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Igor B. Gurkov, Michael J. Morley

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RENEWED DEBATE ON
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MANDATES, CORPORATE
PARENTING STYLES AND
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We argue that multinational headquarter-subsubsidiary relations in international business remain undertheorized as a result of a dearth of constructs that capture and reflect the complex facets of such relations. Based on data from 40 interviews conducted with senior managers in 25 multinational corporations designed to chart both the evolving competitive arena in which they operate and, against this backdrop, the changing nature of the corporations architecture and network of headquarter-subsubsidiary relations, we make the case for a focus on subsidiary mandates, corporate parenting styles and collective psychological contracts, three constructs which we believe offer explanatory power in landscaping the contemporary nature of these relations. We suggest that insights garnered from these constructs may offer the prospect of charting and explaining a greater range of issues pertinent to headquarter-subsubsidiary relationships and, from a theoretical perspective, could serve to renew aspects of the debate on such relationships. Arising from this we present a series of propositions designed to explicate the value of these constructs in opening up potential lines of enquiry in multinational headquarter-subsubsidiary relations.

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Keywords: Multinational Corporations; Headquarter-subsubsidiary Relations; Subsidiary Mandates; Collective Psychological Contacts; Corporate Parenting Styles.

¹ D.Sc., National Research University Higher School of Economics (Moscow, Russia), Professor;
E-mail: gurkov@hse.ru

² Ph.D., University of Limerick (Limerick, Ireland), Professor; E-mail: Michael.Morley@ul.ie

Introduction

Multinational corporations [MNCs] are complex economic organizations [Nell and Ambos, 2013] designing and organizing value creating and value appropriating activities across multiple institutional and cultural contexts simultaneously. Most of those activities are performed by separate organizational subsidiary units which vary in size, form, location and embeddedness. Their mandate may range from operating as country or regional sales entities, to manufacturing/operations units, through to research and development facilities, or indeed on occasion, to serving as tax heaven treasuries. Various aspects of the relationship between these subsidiary units and their headquarter organizations have been, and remain, key lines of enquiry in international business research and there has been a steady increase in the volume of scholarship published in leading journals seeking to unravel aspects of headquarter-subsidiary relationships [Hedlund, 1980; Garnier, 1982; Birkenshaw and Hood, 1998; Goold and Campbell, 2002; Bouquet & Birkinshaw, 2008; Dorrenbacher and Gammelgaard, 2010; Narula, 2014] and in academic volumes dedicated to explicating aspects of the relationship and the future of global organizing [Van Tulder, Verbeke and Dregendijk, 2015, Ambos, Ambos and Birkinshaw, 2016].

One key challenge with academic enquiry into headquarter-subsidiary relationships is the absence of a unifying theory that can encompass and account for the range of situations and interactions in which headquarters and subsidiaries find themselves when transacting business. Tenets of the “behavioral theory of foreign investments”, pioneered by Aharoni in the 1960s [see Aharoni, 2010; Aharoni, 2013] have more recently been employed in the behavioral theory of the multinational corporation [Birkinshaw, Bouquet and Ambos, 2007; Birkinshaw, Holm, Thilenius and Arvidsson, 2000; Birkinshaw and Lingblad, 2005]. Within this approach, aspects of the language of group and organizational psychology are being invoked more commonly in describing particular phenomena in headquarter-subsidiary relations, with, for example, authors variously referring to “perception gaps” [Birkinshaw, Holm, Thilenius, and Arvidsson, 2000; Chini, Ambos and Wehle, 2005], “issue selling and positive and negative attention” [Conroy and Collings, 2016] and “sheer ignorance” [Ciabuschi, Forsgren and Martín Martín, 2012]. Arguably however the behavioral theory of the multinational corporation remains a rather phenomenon driven description of certain underlying processes rather than a developed theoretical framework.

The more recent attempt to use agency theory as a theoretical framework which encompasses some behavioral elements including bounded rationality and self-interest in its efforts at depicting headquarter-subsidiary relationships [Kostova, Nell and Hoenen, 2016] has resulted in a typology of undesired organizational interactions. Although denominated types of headquarter-subsidiary relationships [opportunistic behavior, erroneous behavior] can be evidenced as manifestations of situations where poor internal control mechanisms and/or the loss

of overall strategic orientation of the parent occur, the ideal type of “dutiful behavior” of an obedient knowledgeable and competent subsidiary is arguably less likely given that competence-creating subsidiaries are usually the least obedient subsidiaries and are often found to be constantly demanding a wider “bandwidth” in order to launch subsidiary-initiated projects designed to bolster their institutional position in the MNC and safeguard their futures [see Narula, 2014; Ciabuschi, Forsgren and Martín Martín, 2016]. In addition it may be that headquarters themselves are best not considered as the “principals”, but rather as agents themselves in the network of relations with shareholders ultimately occupying the position of true principals.

The knowledge-based theory of economic organization [Low and Ho, 2015] provides a fresh approach to understanding aspects of the scope of the MNC and offers the prospect of shedding additional light on headquarter-subsidiary relations, especially on relations with foreign R&D units and manufacturing units, but unlike the previously described approaches, it does assume an underlying rationality in the behavior of the MNC as a whole, the making of seamless judgments on where specific knowledge is located and the capacity to evaluate the opportunity costs of internal efforts dedicated to the development of specific knowledge versus the acquiring or contracting of knowledge holders from elsewhere.

Closer examination of other widely used approaches in international management studies including the institutional approach [Wood and Demirbag, 2012; Hotho and Pedersen, 2012; Cantwell, Dunning and Lundan, 2016] and perspectives centering on the explanatory power of national culture differences [Dikova, 2009; Berry, Guillen and Zhou, 2010; Rohlfer and Zhang, 2016] also reveals some weaknesses, most notably with respect to the emphasis being put on *differences* between home country and host countries in various aspects. It has recently been argued that it may be time to distance ourselves from the distance concept [Harzing and Pudelko, 2016]. In addition Stahl, Tung, Kostova and Zellmer-Bruhn argue that ‘undue emphasis on the negative in existing IB research can inhibit our understanding of the dynamics, processes, and conditions that enable organizations to benefit from diversity, including the development of strategic capabilities, improving foreign direct investment decisions, and facilitating synergy creation in mergers and acquisitions across countries’ [2016: 624]. Furthermore, even if we ignore the on-going erosion of the concept of home country in the modern corporation [with more and more frequent cases of differences between the corporation’s country of legal residence and the location of the operational headquarters] the emphasis on differences automatically excludes domestic subsidiaries [R&D centers, sales organizations, manufacturing units located in the same country where the operational center of a corporation resides] from the analysis. Typically, such units occupy a very important part of many MNCs configuration, especially for US MNCs and those from large European economies [Germany, the UK, France and Italy] as well as for Chinese,

Brazilian and Russian MNCs which are in the earlier stages of internationalization [see Rugman [2005] on the myth of globalization]. The closer examination of “born global” companies also reveals that such companies too often are simply firms initially oriented towards exporting of their [sometimes exotic] goods from a narrow domestic base of manufacturing or agriculture operations [see Coelho, de Mella and da Rocha, 2014; Brenes, Sigura and Pichardo, 2015]. Overall therefore, these issues, in combination, limit the explanatory power of the aforementioned theoretical approaches. One of the particular shortcomings evident in existing theoretical approaches is a perceptible dearth of clearly defined constructs that reflect different facets of headquarter-subsubsidiary relationships. For example, subsidiary autonomy is commonly measured by the battery of perceptual measures aimed at capturing the degree of autonomy in particular functional areas [HRM, marketing] while the single most powerful archival measure of subsidiary autonomy - the profit and loss accountability of a subsidiary general manager - is often completely ignored. As a result in this paper we call attention to the potential conceptual utility of three core constructs that, taken together, we believe offer the prospect of landscaping and explaining a continuum of headquarter-subsubsidiary relationship issues and, from a theoretical perspective, renewing aspects of the debate.

The remainder of our paper is organized as follows. In the next section we underline the importance of understanding the two sides of headquarter-subsubsidiary relationships, namely understanding both the headquarter’s perspective and the subsidiary’s perspective which may demonstrate shared, as well as unique features. In this we call attention to the subsidiary mandate as the quintessence of the contractual relationship between the two parties. In the subsequent section, we make the case for a second critically important construct in unearthing and understanding MNC headquarter-subsubsidiary relations, namely the concept of corporate parenting style [CPS]. This is followed by a treatise on a third construct of significance, namely the collective psychological contract. We explicate the mechanics of collective psychological contract formation and depict various forms of such contracts in MNCs. We conclude by reiterating how a renewed emphasis on these three constructs could offer the prospect of augmenting the debate on MNC headquarter-subsubsidiary relations and open up new lines of enquiry on the content and the quality of these relationships along with their impact on strategy and performance.

The theoretical ideas that we bring together in our manuscript have their genesis in a series of investigations conducted between 2012 and 2016. We completed 40 interviews among managers operating at different levels [unit managers, regional CEOs, a global CEO] in 25 MNCs. Several of the corporations in which we interviewed managers are among those listed in the top 1000 industrial corporations of the world [Industry Week, 2015] with a number of them having global annual sales of between 1 and 5 billion US\$. The combined annual sales of the 25

corporations in which we conducted our interviews was 930 billion US\$ in 2015. Some executives were interviewed a number of times between 2014 and 2016. Our semi-structured interviews focused on the evolution of headquarter-subsidiary relations over recent years against the backdrop of unfavorable business conditions in several emerging markets [especially Brazil and Russia]. We also explored whether there were evolving differences in the internal organization of the corporation as a result of the changing competitive landscape. In our fieldwork we followed the approach of “strategy as practice” or the “activity-based view of strategy” [Johnson, Melin, and Whittington, 2003; Vaara and Whittington 2012; Whittington, 2006] paying particular attention to the tools and methods of strategy-making [practices], how strategy work occurs [praxis], and the role of the actors involved [practitioners].

Actors in Headquarter-subsidiary Relations and the Variety of Subsidiaries

At the very outset it is important to recognize the major actors involved in the headquarter-subsidiary relationship. The headquarters are the synonym of the “corporate center” – a unit ensuring financial and strategic control over a corporation’s assets and executing corporate-level strategy. Of note the corporate center can be [and often is] separated from the legal entity serving as the parent company. Among the MNCs in which we conducted our interviews, there are some notable examples of MNCs configured in this way including Oriflame AG, incorporated in Switzerland, but with its corporate center in located in Sweden, and Bunge Limited, incorporated in Bermuda with its corporate center in White Plains, NY. In some cases, there can be more than one parent company, but in almost all cases there is a single corporate center [although some core parts of the headquarters can be relocated abroad [see Baaij, Mom, Van der Bosch, and Volberda, 2015].

With respect to “subsidiaries” we are referring to organizationally separated corporate units that may or may not be incorporated as separate legal entities. In general, our focus here is on the management structures of the corporation rather than on legal structures. Subsidiaries can perform a variety of roles that can be identified according to the major focus of their activities i.e. capital management, asset management, and/or operations management. So called “tax heavens”, more often used by corporations from liberal markets economies than by corporations from coordinated market economies [see Jones and Temouri, 2016], are focused on capital management; R&D centers concentrate on asset management – creation of intangible assets; the key function of manufacturing subsidiaries and sales organizations is operations management. However, subsidiaries often combine several types of activities. For example, a foreign subsidiary incorporated as a legal entity can borrow from local banks thus engaging in capital management. In addition, it may participate in asset management through the development of local brands and,

in the operations sphere it may manufacture and sell goods from its local manufacturing operation alongside imported goods from other subsidiaries in the corporation.

In addition to the major focus of activity of the subsidiary serving as an important determinant of its relationship with headquarters, the very means by which the subsidiary came into being will also be important in characterizing its nature and its relationship with headquarters. For our purposes, at least four modes of subsidiary establishment are distinguishable – *relocation*, *separation*, *installation* and *acquisition*. Relocation refers to situations where a particular facility is moved in its entirety to a different location. This may happen in the case of production facilities where the existing unit is closed and the same production process is installed into a newly established manufacturing facility. Similarly, R&D centers sometimes relocate to other countries. In pure relocations serious efforts involving relocation packages and other benefits are often taken to persuade existing employees to continue employment in the new location [see Author, 2015b]. Separation as a mode of establishing a subsidiary arises in cases when a particular type of existing activity is separated out and developed into a newly created organizational unit. For example, the corporation might split manufacturing from sales in the same country into different organizational units or even into separate legal entities. Installation refers to the development of a new organizational unit for activities that have previously never been performed in that particular country such as a new foreign R&D center. Finally, with respect to acquisitions we can distinguish between acquisitions of subsidiaries of other corporations and acquisition of previously independent stand-alone companies. In the latter case the acquiring parent may often decide to incorporate into its portfolio, in whole or in part, previously independent legal entities which have performed capital, asset and operations management activities. In many instances, the removing of some of these previously performed functions from acquired subsidiaries and centralizing them in headquarter's ambit can prove a difficult transition with respect to how headquarter-subsidiary relations unfold [Dorrenbacher and Geppert, 2006; Dorrenbacher and Gammelgaard, 2011].

The Subsidiary Mandate

For all subsidiaries, regardless of the mechanism by which they have been established, the corporation develops and implements a subsidiary mandate vested in a set of tasks and functions assigned to a subsidiary. This is something which can be considered analogous to the job contract that the employee holds. Like job contracts, subsidiary mandates are rarely complete contracts stipulating all forms of value-adding and value-extracting activities that form the core of headquarter-subsidiary relations. Where they are most complete, such contracts are likely to relate to tax heaven subsidiaries. Relatively detailed descriptions of a subsidiary mandate, though

nonetheless still incomplete contracts as they never clearly identify the conditions for the abandoning of the whole project, can be found in situations involving the design and installation of new manufacturing subsidiaries. These take the form of business plans that stipulate the amount of investment and other resources that are put into a new unit [including, for example, the number of persons comprising the founding teams typically assembled from staff heretofore located in headquarters and in sister-subsidiaries and the anticipated period of their assignments in the new site], the projected level of output, and the expected time horizon for reaching it, the standards of production quality, and, in most cases, some specification of the anticipated timeline by when the newly established unit is expected to make a net contribution to the broader corporation. For other types of subsidiaries the mandate may not be a formal document at all but rather a looser set of rules around subsidiary functioning, coupled with a statement of the standards of expected performance.

Beyond these features, it is apparent that the key element of subsidiary mandate formation lies in determining the fundamental status of the subsidiary. Essentially it may be designated as a cost center, revenue center, or profit center. Cost center designations commonly occur in situations where it operates as a tax haven, a manufacturing unit and/or an R&D unit. If it holds the status of a cost center, the management of the subsidiary typically has the authority to determine inputs [supply of raw materials, the number and qualification of employees etc.]. The performance targets of a cost center are minimization of operating costs at the given volume of output, or maximization of output against the backdrop of the given budget of current expenses. In both cases the corporate center operates on the assumption that it has a handle on the operating costs of the subsidiary and possesses the ability to control the quality of output from it.

Subsidiaries designated as revenue centers typically involve the management of the unit having decision making authority over inputs [supply of raw materials, subsidiary headcount etc.], product mix and production volume. This also means that subsidiary management must possess the skills and abilities to determine and set the optimum production mix and production volume, i.e. to proportionately allocate direct and indirect operating costs between the various products and to determine the cost function of the entire output portfolio.

Designation as a “profit center” confers certain prerogatives on the subsidiary. This status gives the management team of the subsidiary decision-making authority over inputs [supply of raw materials, the actual number of employees and the skills mix], over product mix and production volume, as well over pricing and other marketing issues [promotion, places of sales, variations in products]. Managers in a profit center designated subsidiary command a dignity and respect in the corporate hierarchy vested in the fact that they must be “profit and loss accountable”. Our interviews revealed that corporations in the same line of business differ

significantly in the allocation of profit and loss accountability across the managerial hierarchy. If transfer pricing techniques and tax heavens are actively used to channel subsidiaries' profits as royalties, subsidiary managers have little or no influence on the real profits of a subsidiary. In such situations even country managers are not profit and loss accountable. In other corporations where direct methods of profit appropriation [dividends, repayment of the credits provided to a subsidiary by the corporation] are used, profit and loss accountability status may be assigned to unit managers or even to managers within the subsidiary [for example, to a category manager in a sales organization who is responsible for sales of a particular product].

Generally, very large MNCs with a long history are inclined to assign profit and loss accountability at the very top of corporate hierarchy, to a global product area or global brand managers or, on occasion, to heads of regional headquarters who supervise several plants in a particular country or in a region. Concomitantly, younger and smaller subsidiaries with a high entrepreneurial orientation more often assign profit or loss accountability to plant managers or even to category managers, a tendency which seems to occur across industries – chemical products, food processing, and construction materials. Besides the size and age of the corporation, the ownership structure also plays an important role in allocation of profit and loss accountability. Family-owned and family-managed companies, but also listed companies that recently went public, more often assign profit and loss accountability to lower managerial ranks.

Assigning a subsidiary the status of a profit center does not automatically result in the subsidiary having core capital management responsibilities as part of its mandate. This is determined by the legal status of the corporate unit in question. However, it categorically results in the subsidiary being involved not only in operations management, but also in asset management. Similarly, the absorption of a previously independent company may require the downgrading of its status from a profit center [or, in some cases, a loss center] into a revenue center or cost center. Inevitably, there will also be a learning curve for those previously independent companies as they seek to develop a modus operandi around how to interact with the corporate center and with new sister-subsidiaries.

Dr. Gerd Lenga, the former Managing Director of Knauf CIS, a subsidiary of a German family-owned company Knauf Gips KG described the experience of Knauf arising from its acquisition of previously independent Russian factories and its efforts at transforming underperforming profit centers into functioning cost and revenue centers:

We changed the legal status of assets in Knauf CIS group and tried to simplify its structure. However, the most important was to transform that conglomerate into a monolith. We discovered that for this we needed to change the mentality of plant managers. When I first gathered all plant general managers, they were not talking

to each other, because each saw around him not colleagues but competitors. ... It was very difficult to tune the people to normal communications. Between one and a half and two years were needed for directors to understand that the exchange of experience did not threaten anybody. And then at the meetings sentences like: "We are testing such a product, and your raw material is almost the same, maybe you should try too?" - were heard. Companies began to send their R&D staff to other plants to absorb the technologies. We were organizing workshops of general managers and financial managers at one of our plants...In the autumn we invited them with their spouses to see some of our European plants. In Granada or in other beautiful locations you can combine work and leisure, and this gives an impetus to the development of informal relations. It was necessary that each plant director would realize that his company is a part of the group, that the market is determined by the economic situation, not by someone's whim or habit. If because of the recommendation of the headquarters his sales fall, but the results of the group as a whole rise, then it will not be worse for himself. First of all, we have shown that the expansion or contraction of the market will not affect personal earnings. For this, we developed a complex system of criteria used to determine the remuneration of the General Director. We define technical and economic results of the factories by more than 50 parameters. ... When you have dozens of companies, you can see immediately, where and what needs to be addressed. We explained this to the directors and said to those who have some technical inefficiencies – “you have to go and find out how others could do this more cheaply”. If the salary of the general director is less dependent on sales, for a normal person the professional pride starts to play: he wants to share his inventions - let others try too”. [Lenga, 2015].

Finally, with respect to subsidiary mandates, it is important to point to the importance of variations in the geographical scope of such mandates. A subsidiary can be responsible for specific corporate activities in a particular region of a single [home or host] country, for specific activities in the whole country, for activities in a number of countries or for specific activities of a corporation globally, such as for example in the case of global purchasing units.

Figure 1 depicts the core determinants of subsidiary mandates in a three-dimensional matrix illustrating an initial configuration that a subsidiary mandate might take and dimensions along which the mandate of a particular subsidiary or a group of subsidiaries might change. The number of tasks the subsidiary performs refers to whether it executes a single function in the domain area of operations, assets or capital management or a combination of those activities. The

status of a subsidiary relates to whether it functions as a cost center, revenue center, or profit center, while the geographical scope of activities relates to whether the subsidiary covers a region of a single country, the entire country, several countries or indeed whether it has global reach.

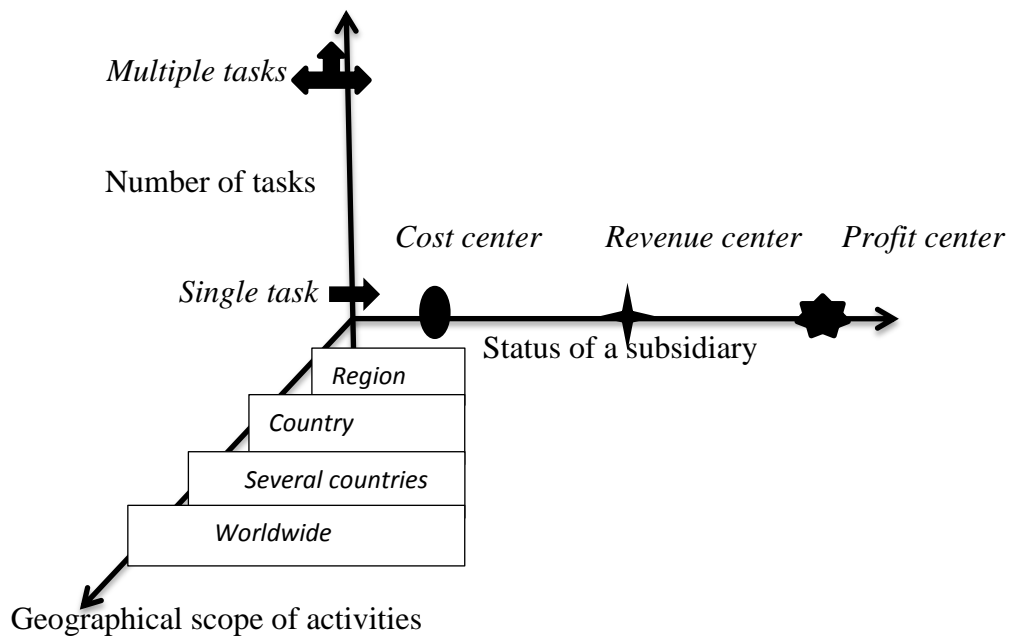


Figure 1. A typology of subsidiary mandates

Thus, by way of illustration, a tax heaven subsidiary may just have two part-time employees [CEO and Chief Accountant], perform a single task [capital management], possess the status of a cost center [having a single performance target relating to the minimization of tax payments on a given amount of profits] and operate with a prescribed geographical reach whereby it accumulates financial flows from subsidiaries in a particular country [see Smith, 2013]. Alternatively, a large sales organization with hundreds of employees may perform two tasks [operations management and also asset management by developing relational assets] and have revenue center status where it seeks to maximize returns within the context of a given sales and marketing budget. Finally, a modest manufacturing unit with a few dozen employees may be incorporated as a separate legal entity, perform all tasks [operations, asset and capital management], hold the status of a profit center with a profit and loss accountable manager and may have global responsibility for supplying its products to all countries the corporation operates in.

Subsidiary mandates are not static entities, rather they evolve. We can distinguish four major factors that shape the evolution of subsidiary mandates. First, this is a continuous search for an optimum solution to the balance between centralization and decentralization of important business functions [especially finance, R&D and marketing]. Centralization of such functions offers better control possibilities over the function, while decentralization allows greater local responsiveness. Often there is a two-way process – in the same corporations some functions are centralized by the headquarters and some functions are allocated to subsidiaries. For example, in Oriflame AG finances are highly centralized [the head of finance of the major subsidiary physically resides in the country of domicile of the corporation], while such important functions as manufacturing and, especially, marketing were spread in the past years across major regions of operations [see Gurkov, 2016a].

Second, an important factor shaping the evolution of the subsidiary's mandate is the extent of 'co-opetition' between subsidiaries [Luo, 2005]. With respect to the competition side of that dyadic relationship subsidiaries of the same corporation with similar mandates are constantly competing for better efficiency of operations. The prize in such a tournament is relocation of responsibilities and thus, resources, from less efficient subsidiaries to more efficient sister-subsidiaries. Such a move is most evident in the functioning of manufacturing subsidiaries, for example, in the European car assembly sector where old assembly plants located in high-cost countries of Western Europe are underinvested or closed down and the production shifted to low-cost locations in Eastern Europe.

A third factor impacting subsidiary mandate dynamics is the constant search for the optimal solution of the "make or buy problem". Over the past decade, the fine slicing of the value

chain [Buckley, 2009] became a common trend whereby subsidiaries are deprived of key functions causing some authors to suggest that the whole phenomenon of subsidiary innovation may be under threat [Reilly and Scott, 2013].

A final factor of particular import relates to the economic and political conditions in the countries where foreign subsidiaries operate. Foreign divestment has for some time been a neglected area of international business studies [McDermott, 2010], but in the past few years this topic has regained attention regarding the divestment solutions of MNCs from particular countries of origin [Berry, 2010; Berry, 2013; Song, 2014], the impact of ownership and control structures on divestment decisions [Feldman, Amit and Villalonga, 2016], the speed of exit from particular unfavorable locations [Soule, Swaminathan and Tihanyi, 2014], and the techniques to justify divestment decisions [Damaraju, Barney and Makhija, 2015]. Clearly, divestment presents the ultimate case of modification [i.e. the complete termination] of a subsidiary mandate.

Overall therefore the subsidiary mandate represents a fundamental building block of the architecture of headquarter-subsidiary relations. All interactions between the headquarters and a subsidiary as inter-organizational relations are underscored by establishing the optimum performance of a particular task by an organizational unit of a specific status operating within a determined geographical scope of activities. Thus, we can formulate our first preposition about the subsidiary mandate.

Preposition 1a: Both underperformance and superior performance of a particular task by the subsidiary lead to a reappraisal of its mandate by the headquarters.

Preposition 1b: Stronger task accomplishment by the subsidiary increases the likelihood of subsidiary mandate expansion, while weaker task accomplishment increases the likelihood of subsidiary mandate retrenchment.

Corporate Parenting Styles

While subsidiary mandate as a construct establishes the tasks, the obligations and the rights of the subsidiary, corporate parenting style [CPS] focuses on unearthing the preferred manner by which a multi-business corporation performs its duties as a corporate parent in configuring, coordinating and managing its multimarket activities [Collis and Montgomery, 1998]. Critical among the suite of activities engaged in by the parent in this respect are the assembling of sets of assets to manage and develop the portfolio of the MNC, the orchestrating of the activities of corporate units including for example regional headquarters, sales organizations, manufacturing units, research and development centers, domestic and offshore corporate treasuries, and the controlling of the activities of territorially dispersed and heterogeneous subsidiary units. While its roots can be traced to Parkinson's satirical volume "*In-laws and Out Laws*" in which he characterizes the 'male' and the 'female' organization [Parkinson, 1962], the concept of CPS only

became a more focused academic line of enquiry some two decades ago. In the interim, it has resulted in important contributions to the corporate strategy and organizational design literatures in particular, and to a lesser extent to the international business literature [Goold and Campbell, 1987; Goold, Campbell and Alexander, 1994; Goold and Luchs, 1996; Goold, Campbell and Alexander, 1998]. The initial theory of CPS positioned itself as a framework around which the role of the corporate center of the MNC in performing corporate parent functions towards subsidiaries could be fully explicated and accounted for. There have been continuous attempts to make corporate parenting a rigorous conceptual model [Kruehler and Pidun, 2011; Kruehler, Pidun, and Rubner, 2001; Nilsson, 2000]. Gurkov [2015] suggests that a combination of value-adding and value-extracting activities is the key for describing a CPS and presented a five-fold typology of CPS ranging from charitable style [with high value-adding and low value value-extracting activities] to exploitive and predatory styles with low value-adding and high or extremely high value-extracting activities. Building on this contribution, Gurkov and Morley [in press] further refined that typology combining exploitative and predatory styles into a single style and highlighting the importance of the manner by which the corporate center executes its functions. They identified four parenting styles labelled after the Greek gods Cronus, Rhea, Zeus and Athena. *Cronus* CPS after the Greek Titan who devoured his children is described as a style in which the dominant intention of the corporate parent is to extract value from the subsidiary, typically in the form of profits and revenues. In addition, the parent doesn't miss the opportunity to divest a subsidiary if the price seems attractive and exceeds the net present value of the expected profits of the subsidiary.

The contrasting CPS they denominate as *Rhea* after the Greek deity, spouse of Cronus. Here, most of the action of the parent is devoted to adding value to the subsidiary by, for example, through equity injections, credit from the parent or from partnering banks at lower interest rates, capacities transfer, knowledge transfer or the relocating of talented employees from HQ or from sister-subsidiaries. *Rhea* CPS can, they suggest, be found more commonly at the early stages of subsidiary development, especially in manufacturing subsidiaries established through relocation, separation and installation, but also in some instances following acquisitions of previously independent companies where injections of capital, technologies and teams of expatriates are essential to bring the newly acquired company closer to the corporate standards of operations and performance.

The third CPS is characterized as *Zeus* after the Greek god and father of many heroes. If the essence of Cronus CPS is *exploitation* and that of Rhea being proximate to the exhibition of a duty of care, the essence of Zeus style, they suggest, may best be thought of as *heroism*. Here the parent inspires the subsidiary towards great achievements encompassing, for example, the

attaining of unique levels of technical efficiency, mastering the production of novel products using leading edge technologies, and active participation in breakthrough corporate projects. The practical impact of this approach is oftentimes to expand the subsidiary mandate towards a range of activities of strategic importance to headquarters and the corporation more broadly. The dynamic exchange of value between the parent and subsidiary often becomes more intensive and becomes mutually reinforcing for both sides. In this scenario the subsidiary absorbs higher amounts of financial support from the parent in exchange for the development of unique tacit knowledge which eventually becomes transferred to and absorbed by other corporate units. They argue that the very network of mechanisms of value exchange themselves may change over time with historical exclusively bilateral parent-subsidiary relations becoming augmented with, and on occasion, supplanted by, active cooperation between sister-subsidiaries around the MNC. In general under Zeus style, the parent often purposely and meaningfully increases the autonomy of the subsidiary beyond subsidiary managers' expectations and creating additional, value adding challenges for subsidiary management.

The final CPS identified by Gurkov and Morley is labeled *Athena*, the daughter of Zeus, who appeared from his head as an adult and equipped for immediate action. The essence of Athena's style is wisdom – the ability to think and act using knowledge, experience, understanding, common sense, and insight. Gurkov and Morley suggest that there are at least two routes to establishing an Athena CPS. It could become the preferred approach through the subsidiary extending its mandate and becoming a strategic partner of the parent by, for example taking regional or global responsibility for particular activities or functions within the corporation. An alternative route to establishing an Athena style could be through the acquisition of a large previously independent company with the suite of well-developed corporate functions [R&D, marketing, manufacturing, PR, finance]. In such a situation, the acquired company, on being formally incorporated as a subsidiary in the MNCs network of operations, may also become a junior partner in a specific “internal strategic alliance”. In this way, they suggest that the definitional emphasis in CPS given to either adding or extracting value begins to lose its centrality as a contestation as the balance of value added by the parent and value extracted from the subsidiary offset each other. In addition, under Athena CPS the process of “capital round-tripping” becomes a mechanism for financing subsidiary development. The subsidiary may report negligible taxable income for a period as its profits, and a significant part of its total revenues, are channeled through royalties into the corporate treasury. Concomitantly, subsidiary managers receive assurances from HQ that all their claims for investments from will receive full consideration and in most cases will be supported.

Overall therefore while the subsidiary mandate presents the framework for HQ-subsubsidiary relations, CPS captures the nature and the content of the interactions. Of critical importance is which factors shape the corporate parenting style. Based on the reasoning presented above we offer our second proposition as follows:

Proposition 2a: Subsidiary mandate expansion or retrenchment will be associated with particular CPS patterns.

Proposition 2b: Subsidiary mandate expansion increases the likelihood of a Zeus or Athena CPS, while subsidiary mandate retrenchment increases the likelihood of a Cronus or Rhea CPS.

Development of a Collective Psychological Contract between the Headquarters and Subsidiary

Subsidiary mandate sets the framework for evolving headquarter-subsubsidiary relations. CPS characterizes both the content and the manner of HQ-subsubsidiary interactions. Against the backdrop of this framework and interactions, repeated patterns of interaction will occur between the headquarters and the subsidiary which in turn lead to the formation of schemata arising from an accumulation of emotions from the exchanges that ensue. These accumulated emotions lead to more or less stable mutual attitudes between the parties which were once described as "the most distinctive and indispensable concept in contemporary social psychology" [Allport, 1935]. Stable prevailing mutual attitudes of two "social entities" [communities] compelled to constant interactions may constitute a collective psychological contract, a construct which is helpful to illuminating headquarter-subsubsidiary interactions. As with individual psychological contracts [see Rousseau, 1995; Rousseau, 2001], there are likely to be differences in the contract formation process between "novice subsidiaries" [totally new corporate units created through separation or installation] and "veteran subsidiaries" which enter the corporation through acquisitions of subsidiaries of other corporations. This difference is vested in the fact that veteran subsidiaries have substantial experience derived from previous relationships with corporate parents resulting in pre-existing psychological contracts containing many elements. The schemata underlying these contracts may prove difficult to alter but ultimately their structure is capable of absorbing a certain amount new knowledge [Sherman and Morley, 2015: 164].

We suggest that there are two basic elements central to how the collective psychological contract in MNC headquarter-subsubsidiary relationships develop, namely *trust and empathy*. Trust, a key element in social scenarios [Adler and Kwon, 2002; Bstieler and Hemmert, 2010; Kramer, 1999; McAllister, 1995], is an assurance that exchange partners would not act exclusively in their

own self-interest [Madhok, 1995; McAllister, 1995; Uzzi, 1997]. The presence of trust is essential for the fulfillment of prescribed duties and obligations [Madhok, 1995]. The centrality of trust in establishing the ‘rules of the game’ for MNCs in different locations has been called attention to by Fey and Shekshnia [2011]. According to McAllister [1995], trust has two components: affective and cognitive, and each component comprises unique factors that motivate trusting behaviors among the parties. Trust is affect-based when it consists of bonds between the parties as they ‘make emotional investments in trust relationships, express genuine care and concern for the welfare of partners, believe in the intrinsic virtue of such relationships, and believe that these sentiments are reciprocated’ [McAllister, 1995: 26]. Cognitive trust refers to trust ‘from the head’ [Chua, Morris and Ingram, 2009: 491], whereby, ‘we choose whom we will trust, in which respects and under what circumstances, and we base the choice on what we believe to be ‘good reasons’, constituting evidence of trustworthiness’ [Lewis and Weigert, 1985: 970]. Arguably, in the relationship pertaining between communities or collectives the affective component of trust may be rather weak as it requires regular face-to-face personal interactions and in headquarter-subsidary relations such personal encounters typically involve a very small portion of subsidiary employees, often limited to a few unit managers. Thus, some subsidiary employees can be indeed affected by some of their colleagues in headquarters, but this does not increase the trustworthiness of headquarters among the majority of subsidiary employees unless there is solid evidence of trustworthy behavior of the headquarters concretely demonstrated and reinforced so that the subsidiary employees witness it. Similarly, the personal sympathy of top corporate executives to some subsidiary employees does not negate the broader range of technical, economic and human capital parameters the subsidiary is assessed by. However, through our interviews we have learned that several MNCs with widely allocated profit and loss accountability among subsidiary managers organize annual gatherings of all profit and loss accountable persons lasting two to three days. Such gatherings can involve between 200 and 300 persons. The official pretext of such get together is to “refresh the corporate DNA” [the set of internal rules and commonly accepted business principles] and to reinforce organizational citizenship among these profit and loss accountable persons, but at a deeper level, the role of such gatherings may be to build and maintain trust through personal interactions with top corporate executives. In addition, beyond the interaction themselves, the actual settings for these encounters plays an important role in building personal relationship. Through interviews with subsidiary managers we were assured that the form of interaction they believe to be the most effective one arises from gathering in informal settings, away from official premises. For example, the highest pride for a subsidiary manager but also a unique occasion to “cut all the rough edges” is to be invited to a boss’ birthday party, especially if such a party takes place in their home and garden.

However, the cognitive component is the more reliable and stable mechanism by which trust is maintained in headquarter-subsidary relationships. This element is based in the belief that the other party does the right things and does the right things in the right way. The perfect example of publicly expressed attitudes of cognitive trust of the headquarters towards a subsidiary can be found in edited transcripts of earning calls of several major MNCs. For example, in Q1 2015 PepsiCo Inc Earnings Call, CEO, Indra Nooyi, addressed the concern of financial analysts regarding high market volatility in Russia in the following way:

‘... I'll just make an overall comment. Russia as a business is doing very well.... Retail, dairy products, juice products, basic snacks -- the business is doing very well. *We have an excellent team in Russia*¹, great productivity programs, putting the pricing through in very judicious ways, doing very good revenue management -- *I am very proud of the Russia team*². And so, we are managing through this volatility very well’ [PepsiCo, 2015:.8].

The level of trust between headquarters and subsidiaries also affects the HRM systems implemented in foreign subsidiaries. For example, Gurkov [2016] found that manufacturing subsidiaries of MNCs in Russia offer additional social benefits to employees more often than local companies do, while Gurkov and Settles [2013], also researching in the Russian context, found that additional medical insurance is offered to all employees by 53% of subsidiaries of foreign companies and only by 26% of local companies, while holiday premiums are offered by 48% of subsidiaries of foreign MNCs and by 25% of local companies. The biggest difference, however, was found in relation to compensating employees for educational expenses. This benefit, based on the assumption that an employee who has undergone further training and education will continue to stay with the current employer and will not search for alternative job opportunities elsewhere, is offered by 46% of subsidiaries of foreign MNCs, but only by 8% of local manufacturing companies.

However, trust on its own does not fully explicate the content of the collective psychological contract. Continuous interpersonal interactions cannot be effectuated without a certain degree of empathy. Again, in community-to-community relations there is not much room for affective empathy - the capacity to respond with an appropriate emotion to another's mental states. In the context of our analysis, again occasional encounters between headquarters' and subsidiary's staff don't provide many opportunities for the displaying of appropriate emotions. At the same time, cognitive empathy, the capacity to understand another's perspective or mental state is an important prerequisite for productive relationships between the headquarters and

subsidiaries. Dr. Gerd Lenga's account of the establishment of the Knauf CIS group is insightful in this regard:

The strategy of the corporation is simple – to work with local raw materials for local markets with local employees. Its departments in different parts of the globe do not depend much on the headquarters. Regional managers are independent almost as the same degree as independent entrepreneurs. In Russia ... Knauf CIS developed a few rules...The third principle is to fire nobody. The enterprise's employees are the people with great experience and if let them an opportunity to work better, the revenues would increase by several times. They know manufacturing and markets but the most important is that this is their factory. My deep belief – downsizing is the deep trauma for an enterprise as it demotivates more persons that you are firing....My reasoning was as follows: let get rid from excessive mouths and fire the every tenth. Our profitability would increase just by one percent because the labor costs are a small share in total costs. But our reputation would be damaged and all the remaining employees thought: "Am I the next in the line for dismissal? In shops and corridors everyone would talk about the uncertain future... Of course, we had to change something in enterprise culture. However, working collectives were internally prepared to the changes. *The people thought – the Germans came, thus, we should gather ourselves up*³ [Lenga, 2015].

This interview excerpt illustrates the centrality of mutual cognitive empathy. From one side, the headquarters [in that case presented by a regional management center acting on behalf of the corporate center] demonstrated a perfect understanding of the employees' perspective and likely mental state in the case of even limited dismissals. From the other side, the last phrase indicates the empathy of the subsidiary's employees towards their new [German] owners, their overall understanding of German passion to "Ordnung" and the collective willingness to cope with the new behavioral standards.

In general, there is strong empirical evidence that both trust and empathy not only exist in headquarter-subsidiary relations, but also play an important role in key corporate decisions like capital allocation. For example, Graham et al. [2015, p.464] in a survey of 1,180 US CEOs found that the second most significant factor in capital allocation which was rated by 72% of respondents as "important or very important" was "the reputation of the divisional manager in terms of delivering on previous projects", i.e. the existence of cognitive trust. At the same time, "the confidence of the divisional manager in the project" i.e. cognitive empathy, was the third

most significant factor in capital allocation, assessed as “important or very important” by 68% of respondents.

Situations in which low trust and low empathy prevail represent fertile ground for the emergence of what is often referred to as the “agency problem”. Low trust and low empathy promotes opportunistic behavior on the part of the subsidiary. This has been characterized by Kostova et al., [2016: 15] as a subsidiary-focused institutional logic ‘calculation with guile’. This prevailing dynamic also results in unpredictable behavior on the part of the corporate center towards such a subsidiary, often resulting in what are read by the subsidiary as inconsistent actions and indeed it may culminate in attempts to divest the subsidiary, such a move often coming as a total surprise to the subsidiary itself. The underlying challenge for corporate HQ centers on the belief that it *has little or no assurance of the satisfactory fulfillment of the mandate by the subsidiary*.

Of note the situation of high trust and low empathy are not that uncommon. More often such situations occur when a subsidiary is assigned a “murky task” [to eliminate competitors in a particular market perhaps sometimes by questionable ethical means or to operate in politically sensitive locations [see Meyer and Thein, 2014] etc.]. In such situations, the corporate center recognizes the abilities, skills and competences of a subsidiary assigned by such a task, but try to keep “psychic distance” from the content of a subsidiary’s activities. Keeping psychic distance may result in a failure to develop empathy, at least from one side of the relationship [the corporate center]. Such an asymmetric position may not last for that long and the subsidiary is often forced [or learns quickly] to keep its empathy also. There can be other situations of high trust and low empathy which happen when ‘stretch goals’ [see Sitkin, See, Miller, Lawlss and Carton, 2011] are assigned by the corporate center to a subsidiary.

The situation of high empathy and low trust is rare. This situation was more common in the early 1990s in Central and Eastern Europe when MNCs first entered the post-communist countries and quickly realized that despite the self-evident willingness among Russian employees to combine and exchange in a positive way with investors, there was a dearth of basic problem solving skills especially when it came to manufacturing and marketing issues. Referring to the Knauf CIS case, Dr. Gerd Lenga explained how they handled this skills gap:

‘When Knauf acquired new plants, all senior managers retained their positions. CEOs typically kept their positions for a long time. After they retired, their deputies, who had been responsible for either production or finances, usually took over. To assist local general directors, a trio of German experts was delegated to every newly acquired enterprise: A financial controller was assigned to plan and report according to corporate-wide standards; a shift manager was relocated from a German plant to oversee

production and maintenance of new standards of quality, assist in the repair of equipment, assess employees, and appoint shift managers in the Russian plant; and an engineer responsible for investments coordinated the plants' first modernization projects' [Gurkov and Kossov, 2014: 23].

Finally, the situation of high mutual trust and high mutual empathy can be considered as the ideal in headquarter-subsidary relationships. This situation not only decreases monitoring costs [for example in Knauf CIS case 'within a short period, however, the need for foreign experts disappeared' [Gurkov and Kossov, 2014: 23] but also creates a balance between subsidiary's initiatives and corporate-wide programs – a subsidiary presents to the corporate center only carefully designed and potentially highly efficient initiatives with the potential to become worldwide best corporate practices [see Gurkov and Filippov, 2013] while the corporate center assesses such initiatives without 'sheer ignorance' [Ciabuschi et al., 2012] and 'headquarters knows best syndrome' [Bouquet, Birkinshaw and Barsoux, 2016]. In situations of mutual trust and empathy the corporate center also tries to not bother too often those subsidiaries with corporate-wide programs which are sometimes perceived as just "whims" of corporate executives striving to increase their visibility to the Board of Directors.

Building on these arguments and linking insights from corporate parenting styles and psychological contracts, we offer the following propositions:

Proposition 3a: A Cronos CPS is likely to drive the collective psychological contract towards lower trust and lower empathy.

Proposition 3b: A Zeus CPS increases trust but may slightly decrease empathy as the subsidiary is assigned a stretch task.

Proposition 3c: A Rhea CPS hardly increases empathy in mutual relations but may slightly decrease trust.

Proposition 3d: The consistent application of Athena CPS results in an increase in both trust and empathy between the headquarters and the subsidiaries.

Conclusions and Suggestions for Further Research

We highlighted three potential facets of headquarter-subsidary relations - the subsidiary mandate which is a formal contract describing mutual duties of a subsidiary and the corporate center, the corporate parenting style which refers to the manner in which value-adding and value-extracting activities are executed, and the collective psychological contract which seeks to capture the prevailing mutual attitudes of the parties resulting from the experience of accumulated interactions. Taken together, these three constructs can assist in providing examinations of the

particularities of the development of a subsidiary from the beginning [creation or inclusion into the corporation] until the end [divestment or liquidation]. More importantly, the abovementioned constructs are applicable to all subsidiaries of the MNC – both domestic and foreign subsidiaries in developed or emerging economies.

We offer these constructs in order to renew the debate on headquarter subsidiary relations. In our view, the whole concepts of “foreignness” and even “distance” are losing their importance, especially for such center-less corporations like Oriflame AG [with the operating center in Sweden, the financial center in the country of domicile – Switzerland, the major research center in Ireland, the major manufacturing facilities in Poland and in Russia, and the important functions spread across all regions of operations]. The more proper term may be *the variety* of physical, institutional, economic, cultural environment an MNC is must operate in. We also should note that psychic and cultural distances can be observed not just in foreign subsidiaries but also in subsidiaries in the home country [for example, the psychic distance between Florida and Wyoming or between Lombardy and Sicily]. In the same vain as the notion that “diverse teams are smarter” [Rock and Holvorson, 2016], modern MNCs should take the advantage of the diversity of their operating units applying varied subsidiary mandates, corporate parenting styles and building different psychological contracts. However, this triad should mutually reinforce and buttress each other. Thus some subsidiary mandates are better effectuated by the application of a particular corporate parenting style which in turn can support a specific collective psychological contact. The initial propositions we set out in our paper are designed to lay basic ground rules for exploring the validity of these associations as a first step towards the development of a normative theory of HQ-subsidiary relationship.

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Igor Gurkov. National Research University Higher School of Economics, Russia, 101000, Moscow, Myasnitskaya 20, gurkov@hse.ru

Michael J. Morley, Kemmy Business School, University of Limerick, Limerick, V94 T9PX, Ireland Michael.Morley@ul.ie,

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