CHAPTER FOURTEEN
Headquarters and Subsidiary

In general, this chapter examines relations between headquarters and the subsidiary. The development of a subsidiary entails risk, and the company chooses between a range of strategies to protect its investment and control it effectively. These include establishing an appropriate structural relationship between itself and the subsidiary.

14.1   Introduction

This section makes the point that needs for control differ, and that these differences influence how headquarters manages the subsidiary. Tight control which involves expatriate staffing tends to add to costs, and may be unnecessary. The second example makes clear that needs for control are influenced by the product that the company is selling, and its relationships with the market.

14.2   Risk for the multinational

Any investment involves risk. When the company decides to pursue its strategic goals by making investments abroad, the risks are usually perceived as greater than when investing at home. This section first examines different structures for investing abroad, and then focuses on the wholly owned subsidiary. (International joint ventures are examined in the following chapter.)

Risks examined include COMPETITIVE risks, ECONOMIC risks, POLITICAL risks. The local community and local government may also feel at risk in hosting the multinational subsidiary.

Culture is an influence on perceptions of risk and cultural differences may cause actual risks. But culture may not be the only influence and is often not the major influence. Relations between headquarters and subsidiary *are* influenced by cultural factors, but are also influenced by industry factors, technology factors, and others.

14.3   Control

The multinational focuses its efforts to take advantage of opportunities and protects itself against risk by using an appropriate style of control.

Make clear that we are not defining control in terms of degrees of authoritarianism but rather of means for making certain options for behavior preferred to others. Any organizational chart symbolizes control; the assistant marketing manager reports first to the marketing manager rather than to the accounts manager. And organizational structures map out preferred routes for communication. For this reason, the headquarters' priorities in controlling subsidiaries are reflected in communications plans.

The discussion keeps returning to core questions:

- Why does headquarters need to control a subsidiary? Which functions most need control? Which functions least need control?
- How is control administered most appropriately?

Inappropriate control (whether too detailed or insufficiently detailed; too authoritarian or insufficiently authoritarian; or exerted by inappropriate means) wastes resources of investment, personnel and time.

First, control can be expensive – for example when exercised by expatriate staffing – and is only justified when the saving or additional profits that it represents is greater than the costs involved. Second, in some instances, close control is unnecessary. (The first case in section 14.1 gives an example of a headquarters which does not have the expertise to contribute to subsidiary activities, and the only control exerted is financial.) Third, close control may actually cause demoralization and be counterproductive – for example, when the local employees values their empowerment and resent headquarters staff evaluating every move they make.

This section deals with a range of forms of control, including by the structure, the technology policy, and the budget.

Discussion of structural relations between headquarters and subsidiary focuses on the extremes of global and transnational models. The differences have implications for relations between subsidiaries, and for the movement of resources between headquarters and subsidiaries, and between subsidiaries. These resources include human resources (dealt with in detail in chapters 16 and 17). Human resource functions may differ markedly. As companies compete increasingly on the basis of knowledge resources, decisions about the acquisition and maintenance of skilled employees assume long-term importance and hence influence strategic planning processes.

Do not allow students to run away with the notion that *all* MNCs are adopting transnational structures. A recent report suggested that only about 15 percent fall into this category. But in industries that focus increasingly on satisfying the particular needs of local markets, transnational policies seem likely to grow in influence.

Structural empowerment and technology policies may also be means of relaxing control in cases where this is appropriate. The exercise of control through the organizational culture and staffing are dealt with in chapter 16.

Make the points that the degree and type of control may vary:

- *Over time*, depending on factors within the subsidiary and the environment, and
- *In different subsidiaries*. It might be decided that Subsidiary A needs close control whereas in Subsidiary B headquarters need only exert light control.

B: Implications for the Business Student

(This section modifies the material on pp. 327–8 of the textbook.)

Increasing numbers of business schools teach programs on an external basis, often on the premises of companies or other educational institutions and sometimes abroad. Investigate whether your school has entered into any such arrangements and answer these questions.

1. What risks does your school perceive in teaching its programs on an external basis?
2. What policies does your school apply when staffing an external program?
   - In what respects is policy uniform in the school and the external program?
   - In what respects does policy take account of differences between the school and the external program? What differences need to be taken into account? Consider differences in: (a) student market; (b) program content; (c) administrative factors.
   - How are these factors taken account of?
3. What control does the school exert over the program?
   - In what administrative areas (including budgeting and finance) is control needed? (a) Why is this control needed? (b) How is this control applied?
   - In what professional and tutorial areas is control needed? (a) Why is this control needed? (b) How is this control applied?
4. How far do factors in the national culture and organizational cultures explain your answers above?

C: Class Discussion Questions

1. Think of examples of MNC subsidiaries operating in your country. How do members of the community feel about it – positively or negatively? How could it enhance its prestige?
2. What different risks may arise in the transfer of different areas of technology from headquarters to subsidiary?
3. What factors other than culture, industry, technology, needs for control, might affect relations between headquarters and subsidiary?
4. In what industries might empowerment of a subsidiary be most desirable? In what industries might empowerment be least desirable?

D: Answers to the Exercise

This exercise shows how environmental factors (including culture) affect priorities in staffing an MNC.

This can be set as a written or oral exercise. Students might work individually or in groups. They might report to you in writing or to the class:

- orally, informally
- orally, in a prepared presentation.

Students must be able to justify their preferred option by referring to the relevant environmental factors. You might limit each choice of option to the three most significant environmental factors that justify it, and ask the students to justify the three. Which environmental factors justify more than one option? It is important to ask what further data should be sought before making a final decision. This exercise presents opportunities for a classroom debate.

E: Additional Exercise Material

This exercise asks about your experience of cultural distance.

1. What cultures are closest to your own?
2. In what ways are these cultures close?
3. What cultures are most distant from your own?
4. In what ways are these cultures distant?
5. Which of these factors are *most* critical in determining whether or not cultures are close?
   a. Similar/different food
   b. Similar/different language
   c. Similar/different national sports
   d. Similar/different political systems
   e. Similar/different ways of greeting
   f. Similar/different ways of expressing disagreement
   g. Similar/different technologies.

F: Test Bank

1. Environmental risk is defined as the threat that events in the environment will:
   a. Adversely affect the company's ability to implement its strategy and achieve its goals

   b. Cause the company to be expropriated
   c. Cause all foreign companies operating in the country to be nationalized
   d. Adversely affect the government's ability to influence how the company implements its strategy.

(Answer, a: p. 315)

2. Competitive risk arises in cases where:
   a. War, revolution and terror occurs or threatens
   b. Local labor is inadequately skilled
   c. New and substitute products threaten
   d. Repatriation of earnings is restricted.

(Answer, c. p. 315)

3. Governments:
   a. Always welcome multinational investment
   b. Almost never welcome multinational investment, unless it leads to technology transfer
   c. Usually welcome multinational investment, particularly when it leads to technology transfer
   d. Prefer multinational investments which attack local monopolies.

(Answer, c: p. 316)

4. The headquarters sees the subsidiary at greater risk when it is:
   a. Acquired
   b. Operating in an unstable environment
   c. Old
   d. Over-performing.

(Answer, b: p. 317)

5. Headquarters is more likely to perceive the national culture of the subsidiary as a source of risk when:
   a. The culture of the subsidiary country has high needs to avoid uncertainty and the cultural distance is wide
   b. The culture of the subsidiary country has high power distances
   c. The culture of the headquarters country has high needs to avoid uncertainty and the cultural distance is narrow
   d. The cultures of both countries are highly masculine.

(Answer, a: pp. 318–19)

6. In general, the highest number of expatriates are found in:
   a. The banking industry
   b. Commodity-based industries
   c. Management services
   d. Telecommunications industries.

(Answer, a: p. 319)

7. In terms of the Bartlett and Ghoshal (*Managing Across Borders*, 1989) taxonomy, the headquarters of the multinational company decides:
   a. Marketing policy, but otherwise permits subsidiaries considerable autonomy
   b. Financial policy, but otherwise permits subsidiaries considerable autonomy
   c. Policy for all functions
   d. Policy for all functions when the product is intended for a global market; otherwise not at all.

(Answer, b: pp. 320–21)

8. A transnational typically:
   a. Standardizes all marketing and production facilities across countries
   b. Develops products for the home market then extends them to other countries with the same characteristics
   c. Achieves cost advantages through economies of scale
   d. Sells products differentiated and adapted by local subsidiaries to meet local market demands.

(Answer, d: p. 321)

9. Griffin and Pustay (*International Business*, 1999) distinguished:
   a. Global, Multinational, International, and Global companies
   b. Multidomestic, Global, and Transnational companies
   c. International, Multidomestic, and Global companies
   d. Global and Transnational companies.

(Answer, b: p. 321)

10. In terms of the Bartlett and Ghoshal (*Managing Across Borders*, 1989) taxonomy, Ericsson represents a company that has:
   a. Developed effective systems for marketing the same product in different markets
   b. Failed to achieve cost advantages through global economies of scale
   c. Restricted country managers to local operations
   d. Developed a set of strong cross-unit integrating devices.

(Answer, d: p. 322)

11. According to Stewart ("Empowering multinational subsidiaries," 1995), members of the subsidiary are most motivated when they are given:
   a. Conformity with headquarters
   b. Detailed instructions
   c. Empowerment
   d. Cutting-edge technology.

(Answer, c: p. 325)

12. The development of new technologies is increasingly decentralized in industries where:
   a. Streams of competitors are entering and leaving the market
   b. Competition is stable
   c. Technology life-cycles are lengthening
   d. The potential cost of theft is great.

(Answer, a: p. 326)