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# The Roles of Subsidiary Boards in Multinational Enterprises☆

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A B S T R A C T

In recent years, shareholders, regulators, and academics have become increasingly interested in how multinational enterprises (MNEs) can ensure sound corporate governance throughout all entities within a firm. One important mechanism available to MNEs for improving their global governance is the subsidiary board of directors. However, to date scant academic research has focused on the roles of subsidiary boards and the factors that influence their involvement in different roles. Using survey data from a sample of MNE subsidiaries operating in Belgium with headquarters in 14 different countries, we find that a subsidiary board performs four roles: control, strategy, coordination, and service. Further, a subsidiary board is more involved in control, strategy, and service roles if the subsidiary operates only in the local market, independently from the headquarters (the local implementer subsidiary). In particular, the board of the local implementer subsidiary is more involved in strategy and coordination roles when more directors are headquarters country nationals. Our findings collectively suggest that the subsidiary board facilitates a subsidiary's pursuit of its strategic objective and helps to manage the headquarters–subsidiary agency problem. Moreover, subsidiary directors' characteristics influence the subsidiary board's ability to perform its roles.



## 1. Introduction

Over the last few decades, the corporate governance of foreign subsidiaries in multinational enterprises (MNEs) has drawn increasing interest from both academic researchers (Filatotchev and Wright, 2011; Gillies and Dickinson, 1999) and practitioners (Gibson et al., 2013). The subsidiary board can oversee the performance of subsidiary management on behalf of headquarters, review a subsidiary's strategic plans and internal policies, and ensure the sound governance at the subsidiary level (Kriger, 1988; Leksell and Lindgren, 1982). Moreover, the subsidiary board can help to integrate the subsidiary into the MNE, facilitating the subsidiary's access to critical resources and knowledge (Kriger, 1988; Leksell and Lindgren, 1982). As such a subsidiary board is a key internal governance mechanism available to the MNE.

Despite the usefulness of subsidiary boards, assigning various tasks to subsidiary boards may be less efficient or too costly, and the extent to which subsidiary boards engage in performing board roles can vary considerably (Reuer et al., 2014). In some cases, subsidiary boards are set up simply to fulfill local legal requirements (Gillies and Dickinson, 1999). This situation raises challenging questions

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for research and practice. What are the roles of subsidiary boards in MNEs beyond legal requirements? What are the factors that influence the subsidiary board's involvement in different roles? While the importance of subsidiary boards is known, little empirical research has examined these questions.

This study investigates the determinants of the roles of subsidiary boards in MNEs. Drawing upon the literature about boards of directors and international management, we first identify four different roles performed by subsidiary boards in MNEs; namely, control, strategy, coordination, and service. Second, we examine factors that influence the subsidiary board's involvement in each of these roles. Specifically, we focus on the subsidiary's strategy and the nationalities of the subsidiary directors.

International business research suggests that foreign subsidiaries possess distinct resources and knowledge, which creates information asymmetry and agency problems in headquarters–subsidiary relations (Roth and O'Donnell, 1996). To take advantages of each subsidiary's distinct capabilities and shape the optimal overall strategy, an MNC can implement different strategies in each of its subsidiaries (Bartlett and Ghoshal, 1986; Birkinshaw and Morrison, 1995; Ghoshal and Bartlett, 1990; Gupta and Govindarajan, 2000). Thus, headquarters must contend with the stress created by controlling a subsidiary's activities on the one hand, while facilitating its ability to achieve its strategic objectives on the other hand. Prior research suggests that headquarters use different control and coordination mechanisms to manage the underlying tension in the headquarters–subsidiary relationships. In the current study, we extend this literature and argue that a subsidiary board can help to manage the tension by performing various roles.

Further, the literature on boards in stand-alone firms suggests that firms adapt their board structure to heterogeneous needs for actions such as monitoring and advising (Boone et al., 2007; Linck et al., 2008). Moreover, these boards' ability to perform a specific task is related to the directors' experience and knowledge (Carpenter and Westphal, 2001; Hillman and Dalziel, 2003; Kim and Cannella, 2008; Kroll et al., 2008; Rindova, 1999) and their power to accomplish the task (Westphal, 1999; Westphal and Zajac, 1997). We assume that these findings can be extended to subsidiary boards. In the context of MNEs, a growing literature on board internationalization provides valuable insights into the antecedents (Oxelheim et al., 2013; Van Veen et al., 2014) and consequences (Masulis et al., 2012; Oxelheim and Randøy, 2003) of recruiting foreign directors onto the corporate boards of MNEs. However, less is known regarding the usefulness of recruiting foreign directors as members of subsidiary boards in MNEs. From this literature, we identify an interesting class of subsidiary board members whose characteristics are unique for MNEs. Specifically, we focus on the presence of headquarters country nationals on subsidiary boards. Because they are representatives of headquarters in the subsidiary, headquarters country nationals on the subsidiary board can be expected to help monitor the subsidiary and ensure the transparency and accountability of the MNE's actions beyond the national context. Moreover, these directors' experience and knowledge of headquarters countries may help to integrate the subsidiary into the MNE group.

Using survey data from a sample of MNE subsidiaries operating in Belgium with headquarters in 14 different countries, we find that a subsidiary board is more involved in control, strategy, and service roles if the subsidiary is a local implementer, which operates only in the local market and carries out certain specific value-added activities independently from the headquarters (Birkinshaw and Morrison, 1995). This scenario suggests that given the difficulties faced by the headquarters in controlling the activities of a local implementer subsidiary centrally, the subsidiary board becomes a particularly important mechanism for watching over the actions and strategic decisions of the subsidiary. Moreover, while a local implementer subsidiary is tightly embedded in the local market, the subsidiary board may span boundaries to bring critical resources to the subsidiary.

Our results further reveal that the board of the local implementer subsidiary is more involved in strategy and coordination roles when more directors are nationals of the headquarters countries. This supports our argument that headquarters country nationals on a subsidiary board have the knowledge and authority to ensure that the subsidiary's strategy is in harmony with the MNE's overall goals. In addition, these directors' professional ties and experience in headquarters countries facilitate headquarters–subsidiary information processing and internal coordination within the MNE. Finally, results from our control variables are consistent with prior research. In particular, we find that Japanese MNEs' subsidiary boards are more active in strategy formulation and coordination tasks (Kriger, 1988).

To the best of our knowledge, our study is the first to provide empirical evidence on the factors that influence a subsidiary board's involvement in different roles. To date, the corporate governance research has looked at boards in stand-alone firms (for reviews see Adams et al., 2010; Hermalin and Weisbach, 2003; Zahra and Pearce, 1989) and corporate boards in MNEs (Lai et al., 2012; Oxelheim et al., 2013; Sanders and Carpenter, 1998; Sherman et al., 1998; Staples, 2007; Tihanyi and Ellstrand, 1998). Only a few studies have examined the roles of subsidiary boards, and they have provided inconclusive results (Björkman, 1994; Gillies and Dickinson, 1999; Kriger, 1988; Leksell and Lindgren, 1982). For example, Kriger (1988) and Björkman (1994) find that subsidiary boards often participate in the strategy formulation of subsidiaries, but Leksell and Lindgren (1982) find little evidence for this role. One possible explanation for the conflicting results could be that the studies look at the roles of the subsidiary board in isolation; none of these studies addresses the extent to which subsidiary boards perform the different roles. Du et al. (2011) investigate the conditions under which foreign subsidiaries maintain active boards that perform tasks beyond fulfilling local legal requirements. Despite the valuable insight, Du et al. (2011) do not account for the various separate roles that boards of multinational subsidiaries actually play and the determinants of each role. We contribute to the emerging field in subsidiary governance by providing evidence that the involvement of the subsidiary board in each role depends on the strategy of the subsidiary and the characteristics of subsidiary directors. As such our study also complements the rich literature on management control in MNE subsidiaries (e.g., Andersson and Forsgren, 1996; Ghoshal and Nohria, 1989; Jaussaud and Schaaper, 2006; Lin, 2014; Nohria and Ghoshal, 1994; Yu et al., 2006) by identifying the subsidiary board as a new control and coordinating mechanism available to MNEs for managing their foreign subsidiaries. Our results confirm that agency theory and resource dependence theory are useful in explaining the roles of subsidiary boards.

The remainder of this study is organized as follows. Section 2 first reviews the literature on board roles in stand-alone firms. It then discusses the roles of subsidiary boards and develops hypotheses on the factors related to these roles. The subsequent two sections