

# Strategic and Operational Scope of Foreign Subsidiary Units

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**Abstract**— *A foreign subsidiary unit formulates the scope of its strategic and operating activities based upon: (a) its MNC headquarters, (b) its host country and regional environments, (c) the global influences of its industry, (d) its own internal organizational environments, and (e) its own strategic leadership. Strategic and operational scope formulation process is vital to the successful unit goal accomplishments. An effective MNC would not be an “empire” model, but a “commonwealth” model.*

**Keywords**— *Foreign subsidiary units, strategic and operational scope of MNC’s units, MNC competitiveness.*

### I. INTRODUCTION

Multinational corporations (MNCs) should develop an effective scope of strategic and operational activities for its foreign subsidiary units. Units may undergo radical or evolutionary change in scope of strategic and operational activities. The stage in the unit’s life cycle determines the scope of its strategic and operating activities. Innovation in and knowledge sharing among foreign subsidiaries are important components for added overall MNC competitiveness in this context, and, they become important components of foreign subsidiaries’ strategic and operational scope (Filippova, 2014; Poon, Kedron and Bagchi-Sen, 2013). Also, important considerations are the subsidiary characteristics and autonomy as they would affect the morale and motivation of the subsidiary management in day-to-day working terms (Raziq, Borini, Perry, and Battisti, 2013).

When India abolished the managing agency system on April 2, 1970, the industrial house of Tatas, run by J.R.D. Tata, had to move his multi-industry enterprise from a centralized “empire” mode of management to a “commonwealth” mode. R.M. Lala, the author of J.R.D. Tata’s biography, entitled “From Empire to Commonwealth,” describes in Chapter XI, J.R.D. Tata’s management style thus: “Until 1970 J.R.D., under the Managing Agency System, ruled an Empire carrying on his shoulders its burden and its glory. From 2 April, 1970 the Empire had become a Commonwealth. J.R.D. found himself in the role of the Head of a Commonwealth where he had to rule with persuasion and influence. His writ no longer ran over all Tata companies, for the Board of Directors of each company was independent of the parent company, although many or some on the Board are from Tata’s and Tata’s still manage them on behalf of the shareholders of each company. In sum, when the Managing Agency System was abolished, an era had ended. As the years passed, powerful Managing Directors of individual companies stamped their own identities on the companies they ran. While J.R.D. is still alive, there was a sense of unity and continuing to knit the various companies together, and, what one might call the Tata ethos still holds sway - a Group identity that is greater than the sum of its many parts. This is so because when J.R.D. had previously ruled his Empire, he did so not as an autocrat but as a democrat who never imposed himself on his chief executives” (Lala, 1993, 272).

A multinational corporation (MNC) must be managed just like a commonwealth of foreign units. It should be managed through participation, discussion and persuasion. It should not be run autocratically. The CEO of an MNC should not command compliance from the chiefs of foreign units, but instead seek open discussions and (near) consensus. This approach of providing fuller local strategies and operational autonomy is vital for foreign units to effectively adjust to host environments.

### II. LITERATURE REVIEW-BROADER THEORETICAL ISSUES

Many scholars have pursued the idea of an organization pursuing the agency theory insofar as it provides the basis of internal organizational control mechanisms (Birkenshaw, Hood & Jonsson, 1998; O’Donnell, 2000; Roth & O’Donnell, 1996; Reuer & Miller, 1997; Roth & Morrison, 1992). Issues of intra-firm interdependence (or relatedness among units and headquarters of an MNC) seem to have strong support in the literature for providing the indication of the management process within an MNC (Birkenshaw, 1996; Rajagopalan & Finkelstein, 1992; Tosi, Katz & Gomez-Mejia, 1997; Zajac & Westphal, 1995). Additionally, competitiveness of foreign subsidiaries is an important issue as the internal mechanisms and inter-relatedness are addressed (Miravittles, Guitart-Tarrés and Nuñez-Carballosa, 2014).

Birkenshaw and Hood (1998) have studied the process by which foreign subsidiary units evolve. They posit that as foreign units evolve, the units increase or decrease their capabilities, and they also change the scope of their charter. Further, Birkenshaw and Hood provide a framework for analyzing a foreign unit's evolution, which they claim is driven by: (a) the headquarters "inputations" and directives, (b) the foreign unit's own choice, and (c) host country environmental influence.

The foreign unit develops its role in its strategic and operating scope through its perception of: (a) the choices of the headquarters and the foreign unit, (b) the perception of local opportunities and threats in the context of the unit's needs, and (c) the needs and expectations of the host country environment. The focus of a foreign unit may shift from one project or problem to another in the context of the above strategic and operating decision making paradigm (Aggarwal & Ramaswami, 1992; Galunic, 1996; Noda & Bower, 1996). The continual assessment followed by the foreign unit depends upon the foreign unit's intra-organizational information evaluation, and based upon it, its re-evaluation of its existing policy. Growth of a foreign unit is predicated upon its resource acquiring capabilities, either on its own from its host country or from its headquarters. Its extant policy considerations should be further evaluated for its changing growth needs. Competitor information and market analyses would further its evaluation of strategic alternatives.

## 2.1 Literature Review of Strategic Decision Making at MNC: Relationship between MNC Headquarters and Its Foreign Units

Table 1 provides the two contrasting attributes of the MNC's headquarters: (a) empire approach, and (b) commonwealth approach. The MNC's headquarters management assumptions have a major impact upon its ways of dealing with its foreign units. If it wants to completely dominate the foreign units then it would adopt the "empire" approach. On the other hand, if it wants to invite inputs ahead of time, fully discuss with the foreign units on an equal basis, and come up with a consensus (or near consensus) in its final decision on major issues, then it would adopt the "commonwealth" approach. Table 1 provides details of attributes of the two approaches.

**TABLE 1**  
**STRATEGIC DECISION MAKING AT MNC: A TALE OF TWO STYLES OF RELATIONSHIPS**  
**BETWEEN MNC HEADQUARTERS AND ITS FOREIGN UNITS**

Dimensions of Attributes	"Empire" Approach	"Commonwealth" Approach
1. Assumptions	Autocratic headquarters rules	Community of units & headquarters
2. Strategic rationale	Headquarters vision is the only correct one	Shared vision actively developed by headquarters and units
3. Organizational philosophy	Headquarters driven growth strategy	Consensus derived growth strategy
4. Strategic flexibility	Limited	Greater
5. Strategic coordination	Very close, tight knit	Loose, often uncoordinated
6. Organizational structure	More focused, uniform even among units	More varying among units
7. Organizational culture	Emphasis on headquarters preferred practices	Grass roots, local, host country national culture
8. Lateral(inter-unit) communication	Not much meaningful	Significant
9. Inputs (by units) in strategic decision making	Limited, reactive	Substantial, proactive
10.Strategy implementation	Headquarters-driven process & method	Headquarters & unit-driven process & method

In the empire approach, the headquarters drives the vision, goals, strategies and structure. It even tries to enforce the preferred organizational culture upon the foreign units. The decision making construct is very confining for the foreign units. They are specifically told what they can and cannot do. There is a tendency to uniformly administer all foreign units with a straight, even hand. This tends to take away any strategic flexibility or adaptability from the foreign units. The highly

centralized decision making process seeks to make unit chiefs loyal, committed order takers and policy implementers. There can be no choice in a tightly run empire.

The opposite approach is one where there is centralized coordination and decision-influencing performed by the headquarters. This provides a forum for fuller discussion and analyses and organization of information and factual data for making decisions. The foreign units perform a valuable role in carefully gathering and analyzing relevant information so that they may provide useful inputs to the discussion and final decision making process. The approach is one of community of the units and headquarters. The decision making style is characterized as participative, open, fair and systematic. There is more grassroots initiative to provide newer ideas and solutions. Further, there is better support for implementation once a decision has been made regarding the future course of action. There is a likelihood of better perceived equity in allocation of resources for expansion, future projects, and human and capital investments. This is because the process is generally more open, and the underlying reasons are usually provided to the units. The unit-to-unit interaction and communication is very strong.

MNCs need to focus upon their choice of managing their foreign units. The nature of global environments can make a decisive impact upon the choice of the MNC headquarters-foreign units relationship. A very competitive and turbulent environment may make the headquarters decentralize all operational decision making, and also some of the local strategic decision making.

### III. MNC HEADQUARTERS-FOREIGN UNITS RELATIONSHIP EXAMPLES AND DISCUSSIONS

The quality of an MNC's headquarters-subsidary unit relationship can be analyzed along many important dimensions. These are delineated in Table 2. The level of perceived organizational crisis or challenge (or lack of it) is an important watershed upon which the MNC-foreign unit relationships exist. If the level of perceived organizational crisis is high, then the relationship can be strained if the foreign unit does not closely and quickly follow the behests of the headquarters. This is found in the case of Mr. Carlos Goshn, the CEO of the ailing Nissan, driving the organization to quickly change, which he successfully did within one and a half years (Time, 2001). To achieve a dramatic turn around, Goshn focused upon all domestic and foreign units to focus on the market, slash costs and become very responsive.

**TABLE 2**  
**MNC HEADQUARTERS-FOREIGN UNITS RELATIONSHIP**

The corporate headquarters-subsidary units' relationships should be analyzed in the context of these issues:

- Level of organizational crisis or challenge
- History or lack of autonomy of the units; or, the power distribution between HQ and units
- Degree of resource self-sufficiency of the unit
- Interdependence of tasks and processes between HQ and the unit
- Operative goal incompatibility
- Task and process differentiation
- Resource scarcity - as felt by all foreign units
- Perceived uncertainty in the external environment
- Diversity of cultures between HQ and units
- Perceived reward system inequity.

Generally speaking, the greater the intensity of any, some, or all of the above would tend to intensify HQ-unit conflict, and, consequently, HQ-unit relationships would suffer. This would result in greater distrust, adversarial working relationships, lack of empathy, increased tensions and decreased creativity, risk-taking and entrepreneurial activities. There are ways to improve. A successful, global company would display lower or lesser intensity on all of the above parameters.

The history of autonomy accorded by the headquarters to its foreign units has a force and momentum which is difficult to reverse unless there is a perceived organizational crisis or challenge. Power distribution between the headquarters and the foreign units is a major factor in determining the relationship. The more equitable the distribution, the better would be the relationship. The greater the interdependence between headquarters and the foreign units, the greater would be the chances of conflict between the headquarters and the foreign units. This is because the decisions and actions of the unit would be second-guessed.

Resource dependence is an important issue. If a foreign unit is dependent upon its MNC headquarters for its resources needed for capital improvements and human development, then the unit's autonomy will be diminished. On the other hand, if it is able to raise its own resources locally (e.g. through retained earnings, plowing back of profits, local long term loans), then it is quite independent of the headquarters. This situation makes it conducive for greater autonomy for the unit.

The better the history of a foreign unit's growth and profit picture, the better would be the chances for greater willing autonomy given to the unit by the MNC headquarters. The headquarters is looking for good profits, good competitive performance, good morale, and good strategic flexibility (to change with the times). Thus, if a foreign unit aspires for greater autonomy, then the best way is to improve its performance on profits, competitiveness, morale and strategic adaptability.

Almost all MNCs would face the problem of cultural diversity between the MNC headquarters and its foreign units. National cultures of the headquarters and those of its foreign units are not only going to be different, but often quite distant. Cultural distance is a problem. And MNCs must seek ways to bridge that. This makes it imperative to have much more frequent interactions and personal visits in both directions; from headquarters to foreign units, and from foreign units to headquarters. This helps to foster personal relationships. Executives on both sides will develop empathy and understanding for each others' problems and difficulties. As it is, the great cultural divide makes it difficult to organize a unified global strategy, so it is not advisable to let weak human relationships spoil the process.

Another common problem may be the perceived inequity of resource allocation for future expansion and growth. If some units feel that they are not getting their fair share of future growth projects, then their feelings of inequity will stifle the units' executive initiative and drive. This must not be allowed to happen. Good, clear, open communication and exposition of headquarters' rationale for allocation of future funds and projects are the keys to good feelings among the MNC's community of foreign units.

Good headquarters-foreign units relationships are vital to sustained MNC growth, profitability and competitiveness. The relationships should be a combination of: (a) supportive or helpful, (b) complimentary or praising, (c) critical thinking or constructive criticism, (d) that which is based upon factual data, (e) continuous or frequent interaction, (f) that which generates innovative solutions to problems, and (g) that which focuses on identifying and developing new opportunities.

#### IV. SUCCESSFUL MNC FOCUS ON THE RELATIONSHIP ISSUES

One may ask, "What are the vital issues for developing successful headquarters-foreign unit relationships?" There are many vital issues. They usually depend upon the unique situation of a particular MNC. However, some of the generic issues are delineated in Table 3. This is neither an exhaustive list nor is it a list of the most important issues for all organizational situations. These will vary for the same MNC over different periods of time.

**TABEL 3**  
**SUCCESSFUL MNC FOCUS ON RELATIONSHIP ISSUES**

<p><b>Successful MNCs focus on:</b></p> <ul style="list-style-type: none"> <li>• Strategic and operational decentralization and coordination</li> <li>• Lateral communication and cooperation across all foreign units</li> <li>• Analytical, rational, data-driven approach as well as insightful, qualitative, judgmental approach</li> <li>• Significant interactions between HQ-unit to people, in a most helpful manner</li> <li>• HQ is seen to seek prior inputs, and seriously consider them in making important decisions that have far reaching impact across the MNC and its units</li> <li>• Future top HQ managers are groomed in the foreign units</li> <li>• Resource allocation process is open, fair, needs as well as results based</li> <li>• Strategy formulation process is systematic, sophisticated, participative, highly integrated, and is based upon inputs from all foreign units and their respective external environmental segments, as seen by the units themselves</li> <li>• Competitors analyses, ethical, societal and human resource issues are an integral part of strategy formulation and implementation process, taking care that inputs from and at unit levels are given at least equal importance</li> <li>• The HQ is perceived by units as being helpful to future growth of the units</li> </ul> <p>A supportive, helpful HQ would foster much more cooperative units. While there is no one formula to improve the HQ-unit relationships, the above may be considered a portfolio of means from which to choose which methods/means would be more useful and effective. Finally, a global far flung MNC cannot be unjustly dominated by its HQ and continue to be successful. The units must share in the vision; goals, strategies, methods and tactics, and the units must also be able to participate more fully. This is a template of an effective HQ-unit relationship model.</p>
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A very likely common issue for an MNC operating in a very dynamic and competitive environment is the challenge of strategic and operational coordination. There is a need for both: (a) autonomy for the foreign units, and (b) a coordinated, if not unified, endeavor to manage the units in the wake of competitive players in the industry. Horizontal communication among the foreign units to share recurring problems among foreign units would be most recommended. Sharing of experiences would foster good team spirit among the foreign units. Before the headquarters makes any significant decision which can have a major impact or concern to the foreign units, the MNC headquarters must check with the units for their ideas, concerns, and suggestions. This approach would diffuse any subsequent conflict. Also, future cooperation would be enhanced so that implementing would be substantially smoother. Seeking prior inputs would be a practical and good approach.

Good relationships between the executives of MNC headquarters and foreign units are always beneficial. It is possible that future executives at the headquarters may be brought in from the various foreign units. The forging of a “one-feeling” is conducive to grooming future executives in the ranks of the MNC headquarters.

Competitive analysis must be conducted globally by an MNC if it is to thrive in the long run. Strategic analyses and reviewing potential opportunities requires active cooperation from all foreign units. Strategic action should be the domain of all of the MNC organization, not just the headquarters executives. The foreign units must be integrated into the process. In this way the units will share in the MNC vision, objectives, goals, strategies and tactics. Through fuller participation and involvement the units would generate a stronger will to further the MNC’s interests worldwide.

Whenever discussions are planned, the MNC should encourage its headquarters and foreign units to generate all the relevant data, information and insights on the problem or project to be analyzed. In this way, analyses would be closely based upon facts, data and genuine depth of insights. This approach would ensure that all decisions are based upon reality, not upon organizational politics and schemes.

## V. CONCLUSION

MNCs should focus upon their global and foreign unit’s host environments in evolving their headquarters-subsidiaries relationship pattern. The more turbulent and competitive the environment, then the more decentralized should be the decision-making. The MNC should regard the foreign units definitely as a commonwealth, or a community, of almost equal members. This would lead to a more power sharing and equality model. The focus should be more to coordinate and cooperate on important on-going activities. The autocratic or “empire” approach of the headquarters is out of place in today’s dynamic, competitive environment.

The history of headquarters-units relationships would significantly influence the future trend of relationships. Happy, cordial helpful relationships of the pristine times tend to so continue. Close ties of consultative nature marked by supportive and reinforcing relationships similarly would continue. The greater the interdependence and resource dependence of the units upon or with the headquarters, then the greater would be the relative power of the headquarters. The focus of the units would move away from headquarters if they are capable of generating resources locally.

There are many issues upon which MNCs should focus if they are to be successful. These include: headquarters decentralizing unit’s local strategic and operational decision making so that each unit has greater strategic flexibility and operational autonomy in order to be competitive, proactive and profitable. The discussions between the headquarters and the units must be based upon factual data and clearly developed analyses so that the quality of decisions would be good. On all strategic decisions there should be substantial interaction between the headquarters and the units, with the headquarters seeking inputs form the units before decision-making. The resource allocation process must be open, fair and should follow a consistent rationale. The headquarters should be the integrator of analyses of competition, ethical, societal, human resource, technological. In this way, the MNC would formulate a comprehensive framework of strategic decision making.

The MNC, its headquarters and its foreign units should ideally function as a close-knit federation of organizations focusing on a common purpose and vision. This approach is preferred to an autocratic headquarters ruling over its subsidiary units. The focus on long term growth and development should guide on all issues, particularly: competitiveness, profitability, organizational development, human resource and capital investments. The future and external orientations should drive the organizational strategy.

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