Many large multinational corporations are hardly a model of organizational efficiency, with the right hand frequently not knowing what the left is doing. A valuable solution developed at one location fails to spread to other sites struggling with a similar problem, so they continually have to reinvent the wheel. Knowledge management systems have helped, but the truth is that many business units still tend to operate more like stand-alone entities than interconnected members of a larger network. Why do some subsidiaries become isolated, and does that insularity indeed impair business performance?

To answer those questions, L. Felipe Monteiro, doctoral candidate, and Julian Birkinshaw, professor of strategic and international management, of the London Business School and Niklas Arvidsson, researcher of the Royal Institute of Technology in Stockholm investigated the knowledge flow of 171 marketing subsidiaries of six Swedish global corporations: Ericsson, Volvo, Sandvik Steel, Coromant, Pharmacia and Alfa Laval Agri. (Details of the study are contained in their article Knowledge Flows Within Multinational Corporations: Explaining Subsidiary Isolation and Its Performance Implications, in press at Organization Science.) Managers at the subsidiaries answered a questionnaire that helped determine the frequency of knowledge transfers between subsidiaries (horizontal flows) as well as between a subsidiary and headquarters (vertical flows). The authors also collected data on each subsidiary’s capabilities (with respect to its accumulation and use of knowledge about customers and competitors) and financial performance (revenues, profits and market share). The data were controlled for several variables, including the size, geographic location and age of the subsidiary.

The study looked specifically at the process of “problemistic search,” in which a subsidiary has a problem — for instance, how best to market a particular product to a new demographic of customers — and then looks for a solution. In an ideal world, the subsidiary finds another business unit that has successfully tackled that very problem and the two groups exchange the valuable knowledge.

Here, it is important to note that perceptions play a huge role. Specifically, people at the subsidiary that has the problem will tend to look for help where they think they will find it. And therein lies the rub: People’s assumptions of where important know-how resides in a large multinational corporation can be highly flawed, to say the least. After all, knowledge is an intangible asset that, by its very nature, is extremely difficult to evaluate. In fact, a subsidiary’s self-evaluation of its own know-how can be markedly off from the assessment by other subsidiaries as well as by headquarters.

Not surprisingly, the study found that knowledge outflows tend to be determined by the recipient’s perception of how good the information source is. (That is, subsidiaries that were viewed as highly capable tended to be more popular sources of knowledge.) What was interesting, though, was the role that perceptions played in terms of the inflow of knowledge. Specifically, subsidiaries that perceived themselves highly tended to seek out and find information more readily than other subsidiaries. This finding is somewhat counterintuitive. After all, shouldn’t a business unit that perceives itself as less capable be more inclined to get help? But a poorly performing subsidiary might be too consumed (and embarrassed) with its internal problems to seek external assistance, whereas an average or good subsidiary has fewer distractions and might eagerly approach top performers for tips.

The result: Knowledge appears to be transferred mainly between members of a perceived “in” crowd. In contrast, subsidiaries that are viewed poorly (by others as well as by themselves) tend to keep to themselves: They won’t seek help from others, nor will others approach them for assistance. Thus, members of this “out” crowd rarely, if ever, exchange information. In the study, 12% of the subsidiaries participated in a knowledge exchange with another subsidiary or with headquarters less than once a year. It is important to note that both cycles are self-reinforcing: Sharing tends to lead to more sharing in the future, whereas keeping others at arm’s length tends to result in even greater insularity. Thus, an alienated subsidiary can easily be caught in a downward spiral of ever-increasing isolation.

Being in the “out” crowd appears to have its costs: Subsidiaries that didn’t exchange knowledge tended to perform worse than those that did. The authors refer to this syndrome as the “liability of internal isolation.” But it’s not absolutely clear what causes what. That is, does isolation lead to lower performance, or vice versa? (Or perhaps each exacerbates the other in a self-reinforcing loop.) Future research could help untangle that relationship, but it’s easy to see the benefits of being a member of the “in” crowd. Subsidiaries that exchange knowledge regularly become aware of best practices...
or new products developed elsewhere, and they are also more tapped into an information network from which they can learn about new opportunities and emerging problems.

The authors have three suggestions for avoiding the liability of internal isolation. First, companies can encourage the development of personal networks among the subsidiary managers, placing well-connected executives at subsidiaries that have a history of isolation. Second, special attention should be paid to any language barriers. If a subsidiary manager has a particular deficiency (for instance, a lack of rudimentary English), a deputy with the appropriate proficiency should be assigned to that location. Finally, companies should try to minimize any gaps between perception and reality with respect to subsidiary capabilities. At Alfa Laval Agri, for example, the subsidiary managers attend quarterly meetings to share information about the performance of their respective units. This helps the managers keep abreast of where valuable knowledge truly resides in the multinational corporation.

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— Alden M. Hayashi