



# **STRATEGY, TASK AND COORDINATION: THE HQ- SUBSIDIARY RELATIONSHIP IN MULTINATIONAL CORPORATIONS**

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**Working Paper, No.4 - June 2005**

# WORKING PAPER

Number 4, June 2005

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## ACKNOWLEDGEMENTS:

THE AUTHOR WOULD LIKE TO GRATEFULLY ACKNOWLEDGE THE ASSISTANCE OF CAROL KULIK,  
CHRISTINA CREGAN AND STEPHEN NICHOLAS.

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## **ABSTRACT**

Integrating insights from earlier studies on subsidiary types, models of MNC growth, the transaction costs/agency literature and Porter's notions of strategy this paper presents a reconceptualization of the HQ-subsidiary relationship in the MNC. It proposes that the choice of advantage-generating strategy employed by HQ determines the congruent subsidiary task/type, the associated knowledge asymmetries between HQ and the subsidiary and the overall organizational form. These subsequently influence subsidiary autonomy, control and coordination.

This paper is concerned with the relationship between headquarters (HQ) and subsidiaries in multinational corporations (MNCs). This will always be an important topic because the HQ-subsidiary connection is the primary conduit through which HQ is able to manage the corporation. It enables the transfer of the MNC's ownership advantage, the design and implementation of more efficacious and appropriate corporate and subsidiary structures, control mechanisms, and coordination systems. All of these facilitate inter-unit product, personnel, factor and knowledge flows of every kind.

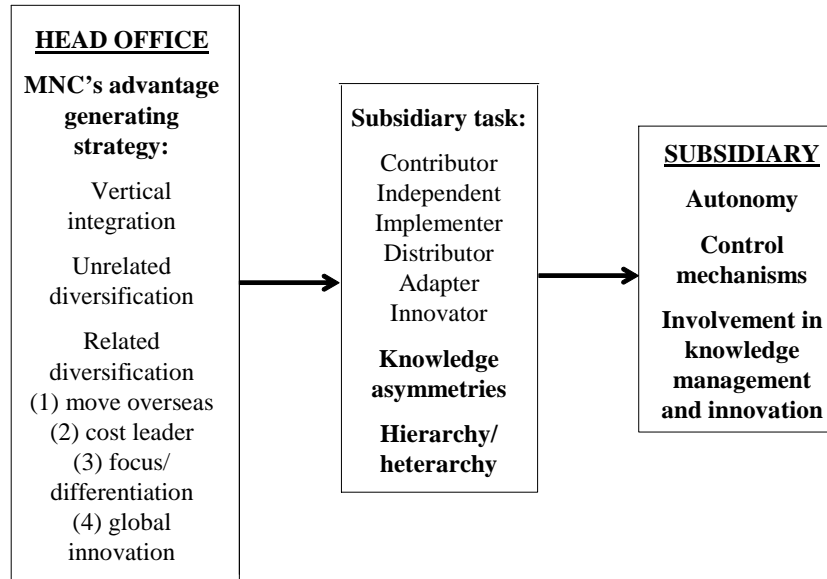
There has been a tendency in the recent literature to eschew more mundane topics such as the HQ-subsidiary relationship in favor of unit interdependence, alliances, knowledge clusters, trust networks and more academically fashionable concerns in the network capitalism domain. Nevertheless, interest does remain in the HQ-subsidiary relationship and the subsidiary task/role (see for example Peterson, Napier and Shul-Shim, 2000; Asakawa, 2001; Benito, Groggaard and Narula, 2003; Hewett, Roth and Roth, 2003).

While Birkinshaw and Hood (1998) suggested that the traditional HQ-subsidiary relationship research stream had come to an end in the mid-1980s, they were circumspect enough to warn against throwing the baby out with the bathwater, "the subsidiary's most critical relationship was, and still is, with its corporate headquarters" (1998: 6). The available statistics tend to support Birkinshaw and Hood's prudence. An OECD report (OECD, 2002) indicates that nearly 79,000 strategic alliances, JVs, R&D and sales/marketing agreements were instituted between 1990 and 2000. This is approaching a mean of 8000 such ventures per year and the database probably underestimates the number. It is an impressive figure and justifies the interest in these phenomena. It must, however, be seen in the context of a global economy containing perhaps 63,000 MNCs with some 700,000 subsidiaries (UNCTAD 2000). Despite the array of more novel alternatives, in many cases the HQ-subsidiary relationship and the consequent tasks performed by the subsidiary remain central to our understanding of MNC functioning.

This paper aims to revisit and advance our understanding of the HQ-subsidiary link by developing and presenting propositions relating MNC strategies, subsidiary tasks/types, knowledge asymmetries and organizational characteristics. Drawing upon the transaction costs and agency literatures and some of the classic studies of multinationals and their strategies, the paper provides a conceptual underpinning to the nature of the HQ-subsidiary relationship, helping to reconcile the diverse literatures and practices relating to these academically and practically important ties.

As the paper is founded upon a logic that generates a finite number of ideal subsidiary types, it is a normative theoretical contribution. It is an explanatory model that predicts "organizational forms that might exist rather than existing organizations" (Doty and Glick, 1994: 233). As such, its primary purpose is not to advocate actions that have performance implications for the firm although some extrapolations in this direction might be possible.

The study builds upon earlier work in several ways. First, rather than treading the typical path of presenting a decision rule classification to derive a subsidiary taxonomy, it develops a guiding framework that links the overall strategy of the MNC with subsidiary types through the intervening constructs of subsidiary task, knowledge asymmetries and the hierarchy/heterarchy distinction. The framework is outlined in Figure 1. It is based upon the proposition that while many subsidiaries carry out a range of functions, analytically there are only six primary subsidiary tasks and hence ideal subsidiary types. These six types are each



**Figure 1. The HQ-subsidary relationship in the MNC**

congruent with a particular firm strategy and in each case there are specific implications for subsidiary autonomy and the mechanisms of control and coordination employed by the MNC. Second, the study takes a subsidiary-centric stance rather than the more prevalent HQ standpoint. Because MNCs do not usually rely upon a single strategy to develop advantage, it is unrealistic to attempt to specify a single strategy for an entire MNC. Thus a MNC's range of strategies will lead to a multiplicity of subsidiary tasks. A subsidiary perspective finesses the difficulty that this might present for a conceptual framework that has MNC strategy as the prime determinant of subsidiary task. Different strategies may lead to subsidiaries in the MNC having different tasks but it is argued that any given subsidiary task is likely to be the result of a single strategic imperative emanating from HQ. Third, the greater comprehensiveness of the framework offers the opportunity for investigation of a wider range of issues, questions, industries, home and host countries and MNC types.

The paper is organized as follows. First, the relationship between the strategies implemented by the MNC and subsidiary task and type is considered. This involves a brief review of earlier subsidiary classifications then a theoretical derivation of the ideal form of six subsidiary types is presented. The next section explores the internationalization and internalization literatures to determine the relationship between knowledge asymmetries, subsidiary autonomy and control mechanisms. In section three the major research propositions are derived. The final section assesses the contribution of the paper and offers suggestions as to how the propositions might be investigated.

## Subsidiary types

### *Earlier studies*

There have been several previous attempts to classify subsidiary type on the basis of subsidiary task. Overall, these studies produce a considerable assortment of subsidiary types but each study generates a limited number and its applicability is restricted by contextual factors such as conceptual focus, range of industries, timeframe, MNC type and home/host country. It is likely that a particular perspective may be well suited to a particular research question or business issue but the centrality of the HQ-subsidiary tie and the consequences for issues of control and autonomy argue for the usefulness of a more general framework

All of the major studies that classify subsidiaries "categorize phenomena into mutually exclusive and exhaustive sets ... (on the basis of) ... a series of discrete decision rules" (Doty and Glick, 1994: 232). The variability in context and analytical focus has resulted in a wide assortment of decision criteria being used in developing sets of subsidiaries: extent of market involvement (Canada/North America/World) vs subsidiary autonomy (D'Cruz, 1986); market scope vs product scope and value-added scope (White and Poynter, 1984); subsidiary competence vs strategic importance of the local environment (Bartlett and Ghoshal, 1986); inflow and outflow of subsidiary knowledge (Gupta and Govindarajan, 1991); integration vs localization (Jarillo and Martinez, 1990; Taggart, 1997b); procedural justice vs subsidiary autonomy (Taggart, 1997a); and MNC strategy type vs subsidiary capabilities vs level of accommodation in the local environment (Hoffman, 1994). They are usually presented as 2x2 or other matrices and the variability ensures there is no consensus of categories derived. The issue of whether typologies are acceptable as theory has been debated (Bacharach, 1989; Doty and Glick, 1994) but the examples above are clearly classification schemes or taxonomies in the sense proposed by Doty and Glick (1994). They assign subsidiaries to sets on the basis of high and low levels of the decision criteria. Having done so, the studies then take one of several routes. Some provide descriptions of their categorizations but do not supply the statement of a relationship between constructs or variables that constitutes theory (White and Poynter, 1984; D'Cruz, 1986; Bartlett and Ghoshal, 1986; Hoffman, 1994). Others empirically examine the classifications to assess the extent to which the types exist in reality and thus confirm their status as classification schemes only (Jarillo and Martinez, 1990; Taggart, 1997a,b). Only Gupta and Govindarajan (1991) use their classification to derive research hypotheses. They conceptualize the MNC as a network of transactions and concentrate upon knowledge flows (expertise or external market data of strategic value) with the magnitude and direction of communications varying depending upon the subsidiary's location in the innovation network of the MNC. The classifications allocate subsidiaries into groups on the basis of high and low values of outflows and inflows of knowledge between the subsidiary and the rest of the MNC. Gupta and Govindarajan (1991) then hypothesize associations between their four subsidiary type and various control mechanisms. Their study is a major step forward but the hypotheses are derived from what is, in the final analysis, an essentially ad hoc classification of types and the study is restricted by their "decision to focus only on knowledge flow patterns" (Gupta and Govindarajan, 1991: 772). As a result, their control implications primarily relate to the innovation process.

Many of these studies have been cited widely but few have been the progenitors of further empirical investigations. Hence, despite some effort and the importance of the issue, the

prevailing models of subsidiary type are incomplete and there remains potential for a more complete framework.

### ***A typology of subsidiary tasks***

Grounded in the theoretical insights into strategy presented by Porter (1985, 1987), Caves (1996) and Bartlett and Ghoshal (1989), the central theme of this section is that the strategy employed by a MNC, at either the corporate or business level, imposes a particular task upon the subsidiary and hence leads to the development of a congruent subsidiary type. While a given subsidiary may perform several tasks or a particular strategy may require some differentiation of tasks among subsidiaries, it is proposed that there are only a limited number of subsidiary types.

Porter (1985, 1987) argues that the multidivisional organization implements strategy at two levels. At the corporate level, the firm's three choices of strategy are vertical integration and unrelated and related diversification. Business level (generic) strategy is concerned with how to create competitive advantage at the level of the individual business. The available generic strategies are cost leadership, differentiation and focus on particular geographic, product or customer segments or niches. The focus strategy can be applied via either cost leadership or differentiation. Since competition between firms exists primarily at the business level, the term competitive strategy should properly be reserved for strategies employed at this level. In the present analysis, since the analysis deals with strategies employed at both levels, a more convenient term advantage-generating strategy is used when necessary.

Congruent with Porter's corporate level strategies Caves (1996) distinguishes three types of MNC. He labels them vertical, portfolio diversified and horizontal. Since the horizontal MNC may gain advantage from four different business level strategies, it is possible to identify six separate advantage-generating strategies, each of which leads to a particular subsidiary type.

Caves' vertical MNC employs Porter's vertical integration strategy. In the archetypal form of this strategy, each subsidiary performs a single task, is simply one link, within the product/service value chain. The subsidiary matching this strategy is termed a value chain contributor subsidiary (for convenience, contributor hereafter). This brief statement oversimplifies a complex reality. Of the six subsidiary tasks that are proposed this is the most elusive in practice. Clarifying exactly what constitutes vertical integration is problematic. In the modern MNC, vertical integration elements are so deeply embedded in the global and transnational corporate forms that they are difficult to disentangle. This is not necessarily detrimental to the analysis, however, since ideal types are, essentially, "theoretical abstractions" (Doty and Glick, 1994: 233).

Caves' portfolio diversified MNC utilizes Porter's unrelated diversification strategy based upon managing the growth, harvesting and divestment opportunities of a portfolio of independent firms. Except for some strategic and/or financial guidance by HQ the subsidiary usually acts autonomously. Hence the archetypal subsidiary congruent with this strategy is labeled independent.

Caves' horizontal MNC is the outcome of Porter's corporate level strategy of related diversification. In this strategy, competitive advantage arises at the business level via four possible strategies: moving into a new overseas location, cost leadership, differentiation/focus

and global innovation. These are all derived, either singly or in combination, from Porter's generic strategies. Four subsidiary types are produced.

The *implementer* subsidiary ideal type arises when geographic diversification takes place and a domestic product or process innovation is exploited in a new overseas location (Chandler, 1990: 39). The advantage achieved by this innovation may be based upon any of the generic strategies but a move into a new competition-free or reduced location provides a straightforward opportunity to exploit the MNC's ownership advantage. It is a move into a host environment where the subsidiary acts as the extractor of value from the MNC's ownership advantage by generating products similar to those produced at HQ.

MNC will have some manufacturing subsidiaries either centralized or Absence of competition in a host environment rarely endures and when competition arrives the subsidiary must regain or sustain its advantage via cost leadership or differentiation-based focus. Cost leadership is typically based upon attaining volumes of production of standardized products that permit economies of scale. This can be accomplished in various ways but, in MNCs, commonly involves developing a global network of subsidiaries within which some produce and others distribute the standard low cost product throughout the world. The majority of these overseas subsidiaries are delivery pipelines to a unified global market. While the vertically-integrated on the basis of advantaged location, with this strategy the most common subsidiary type found is best described as a distributor.

The differentiation/focus strategy is accomplished by selling products that have been adapted to suit a particular market segment. In the international arena this means geographic market segmentation, delivering products that are adapted variations of overall MNC products, tailored to suit local market tastes. A subsidiary that is locally focused and adaptive - the *adapter* - is the archetypal associate of this strategy.

The sixth subsidiary type is the outcome of a distinctive extension of the above strategies. All firms engage in a degree of product differentiation, via new product development and innovation but, according to many authors (Bartlett and Ghoshal, 1989; Casson, 1997; Hedlund, 1986; Nohria and Ghoshal, 1994, 1997), since the 1980s a new organizational form has begun to appear in MNCs. While there is room for debate as to whether it is yet truly manifest, it is argued that this form is the result of a need for a new competitive strategy based upon a new pattern of innovation. This subset of MNCs gains a particular advantage from leveraging the global knowledge resources of its entire network to generate innovations. The subsidiaries most representative of this strategy are the relatively large, resource-rich firms that act as important nodes in the MNC network. They may perform many tasks on behalf of the MNC but, for the purposes of description in this analysis, they often act as major foci for the process of innovation. Hence they are termed *innovator* subsidiaries.

These subsidiary types are readily unearthed in many of the classic studies of strategy such as Chandler (1962, 1977), Vernon (1966), Stopford and Wells (1972) and Bartlett and Ghoshal (1989).

In summary, at the corporate level, the MNC can create advantage by managing its subsidiaries as a vertically integrated value chain or as a portfolio of investments. Alternatively, at the business level, it can generate advantage by having a strategy that presents the market with the first product of its kind or the cheapest or a market segmented version or a continuous stream of new products. Each of these imposes a distinct task upon the subsidiary and hence:

*Proposition 1: Six ideal subsidiary types can be identified in MNCs: contributor, independent, implementer, distributor, adapter and innovator. Each corresponds to one of the six available advantage-generating strategies.*

In practice, many MNCs are strategic amalgams and implement several strategies simultaneously but for analytical purposes the basic strategies and their ensuing subsidiary types are distinct. In addition, it is proposed that each HQ strategy will bring about distinctive knowledge asymmetries between HQ and the subsidiary and the need for either a hierarchical or heterarchical organizational form. These, in their turn, impose the need for appropriate control and coordination mechanisms.

### **Knowledge asymmetry, control and autonomy**

The following review links subsidiary task to the knowledge asymmetries that arise between HQ and subsidiary and examines their implications for issues of autonomy, control and coordination. Knowledge asymmetries are derived from the interplay between several categories of knowledge. These are the knowledge gained from and how to implement the internationalization process, the knowledge embedded in the HQ's ownership advantage, the internalization advantage that subsequently arises, the subsidiary's knowledge of the host environment and the knowledge that the subsidiary holds as a result of its part in the transformation process.

### ***Internationalization***

The Uppsala model of internationalization (Johanson and Wiedersheim-Paul, 1975; Johanson and Valne, 1977, 1990) proposes that firms acquire knowledge about international operations by the expedient of operating in a new market. They learn incrementally thus gradually reducing uncertainty and reducing the perceived risk. Each successive step is postponed until the perceived risk is lower than the bearable risk (Johanson and Valne, 1977). The knowledge growth about internationalization is highly dependent upon individual acquisition of knowledge and is "therefore difficult to transfer to other individuals and contexts" (Forsgren, 2002: 259). Over time, the firm learns to carry out its international operations with increasing effectiveness. The Uppsala model does not imply any specific subsidiary type. It does, however, accentuate the importance of two types of knowledge in the HQ-subsidiary relationship. Increasing experience of operations in a host market brings increasing knowledge concerning characteristics of that market. The importance of individuals in the acquisition of that knowledge often results in that knowledge not being readily available to HQ. Headquarters does, however, on its part, develop knowledge of the management of the overall internationalization process.

### ***Internalization, transaction costs and agency***

The major theoretical foundation of the MNC is centred on internalization theory and its transaction cost and agency components. This approach argues that FDI (and its attendant manifestation, the MNC) arises when the market fails. Failure occurs because in some instances the market is a more costly/inefficient way to undertake certain types of transactions than via the operations of a firm. In these cases, the firm opts to internalize its ownership advantage and when this takes place across borders it brings about the MNC (see for example Buckley and Casson, 1976; Caves, 1996; Hood and Young, 1979; Rugman 1996). Within the MNC, HQ-subsidary knowledge asymmetries are particularly problematic because the relationship crosses national and cultural borders and is often heightened by communications problems arising from issues such as language, multilocation and time differences. Appropriate control systems must be developed to ameliorate these problems.

Chandler's work on the modern business organization (Chandler 1962, 1977, 1990) firmly establishes the relationship between strategy and structure but it does not clarify the internal mechanics of the relationship, particularly with regard to control of MNC subsidiaries. Control has been approached from many directions but several studies, primarily from the transaction cost and agency viewpoints, help to remedy the deficiency in the case of the MNC.

For Baliga and Jaeger (1984; Jaeger and Baliga, 1985; following Ouchi, 1977, 1979) the central issue of subsidiary control is the asymmetry of knowledge about the transformation process in the subsidiary. If HQ's knowledge is superior then it can impose bureaucratic output or behavioral controls. If the subsidiary's knowledge is superior then HQ must control via cultural/normative mechanisms, based upon encouraging and disseminating shared values and norms of behavior. Although focusing on the market versus hierarchy distinction, Hennart's (1991) further development theoretically derives the mechanisms that MNCs employ to control their subsidiaries by demonstrating that they are closely analogous to the control process that firms use when managing individual employees. In doing so, he again highlights the central role played by the asymmetry of knowledge regarding the transformation process. He demonstrates how the bounded rationality of HQ management and the potential opportunism of the subsidiary management will influence the design of the control mechanisms. Hierarchy (centralization) is used when HQ has a greater knowledge of the subsidiary production function and the subsidiary's performance is difficult to measure. Alternatively, when subsidiary output is easily measurable but the subsidiary has greater knowledge of the production function than HQ, then setting up a profit center with suitable transfer pricing arrangements, elicits the required behavior, providing that subsidiary management remuneration is a function of performance. In the event of subsidiary management having superior knowledge and performance being difficult to evaluate, it becomes necessary for management to design more complex mechanisms to ensure the internalization of HQ goals by subsidiary management via, for example, selection and socialization processes.

The agency perspective adds to understanding of the HQ-subsidary relationship because it reveals how the role of principal is played by HQ vis a vis the agent role of the subsidiary. Curbing the principal's potential residual loss (Jensen and Meckling, 1976) that might arise from the agent's opportunistic use of its superior local knowledge requires the use of one of several devices depending upon circumstances. If a firm's owners' prime control tool, the board of directors, is considered to be analogous to HQ in a MNC (O'Donnell, 2000), the devices available are directly analogous to those in Hennart's opportunism/bounded rationality schema above. Mechanisms such as monitoring and sanctions for non-compliance are

hierarchical, transfer pricing and profit-based incentives are market oriented (Roth and O'Donnell, 1996) and selection or socialization are cultural/normative mechanisms. The implication from these studies is that subsidiary context, defined in terms of various knowledge asymmetries, is a major justification for using a particular control mechanism. Different contexts will lead to different control mechanisms.

### ***Subsidiary autonomy***

Subsidiary autonomy is the antithesis of HQ control. The control mechanisms adopted by the MNC to proscribe potential opportunistic behavior in the subsidiary have important effects upon the subsidiary's autonomy. A significant amount of research has been done on subsidiary autonomy in the last 25 years and the list of factors that scholars have suggested will influence the level of subsidiary autonomy is very long. (see for example Young and Tavares, 2004, and Simoes, Biscaya and Nevado, 2000) From the perspective of the HQ-subsidiary relationship, subsidiary autonomy is likely to be primarily associated with the subsidiary's superiority over HQ with regard to knowledge of the host environment, the subsidiary's transformation process and assorted marketing, procurement, distribution and other issues. In summary, to pre-empt the following analysis and propositions, the level of subsidiary autonomy for the six discrete subsidiary types proposed will follow a specific pattern. The *independent* will demonstrate the highest value for subsidiary autonomy, the *innovator* next, followed by the *contributor*, the *implementer*, the *adapter* and the *distributor* will have the lowest autonomy value.

### **Development of propositions**

Since the particular knowledge asymmetries appearing in the HQ-subsidiary relationship and arising from the overall MNC strategies create predispositions for level of subsidiary autonomy and the need for appropriate control mechanisms, then

*Proposition 2. For each type of subsidiary, the level of subsidiary autonomy and the frequency of use of different control mechanisms will be a function of the knowledge asymmetries between HQ and subsidiary.*

Each of the six HQ strategies and their congruent subsidiary types are now examined individually.

### ***Unrelated diversification***

Unrelated diversification is the strategy of the portfolio diversified MNC and it occurs when the MNC assembles collections of unrelated businesses. Competitive advantage lies in managing the portfolio to elicit various short/long term economic gains and/or the minimizing of risk exposure (Caves, 1996). It is highly unlikely that the details of the business of the subsidiary firms will be well understood by HQ. The archetypal subsidiary congruent with this strategy is the *independent*. All knowledge central to the transformation process is held in the subsidiary as is the important knowledge relating to the subsidiary's business context.

*Proposition 3a. Independent subsidiaries will be associated with the highest level of subsidiary autonomy among the six subsidiary types.*

With inferior knowledge of the transformation process, the host environment and most other factors, the literature suggests that HQ should utilize cultural controls. However, shared norms and values are likely to be difficult to inculcate in subsidiaries performing diverse tasks in differing industries. It is even possible that such corporate conformity might be counterproductive. The theoretical models from the literature above do not make specific predictions for this context. If the output of a subsidiary is easily measured then Hennart's proposition of making the subsidiary a profit center with suitable transfer pricing and performance-based subsidiary management remuneration is appropriate. If the output is not easily measured then HQ can only impose broadly-based performance requirements such as ROA.

*Proposition 3b. If their output is easily measurable, independent subsidiaries will be set up as profit centers with transfer pricing and profit-based subsidiary management remuneration arrangements. If their output is not easily measurable, control will focus upon broadly-based performance measures.*

### ***Vertical integration***

Driven by a motivation such as the need or desire to secure access to upstream or downstream products, services, knowledge or factors, the firm takes control of other firms up or down the value chain. The contributor subsidiary is a crucial link in the MNC's vertical integration strategy. In many instances, HQ is likely to have had an initial position in one or several stages of the value chain and, as such, is likely to have some considerable knowledge of the overall process. However, it is probable that HQ's knowledge of the detail of any individual subsidiary's transformation process will be inferior to that of the subsidiary. Knowledge of overall issues such as marketing of the final product or inter-subsidiary transport will usually lie with HQ. However, which side of the HQ-subsidiary relationship has the greatest knowledge of issues such as procurement, distribution and marketing at the level of the subsidiary in the host country, is likely to be contextually dependent. On balance

*Proposition 4a: Contributor subsidiaries will be associated with the third highest level of subsidiary autonomy among the six subsidiary types.*

Given that the HQ has some knowledge of the subsidiary production function, there is the opportunity to control via specific output measures but the sequential interdependence in the value chain is also likely to demand transfer-pricing arrangements. The interdependence in the value chain is also likely to mean that knowledge of the host environment is not critical.

*Proposition 4b: Control of the contributor subsidiaries will be based upon output reporting and transfer-pricing arrangements*

***Related diversification: Domestic innovation and the move into a new overseas location***

The *implementer* subsidiary is associated with subsidiaries that are exploiters of the MNC's ownership advantage in a new, relatively competition-free, overseas location. While such locations were probably more common in the early decades of the 20th century, that were Chandler's concerns, they do still exist today, although it is likely that the strategy will only be evident in some relatively specialized product niches. The subsidiary will probably begin life as a sales office initially, facilitating export, but may develop into a simple implementer of the MNC's technology via assembly of ckd (completely knocked down) imported subassemblies or some similar process (D'Cruz, 1986, Vernon, 1966; White and Poynter, 1984). While the export/sales phase may give rise to a *distributor* subsidiary, the archetypal subsidiary strategy congruent with this advantage generating strategy is best described as an *implementer* of the HQ's firm specific advantage.

The subsidiary produces a similar product to HQ, is likely to be involved only slightly in innovation and adapting the product for the local market but, in many instances, will depend upon its own resources to some extent. The subsidiary has knowledge of the transformation process but somewhat less than HQ and knowledge of the host environment is relatively unimportant. On the basis of this analysis it is expected that the *implementer* will exhibit relatively low levels of autonomy.

*Proposition 5a. Implementer subsidiaries will be associated with the second lowest level of subsidiary autonomy among the six types.*

In this strategy, all the significant knowledge is held at HQ, with the subsidiary's role restricted to implementing HQ's ownership advantage. Knowledge of the local environment is of little concern at HQ since the MNC's basic products are unopposed in the market. Bureaucratic/hierarchical controls are appropriate.

*Proposition 5b. If their output is easily measurable, control of implementer subsidiaries will be based upon output reporting. If their output is not easily measurable, control will be based upon behavioral controls such as company manuals and standard operating procedures.*

***Related diversification: Cost leadership***

The *distributor* is the commonest subsidiary type in MNCs that produce large volumes of low cost standardized products for the global market. The subsidiary's role is that of a delivery pipeline for goods produced elsewhere in the group with little further contribution. The subsidiary has less knowledge of the transformation process than HQ and any important knowledge of the host environment will be held at HQ to inform the global distribution of the product. For these subsidiaries, knowledge of the local environment is important only in terms of ensuring correspondence and coordination with global marketing and distribution policies. These subsidiaries are predicted to have the lowest autonomy.

*Proposition 6a. Distributor subsidiaries will be associated with the lowest level of subsidiary autonomy.*

Most knowledge relevant to the effective operation of the distributor subsidiary is held at HQ. Their primary output is easily measurable sales volume.

*Proposition 6b. Control of distributor subsidiaries will be based upon output reporting.*

***Related diversification: Focus/differentiation***

It is probable that the *adapter* subsidiary will have some innovative capacity and some need to work from its own resources. The basic transformation process was probably developed at HQ but the knowledge of the host environment that enables suitable adaptation and brings much of the advantage from the strategy resides with the subsidiary. A key question is exactly what is involved in the adaptation process. This may constitute anything from merely minor adaptation of a product produced elsewhere (little more than a *distributor*) to full-scale production of an adapted product. On balance

*Proposition 7a. Adapter subsidiaries will be associated with the fourth highest level of subsidiary autonomy.*

Basic knowledge of the transformation process lies at HQ as it was probably developed there but the detailed knowledge of the host environment that enables suitable adaptation, integration into the host market and brings much of the advantage from the strategy resides with the subsidiary. Some bureaucratic control of output and/or behavior is possible but it must be augmented by cultural controls.

*Proposition 7b. If output measures are available, control of the adapter subsidiary will be based upon output measures and cultural controls. If output measures are not available, control will be based upon bureaucratic behavioral and cultural controls.*

***Related diversification: Global innovation***

While there are many variations on the nature of the knowledge asymmetries in the five HQ-subsidiary relationships detailed above, all of them are hierarchical in nature. Even if HQ knows little or nothing of the subsidiary's business, the strategic configuration of the MNC is centralized. The final strategy and subsidiary type to be discussed are congruent with a new organizational form.

The *innovator* is the ideal type subsidiary of this strategy. Innovations are generated via a process of knowledge management that encompasses the entire global network of the

firm. Knowledge management is no longer a simple cooperative process instigated and directed by HQ. All subsidiaries that are capable contribute to the innovation process via a vast array of, often electronic, inter-unit communication and knowledge management linkages. Innovation and new products are the products of a complex interplay between all parts of the MNC. There might be centres of innovation excellence set up and these often act as foci for tapping the resources of the total network (Birkinshaw and Hood, 2000). As with the domestic innovations considered earlier, these globally developed innovations bring initial advantages but these advantages too are ephemeral and must, in their turn, be rebuilt and extended via cost reductions and/or differentiation. The entire process is iterative. The need to leverage all the knowledge resources of the MNC means that the coordination demands of this strategy are intense. These firms have a considerable range of capabilities and, on occasions, independence of action although key knowledge might be found at HQ or in any subsidiary within the group. Since they are deeply embedded in the corporate network, they are not likely to be the most autonomous of the subsidiary types considered but they are, nevertheless, expected to show substantial autonomy.

*Proposition 8a. Innovator subsidiaries will be associated with the second highest level of subsidiary autonomy.*

The non-hierarchical nature of the HQ-subsidiary relationship in these MNCs militates against effective use of hierarchical control mechanisms of any kind.

*Proposition 8b. Control of innovator subsidiaries will be based upon cultural control mechanisms.*

The overall MNC strategy also determines whether the MNC will have an hierarchic or heterarchic organizational form and hence the types of coordination mechanisms that will be evident. It is argued that five of the six subsidiary types are to be found in hierarchic MNCs while the sixth is proposed to be typical of the heterarchic organizational form. Given the emphasis on innovation in the heterarchic form:

*Proposition 8c: The subsidiary type typical of heterarchic MNCs, the innovator, will be more deeply embedded in the knowledge and innovation coordination processes of the MNC than any of the other subsidiary types.*

Each of these broad propositions is capable of being articulated into more specific hypotheses as the particular phenomenon is examined.

## Discussion

Otterbeck (1981) was the culmination of a broadly based project examining HQ-subsidiary relationships in MNCs. The central areas of concern in that project were the factors that influenced performance of the subsidiary task, subsidiary autonomy, and control and

coordination mechanisms. The intervening two decades have seen considerable effort but only sporadic progress in further illuminating this important phenomenon. In addition, because of their limited application, none of the subsidiary classifications reviewed earlier have become established.

In this paper the features of the HQ-subsidiary relationship have been analyzed from a novel and subsidiary-centric standpoint. Based upon a range of well-known theoretical and conceptual insights this paper argues that the choice of advantage-generating strategy employed by the MNC, the knowledge asymmetries that this strategy produces, the subsidiary tasks (and hence subsidiary types), subsidiary autonomy and how the subsidiaries are controlled and coordinated are intimately and reciprocally interrelated features of the HQ-subsidiary relationship. While some of the links in the model have been addressed individually in the literature, this conceptualization is a step forward because, for the first time, it synthesizes and integrates often disparate, conceptual and empirical knowledge, to produce a coherent and more comprehensive model of an important managerial phenomenon. The model provides a theoretical underpinning to the developing phenomenon of subsidiary tasks/types as they evolve to take advantage of different advantage-generating strategies that arise in changing contexts.

### ***Some limitations and possibilities***

Doty and Glick (1994) argue that the inclusion of hybrid types threatens the falsifiability of a typology that aspires to acceptance as theory. In most MNCs some subsidiaries will perform several tasks but these multi-task subsidiaries are not hybrid types in the sense proposed by Doty and Glick. A particular subsidiary may take on the tasks of a combination of ideal types but the several tasks are analytically distinct, if often difficult to disentangle in practice. There are no hybrid types in this typology.

The normative stance of the model creates a formal analysis that somewhat undervalues some of the 'softer' elements of MNC research that have been noted in the literature. Bartlett and Ghoshal (1995), for example, have appealed for managers to go beyond 'structures, systems and strategy' to 'people, processes and purpose'. These softer elements are implicit in the cultural control mechanisms of Ouchi, Hennart and others but the details of their logic and implementation are beyond the scope of this analysis.

This paper draws upon several theoretical perspectives but it is appreciated that others may well inform this topic. Knowledge issues (albeit asymmetries rather than flows) have been important aspects of this model and Birkinshaw and Hood (1998, 2000), for example, have applied the knowledge-based approach to a closely related topic, subsidiary development and the subsidiary's place in the MNC's innovation network. In addition, Miller (1996) and Siggelkow (2002) have developed configurations approaches that are extensions of contingency theory and might usefully be applied. Again they lie beyond the scope of this paper.

### ***Future directions***

Following Bacharach (1989), the primary requirements of a theory are that it should identify constructs and specify falsifiable relationships between those constructs.

The first direct empirical task arising from this analysis is the need to confirm the existence of subsidiaries that match or approximate to the proposed ideal types. The literature offers three methods to ascertain the task that subsidiaries perform within the MNC. Jarillo and Martinez (1990) and Kobrin (1991) infer the nature of the subsidiary task from quantitative measures of diverse activities within the MNC such as percentage of inputs received from other group companies or percentage of local R&D out of total R&D. Roth and Morrison (1992) and Taggart (1997a) deduce the subsidiary task from managerial perceptions of the extent of issues such as heterogeneity of customers, dependence upon other units and degree of standardization of production technology. Most recently, O'Donnell (2000) directly asked respondents the extent to which certain statements accurately describe the role of the subsidiary in the MNC. If the last method is applied and the responses framed upon say a 5 or 7 point Likert scale, it is possible to use k-means cluster analysis to identify clusters of subsidiaries of particular types.

Investigation of the relationship between subsidiary type and subsidiary autonomy would simultaneously confirm part of the theoretical framework and act as a validation of the cluster solution. There are many other factors that have been suggested to encroach upon the subsidiary's autonomy. Controlling for the range of contingent factors, subsidiary autonomy could be usefully explored using ANCOVA and paired comparisons of level of subsidiary autonomy. Following a somewhat similar logic, ANCOVA would also be appropriate to investigate the subsidiary type-control/coordination propositions.

More generally, the analysis establishes subsidiary type as a potentially relevant variable in a wide range of MNC focused studies, such as the use of expatriate managers, R&D and innovation, communication and so on. Further, because subsidiary type is a simpler construct, it may be useful to circumvent many of the difficulties encountered in operationalizing overall MNC strategy as a variable in empirical studies.

### ***A tentative reconciliation***

It can be argued that any new typology ought to take account of the range of subsidiary types found in earlier studies. This is an extremely demanding criterion since these earlier studies emerge from disparate contexts and perspectives and use subsidiary characteristics dissimilar from those in this analysis. Table 1 is a tentative provisional attempt, using knowledge asymmetry criteria and necessarily presented without detailed argument, to encompass all of the earlier types within the six subsidiary types proposed here.

**Table 1. Comparison of present typology with previous studies**

<i>Independent</i>	<i>Contributor</i>	<i>Implementer</i>	<i>Distributor</i>	<i>Adapter</i>	<i>Innovator</i>
W&P: strategic independent	W&P: rationalized manufacturer	D'C: satellite	J&M: receptive	D'C: branch	J&M: active
G&G: local innovator	D'C: rationalized manufacturer	W&P: miniature replica/adopter	T: collaborator	W&P: miniature replica/adapter	G&G: integrated player
T: militant	B&G: contributor	B&G: implementer	D'C: import	W&P: miniature replica/innovator	B&G: strategic leader
	T: partner	G&G: implementer	W&P: marketing satellite	J&M: autonomous	
	G&G: global innovator	T: vassal			

D'C: world product mandate and W&P: product specialist are either *implementers* or *adapters* that are present alongside the more numerous *distributor* subsidiaries.

B&G: black hole is not categorized

D'C = D'Cruz; W&P = White & Poynter; J&M = Jarillo & Martinez; B&G = Bartlett & Ghoshal;  
G&G = Gupta & Govindarajan; T = Taggart

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