Subsidiary performance: The contingency of multinational corporation's international strategy

Liang-Hung Lin*

Department of International Business, National Kaohsiung University of Applied Sciences, 415 Chien Kang Road, Kaohsiung 807, Taiwan

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SUMMARY

Considering subsidiary performance, this study investigates the relationships among multinational corporation's (MNCs) international strategy, headquarters uniculturalism, and headquarters control over the subsidiary, as well as their interactive effects on subsidiary performance. From statistically analyses from a sample of 134 MNC subsidiaries in Taiwan, this study reveals two critical contingencies: (1) a global integration strategy with headquarters high uniculturalism and tight control over subsidiary, and (2) a local responsiveness strategy with headquarters low uniculturalism and loose control over subsidiary, are associated with superior subsidiary performance. Based on contingency theory and the exploration–exploitation framework of organizational learning, this study elucidates that appropriate fits among international strategy and formal and informal organizational design facilitate superior subsidiary performance.

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Introduction

This article intends to understand subsidiary performance by connecting perspectives of contingency theory (Burns & Stalker, 1961) and the exploration–exploitation framework of organizational learning (March, 1991). As management of multinational corporations (MNCs) evolves, it is increasingly important to explore the relationships and proper fits among strategy, culture and control in MNCs. The main advantages for such fits include a clear specification of when a designated culture and control over subsidiaries are appropriate to enhance subsidiary performance (Kretschmer, 2009; Rugman & Hodgetts, 2001). Fit is a central concept in the contingency theory (Lawrence & Lorsch, 1967) that suggests “a given set of environmental characteristics demands a certain response from an organization in order for it to be effective” (Toulan, Birkinshaw, & Arnold, 2007, p. 61). The literature on contingency theory argues that organizational performance is largely determined by the level of fit or congruence among various actors and conditions, including the fit between strategy and organizational structure (Chandler, 1962; Egelhoff, 1982), and strategy and control (Stopford & Wells, 1972), as well as the congruence of four dimensions in an organization, namely individual, formal organization, informal organization, and the work (Nadler & Tushman, 1997).

However, there is still a research gap in the existing literature: the MNC strategy-control and strategy-culture fits are not empirically examined at the same time.

This study explores the concept of MNC fit, which is referred to as the level of agreement or consistency between headquarters and its subsidiaries. MNC fit is also a concept that extends the contingency theory across organizational boundaries. Although contingency or congruence can take many forms, this study is interested in connections between MNC’s international strategy, as well as headquarters control and international strategy and headquarters uniculturalism (e.g., Habib & Victor, 1991; Wolf & Egelhoff, 2002; Zellmer-Bruhn & Gibson, 2006). Since contingency theory suggests that the alignment or congruence between strategy and control and culture drives superior performance (Tushman & O’Reilly, 1997), this study raises two research questions. What are the benefits of strategy-culture and strategy-control fits in a setting of international business, and to what extent do these fits influence subsidiary performance?

This study aims to extend the understanding of MNC performance from various streams of management literature. In human resources studies, headquarters uniculturalism/multiculturalism is argued to affect employee satisfaction and be responsible for manager turnover of the subsidiary because employees of the subsidiary company are constantly confronted by considerable pressure to conform to the norms and values of headquarters (Clark & Geppert, 2011). Strategic management studies (Bartlett & Ghoshal, 2000) emphasize the importance of MNC international strategy and consider various strategies as different means to achieve different
This study defines integration-responsiveness (IR) framework (Bartlett & Ghoshal, 1989, 2000; Prahalad & Doz, 1987) was widely used to analyze environmental pressures concerning global integration and local responsiveness. This study defines local responsiveness strategy as the MNC’s differentiated products and services to meet various local demands, as well as differentiated policies and actions to adapt to local markets (Harzing, 2000). Pressure for local responsiveness derives from the circumstance that MNC must respond to contingencies varying dramatically among the environments where it operates. Those contingencies might be particular customer tastes, special government regulations, and different resource characteristics. For MNCs facing intense pressure for local responsiveness, managers should adjust practices in various subsidiaries in accordance with distinctive demand in each market. Therefore, these firms must develop adaptability to manage diverse market demands and learn how to quickly innovate products and practices by country (Bartlett & Ghoshal, 2000). Such exploratory learning is important in local responsive subsidiaries because the diversity of the local markets presents unique learning opportunities for MNCs (Luo, 2001). Subsidiary exploration refers to organizational behavior characterized by variation, risktaking, experimentation, discovery and the pursuit of new knowledge external to the MNC. Exploration is generally related to radical innovation, loosely coupled systems, risktaking, flexibility, often in the context of emerging markets and technologies. The organizational learning literature (e.g., Benner & Tushman, 2003; Holmqvist, 2004; O’Reilly & Tushman, 2008) generally argues that critical tasks in exploratory subsidiaries should focus on the adaptability by introducing market-specific products and breakthrough innovations in new market domains.

Grounding on the I-R framework, this study defines a global integration strategy as an MNC operating in industries of relatively standardized customer demand and pursuing economies of scale (Harzing, 2000). Pressure for global integration arises from organization’s opportunities to exploit commonalities across nations, including the integration of similar activities in order to reach production efficiency and economies of scale. For MNCs facing pressure for global integration, managers should learn how to save costs within worldwide networks and reduce redundancy among subsidiaries. Such exploitative learning is important in globally integrated subsidiaries because efficiency and cost are the major concerns for the MNC headquarters (Luo, 2001). Subsidiary exploitation refers to

gains (e.g., benefits of economies of scale from a global integration strategy vs. benefits of economies of scope and market expansion from a local responsiveness strategy). In the organizational management literature, headquarters control is argued to be central in theories of international organization because executing a proper degree of control is important maximize value creation and at the same time minimize value destruction in managing foreign subsidiaries (Bartlett & Ghoshal, 2000; Harzing, 2000).

Previous literature suggests three important relevant relationships among international strategy and headquarters uniculturality and control. First, MNC’s intention of adopting international strategy influences the necessary level of uniculturism (Doz & Prahalad, 1991). Second, the extent of headquarters control depends on the strategic contexts (Russo & Harrison, 2005; Wasserman, 2008). Finally, the degree of uniculturism largely depends on both benefits and costs associated with different strategies (Nohria & Ghoshal, 1994). Insight into when high uniculturality and tight control over subsidiary are needed would be valuable to the MNCs decision makers who are responsible for subsidiary performance. There is a need to develop an integrated model that simultaneously examines the effects of MNCs strategy, culture, and control, as well as their interactive effects on performance.

For understanding the complex relationships among strategy, control, and culture in MNCs (Wasserman, 2008), this study applies the exploration–exploitation framework of organizational learning (Levitt & March, 1988; March, 1991) to explain the performance implication of MNC fit. According to the exploration–exploitation framework of organizational learning, “essence of exploration is experimentation with new alternatives, whereas essence of exploitation is the refinement and extension of existing competences” (March, 1991, p. 85). In other words, exploration can be defined as “the pursuit of new knowledge”, exploitation as “the use and development of things already known” (Lewinthal & March, 1993, p. 105). In the context of international business, an MNC may establish an exploitative subsidiary to enhance efficiency in the existing area of expertise, or an exploratory subsidiary to enhance innovativeness by means of extending the existing area of expertise, and searching for new organizational direction (Benner & Tushman, 2003; Rothaermel & Alexandre, 2009). In general, exploitative learning is crucial for subsidiaries that face high levels of global integration, whereas exploratory learning is important for multidomestic subsidiaries. Exploratory and exploitative subsidiaries are argued to require different strategies, cultures, and controls in different subunits (Tushman & O’Reilly, 1997), thereby effectively transferring knowledge and resources between headquarters and subsidiaries (Monteiro, Arvidsson, & Birkinshaw, 2008).

This study combines the perspectives of contingency and organizational learning and contributes to the existing MNC theories in two aspects. First, as contingency theory predicts, strategy, culture and control need to be consistent with each other in order to generate superior performance (Galunic & Eisenhardt, 1996). This study extends contingency theory into a setting of international business, in which the selection of an international strategy influences the subsequent decisions on headquarters uniculturality and control. Proper strategy-culture and strategy-control fits can facilitate superior subsidiary performance in MNCs. The second theoretical contribution concerns the exploration–exploitation insights in predicting subsidiary performance. On the one hand, an exploitative subsidiary can realize benefits of economies of scale, as a MNC of international integration adopts high levels of control and uniculturality over the subsidiary. On the other hand, an exploratory subsidiary can realize benefits of economies of scope, as a MNC of local responsiveness adopts low levels of control and uniculturality.

Literature and hypotheses settings

International strategy and organizational learning

There is considerable variation in the typology of international strategy. The perspective of global versus federal strategy is a good example. Global strategy is considered as the pursuit of standardization, delivering similar product worldwide, and managing global cash flows (Ghoshal, 1987). Federal firms are considered to be locally responsive with respect to products and globally integrated with respect to manufacturing processes (Prahalad & Doz, 1987). However, the dichotomy between global and federal MNCs is not appropriate, for it masks the variation among firms adopting the same strategy, as well as ignores the similarities among firms adopting different strategies (Deviney, Midgley, & Venai, 2000). Following Dunning’s (1981) eclectic OLI (ownership, location, and internalization) paradigm, Luo (2001) as well as Özsoyer and Genctürk (2003) analyzed the internationalization of value chain activities and emphasized three key issues: (1) the configuration of activities including whether the activities should be distributed to headquarters or subsidiaries; (2) the coordination of activities, including whether activities should be standardized or adapted in each nation; (3) the linkage of activities, including how these activities are linked across functions.

In studies of MNC international strategy, the integration-responsiveness (IR) framework (Bartlett & Ghoshal, 1989, 2000; Prahalad & Doz, 1987) was widely used to analyze environmental pressures concerning global integration and local responsiveness. This study defines local responsiveness strategy as the MNC’s differentiated products and services to meet various local demands, as well as differentiated policies and actions to adapt to local markets (Harzing, 2000). Pressure for local responsiveness derives from the circumstance that MNC must respond to contingencies varying dramatically among the environments where it operates. Those contingencies might be particular customer tastes, special government regulations, and different resource characteristics. For MNCs facing intense pressure for local responsiveness, managers should adjust practices in various subsidiaries in accordance with distinctive demand in each market. Therefore, these firms must develop adaptability to manage diverse market demands and learn how to quickly innovate products and practices by country (Bartlett & Ghoshal, 2000). Such exploratory learning is important in local responsive subsidiaries because the diversity of the local markets presents unique learning opportunities for MNCs (Luo, 2001). Subsidiary exploration refers to organizational behavior characterized by variation, risktaking, experimentation, discovery and the pursuit of new knowledge external to the MNC. Exploration is generally related to radical innovation, loosely coupled systems, risktaking, flexibility, often in the context of emerging markets and technologies. The organizational learning literature (e.g., Benner & Tushman, 2003; Holmqvist, 2004; O’Reilly & Tushman, 2008) generally argues that critical tasks in exploratory subsidiaries should focus on the adaptability by introducing market-specific products and breakthrough innovations in new market domains.

Grounding on the I-R framework, this study defines a global integration strategy as an MNC operating in industries of relatively standardized customer demand and pursuing economies of scale (Harzing, 2000). Pressure for global integration arises from organization’s opportunities to exploit commonalities across nations, including the integration of similar activities in order to reach production efficiency and economies of scale. For MNCs facing pressure for global integration, managers should learn how to save costs within worldwide networks and reduce redundancy among subsidiaries. Such exploitative learning is important in globally integrated subsidiaries because efficiency and cost are the major concerns for the MNC headquarters (Luo, 2001). Subsidiary exploitation refers
to organizational behavior characterized by refinement, efficiency, production, and the pursuit of devising ways to exploit those things that are already known by the MNC (Levinthal & March, 1993; March, 1991). Different from exploration, exploitation is generally related to incremental innovation, high control, low risk, efficiency, and stable markets and technologies (Benner & Tushman, 2003; Raisch & Birkinshaw, 2008).

**Headquarters control**

Organizational control is referred to as monitoring the behavior of individuals in an organization and providing feedbacks to correct inconsistencies from the desired behavior (Thompson, 1967). The importance of control lies in bringing about conformance to organizational requirements and accomplishment of organizational goals. Therefore, control can be conceptualized as “the central activity of monitoring which is supported by selection and training” (Jaeger, 1983, p. 92). In the context of international business, headquarters control can be defined as “a vertical relationship between a higher ranked unit (headquarters) and a lower ranked unit (subsidiaries)” (Kretschmer, 2009, p. 8). In this relationship, an element of power (Harzing, 2000) usually is usually involved in the headquarters to shape subsidiaries’ decisions and actions (Gupta & Govindarajan, 1994).

Highlighting the importance of headquarters–subsidiary relationship, Bartlett and Ghoshal (1989) introduced three means of headquarters control. The first is centralization, which concerns the extent of formal hierarchical authority exercised by the headquarters over subsidiary actions. The second is standardization, referring to the extent to which the headquarters specifies how decisions are made, so that subsidiary behavior becomes predictable. The third is socialization, which shapes subsidiary manager’s perspectives through a set of shared goals and beliefs. Based on the argument that headquarters control should fit the overall environmental contingencies, Bartlett and Ghoshal (1992) and Ghoshal and Nohria (1993) suggested that different levels of centralization, standardization, and socialization are necessary in different environment conditions.

It is also argued that MNCs pursuing different international strategies might require various levels of headquarters control (Andersson, Björkman, & Forsgren, 2005; Kretschmer, 2009). Responding to pressures for global integration, international businesses might mass-produce a standardized product at the optimal location (or outsourcing), to realize location economies. This strategy is useful for local firms to go abroad if they produce commodity-type products, which are expected to be actively adapted to different national governmental regulations and local business practices. As products are expected to be adaptively used to different national preference, both modifications of the existing products as well as new product development (NPD) are necessary. Such high local responsiveness subsidiaries require distinct research and development (R&D), and marketing activities to make their products and services more appealing to a variety of local consumers. Under this situation, MNC headquarters and subsidiaries act as a loosely coupled federation of independent national divisions. In other words, subsidiaries operate rather independently from headquarters and other subsidiaries, since their major ties are with local demands. As a result, the local responsiveness strategy requires less inter–subsidiary coordination and headquarters control because all value chain activities are handled locally (Bartlett & Ghoshal, 2000).

In order to reduce cost and redundancy by means of quality and efficiency improvement of the existing products, exploitation is the key. As organizations learn to enhance efficiency through incremental improvements and variation reduction in routines, their linkage between routines and exploitative learning in the existing activities is tight (Levitt & March, 1988). An MNC of global strategy tends to promote global operations and explicitly organizes interdependent products and processes in both inter- and intraorganizational networks. For example, an MNC often increases control through centralization of decision making to enhance cost efficiency, and usually rationalizes global manufacturing activities by standardizing products and processes across local markets. In the subsidiary level, strong pressures for global integration can strengthen subunits’ perception of the connections with corporation’s global issues. Such subsidiaries, as “implementers” of the global manufacturing process, rely more on knowledge and technologies produced by other subsidiaries or headquarters (Gupta & Govindarajan, 1994). Thus, these subunits might be confronted by problems of integrating production activities with operations in other subsidiaries and tend to resolve them through exchange and refinement of existing knowledge. Through developing absorptive capability (Rothenberg & Alexandre, 2009) and managing collaborations (Powell, Koput, & Smith-Doerr, 1996), local subsidiaries benefit themselves from coordinating their knowledge with the knowledge developed by the headquarters and other subsidiaries (Monteiro et al., 2008).

The strategy–structure–performance model (Chandler, 1962) suggests that organizations adopt different strategies in response to environmental changes and in order to meet profit or growth objectives (Jones & Hill, 1988). An appropriate fit between headquarters control and strategy is an essential determinant of superior performance in MNCs (Nohria & Ghoshal, 1994). An MNC adopting global integration strategy tends to increase coordination benefits and reduce production costs by sharing resources and integrating knowledge between headquarters and subsidiaries. Given that such exploitative efforts of decreasing variance and increasing efficiency may require enhanced coordination and integration, a highly centralized headquarters with tight control over the subsidiaries is necessary (Benner & Tushman, 2003). The interdependent subunits must be tightly coupled in order to share knowledge and transfer resources in a coordinated manner (Lavie & Rosenkopf, 2006), which can further facilitate communication between subsidiaries and headquarters (Monteiro et al., 2008).

Thus, in some respects, a local responsiveness strategy is the reverse of a global integration strategy (Harzing, 2000). Following Bartlett and Ghoshal (1989), and Doz and Prahalad (1991), a local responsive MNC is strategically oriented to respond to local demands. Products and services are differentiated to meet national differences, and organizational policies are characterized to conform to governmental regulations and local business practices. As products are expected to be adapted to different national preference, both modifications of the existing products as well as new product development (NPD) are necessary. Such high local responsiveness subsidiaries require distinct research and development (R&D), and marketing activities to make their products and services more appealing to a variety of local consumers. Under this situation, MNC headquarters and subsidiaries act as a loosely coupled federation of independent national divisions. In other words, subsidiaries operate rather independently from headquarters and other subsidiaries, since their major ties are with local demands. As a result, the local responsiveness strategy requires less inter–subsidiary coordination and headquarters control because all value chain activities are handled locally (Bartlett & Ghoshal, 2000).

While exploitation involves the search for efficiency improvement in the existing products of the MNC, exploration involves the search for adaptive products/services in every local market (Benner & Tushman, 2003). A multidomestic subsidiary is exploratory in two ways. First, local managers might find opportunities to creatively redeploy firm’s current distinctive competences to develop new...
Appendix A: Study measures

<table>
<thead>
<tr>
<th>Measure</th>
<th>Items</th>
<th>Sources</th>
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<tbody>
<tr>
<td>Headquarters control</td>
<td>1. This subsidiary is able to decide for itself how it invests in new technology (reversed)</td>
<td>Williams and van Triest (2009)</td>
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<td></td>
<td>2. This subsidiary is able to decide human resource policy for itself (reversed)</td>
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<td></td>
<td>3. This subsidiary has a headcount which is strictly dictated by the headquarters</td>
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<td></td>
<td>4. This subsidiary makes a big attempt to stick to budget levels set by the headquarters</td>
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<td>Headquarters uninculturalism</td>
<td>1. This subsidiary emphasizes corporate values and norms on internal induction and training courses</td>
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<td></td>
<td>2. Managers in this subsidiary agree to the goals of the headquarters</td>
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<td></td>
<td>3. Managers in this subsidiary use the same standards of behavior as headquarters colleagues</td>
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<td></td>
<td>4. Managers in this subsidiary support new global initiatives launched by the headquarters</td>
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<tr>
<td>Global integration strategy</td>
<td>1. Please give your best estimate of the percentage of purchases from headquarters in relation to the total amount of purchase of this subsidiary</td>
<td>Harzing (2000)</td>
</tr>
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<td></td>
<td>2. Please give your best estimate of the percentage of purchases from other subsidiaries of the group in relation to the total amount of purchase of this subsidiary</td>
<td></td>
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<tr>
<td></td>
<td>3. Please give your best estimate of the percentage of the yearly output of this subsidiary that is sold or delivered to headquarters</td>
<td></td>
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<td></td>
<td>4. Please give your best estimate of the percentage of the yearly output of this subsidiary that is sold or delivered to other subsidiaries of the group</td>
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</tr>
<tr>
<td>Local responsiveness strategy</td>
<td>1. Please give your best estimate of the percentage of R&amp;D incorporated into products sold by this subsidiary that is actually performed by this subsidiary</td>
<td></td>
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<tr>
<td></td>
<td>2. Please give your best estimate of the percentage of company products sold by this subsidiary that have been manufactured by this subsidiary</td>
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<td></td>
<td>3. Please give your best estimate of the percentage of company products sold by this subsidiary that have been created or substantially modified for this market</td>
<td></td>
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<td></td>
<td>4. Please give your best estimate of the percentage of marketing for company products sold by this subsidiary that is consciously adapted to local circumstances</td>
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References


