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

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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.

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

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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 uniculturalism and control. First, MNC's intention of adopting international strategy influences the necessary level of uniculturalism (Doz & Prahalad, 1991). Second, the extent of headquarters control depends on the strategic contexts (Russo & Harrison, 2005; Wasserman, 2008). Finally, the degree of uniculturalism largely depends on both benefits and costs associated with different strategies (Nohria & Ghoshal, 1994). Insight into when high uniculturalism 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" (Levinthal & 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 fro 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 uniculturalism 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 uniculturalism 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 uniculturalism.

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 (Devinney, Midgley, & Venaik, 2000). Following Dunning's (1981) eclectic *OLI* (ownership, location, and internalization) paradigm, Luo (2001) as well as Özsomer 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