

THE ROLE OF THE HQ AND FOREIGN SUBSIDIARIES

Lecture 8
Multinational Corporations: Theory and Practice
Winter term 2023/24

Strategic Leadership and Global Management
Prof. Dr Dodo zu Knyphausen-Aufseß

Note: The content of this file is released exclusively to support teaching in the context of the module "Multinational Corporations and Corporate Control" in the winter semester 2023/24.

GUIDELINE

Multinational corporations, by definition, have entities located in different countries. How are these entities connected with each other, how are they coordinated? What is the role of the corporate headquarters (CHQ), what is the role of subsidiaries? These are the questions to be discussed in this lecture.

I will, in all brevity, introduce four perspectives to answer these questions. The first perspective focuses on different coordination mechanisms, some of them are more structural and formal, others more informal and subtle (slide 3). Slides 4-6 provide examples for three of these mechanisms. This perspective is basically a top-down perspective.

The second perspective focuses on the roles and possible value-added of the CHQ. This perspective has overlaps with what we know from the discussion of CHQ functions in the more general context of the multi-business firm, as discussed in my summer semester class on Strategic Management (slide 7). Slide 8 gives you, hopefully, an intuition of what promises the existence of a CHQ has to offer to make the MNC successful.

The third perspective helps to identify possible roles for the subsidiaries—roles that are “taken” from the CHQ, but that can also be “made” by the subsidiaries themselves. Slide 9 gives an overview of different approaches found in the literature; slides 10-11 show (after lecture 2: again, at least partly) one of the approaches in more detail.

The fourth perspective completely switches to the perspective of the subsidiaries. Slide 12 provides a framework for discussing the most important research studies in this field, as done in the recent review article by Meyer et al. (2020, see literature folder). Slide 13 exemplifies at least one approach in this domain: the idea of “subsidiary entrepreneurship”, and slide 14 highlights some aspects of a research article that was published by one of my (former) doctoral students and myself on this topic. Slide 15 summarizes another study we have conducted at my chair – this time focusing on the question how a German multinational is trying to make the best of R&D units located in China. The appendix (slides 19 and 20) adds the abstracts of these two articles.

I end this lecture with two final reflections. The first (slide 16) is based on an article by Bartlett and Ghoshal published back in the 1990s; the core argument is that the closer we get to the concept of a “transnational” company based on network characteristics, the more the relationship between parent and subsidiaries may shift. The second reflection (slide 17) deals with the question of whether the concept of the “subsidiary” is still viable at all. The two abstracts present divergent views on this.

MECHANISMS FOR COORDINATING FOREIGN SUBSIDIARIES

STRUCTURAL AND FORMAL MECHANISMS

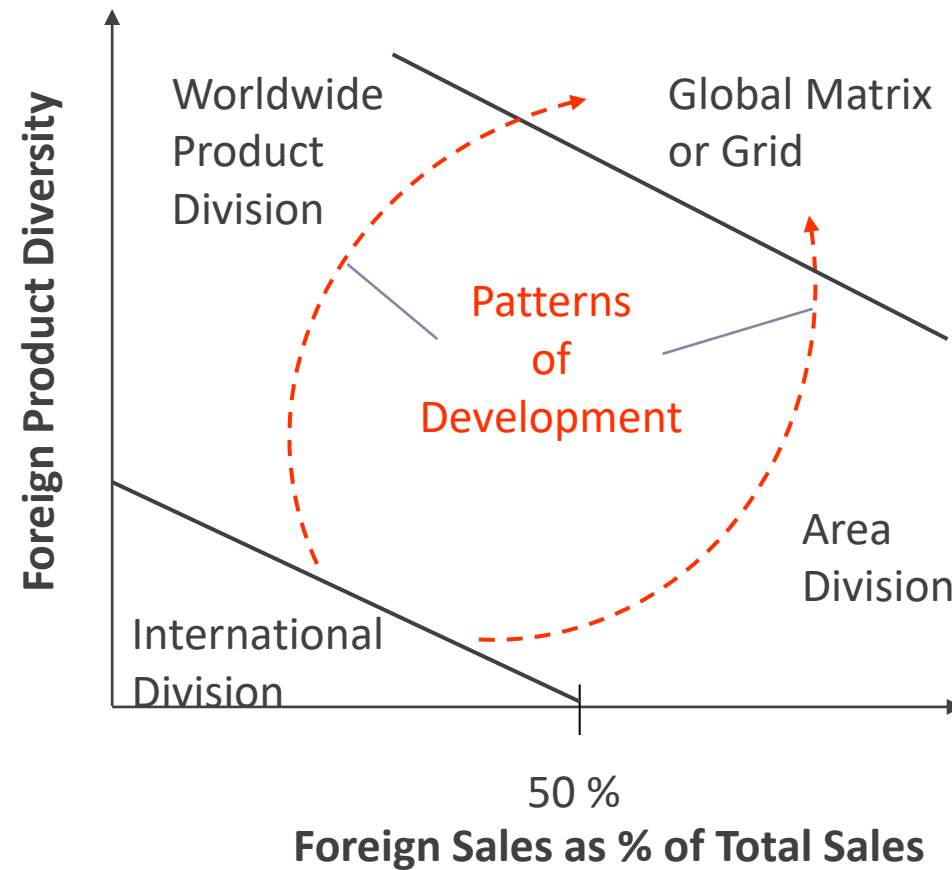
1. Departmentalization or grouping of organizational units, shaping the formal structure
2. Centralization or decentralization of decision making through the hierarchy of formal authority
3. Formalization and standardization: written policies, rules, job descriptions, and standard procedures, through instruments such as manuals, charts, etc.
4. Planning: strategic planning, budgeting, functional plans, scheduling, etc.
5. Output and behavior control: financial performance, technical reports, sales and marketing data, etc. and direct supervision

OTHER MECHANISMS, MORE INFORMAL AND SUBTLE

6. Lateral or cross-departmental relations: direct managerial contact, temporary or permanent teams, task forces, committees, integrators, and integrative departments
7. Informal communication: personal contacts among managers, management trips, meetings, conferences, transfer of managers, etc.
8. Socialization: building an organizational culture of known and shared strategic objectives and values by training, transfer of managers, career path management, measurement and reward systems, etc.

Source: Martinez, J.I./Jarillo, J. C. (1989), The evolution of coordination mechanisms in multinational corporations. *Journal of International Business Studies* 20, 489–514 (503)

STRATEGY AND STRUCTURE IN THE MNC: THE STOPFORD-WELLS-MODEL



Source: Stopford, J.M./Wells, L.T. (1972) *Managing the Multinational Enterprise/Organization of the Firm and Ownership of the Subsidiaries*. Basic Books, New York




PLANNING AND BUDGETING: THE LESSARD-LORANGE MODEL

Rate used for translating budget	Rate used to translate actual performance for comparison with budget		
	Initial t_0	Projected t_0	Ending t_1
Initial t_0	A	B	C
Projected t_0	D	E	F
Ending t_1	G	H	I

- Fields A, C, E, F and I are useful procedures for the conversion. E and F are preferred in practice.
- For the evaluation of the success of the legal entities, the procedure according to field F is recommended. If the performance of the local management is to be evaluated, constellation E is preferable, since here the decision makers are not held accountable for consequences of unexpected exchange rate changes.

Source: Lessard, D. R./Lorange, P. (1977), Currency Changes and Management Control: Resolving the Centralization/Decentralization Dilemma. *The Accounting Review* 52, 628-637

“SOFT” COORDINATION VIA PERSONELL TRANSFER

		ADVANTAGES	DISADVANTAGES
Ethnocentric Approach		<ul style="list-style-type: none"> ▪ Supports the implementation of a uniform corporate policy ▪ Facilitates communication and coordination with the parent company ▪ Compensates for the lack of suitable managers in the host country 	<ul style="list-style-type: none"> ▪ Programmed conflicts between leaders and guided ▪ Little knowledge of the market: often a lot of adaptation time required ▪ Unequal distribution of incentives is perceived as unfair from a local perspective
	Transfer of the superior corporate culture of the home country abroad		
Polycentric Approach		<ul style="list-style-type: none"> ▪ Increased motivation for local junior managers ▪ No cultural and language barriers ▪ No complex preparation programs ▪ Use of local knowledge ▪ Relief in dealing with politically sensitive situations ▪ No special surcharges for salaries 	<ul style="list-style-type: none"> ▪ Coordination between parent company and foreign subsidiary possibly problematic ▪ Possible loyalty problems ▪ Sufficient availability of suitable candidates questionable
	Management positions are to be filled predominantly with local staff		
Geocentric/Synergistic Approach		<ul style="list-style-type: none"> ▪ Highest possible availability of candidates through the development of an international management pool ▪ Avoidance of overly strong national identification ▪ Transfer of experience and knowledge also between subsidiaries 	<ul style="list-style-type: none"> • High costs • Often no familiarity with specific market conditions • High demands on the adaptability of managers (and their families) • Identity determination for national subsidiaries may be problematic
	The nationality of managers is not taken into account; only performance counts. Candidates from third countries are also considered.		

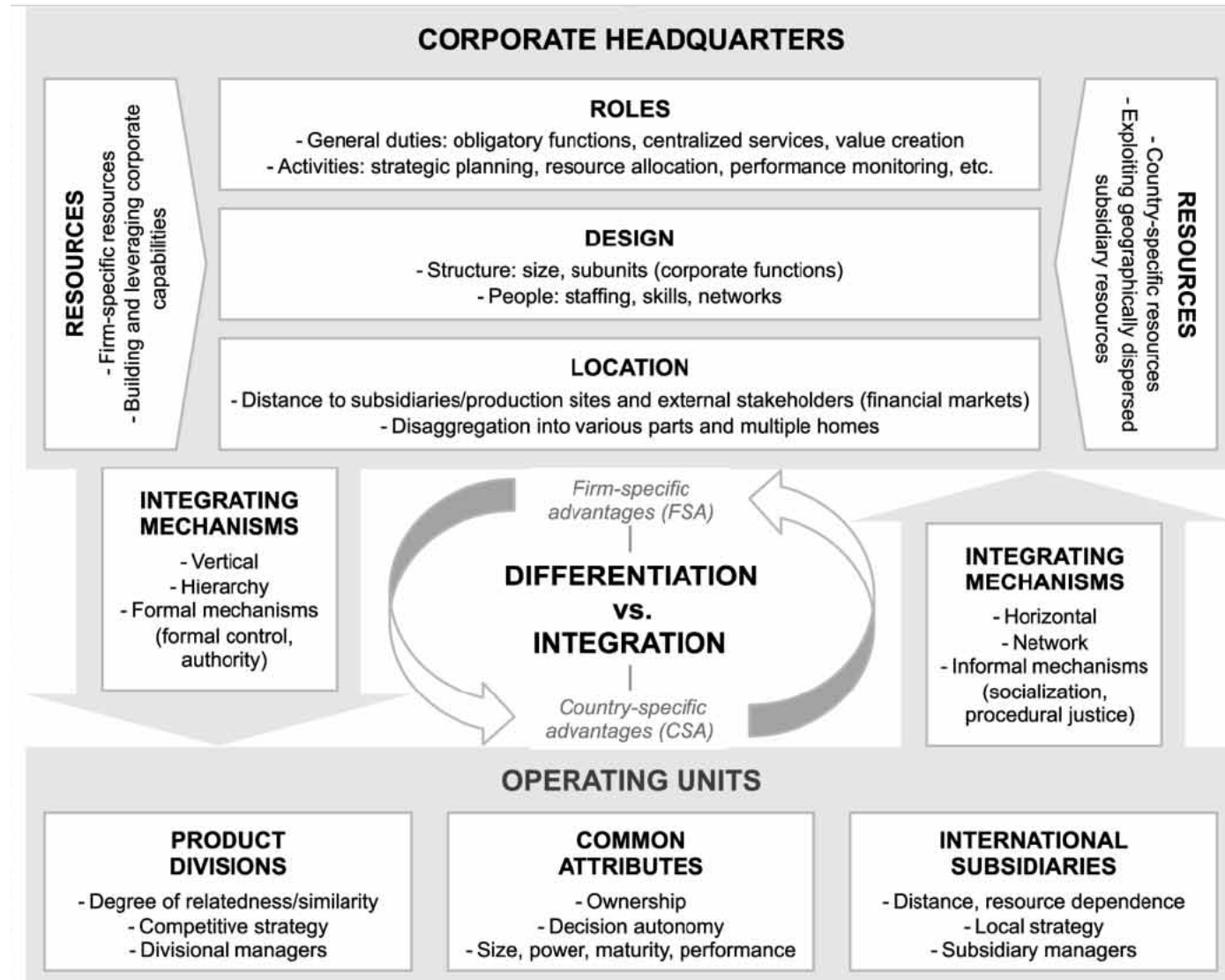
Source: Based on Perlmutter, H. (1969), The Tortuous Evolution of the Multinational Corporation. *Columbia Journal of World Business* 5, 9-18

A CORPORATE HEADQUARTERS PERSPECTIVE

	MULTIBUSINESS FIRM	MULTINATIONAL FIRM
Typical CHQ terms	Corporate center, corporate headquarters, general office, parent (company), parent firm	Central administrative office, (corporate) headquarters, global headquarters
Intellectual roots	Chandler (1962), Drucker (1946), Lawrence and Lorsch (1967), Lorsch and Allen (1973), Sloan (1964)	Baliga and Jaeger (1984), Bartlett and Ghoshal (1989), Prahalad and Doz (1987)
Perspective on the CHQ	Ability and importance of the CHQ to create value for the overall firm Mainly top-down perspective: “The CHQ is in control” of the product divisions	Ability and importance of the subsidiaries contributing to value creation for the overall firm Mainly bottom-up perspective: “Differentiated network” of independent nodes of subsidiaries and the CHQ as the network switch for horizontal linkages
Topics	CHQ roles and design, CHQ/firm boundaries, CHQ resources/capabilities, CHQ–product divisions, CHQ value added/destroyed	CHQ (re)location, CHQ–international subsidiary relationships, CHQ and organization structure
Theories	Economic: Transaction cost economics, financial economics Organizational: Agency theory, contingency theory, resource-based view, dynamic capabilities	Economic: Economic geography, international business Organizational: Agency theory, resource-dependence theory, control theory, institutional theory, attention-based view, stakeholder theory
Methods	Qualitative fieldwork, quantitative analysis (e.g. surveys and archival data), conceptual (generic normative frameworks)	Quantitative analysis (e.g. surveys of subsidiaries in multinational corporations)
Overviews	See Menz et al. (2015), Kunisch et al. (2015)	See Menz et al. (2015), Kunisch et al. (2015), Meyer et al. (2020)

Source: Menz, M./Kunisch, S./Collis, D. J. (2015), The Corporate Headquarters in the Contemporary Corporation: Advancing a Multimarket Firm Perspective. *Academy of Management Annals* 9, 633-714 (p. 637), adapted.

HOW THE CHQ IMPACTS IST SUBSIDIARIES: A FRAMEWORK



Source: Menz et al. (2015), 644

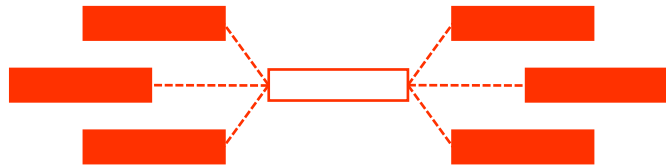
TYPES OF SUBSIDIARY ROLES

	TYPOLOGIES	ORIGINS	NOTES
FDI motives	<ul style="list-style-type: none"> • Market seeking • (Natural) resource seeking • Efficiency seeking • Strategic asset (competence) seeking 	Dunning (1993)	Focus on the original objectives when the subsidiary was set up
Integration responsiveness	2 x 2 matrix of global Integration and local adaptation, leading to <ul style="list-style-type: none"> • Multinational • International • Global • Transnational 	Prahalad & Doz (1987), Bartlett & Ghoshal (1989), Taggart (1998), Harzing (2000)	Originally an MNE-level framework, recent studies highlight subsidiary-level variations along these dimensions
Subsidiary mandate types	<ul style="list-style-type: none"> • World mandate • Specialist contributor • Local implementer 	B&G (1989), Birkinshaw & Morrison (1995), Birkinshaw & Hood (1997)	Focus on the contribution of specialized subsidiaries to the global operations of the MNEs
Knowledge contribution types	2 x 2 matrix-based knowledge inflows and outflows, leading to distinction of knowledge-creating and knowledge-exploiting subsidiaries	Gupta & Govindarajan (1991), Kümmeler (1997), Cantwell & Mudambi (2005)	Focus on the location of knowledge creation and the directions of knowledge flows
Global value chain position	By stages of the value chain covered by the subsidiary	Rugman, Verbeke, & Yuan (2011)	Focus on the position of subsidiaries in global value chains

Source: Meyer, K. E./Li, C./Schotter, A. J. (2020), Managing the MNE subsidiary: Advancing a multi-level and dynamic research agenda. *Journal of International Business Studies* 51, 538-576 (541)., adapted

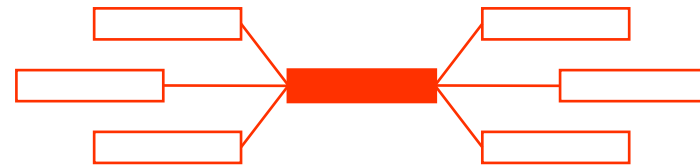
BARTLETT AND GHOSHAL'S NETWORK VIEW OF THE MNC

Model of the multinational organization



- **Multinational mentality:** Management regards overseas operations as a portfolio of independent businesses
- **Personal control:** Informal HG-Sub relationships overlaid with simple financial controls
- **Decentralized federation:** Many key assets, responsibilities and decisions decentralized

Model of the global organization



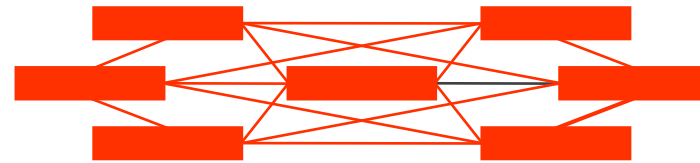
- **Global mentality:** Management treats overseas operations as delivery pipelines to a unified global market
- **Operational control:** Tight central control of decisions, resources and information
- **Centralized hub:** Most strategic assets, resources, responsibilities and decisions centralized

Model of the international organization



- **International mentality:** Management regards overseas operations as appendages to a central domestic corporation
- **Administrative control:** Formal management planning and control systems allow tighter HQ-Sub linkage
- **Coordinated federation:** Many assets, resources, responsibilities and decisions still decentralized, but controlled by HQ

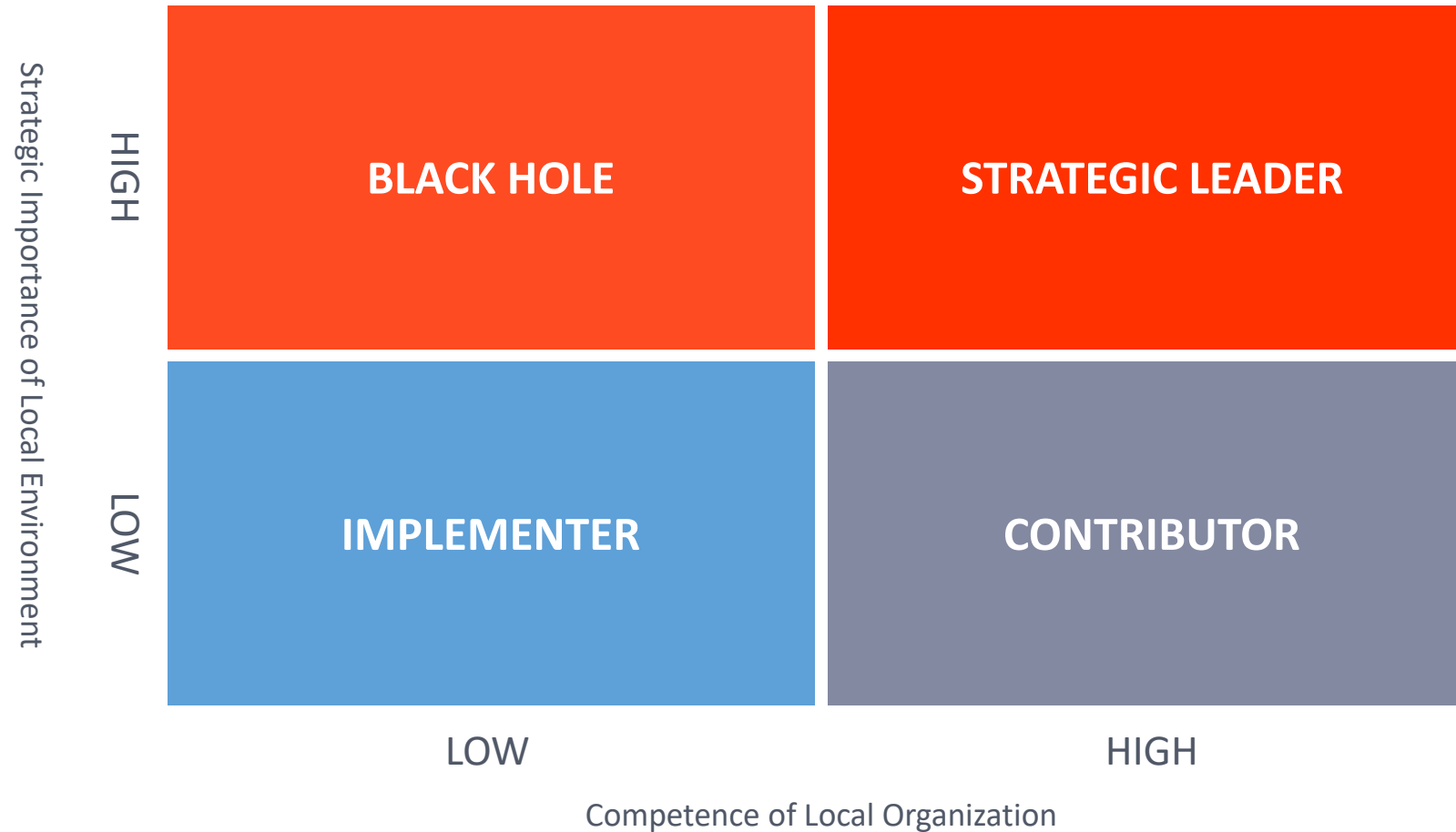
The transnational solution



- **Complex process of coordination and cooperation in an environment of joint decision making**
- **Large flows of components, products, resources, people and information among independent units**
- **Distributed, specialized resources and capabilities**

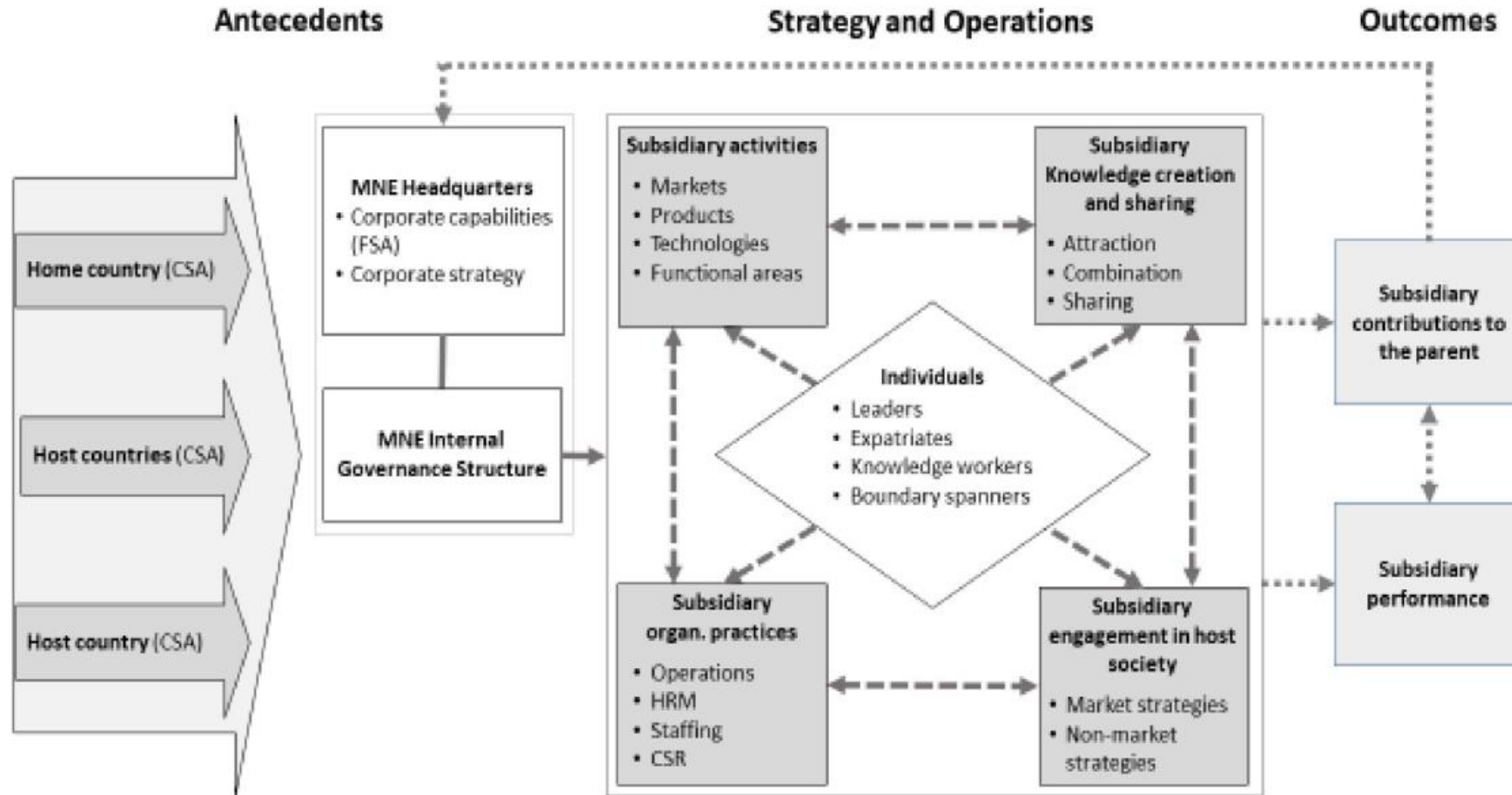
Source: Bartlett, C.A./ Ghoshal, S. (1989) *Managing Across Borders: The Transnational Solution*. Boston: Harvard Business School Press, p. 50-52 and p. 89.

TYPICAL ROLES OF LOCAL SUBSIDIARIES, ACCORDING TO BARTLETT AND GHOSHAL



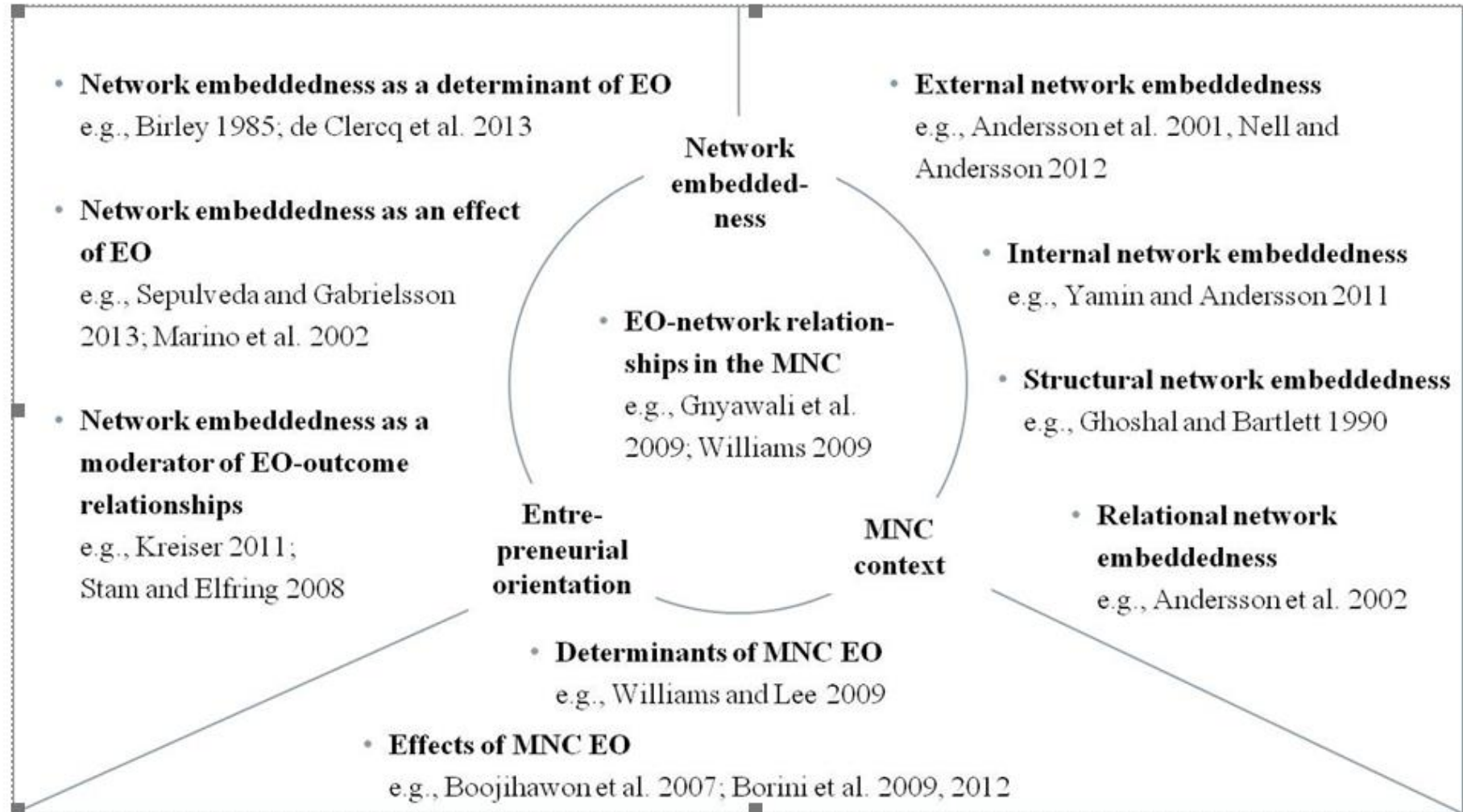
Source: Bartlett, C.A./ Ghoshal, S. (1989)

CONCEPTUAL FRAMEWORK FOR SUBSIDIARY MANAGEMENT



Source: Meyer, K. E./Li, C./Schotter, A. J. (2020), Managing the MNE subsidiary: Advancing a multi-level and dynamic research agenda. *Journal of International Business Studies* 51, 538-576 (547).

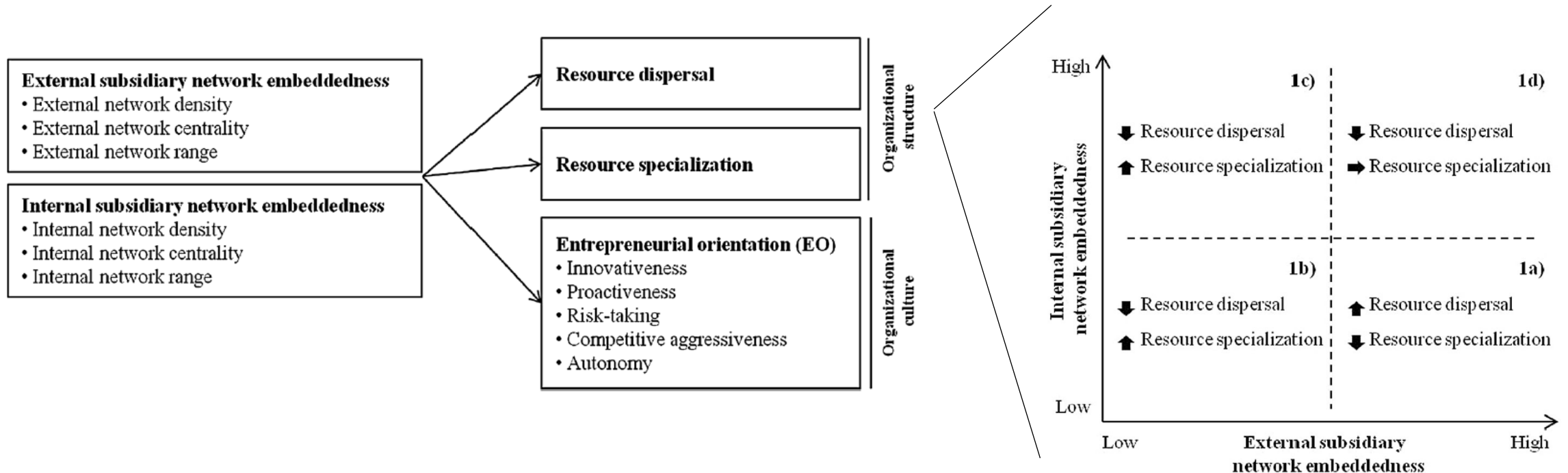
RESEARCH ON SUBSIDIARY ENTREPRENEURSHIP



Source: Djodat, N. (2015), Network Embeddedness, Organizational Structure and Entrepreneurial Orientation in the Multinational Corporation: Research Agenda, Theoretical Model and Empirical Study. Dissertation TU Berlin, p. 28

MNC STRUCTURE AND ENTREPRENEURIAL ORIENTATION: TOWARDS A FRAMEWORK

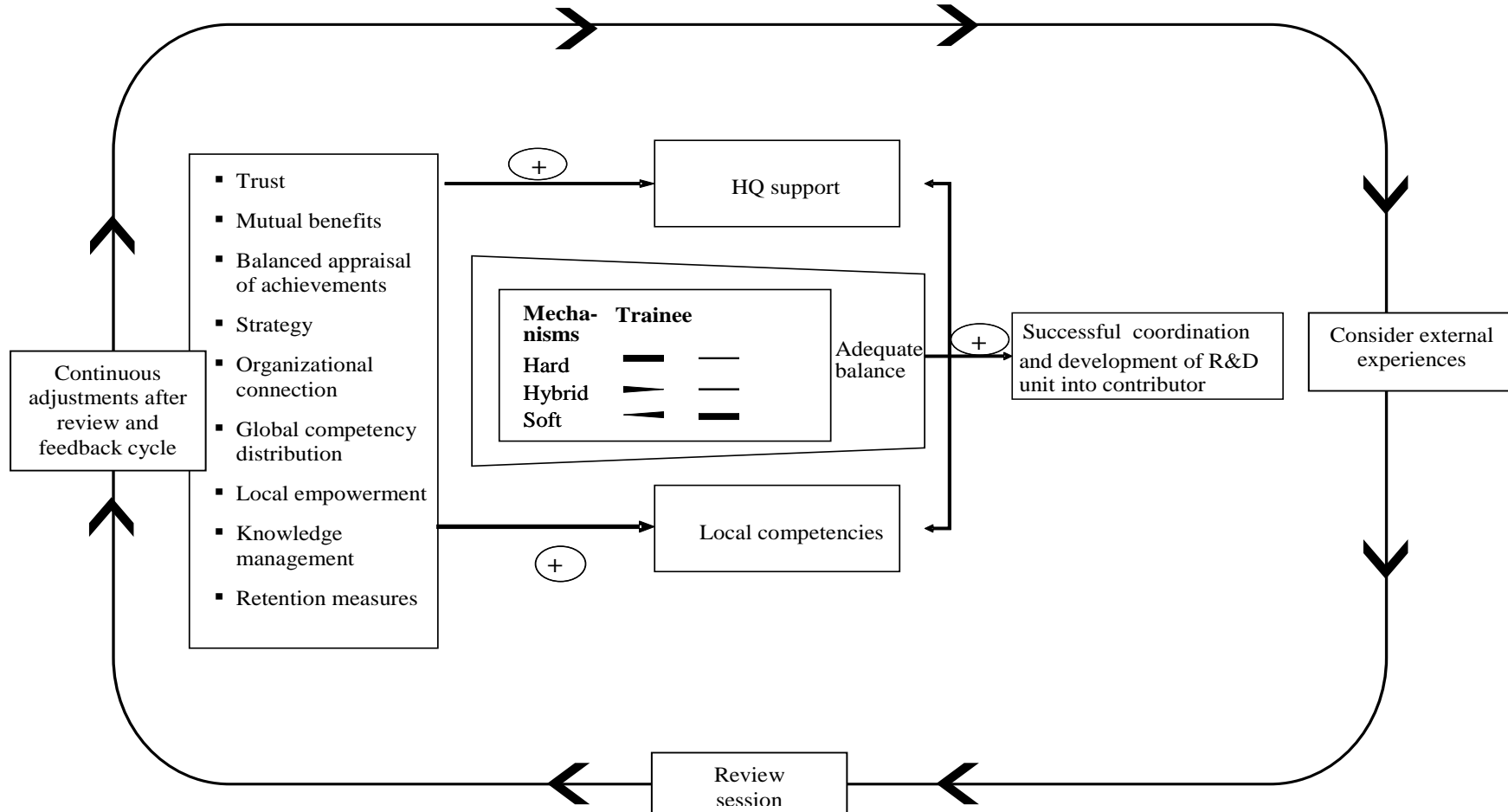
A REFINEMENT ON GHOSHAL AND BARTLETT'S NETWORK THEORY OF THE MNC



Source: Djodat, N./zu Knyphausen-Aufseß, D. (2017), Revisiting Ghoshal and Bartlett's Theory of the Multinational Corporation as an Interorganizational Network. *Management International Review* 17, 349-378

MANAGING INTERNATIONAL R&D UNITS IN CHINA

BASED ON CASE STUDIES OF FOUR R&D UNITS OF A GERMAN MNC



Source: Sauerberg, I./zu Knyphausen-Aufseß, D./Schweizer, L. (2017). Managing international R&D units: the evolution from HQ-control to HQ-support and local autonomy and competence development in the case of China. *Managementforschung* 27, 27-76 (p. 68)

LOOKING FORWARD BY LOOKING BACK: CHANGING DISTRIBUTION OF ROLES WITHIN MNEs?

LEARNING FROM ABB IN THE 1990s

Traditional Model

Formal Organization: M-Form →Top-Management as the strategic and entrepreneurial core <ul style="list-style-type: none"> ▪ Initiative ▪ Structure ▪ Conflict resolution
Administrative Processes →Middle Management as “vertical bridge” between top- und line management; allocation of financial resources
Political Behavior and Learning →Line management as the center of balancing interests and trial-and-error learning

Alternative Model

Creating and pursuing opportunities	Reviewing, developing and supporting initiatives	Establishing corporate mission and performance standards; “Fingers-in-the-Pie”-Management	Entrepreneurial Process
Managing operational interdependencies and personal networks	Linking skills, knowledge and resources	Developing and nurturing organizational values	Integration Process
Managing the tension between short-term performance and long-term ambitions	Creating and maintaining organizational trust	Shaping and embedding corporate purpose	Renewal Process
Line Management	Middle Management	Top Management	

Core Processes

Source: Bartlett, C. & Ghoshal, S. (1993) Beyond the M-form: Toward a managerial theory of the firm. *Strategic Management Journal* 14, Winter Special Issue, 23-46

FINAL REFLECTIONS ON THE SUBSIDIARY CONSTRUCT AS SUCH

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RESEARCH NOTE

Whither national subsidiaries? The need to refocus international management research on structures and processes that matter

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Abstract

The notion that multinational companies (MNCs) are comprised of multiple subsidiaries in different countries is one that underpins voluminous research in international management. This body of research was recently the subject of an authoritative and comprehensive review in this journal (Meyer et al. in *J Int Bus Stud* 51(4):538–576, 2020). However, we share the concerns about the prevalence of the term ‘subsidiary’ within academic writing expressed by some others (Mees-Buss et al. in *J Int Bus Stud* 50(9):1513–1543, 2019) and take this further by questioning the assumptions of authority and control on which it is based. We argue that the role of national subsidiaries in how MNCs are organized has been eroded by developments ‘from above’ and ‘from below’ the national level such that it cannot be assumed that national subsidiaries are important influences on how MNCs govern and coordinate their production and service provision and how work is organized. We set out the implications for theory and methods in international management (IM).

Journal of International Business Studies (2022) 53, 203–210.
<https://doi.org/10.1057/s41267-021-00437-y>

Keywords: multinational corporations; subsidiary role; international business research agenda

COMMENTARY

And the subsidiary lives on: Harnessing complex realities in the contemporary MNE

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Abstract

Managing multinational enterprise subsidiaries is a core facet of international business research. A shifting reality on the ground has triggered concerns around the waning relevance of the subsidiary because the MNE and its structure and processes have become increasingly complex. Consequently, more decentralized, responsive, and fluid organizational designs are now at the core of IB research. Juxtaposing recent arguments questioning subsidiary research altogether, we argue that IB scholars can explore and explain complex realities in the contemporary MNE without unnecessarily restricting the breadth of the field and giving up links to established research and theory. We reframe conversations around inward- and outward-looking perspectives, providing a path forward that emphasizes the importance of embracing the subsidiary concept in research reflecting today’s complex business environment.

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<https://doi.org/10.1057/s41267-022-00552-4>

Keywords: global strategy; international business; multinational corporation; structural differentiation; subsidiary management

The background of the slide is a close-up, shallow depth-of-field photograph of an open, antique book. The pages are aged, yellowed, and slightly curved. A dark metal bookmark is visible, resting between the pages. The lighting is soft, highlighting the texture of the paper and the binding.

APPENDIX

THE ROLE OF HQ AND FOREIGN SUBSIDIARIES

Multinational Corporations and Corporate Control
Lecture 8

APPENDIX 1:

ABSTRACT FOR ARTICLE DISCUSSED ON PAGE 14

More than 25 years after its appearance, Ghoshal and Bartlett's seminal paper 'The Multinational Corporation as an Interorganizational Network' stands as a widely recognized but insufficiently understood contribution to the international management literature. This paper reviews related literature, celebrates and critically discusses Ghoshal and Bartlett's work and proposes ways to address its main limitations, which are a lack of a defined set of parameters describing networks and the delineation of network boundaries. We then translate their theory into concrete propositions and thereby bring it closer to empirical testing. Taking a subsidiary-network perspective, we expand the authors' work by combining network and entrepreneurship literature and theoretically deducting positive effects of networks on subsidiary entrepreneurial orientation. This yields entirely new insights and amore holistic view of the effects of subsidiary networks.

APPENDIX 2:

ABSTRACT FOR ARTICLE DISCUSSED ON PAGE 15

The ongoing expansion of international research and development (R&D) activities, especially in China, provides multinational corporations (MNCs) with the major challenge of keeping a balance between headquarters (HQ) control and support for the local autonomy of subsidiaries, given the considerable cultural, organizational, and geographic distance involved. Based on 42 interviews, we first identify the most important coordination mechanisms. Based on these, we describe the evolution of R&D units over time and identify a number of enablers for successful coordination between HQ and the subsidiaries. Our findings suggest that these enablers not only positively affect the provision of adequate HQ support but also provide an opportunity to build up sufficient local competencies to allow local Chinese R&D units to develop a contributing role. Moreover, we find that global R&D organizations need to not only foster trust and mutual benefits between HQ and local teams but also clearly define the local units' strategy and their role within global competency distribution. Global R&D organizations also need to allow local empowerment and employ suitable retention measures and local knowledge management structures as well as to ensure a balanced appraisal of achievements and the establishment of good organizational connections. All these elements will be integrated into a consistent development and review process that describes the evolution from HQ control to HQ support as well as local autonomy and competence development.