](#) notes that several factors are mentioned as precipitating circumstances for FD, which can be grouped as market factors (including the home country, the host country and the industry in which the firm operates) and firm factors (features of the parent MNC and the subsidiary).

Market factors leading to divestment

At a market level, few studies focused on the impact of home country factors on divestment intensity. However, [Soule et al. \(2014\)](#) found that firms from home countries with higher levels of political freedom and transparency were more likely to divest from Burma due to external pressures. [Wan et al. \(2015\)](#) suggest that the country of origin of the MNC and the host country where the foreign operations are located (emerging and developed countries) influence the propensity to divest internationally. Existing research agrees that growth of both the host country's economy and the industry decrease the likelihood of divestment ([Benito, 1997](#); [Berry, 2013](#); [Delios and Makino, 2003](#); [Li, 1995](#)). Conversely, unfavorable environments like recessions or economic crisis, decrease the likelihood of subsidiaries' survival ([Godart et al., 2012](#); [Varum et al., 2014](#)).

Changes in environmental conditions also affect divestment. [Belderbos \(1997\)](#) showed that anti-dumping duties contributed to Japanese FDI in the European Union (EU) and in United States (US) plants. However, when those anti-dumping duties were lifted, those plants were divested ([Belderbos, 2003](#)). [Griffin \(2003\)](#) found that, when the reasons for the initial investment ceased to exist, MNCs divested. Technological changes and improvements can also trigger divestment because they raise the risks of product obsolescence ([McDermott, 2010](#)). The socio-economic uncertainty in a country (e.g. political instability, currency appreciation and exchange rate volatility) can lead to divestment because it increases the costs and governance issues of running diversified businesses ([Berry, 2013](#); [Panibratov and Brown, 2018](#); [Song, 2014](#)).

High labor cost countries or labor cost increases are well-accepted antecedents of divestment and relocation activities to low-cost countries to decrease production costs ([Belderbos and Zou, 2009](#); [Fisch and Zschoche, 2012](#)). [Bernard et al. \(2006\)](#) found that plant survival was negatively associated with industry exposure to low-wage country imports.

Research has also shown that overall, the higher the cross-cultural distance between the host country and the MNC headquarters, the higher the likelihood of exit ([Kang et al., 2017](#); [Pattnaik and Lee, 2014](#)). A well-accepted reason to divest is the liability of foreignness ([Zaheer, 1995](#)) or the social and economic costs that firms face when conducting businesses abroad ([Van Beveren, 2007](#)).

Firm factors leading to divestment

At firm level, the MNC's strategy plays an important role on divestment. MNCs may divest to decrease the level of diversification, to focus on core activities and to restore control ([Duhaime and Grant, 1984](#)). Divestment can also be a way to obtain funds to finance other investments in the MNC network ([Norbäck et al., 2015](#)). [Procher and Engel \(2018\)](#) demonstrate that new investments are related to subsequent divestment (and vice versa) because of competitive pressures of new investments in the MNC network. Moreover, the faster the internationalization of firms, the likelier the divestment because divesting

operations can be a measure to ease the strain on a firm's managerial resources associated with a rapid international expansion (Mohr *et al.*, 2018).

The appointment of a new CEO, with no attachment to previous investment decisions is accepted as promoting FD (McDermott, 2010; Torneden and Boddewyn, 1974). Moreover, divestment is more likely when managers (Nees, 1978) and firms have prior divestment experience (Panibratov and Brown, 2018; Silva and Moreira, 2019).

One line of research has specifically focused on the influence of entry mode (Delios and Makino, 2003; Dhanaraj and Beamish, 2004; Hennart *et al.*, 1998; Mata and Portugal, 2000), ownership structure (Brouthers and Hennart, 2007; Chung and Beamish, 2005; Dhanaraj and Beamish, 2004; Li, 1995; Makino and Beamish, 1998) and foreign experience (Delios and Beamish, 2001; Delios and Makino, 2003; Dhanaraj and Beamish, 2004; Li, 1995; Shaver *et al.*, 1997; Vermuelen and Barkema, 2001) on subsidiary survival. The literature tends to support that wholly-owned greenfield investments last longer than wholly-owned acquisitions (Chung and Beamish, 2005; Vermuelen and Barkema, 2001), that minority levels of ownership are associated with higher mortality (Mata and Portugal, 2000) and that the accumulation of international experience decreases the liability of foreignness and increases survival (Vermuelen and Barkema, 2001).

Empirical studies have tested other variables such as relatedness with the parent MNC's core activity, asset specificity, performance and size. Subsidiaries that are more related to their parent's core business are less likely to be divested because they have lower governance costs, benefit from the parent MNC knowledge and resources, build synergies and inter-firm relationships, and achieve economies of scale more easily (Benito, 1997; Berry, 2013; Li, 1995). Asset specificity may increase the survival ratio as it may be more difficult to find buyers for more specific assets (Mata and Portugal, 2000) and it may be less profitable to the overall firm's activity to sell-off or shutdown that business (Porter, 1976).

Subsidiary performance and size are among the most significant reasons for divestment (Berry, 2013; Coucke and Sleuwaegen, 2008; Lampón *et al.*, 2015; Silva and Moreira, 2019; Sousa and Tan, 2015). Bernard and Jensen (2007) claim that more productive plants are more likely to survive. More recently, Lampón *et al.* (2015) demonstrated that both external (compared with other industry peers) and internal efficiency (intra-firm rivalry) were important for determining a plant's survival. Larger plants are also found to last longer. Small subsidiaries are more likely to be closed as it is usually easier to dispose of smaller investments than large ones (Coucke and Sleuwaegen, 2008; Pennings and Sleuwaegen, 2000).

Finally, operational flexibility plays an important role in divestment decisions because fully divesting from a location with increasing labor costs removes the opportunity to shift production back when conditions go into reverse (Fisch and Zschoche, 2012; Zschoche, 2016). Table I presents an overview of the main factors and rationales influencing divestment and survival.

Methods

To examine the reasons why a subsidiary might not be divested, we conducted a single case study. Case studies are commonly used in international businesses (Ooi and Richardson, 2019; Piekkari *et al.*, 2009; Ratten and Tajeddini, 2017; Siggelkow, 2002) as international business researchers emphasize the local context, and meaning makes the case study research a fruitful methodology (Welch *et al.*, 2011). Case studies also constitute a meaningful way to allow readers to see the world and not just the literature (Siggelkow, 2007). Dyer and Wilkins (1991) note that when the case study researcher is concerned with the development of idiographic explanations and deep contextualization, a single case may

Market factors	Rationale	Study
Home country political characteristics	Unfavorable attitudes from home countries towards host countries lead to external pressures from stakeholders leading to divestment	Soule <i>et al.</i> (2014), Wan <i>et al.</i> (2015)
Country growth	Economic growth is indicative of the attractiveness of a country or industry to FDI	Li (1995), Benito (1997), Delios and Makino (2003), Berry (2013)
Unfavorable environment	Unfavorable macroeconomic conditions affect market conditions and market expectations about the future	Godart <i>et al.</i> (2012), Varum <i>et al.</i> (2014)
Environmental changes	Changes in the conditions and assumptions in which the initial investment took place	Belderbos (1997), Belderbos (2003), Griffin (2003), McDermott (2010)
Environmental uncertainty	Uncertainty increases the costs and governance issues of diversified firms to efficiently manage their businesses	Berry (2013), Song (2014), Panibratov and Brown (2018)
Labor costs	Decreases subsidiaries' competitiveness because of increasing costs of production	Bernard <i>et al.</i> (2006), Belderbos and Zou (2009), Fisch and Zschoche (2012)
Cultural distance	Increases the complexity and the transaction costs between the headquarters and the subsidiary	Pattnaik and Lee (2014), Kang <i>et al.</i> (2017)
Liability of foreignness	Higher social and economic costs that foreign firms face when making businesses abroad compared to their local competitors	Zaheer (1995), Van Beveren (2007)
Firm factors	Rationale	Study
Diversification level	A high diversification level contributes to exceed the optimal level of control, leading to inefficient resource allocation and decreasing internal synergies	Duhaime and Grant (1984)
Strategy	Divestment can be due to a poor pre-investment decision, because of the need to increase the focus of the firm, because of a lack of fit between subsidiaries and of a new corporate strategy, or due to the need to obtain funds to finance new investments	McDermott (2010), Norbäck <i>et al.</i> (2015), Sousa and Tan (2015)
New investments	New investments increase the competitive pressures between the existing assets within the parent MNC network	Procher and Engel (2018)
Internationalization speed	Faster international expansions increase the strain on firms' managerial resources and divestments can be used to freed up those managerial resources, eliminating the negative effects of the excessive strain of firms' managerial resources	Mohr <i>et al.</i> (2018)
Managerial changes	New CEOs have no psychological attachment to existing subsidiaries or to previous investments and thus have the room to perform the necessary actions because any performance issue can be attributed to previous management policies	Torneden and Boddewyn (1974), McDermott (2010)

Table I.
Main factors
influencing
divestment and
survival

(continued)

Firm factors	Rationale	Study
Divestment experience	Prior divestment experience allows managers to be less reluctant to engage in divestments and previous organizational knowledge allows MNCs to manage these processes more efficiently	Nees (1978), Panibratov and Brown (2018), Silva and Moreira (2019)
Entry mode	Greenfield last longer than acquisitions because of managers' attachment to greenfield investments and because of the difficulties of integrating acquisitions	Vermuelen and Barkema (2001), Chung and Beamish (2005)
Ownership structure	Higher levels of ownership are associated with a higher commitment to foreign operations and small stakes on international operations make assets easier to sell and difficult to manage because of the governance costs of managing multiple partners interests	Mata and Portugal (2000)
Foreign experience	Foreign experience decreases the liability of foreignness, provides valuable knowledge that decreases the risks of failure, allow firms to better evaluate alternatives before divesting and being international for a long period increases the difficulties of giving up foreign operations	Li (1995), Shaver <i>et al.</i> (1997), Vermuelen and Barkema (2001), Delios and Makino (2003), Pattnaik and Lee (2014), Wan <i>et al.</i> (2015), Mohr <i>et al.</i> (2018), Panibratov and Brown (2018)
Relatedness	Subsidiaries related to their parent firms' core activity build intra-firm relationships, synergies and achieve economies of scale more easily	Li (1995), Benito (1997), Berry (2013)
Specialization	It is more difficult to find buyers for specific assets and it may not pay-off to shut down highly specialized subsidiaries as they may have an important contribution to the overall firm performance	Bernard and Jensen (2007), Mata and Portugal (2000), Porter (1976)
Performance	High profitable assets are more likely to be retained as owners exert pressure to improve returns and increase the values of their shares	Bernard and Jensen (2007), Coucke and Sleuwaegen (2008), Berry (2013), Lampón <i>et al.</i> (2015), Sousa and Tan (2015), Silva and Moreira (2019)
Size	Larger sized subsidiaries often translate into specific advantages and a low level of investment corresponds to a low level of commitment, as it is usually easier to dispose of smaller rather than larger assets	Pennings and Sleuwaegen (2000), Coucke and Sleuwaegen (2008)
Operational flexibility	Locations that offer the flexibility to react to cost developments by shifting production through the network may offset the need to divest as production can be shift back as soon as conditions are reverted	Fisch and Zschoche (2012), Zschoche (2016)

Table I.

be adopted. An inductive approach was used to analyze how a subsidiary from a large foreign MNC operating in Portugal survived in an apparent unattractive labor cost location, unlike other sister units that were divested in the same country and industry. Inductive logic is grounded on observing real-life phenomena that serve as the basis for the case selection

(Fletcher *et al.*, 2018) and involves a deep immersion in the phenomenon and openness to various types of rich data (Eisenhardt *et al.*, 2016).

Case selection

Joining the European Economic Community (EEC) in 1986 allowed Portugal to attract considerable amounts of FDI during the 1980s and 1990s (Georgopoulos and Preusse, 2006) because of available EEC structural funds and public policies that fostered FDI, contributing to the revival of the Portuguese industry and to the increase of the national production (Gonçalves *et al.*, 2015). Figure 1 shows how Portugal's FDI increased above the euro Area between 1986 and 1994, immediately after joining the EEC.

Important investments were made during this period by large foreign MNCs such as Visteon in 1989, Yazaki-Saltano in 1986 or AutoEuropa in 1991, among others. The 1980s were characterized by a significant increase in investment in labor-intensive work, with production organized to exploit the specific advantages of several countries (Dunning, 1993).

During the 2000s, Portugal lost competitiveness as a FDI location. This was attributed to the reduction of EU structural funds, the loss of currency devaluation tools to support competitiveness, and increased competition from Eastern European countries with lower wages (Porter, 2002). Between 2001 and 2013, the unemployment rate rose from 4 per cent to 16.2 per cent and the manufacturing industry lost over half a million workplaces (Pordata, 2019).

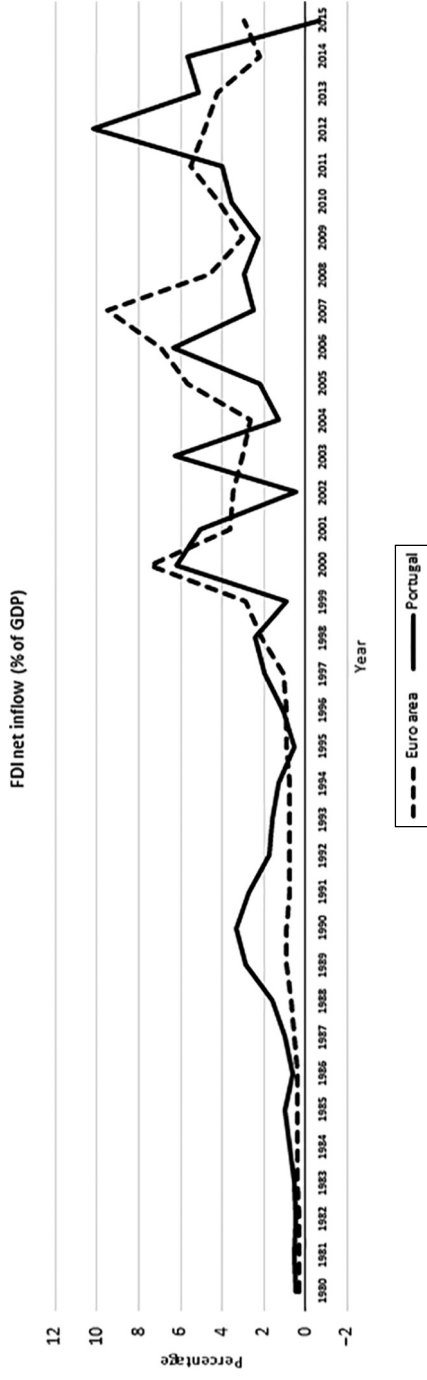
The FD theory suggests that MNCs divest if losing a single OLI advantage (Boddewyn, 1983). Thus, an initial requirement was to identify industries that have clearly experienced divestment. The electric and electronics industry (EEI) seemed suitable for this research for three main reasons.

First, it is a manufacturing industry that witnessed an increase in divestment activity, particularly after 2000. Between 2000 and 2015, the EEI in Portugal lost more than 20,000 jobs and over 35 per cent of its firms. EEI sectors such as wiring harnesses decreased production levels by over 67 per cent between 2003 and 2015 (ANIMEE, 2003, 2015). Second, as wiring harnesses are acknowledged to be based on labor-intensive operations (Bertolotti and Griffiths, 1987), it seems plausible to assume that the loss of the location advantage, as indicated by Porter (2002), could have encouraged divestment. Finally, we focus on a subsidiary from a large foreign MNC belonging to the EEI that divested other units in Portugal, so that we could examine the reasons that contributed to the survival of that particular subsidiary.

Case description

For reasons of confidentiality we will call the parent firm BETA and its subsidiary ALPHA. BETA is one of the largest automotive component suppliers in the world. BETA's activity in Portugal began in 1981 and in 2001 reached its peak with more than 6,000 employees spread across six subsidiaries, exporting almost all its production. Since then, BETA has conducted several divestments in Portugal. By 2013, the firm had just three subsidiaries and the number of employees had dropped to 2,850. ALPHA belongs to BETA and operates in the EEI, specializing in producing wiring harnesses for vehicles. It has employed as many as 1,200 workers, adjusting staffing levels according to automotive industry demand.

At an early stage, the ALPHA subsidiary did not operate under BETA's umbrella brand, using instead its own brand (a procedure adopted by other subsidiaries in both Portugal and Spain). ALPHA supplied CHARLIE (one of the three largest car manufacturers in the world) which was simultaneously ALPHA's major shareholder and primary customer. In the late 1990s, after restructuring, CHARLIE spun-off BETA, which developed into a publicly



Source: The World Bank data

Figure 1.
Portugal FDI net
inflow between 1980-
2015

owned firm, fully independent from CHARLIE. This marked a turning point for ALPHA. With an increase in wiring harness market competition and seeing its previously internal customer now purchasing in other markets, ALPHA was forced to change the scope of its business and sought a new strategy. ALPHA shifted from a comfortable situation where CHARLIE set production pace and specifications, ensuring the subsidiary's sustainability, to one where it could no longer rely on the leading car producer for its survival.

Data collection

This study relied primarily on semi-structured interviews with nine of ALPHA's stakeholders (three managers, an industry expert, a local newspaper journalist specialized in economic affairs, the head of the local trade union, the head of the national trade union, the city mayor, and a bank manager responsible for ALPHA's account). The variety of informants allowed us to capture both an internal and an external view, offering the richness of multiple perspectives and contributing to the design of a more intricate theory while avoiding bias in the analysis (Miller *et al.*, 1997).

All interviews were conducted in person and lasted on average 45 min. The information for this research was triangulated in two different ways (Eisenhardt, 1989; Yin, 2003). First, we interviewed different stakeholders, with different knowledge of and relationships with the subsidiary. This allowed us to better understand the development of the subsidiary from its foundation to the present day, and to juxtapose the different stories and perspectives of the various participants. Second, the data from the interviews were double checked and cross-referenced with secondary sources such as the firm's annual reports, brochures, industry reports and press reports to obtain a full and unbiased picture of crucial events and their timeline. Figure 2 shows a timeline of BETA's main events.

We conducted and examined ten interviews with the nine respondents. Table II provides a description of the respondents, their relationship with ALPHA and their main contributions.

Written notes and data from the interviews were coded (Strauss and Corbin, 1998) and examined with the support of NVivo (Ooi and Richardson, 2019). We developed a coding structure to convert qualitative case descriptions into quantifiable variables. The process began with the identification of four macro-categories which were used as guidelines in the interview script (Moschieri, 2011). The macro-categories used were:

- investment: the main drivers for the initial investment in Portugal;
- restructuring: which implications did it have for the subsidiary;
- divestment: the main reasons behind industry and parent MNC divestments; and
- non-divestment: why ALPHA was retained *vis-à-vis* other sister subsidiaries which were divested.

Within these four macro-categories, smaller and more specific events were progressively identified. Through the process of data reduction, we sought similar events, patterns and variance in subcategories. Initially, we separated the observations and then, gradually aggregated them into constructs according to their contents.

Data analysis

This paper identifies five main reasons that contributed to the survival of this particular subsidiary, unlike other units in the same country, industry and parent MNC that were divested. Appendix shows the final coding categories together with some illustrative extracts from the individual interviews (Miles *et al.*, 2014).

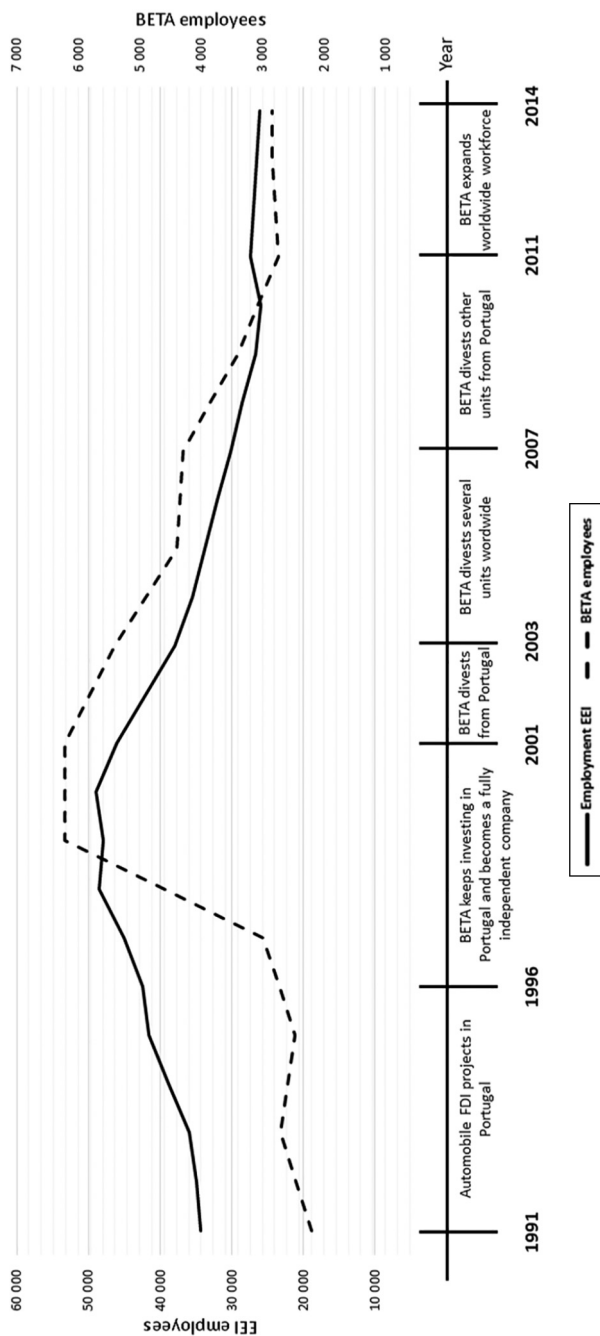


Figure 2. Timeline of BETA's main events

Table II.
Interviewees
description,
relationship with
ALPHA and main
contributions

No. of Interviews	Job	Case study contribution
1	Industry expert	Characterization of the EEI industry; main stages and EEI development through time; main challenges facing the EEI industry; impact of the wiring harnesses division divestment in the EEI
1	Manager A	Manager at ALPHA since its foundation; followed the initial investment at ALPHA and installation of assembly lines; followed the impact of the restructure of BETA on ALPHA
1	Head of local trade union	Represents ALPHA's employees in the region; followed BETA's closure of other units in the region; awareness on ALPHA's requirements to remain competitive; knowledge on divestments social impact
2	Manager B	Manager at ALPHA since its foundation; followed ALPHA's initial investment reasons; followed the impact of the restructure of BETA on ALPHA; followed the relationships between ALPHA and local businesses and industrial clusters created to supply ALPHA; followed BETA's relocations
1	Manager C	Manager at ALPHA since its foundation; followed the impact of the restructure of BETA on ALPHA; responsible for relocating lines of production to ALPHA; expatriated manager in several locations
1	Bank manager	Followed ALPHA's initial investment project; knowledge on subsidization projects and established agreements; knowledge on ALPHA's financial ratios
1	Local newspaper journalist	Followed ALPHA's main events since its foundation; reported ALPHA's internal events (quality awards, politicians' visits); reported ALPHA's production increases, downsizings and expansionist actions
1	City mayor	Knowledge on ALPHA's meso and macro requirements to remain competitive
1	Head of national trade union	Knowledge on EEI industry challenges; knowledge on BETA's development in Portugal; followed EEI divestments through time; followed BETA's divestments through time; knowledge on EEI competitiveness drivers; knowledge on BETA's competitiveness drivers; knowledge on divestments social impact/and on employees

Customer base diversification

During the interviews, the reason most commonly evoked by participants for how ALPHA managed to avoid divestment and hold on to its manufacturing activity was the diversity of its customer base. The restructuring that BETA underwent during the 1990s had major implications for ALPHA and turned out to be crucial in the survival of the subsidiary. At an early stage of its existence, ALPHA manufactured mainly for a market-leading motor vehicle manufacturer (and its various brands) – CHARLIE. This relationship was beneficial for both parties. CHARLIE indirectly controlled ALPHA's production pace, output and manufacturing specifications as shareholder and main customer. CHARLIE also provided ALPHA with stable demand for its production. Despite this advantage, the umbilical relationship with CHARLIE prevented ALPHA from supplying other car manufacturers as stated during an interview:

At that stage, under the brand label ALPHA and with the existing relationship with CHARLIE, it was not possible to manufacture for other car makers. (Interview #6. Manager C)

ALPHA was bound to CHARLIE's market characteristics (generalist car brands), and therefore entirely focused on the mass production of wiring harnesses. Furthermore, because of the strong relationship between the two firms, ALPHA was unable to supply any of

CHARLIE's competitors. After the restructuring, BETA emerged as a fully owned firm and ALPHA (as part of it) was able to adopt a new business strategy, which was crucial in the increasingly competitive wiring harness industry. Deprived of its former internal customer, ALPHA was prompted to diversify its customer base, and began to manufacture wiring harnesses for other vehicle manufacturers and their brands, including supercar brands and tractors (niche markets), and simultaneously diversified its product portfolio. As stated by one of the participants:

ALPHA became specialized in [...] wiring harnesses for sports supercars and tractors. These wirings require a deeper level of attention, the processes are not as automated, and production volumes are lower. (Interview #2. Manager A)

Although triggered by the restructuring of its parent MNC, ALPHA's opportunity to begin supplying other markets, in general, and the niche market brands of other vehicle manufacturers, in particular, which are product quality driven, allowed the subsidiary to decrease its business risk and contributed to its survival. Taking this into account, we propose that:

P1. Subsidiaries in labor intensive industries are less likely to be divested when they diversify their customer base.

Asset specificity

ALPHA's new customer base increased its specificity within its parent MNC. Whereas at an early stage ALPHA focused on the standardized mass production of wiring harnesses due to its relationship with CHARLIE, after the restructuring it began manufacturing more products with a low degree of standardization, high complexity and lower production volumes, to suit the needs of some of its new customer base.

An important factor is that ALPHA manufactures for niche markets where labor costs are not such an important differentiator as in mass production. (Interview #8. Local newspaper journalist)

This change increased the subsidiary's specificity in the wiring harnesses sector. ALPHA managed not only to remain in the same business activity, but also to remain competitive by progressively engaging in a niche market strategy that helped to mitigate the impact of its labor costs. This is of great importance, as wiring harness suppliers traditionally manufacture to an assembler's specifications (facing severe cost control pressures, whilst simultaneously bound to specific suppliers and consequently lacking the freedom to control their own costs). They participate little, or not at all, in new product development activities and have little opportunity to get involved in upstream value chain activities.

This is the primary reason why the wiring harnesses division has such low levels of innovation or R&D at a subsidiary level. The only room for improvement is at an operational level by enhancing assembly line productivity. Nevertheless, ALPHA managed to improve its value chain position by specializing in highly complex wiring harnesses. Based on that, we propose that:

P2a. Subsidiaries in labor intensive industries that diversify their customer base and supply niche market clients are more likely to increase their level of specialization.

P2b. Subsidiaries in labor intensive industries are less likely to be divested when their level of specialization is high.

Efficiency and product quality

In the interviews, several participants emphasized the importance of ALPHA's efficiency levels to BETA. Performance can be related with both financial and operational results. Despite certain difficulties in collecting financial data because of confidentiality issues, we obtained an overview of ALPHA's overall financial health:

No large foreign MNC subsidiaries in the city have been subjected to credit restrictions as such, and to the best of my knowledge, they are apparently in a healthy financial position. (Interview #7. Bank manager)

However, ALPHA's stable financial position alone may not have been enough to prevent this subsidiary from being divested. BETA closed other subsidiaries in Portugal. Perhaps more relevant than its financial position were ALPHA's high levels of excellence, productivity and quality, as evidenced by the interviewees:

ALPHA has one of the highest efficiencies within the MNC. (Interview #6. Manager C)

It seems to be generally accepted that ALPHA was one of the most efficient subsidiaries within BETA, a fact which discouraged its divestment since corporate managers are traditionally reluctant to dispose of their best assets. These high levels of efficiency were achieved through high levels of productivity and product quality.

This is particularly relevant in an industry where suppliers are strongly pressured by their customers to meet requirements and output levels. In the highly competitive automotive industry, order delays and missed deadlines may lead to the loss of important pre-established contracts and may negatively affect the entire supply chain.

The other main driver behind the high levels of efficiency was product quality. This was of the utmost importance considering that ALPHA supplied highly specialized brands in which the ability to manufacture complex products to a high level of quality was clearly a differentiating factor.

BETA imposed the work methodology and found a hand labor that had some skills and knowledge, reaching very high levels of production and quality, having the best of both worlds, that is, manufacturing at a lower cost while matching the same quality levels as those of the country they were relocating from. (Interview #5. Manager B)

ALPHA was installed here and since then, received the visit of American CEOs several times, especially on firm anniversaries or whenever ALPHA won international quality awards. (Interview #8. Local newspaper journalist)

ALPHA therefore appears to hold a high reputation within the MNC because of its trusted quality levels. As such, we propose that:

P3a. Subsidiaries in labor intensive industries are less likely to be divested when they exhibit high levels of external and internal efficiency.

P3b. Subsidiaries in labor intensive industries are less likely to be divested when they exhibit high levels of external and internal product quality.

Established local advantages and national governmental agreements

During the interviews, several references were made emphasizing the importance of established agreements and incentives which helped to maintain ALPHA in its current location. These agreements can be split into two levels:

- (1) Governmental and European agreements, involving programs such as Europe 2020, in which the MNC commits to maintain a given number of workplaces during a certain period; and
- (2) Local advantages, whereby the local government grants fiscal or other benefits to the subsidiary, in order to increase the location's attractiveness and retain investment.

BETA has an agreement with the city hall and the EU [...] the EU provided financing, with additional bonuses because ALPHA's location was in Portugal and in particular, in the inland region[1], thus, if they want to divest, they will have to pay compensation. (Interview #7. Bank manager)

The quotations below further emphasize the importance of offering fiscal incentives, and demonstrate the positive effects of the effort to decrease contextual costs on ALPHA's competitiveness:

First, they facilitated the location of premises, sold it at a symbolic price, and currently, the local government grants fiscal benefits [...] the local government also provides advantageous energy costs based on an agreement with the energy provider. (Interview #7. Bank manager)

Recently, we made a small investment to meet some of their current needs [...] obviously, that is not the sole reason why ALPHA remains here. (Interview #9. City Mayor)

These agreements and benefits work at two different levels. They increase the exit barriers of closure, as the cost of relocating comprises not only the initial investment in the new location but also the cost of shutting down the current facilities, including compensation (which significantly increases in the case of broken agreements). On the other hand, by providing fiscal benefits, lower energy costs and lower capital requirements (for example the investment in building ground) they increase the subsidiary's competitiveness and decrease the attractiveness of alternative locations. Considering these reasons, we propose as follows:

- P4a.* Subsidiaries in labor-intensive industries are less likely to be divested when there are relevant governmental and EU agreements entailing high payments and compensation in the case of breaking contracts.
- P4b.* Subsidiaries in labor-intensive industries are less likely to be divested when they benefit from local government advantages.

Unsuccessful relocation experiences and relocation barriers. Another factor that contributed to the survival of ALPHA was the experience of its parent MNC when relocating production to other locations, which served to underline the difficulty of reaching the same efficiency standards as in Portugal. The data collected indicates that BETA's relocation of subsidiaries failed to meet expectations. While it is unlikely that this could have accounted for the retention of ALPHA on its own, these issues may have highlighted the strategic importance of ALPHA and the challenges involved in transferring a highly specialized production operation to cheaper labor cost countries. In other words, whereas from an exclusively economic perspective, relocation might have seemed a better option, the reality was that production costs ended up being higher than foreseen because of quality issues and reworks. Relocation issues came from cultural differences, personnel availability and legal instability. One of the interviewees observed as follows:

Of the relocation experiences, none of them was particularly successful. The lack of success was not due to economic reasons but cultural ones. One of the countries was strongly influenced by religious issues while the other was of tribal influence. (Interview #5. Manager B)

Two of ALPHA's managers described some of the main cultural and religious differences which caused efficiency decreases in relocated units:

When they relocated to Country A, hand labor was not as friendly as in Portugal [...] In religious based countries [...] you have a biased workforce because you cannot resort to women in manufacturing lines as it is culturally unacceptable. The main issue is that men were not as productive as women in these tasks. (Interview #5. Manager B)

In Country B for example, absenteeism is very high compared to Portugal [...] this has two implications from a managerial standpoint: either you do not accept large orders or alternatively, you create stock. However, stock increases costs. (Interview #6. Manager C)

The numerous problems encountered in these relocation experiences ultimately led to lower levels of efficiency and higher production costs than forecast. Additionally, the new units struggled to meet the required quality levels and the constant need for rework increased the final cost of the products. One of the issues was related to personnel availability:

When they installed those units abroad, they might have benefited from tax advantages and credit lines [...] you cannot find qualified personnel in those countries; besides, it is not easy to expatriate employees to those locations. (Interview #8. Local newspaper journalist)

In Country B, they built a labor-intensive plant in a location short of hand labor. Now they need several daily buses to carry employees. (Interview #6. Manager C)

Another issue was legal instability:

When they relocated, they made the wrong assumption that labor rules were close to EU ones where everything is legislated by a general law, business agreements or labor codes [...] which was not the case in those locations. (Interview #5. Manager B)

We believe that MNCs that have faced relocation issues are less likely to divest some of their current subsidiaries given their previous experience. In addition, several barriers increased the costs and risks of relocating. Hence our final propositions:

- P5.* Subsidiaries in labor intensive industries whose parent firm had previous unsuccessful relocation experiences are less likely to be divested.
- P6.* Cultural, legal and logistic factors constitute barriers to relocation and influence the parent firm's decision to divest.

Based on the analysis, [Figure 3](#) depicts our proposed conceptual framework and the main reasons that contributed to the survival of the unit.

Discussion

The permanently changing world, increasing globalization, the liberalization of production economies, the withdrawal of barriers to free trade and the spread of information and telecommunications technologies have changed the way businesses operate. As a result, MNCs have developed strategies in the search to exploit favorable production factors globally. All these factors ultimately led to divestment, to the benefit of some locations and the detriment of others.

In the case of labor-intensive industries such as that of wiring harnesses, MNCs focus on establishing production in countries with cheaper labor, considering its weight in the final cost of the product. Subsidiaries at the end of supply chains and in labor intensive industries are unable to compete on equal terms with cheaper locations.

The featured case study shows how a subsidiary operating in the highly competitive EEI and located in a country with comparatively high labor costs managed to survive, unlike other units that were divested in the same country and industry by the parent MNC.

Subsidiary factors that contributed to survival

One of the main reasons for ALPHA's survival was the diversification of its product portfolio and customer base, which helped to reduce its disadvantage *vis-à-vis* alternative lower-cost production sites. ALPHA's example is of particular importance as the subsidiary has not engaged in product R&D activities, but initially diversified its customer base, focusing on several niche markets and high-end customers, increasing production complexity and taking advantage of its skilled labor.

The production changes undertaken by the subsidiary, which were client driven, increased its specificity in the parent MNC, as it became highly specialized in high quality wiring harnesses.

To avoid divestment in highly competitive industries, subsidiaries need to reach high levels of efficiency, both externally and internally. The literature is unanimous in emphasizing the importance of unit performance. The evidence collected from the field indicated that ALPHA was a high performer and financially healthy, supporting the general notion that more productive plants are more likely to survive. However, this alone might not have been sufficient. Resources can be employed more profitably elsewhere and therefore subsidiaries must also excel in their parent MNC network. So internal performance is important as well. ALPHA has been mentioned as a role model in the MNC and the evidence supports the importance of the subsidiary's internal efficiency. All other things being equal, managers will be reluctant to divest their most efficient subsidiaries, even if, from an exclusively economic perspective, alternative locations may appear more attractive. Subsidiaries can also differentiate themselves by their level of product quality.

Parent multinational corporations factors that contributed to survival

Existing research has demonstrated that previous experience has a twofold impact. Experience of foreign investment and of international markets help firms to make better decisions and decrease the liability of foreignness, increasing the likelihood of survival.

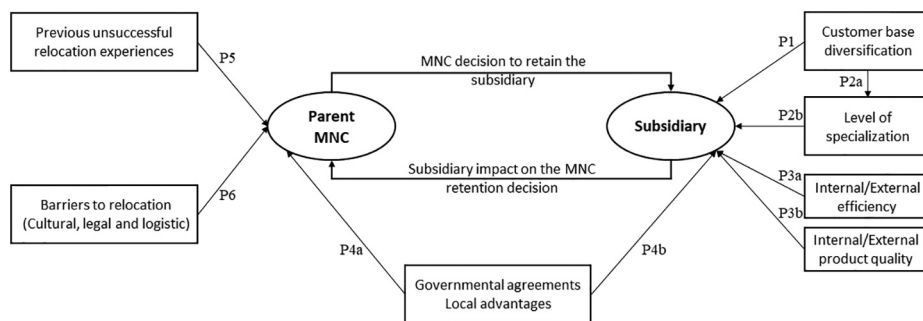


Figure 3. Conceptual framework

Similarly, divestment experience supports the decision to divest, due to existing organizational knowledge in conducting these processes.

In this case study, BETA's previous experiences of relocation contributed to the decision to retain ALPHA in Portugal, as these relocations had failed to meet expectations. A firm's unsuccessful relocation experiences shape the decision to divest or retain existing subsidiaries. This emphasizes the role of behavioral factors in the decision to divest at MNC level, and how previous (successful or failed investment) experiences shape future decisions.

The literature on organizational learning suggests that organizations learn by interpreting and retrieving relevant knowledge from past experiences in a specific domain (Levitt and March, 1988). In situations where there has been learning from the characteristics of the markets in which prior expansions were made, these experiences should help a firm's current expansion (Ingram and Baum, 1997).

The acquired organizational knowledge may contribute for expansion and contraction decisions. On the one hand, the relocated units failed to reach the expected efficiency levels in the new location and, on the other hand, the MNC attributed a higher value to remaining units as they became more difficult to replace or replicate.

In terms of practical relevance, these findings also demonstrate the importance of barriers to relocation, and highlight three factors – cultural, legal and logistic – that should be considered by MNC managers when reconfiguring their production network. The benefits of relocating, such as economies of scale and scope, may be lost if costs and risks are not properly assessed.

BETA's relocation issues came from different sources, including difficulties in finding specialized hand labor and expatriating specialized personnel. Additional logistic risks included organizational difficulties in working with just-in-time philosophies and factors such as delays in responsiveness, lack of flexibility and the ability to deliver on time. This caused production planning in relocated units to manufacture to stock. MNCs must ensure they relocate to countries that are culturally compatible with the ones they are relocating from. The featured case highlights how the transition to culturally distant countries was not as smooth as expected owing to cultural issues. While early relocation to Portugal achieved a positive outcome due to compatible organizational cultures, relocation to other locations failed to live up to expectations due to religious differences and less stringent labor laws that led to high levels of absenteeism. In an industry driven by product cost, these issues can increase the final cost of products to the point where relocation into cheap labor countries becomes unprofitable.

Host country factors that contributed to survival

One factor that influences FDI is the level of incentives and subsidies. Dunning (1980) indicated that location advantages include special taxes and tariffs.

The case study demonstrates that established agreements help to retain investments by increasing exit barriers. Porter (1979) pointed out the impact of variables such as redundancy costs, which include payments due to the termination of contracts, or other closure costs derived from contract contingencies and from cutting short tenancy agreements. If closure costs increase significantly because of contract default, divesting may not pay off.

Moreover, local governments that provide additional advantages such as fiscal incentives and lower contextual costs contribute to the attractiveness of a geographical location and help to amortize fixed costs, allowing a faster return on investment. A high level of integration with the surrounding environment is also an important reason to resist change of location (Amburgey *et al.*, 1990). In addition, relations of trust and long-term

commitment with local institutions may increase the psychological costs of closure, and although they may not generate a sustainable competitive advantage, they allow subsidiaries to increase their competitiveness and regions to retain employment and wealth. Ultimately, the local embeddedness of plants in local regions may tip the balance in favor of the survival of the business plant.

Conclusion, limitations and future research

The FD theory proposes that MNCs divest when losing an OLI advantage. Overall, the results support the notion that the survival of a subsidiary is contingent on the interplay of internal and external factors, meaning that the decision to divest is best taken on a case by case basis.

Subsidiaries operating in labor intensive industries and located in comparatively higher labor cost countries should seek higher levels of specialization and quality to counterbalance their higher manufacturing costs, because under equal conditions they cannot remain competitive. They should reach high levels of efficiency, both internally and in comparison, with industry peers. Using skilled labor and achieving a high product quality can be the deciding factor compared to lower cost locations.

In addition, local and national governments can raise exit barriers by increasing the cost of closures, or by developing focused measures in cooperation with a firm's management to improve the subsidiary's competitiveness, highlighting the importance of institutional integration, relationships and high levels of trust at local levels.

This analysis underscores the importance of behavioral aspects and of previous experiences on survival research, supporting the role of the theory of organizational learning in expansion and contraction decisions and activities. The analysis of the featured subsidiary also revealed the existence of three barriers to relocation. These barriers to relocation highlight the difficulties of internationalizing to culturally distant countries and of making certain (highly specific) investments abroad. Understanding the reasons not only for divestment but also for survival can contribute to the development of measures that prevent closures.

Limitations and future research

This paper has some limitations and provides opportunities for further research. Because of the importance of the contextual detail, this paper explores a single case. This approach contributes to the analysis of an event but limits the generalizability of the findings.

Future research could explore whether our results are replicated in two different circumstances. First, we examined survival in a setting which clearly experienced divestment driven by increases in labor costs, the emergence of cheaper alternative locations and developing MNC strategies based on the free flow of goods. New studies could examine how firms retain their subsidiaries in different circumstances other than labor costs increases. Second, the subsidiary examined operates in a labor intensive industry. [Berry \(2010\)](#) suggests that divestment may vary according to industry types. We therefore suggest that future studies could be conducted in knowledge intensive industries or services, where labor costs are less relevant.

This research adopted an integrated approach to the selection of the subsidiary's stakeholders, but we were not able to collect primary data in the parent MNC. While we present some factors that have determined the survival of the subsidiary, we were unable to determine which of them were the most influential. Research based on management surveys testing the proposed framework can provide further insights into the extent to which each of these variables contributed to the survival of the subsidiary.

We have opened an avenue for research into how previous experience of unsuccessful relocation and investment may affect a manager's behavior. Future studies could be conducted to examine how such events shape a manager's behavior and investment/divestment patterns.

Note

1. In Portugal, part of the inland region is considered a less favored economic region.

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Table AI.
Selected quotes from
the individual
interviews

	Industry expert	Manager A	Head of local trade union	Manager B	Manager C	Bank manager	Local newspaper journalist	City mayor	Head of national trade union
<i>Investment Incentives</i>	“Portugal had strong incentives to investment at the time”	“there were incentives from the Portuguese government and from the local governments”	“there were structural funds available from the EEC [...] tax advantages”	“they did not paid taxes [...] there were agreements that allowed an easy relocation and flow of capital”		“the construction ground was ceded by the town hall”	“the town hall [...] transacted the construction ground at a symbolic price, almost free of charge”	“years ago, we used to grant the construction ground [...] it was a way to attract these multinationals, but now it is not enough”	
<i>Hand labor</i>	“hand labor was as specialized as possible and guaranteed a certain level of quality [...] the objective was to hire cheap labor”		“Portugal had the lowest wages in Europe”	“were already relocating in the search of favorable labor costs”	“it had to do with the workforce, labor here was cheaper [...] we were also good regarding labor efficiency”		“the inland region of Portugal was even cheaper than the largest and more populated cities”		
<i>Host country</i>			“Portugal had a certain level of development and [...] political and governmental stability [...] granted access to a large EU market”	“Portugal adheres to the EEC [...] had a social climate pacified because more than 10 years passed since the revolution”					

(continued)

	Industry expert	Manager A	Head of local trade union	Manager B	Manager C	Bank manager	Local newspaper journalist	City mayor	Head of national trade union
<i>Restructuring</i>									
Diversification and new customers		<p>"there were several changes [...] we began manufacturing for the Germans, to specialized American brands, to the Italians"</p>	<p>"ALPHA loses its umbilical union with [...] CHARLIE and diversifies, starting to work with other clients that no longer gravitated around CHARLIE"</p>	<p>"under the brand label ALPHA and with the existing relationship with CHARLIE, it was not possible to manufacture for other car makers [...] the competition in the wirings was increasing [...] there was the need to extend the scope of the business"</p>	<p>"it was the outcome of restructuring and mergers and acquisitions [...] the core activity of ALPHA never changed, they always manufactured wiring harnesses [...] but the brands to which they manufacture changed"</p>				
<i>Divestment</i>									
Better alternative locations	<p>"with the enlargement of the EU, some companies woke up too late [...] there were other alternatives [...] wiring harnesses plants were relocated"</p>	<p>"these plants are not competitive [...] they are practically all hand labor [...] wiring harnesses plants are not much suitable to automation [...] cheap hand labor is not here, hence its relocation"</p>	<p>"with the entry of new countries into the EU, Portugal ceased to be a country as attractive as the new state members"</p>	<p>"we could no longer compete in cost [...] besides, some eastern locations are geographically closer to their German clients than we are"</p>	<p>"in other locations they earned substantially less than here [...] and still worked on Saturdays"</p>		<p>"it is a process of globalization, happened in other locations as well"</p>	<p>"in this industry the reasons to divest were related with the hand labor [...] the relationship between the cost of the products and its price"</p>	

(continued)

Table AI.

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	Industry expert	Manager A	Head of local trade union	Manager B	Manager C	Bank manager	Local newspaper journalist	City mayor	Head of national trade union
Host country		“with the high amount of taxes, licensing bureaucracy [...] there is still the judicial issues”	“the costs of context, namely, the high costs of energy, taxes [...] credit is more expensive than in other locations”						“then, there is the costs of the context such as electricity [...] the road network, the accessibilities to harbors”
Unruly industry	“there was some crisis in the industry and in other related industries [...] the rules of the game changed often”	“we are competing with countries that do not follow our standards regarding safety [...] we compete in a global market with different rules”	“they do not follow the required environmental standards [...] hence, gain competitiveness”	“has preferential agreements [...] they let them enter the market, but they had to manufacture there [...] due to intergovernmental agreements”					
Third party agreements							“if they wanted to sell cars in some markets, they had to manufacture them there”		

(continued)

Table AI.

Industry expert	Manager A	Head of local trade union	Manager B	Manager C	Bank manager	Local newspaper journalist	City mayor	Head of national trade union
Governmental and local agreements		<p>"one of the managers holds a privileged relationship with the city hall [...] which contributes to its retention"</p>			<p>"BETA has an agreement with the city hall and the EU [...] received funding not for future investments, but to retain the existing ones [...] local governments have always favored large MNC subsidiaries"</p>		<p>"we made a small investment to meet some of their current needs"</p>	
Previous experiences		<p>"Of the relocation experiences, none of them was particularly successful. The lack of success was not due to economic reasons but cultural ones [...] when considering the quality factor, relocations did not compensate"</p>	<p>"absenteeism is very high compared to Portugal [...] this is very hard to manage and deal with in manufacturing plants [...] either you do not accept large orders or alternatively, you create stock [...] built a labor-intensive plant in a location short of hand labor"</p>	<p>"in certain countries they had access to cheaper labor [...] but had the inconvenience of a much higher risk, political instability [...] they cannot afford to compromise or fail the supply to certain brands"</p>	<p>"there were personnel from ALPHA that helped BETA relocate activities to low cost countries, but the reality between Portugal and those countries is not the same [...] when they installed those units abroad, they might have benefited from tax advantages and credit lines [...] you cannot find qualified personnel in those countries"</p>			