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## In Search of Theory: Towards an Integrating Conceptual Framework for Subsidiary Research

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## **ABSTRACT**

Despite the importance of the strategic choices taken by subsidiary managers to the long term survival of their unit, little is known about the phenomenon. (Dörrenbächer & Geppert, 2009, Scott, Gibbons, & Coughlan, 2010). This paper analyses and synthesises the research streams on subsidiary management to date to provide critical conceptual insights and proposes a new theoretical approach to subsidiary analysis, applied to the critical routine of subsidiary strategy.

The adoption of more global business structures by MNEs has led to additional strategic constraints on subsidiary managers (Buckley, 2009, Buckley & Ghauri, 2004, Mudambi, 2008), which we categorise as the dual embeddedness constraint, the domain constraint and the resource constraint. Paradoxically despite these exacerbating constraints, expectations on subsidiary managers to create knowledge and innovation and develop their mandate are escalating, forcing them to evaluate the range of strategic decisions remaining under their control,

While the literature implicitly assumes that subsidiary managers can respond to MNC pressures by reconfiguring resources and developing capabilities (Birkinshaw & Hood, 1998), improving performance (Subramaniam & Watson, 2006) and influencing the strategic direction of the MNE as a whole (Andersson, Bjorkman, & Forsgren, 2005, Williams, 2009), there is an absence of guidance on how subsidiary managers develop strategies to achieve these options, and influence strategy from below (Andersson, Forsgren, & Holm, 2007). Our review of the empirical and theoretical research on subsidiary management identifies how the tensions between the headquarters perspective and the subsidiary perspective have resulted in the application of inappropriate conceptual frameworks. Platforming from the four primary theoretical approaches applied to date, and combining critical tenets of both the resourced based and transaction cost approaches, we develop a conceptual framework which overcomes prior theoretical limitations and offers a new perspective of subsidiary to apply to the subsidiary unit of analysis.

# **In Search of Theory: Towards an Integrating Conceptual Framework for Subsidiary Research**

## **INTRODUCTION**

The MNE/subsidiary literature to date has examined the respective roles and relationships between headquarters and subsidiaries, and determinants of their respective contributions to organisation. The initial objective of theory was to minimise agency risk through maximising headquarters control of subsidiary activities (Roth and O'Donnell, Doz and Prahalad), which evolved to perceiving the MNE as a federative structure, which achieves competitive advantage through harnessing the knowledge and initiative generation of its dispersed subsidiaries (Andersson et al, 2007). More recently, the emerging perspective of the MNE as a 'global factory' suggests that strands of separate activities are distributed to subsidiaries by a remote, controlling headquarters (Buckley, 2009).

The sharp contrast between the federative approach to understanding subsidiary behaviour and the 'global factory' view has critical implications for deriving normative theory and practitioner guidance from subsidiary research. In response to this theoretical and management imperative, we examine how critical strategic management perspectives have been applied to understanding the evolution of subsidiary role. By analysing the theoretical lens adopted to date in exploring the determinants of subsidiary role and contribution to the MNE, we identify and build a conceptual framework which overcomes prior theoretical limitations and offers a new perspective of subsidiary to apply to the subsidiary unit of analysis.

The primary contribution of this paper is the development of a conceptual framework which combines the critical tenets of the two dominant theories of the firm to the subsidiary unit of

analysis. This framework integrates some critical elements in the subsidiary's context which should assist in achieving normative implications from future empirical investigations, and enhance the relevance and value of future research to management needs in a time of exacerbating expectations and an increasing competitive environment.

The approach taken by this paper is to first demonstrate how subsidiary research to date has largely evolved in response to business reality, largely with the absence of supporting theoretical frameworks. The next section considers the appropriateness of the available theories and the need to uncover the complexities of subsidiary strategy development to achieve the critical insights for a conceptual foundation. The final section integrates the insights from exploring subsidiary strategy development with the key tenets of the RBV to develop a conceptual framework which overcomes prior theoretical limitations and offers a new perspective of subsidiary analysis.

### **Conceptual Background**

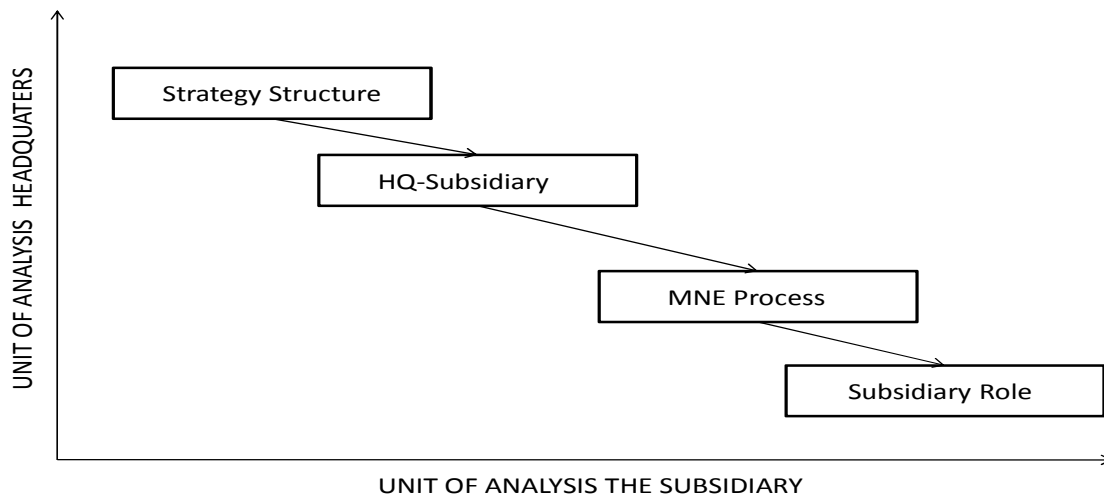
The evolution of research on subsidiary operations of MNEs mirrors the evolution of strategic management as a distinct discipline, as a classical *Strategy Structure Approach*, was initially adopted. Efforts focused on understanding why certain organisational structures were selected (Daniels, Pitts, & Tretter, 1984, Egelhoff, 1982, Stopford, 1972) and then on finding more flexible approaches to the traditional hierarchy. It was assumed that structure adapts to fit strategy, as captured by Bartlett and Ghoshal's (1989) "transnational solution" to the design of MNEs, according scant consideration to the role of the subsidiary.

Agency concerns and the need to balance autonomy (Patterson & Brock, 2002) throughout the MNE with control (Gates & Egelhoff, 1986, Hedlund, 1981), led to a focus on *headquarters-*

*subsidiary relationships*. Increasing recognition of the need for subsidiary support to implement headquarters' programmes introduced the concept of subsidiary level decision making (Hulbert, Brandt, & Richers, 1980). While some acknowledgement of the need for co-operation across the MNE emerged (Bartlett & Ghoshal, 1986, Ghoshal & Nohria, 1989), the 'United Nations Syndrome' (Bartlett and Ghoshal, (1986) in which headquarters treated all subsidiaries alike remained dominant.

Recognition of more complex relationships between headquarters and their subsidiary units led to the *MNE process perspective* (Birkinshaw & Pedersen, 2009). Subsidiary autonomy, access to key MNE resources, and the influence of management systems or culture on subsidiary behaviour were increasingly recognised (Bartlett, 1979, Doz, 1976, Hedlund, 1986, Prahalad & Doz, 1981, Prahalad, 1976). Headquarters remained the primary unit of analysis however, until Ghoshal's (1986) study of subsidiary innovation processes inspired exploration of how subsidiary autonomy and access to critical resources led to differentiating subsidiary roles within the MNE (Bartlett & Ghoshal, 1986). Subsidiary roles were then classified by their integration-responsiveness (IR) within the MNE (Jarillo & Martinez, 1990, Prahalad & Doz, 1987), their strategic positioning and strategy (Taggart, 1997b, 1998d, 1998a). Adopting the subsidiary as the unit of analysis and, to some extent, taking the headquarters as an external factor, allowed for a more detailed examination of subsidiary strategic roles (Patterson & Brock, 2002). Building on the initial analysis of Birkinshaw and Pedersen (2009), Figure 1 demonstrates the increasing prominence of the subsidiary in theory development, and the emergence of literature focusing explicitly on aspects of *subsidiary role* within the MNE.

## SUBSIDIARY MANAGEMENT RESEARCH



Adapted from Paterson and Brock (2002) & Birkinshaw and Pedersen (2009)

### **Resolving the Dual Conflicts**

Greater recognition of subsidiary role led to a deeper consideration of the complex reality of subsidiary context, as units operate within an internal network of headquarters and subsidiary relationships and in multifaceted external environments. The challenge for both the MNE and the subsidiary is to exploit these positions for the benefit of the organisation overall, but they must operate within two sometimes contrasting and competing positions. The objective of the MNE is to exploit its subsidiary network to achieve sustained competitive advantage. This may conflict with the often dual objectives of subsidiary management, to contribute to their parent organisation and to ensure the survival of their unit. These complexities are reflected in the intertwining nature of the literature exploring the evolution of subsidiary role.

Research moved from exploring subsidiary differentiation based on unit responsibilities, served markets, network position, competencies and resources, to investigating the roles of centres of excellence (CoE), or subsidiaries with specialist functional activities (Fratocchi & Holm, 1998, Frost, Birkinshaw, & Ensign, 2002, Holm & Pedersen, 2000, Surlemont, 1998).

This provided critical insights into how subsidiaries could protect their position by exploiting their unique capabilities, resources and/or network integration within their MNE (Anderson & Forsgren, 2000, Bartlett & Ghoshal, 1986), although there is still uncertainty as to how CoEs arise (Patterson & Brock, 2002). They are however perceived largely as a headquarters led strategy, whether formally determined or gradually emergent, as it would be difficult for an individual subsidiary to build sufficient specialised resources and talent within its unit, without headquarters support (Birkinshaw & Pedersen, 2009). This recognition of *specialised subsidiary roles* also led to exploration of factors leading to the development of regional (Lehrer & Asakawa, 1999, Schutte, 1998) and divisional headquarters (Forsgren, Holm, & Johanson, 1995), and of subsidiary R&D (Asakawa, 2001, Cantwell & Mudambi, 2005, Kummerle, 1997, Noble & Birkinshaw, 1998).

Traditionally headquarters was perceived as the driver of foreign direct investment (Chang, 1996, Chang, 1995, Kogut, 1983), and with few exceptions the subsidiary input to initiating and contributing to the *evolution of subsidiary role* was overlooked (Crookell, 1987; Jarillo and Martinez (1990) and Papanastassiou and Pearce (1994). Studies then explored subsidiary development as a series of stages towards building integration and importance within the MNE (Birkinshaw & Fey, 2000, Birkinshaw & Hood, 1998, Chang & Rosenzweig, 1998, Crookell, 1987, Delany, 1998). A new emphasis emerged focusing on the interaction between the MNE, the subsidiary unit and the local environment (Birkinshaw and Hood; 1998: Cantwell and Mudambi, 2005). The importance of generating subsidiary initiatives, developing competence creating mandates (Cantwell and Mudambi, 2005) and engaging in micro politics (Dorrenbacher and Gammelgaard (2006) accords an accompanying recognition of the role of pro-active subsidiary management in determining subsidiary role.

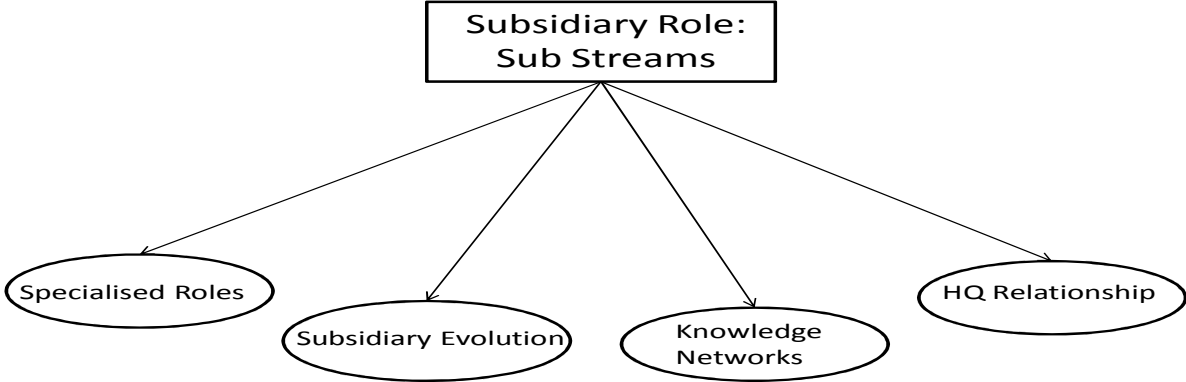


The researcher's perspective plays a crucial role in the selection and emphasis of the perspective on subsidiary evolution adopted (Patterson & Brock, 2002). Brock (2000) identifies how researchers from larger countries tend to espouse a corporate point of view, and assume that parent company managers are the predominant drivers of subsidiary evolution (Chang, 1995, Malnight, 1996). In contrast, research originating from smaller countries tends to adopt a subsidiary perspective and emphasise subsidiary initiative (Birkinshaw, 1997).

Initial consideration of the determinants and impact of patterns of information flow between subsidiaries and HQ led to recognition of the value of *Subsidiary Knowledge Networks*. Firstly it was the internal network that was the focus of attention. Gupta and Govindarajan (1991, 2000, 1994) set about explaining the patterns of information flow between subsidiaries and their HQ and Szulanski (1996) has contributed to the transfer of 'best practices' between subsidiaries within the MNE. In terms of the subsidiary's external network research has focused on the strength of linkages between the subsidiary and its local environment.

Research to date suggests that a subsidiary's access to an external network will only enhance its internal network position if it provides superior knowledge of significant importance to other MNE units (Andersson, Forsgren, & Holm, 2007). Any shift towards a global factory style operation would reduce subsidiary potential for external embeddedness (Buckley & Ghauri, 2004, Mudambi, 2008, Yamin & Forsgren, 2006), emphasising the value of subsidiary internal 'embeddedness' within the MNE network as a strategic option for position protection (Garcia-Pont, Canales, & Noboa, 2009).

The complexities of subsidiary position are further reflected in recent approaches to examining *Headquarters Subsidiary Relationships* which consider how procedural justice can apply to the headquarters / subsidiary planning process (Kim, 1993a, 1993b, Kim & Mauborgne, 1991, Taggart, 1997a), the significance of perception gaps between HQ and subsidiary managers, and the related consequences. (Birkinshaw, Holm, Thilenius, & Arvidsson, 2000, Holm, Johanson, & Thilenius, 1995, Luo, 2003). The impact of micro issues, such as political negotiations between subsidiary managers and their headquarters, in shaping the internal MNE dynamics is also increasingly acknowledged (Dörrenbächer & Gammelgaard, 2006, 2009, Dörrenbächer & Geppert, 2006). The four approaches, which illustrated in Figure 2 as mutually exclusive for ease of discussion, are in reality, interlinked.



Adapted from Paterson and Brock (2002) & Birkinshaw and Pedersen (2009)

**Lack of an Integrative Framework**

The pre-ceding analysis of the subsidiary literature demonstrates that different dimensions of MNC /subsidiary relationships and characteristics have been studied without the application of a strong integrative conceptual framework and that the work lacks coherency of a discipline. The work to date has followed the evolution of the unit of analysis based on

observance of practitioner behaviour but has failed to develop a cogent approach. Borrowing from the firm level theory to the subsidiary unit, simply adds another level of complexity in addition to, as bemoaned by Birkinshaw and Pedersen (2009), the eclectic and incommensurable nature of most MNE theories. But before we can build on the approaches taken to date we must consider their value.

Transaction Cost Economics (TCE) while not specifically developed for the MNE context is the most broadly used theory in analysing the MNE. It seeks to rationalise MNE existence in terms of ownership specific advantages against incumbent domestic competitors, location specific advantages that favour investment in the local economy, and the intermediate market failure that favours 'internalisation' over other forms of contractual arrangements (Buckley & Casson, 1976, Dunning, 1980, Rugman, 1981). Despite its proliferation in the literature, there are a number of international management scholars (Bartlett & Ghoshal, 1989, Birkinshaw, 2000, Doz & Prahalad, 1991, Ghoshal & Moran, 1996, Hedlund, 1994) who criticise its ability to provide an in depth understanding of the actual functioning of complex organisations such as MNEs.

Similarly, *network theory* can be criticised for failing to offer an appropriate theoretical lens. The MNE is now predominantly conceptualised as a network (Forsgren, 1992, Ghoshal & Bartlett, 1990), extending the original application of social exchange theory and resource dependency (Emerson, 1962). This approach perceives the subsidiary, not as a subordinate entity within the MNE, but as a node in a network, with links to external and internal actors, enjoying significant degrees of freedom and influence. While an attractive framework for exploring how subsidiaries evolve and exchange information with other actors, its main

weakness, is that it is frequently used in a purely descriptive way, which makes it irrefutable, detracting from its power as a theory (Birkinshaw & Pedersen, 2009).

Similarly the promise of Institutional theory, (Rosenzweig and Singh (1991) and Westney (1994, 1990), argues that firms will deliberately adopt practices and behaviours similar to others in their task environment (DiMaggio & Powell, 1983, Meyer & Rowan, 1977). Westney argues that subsidiary units face competing isomorphic pulls from the host country and from the rest of the MNE. by comparing the practices of an individual unit to those in the host country and the MNE, implications could be drawn about the MNE's strategy. This line of thinking was applied to a number of empirical studies (Rosenzweig & Nohria, 1995, Westney, 1990), but the interest in institutional theory has dropped of in recent years baring some exceptions (e.g. Kostova & Roth, 2002).

A number of other theoretical perspectives also occasionally feature in subsidiary management research. For example, Birkinshaw (1999) portrays the MNE as an internal network system in which subsidiary units compete with one another for charters, but it is not yet clear if this approach will yield any valuable insights. In addition, several concepts have been adapted from the social psychology literature, including procedural justice (Kim & Mauborgne, 1991) and feedback seeking behaviour (Gupta, Govindarajan, & Malhotra, 1999), to model the HQ subsidiary relationship. Agency theory has also been used in this way (Chang, 1999, Kim, Prescott, & Kim, 2005) but its usefulness for studying headquarters and subsidiary relationships has been questioned (Watson O'Donnell, 2000).

Interestingly, the theory which is arguably the dominant conceptual paradigm in strategic management has received relatively little attention in the MNE literature. The resource based

view of the firm has the potential to contribute greatly to the study of the MNE, but with few notable exceptions (e.g. Birkinshaw & Hood, 1998, Rugman & Verbeke, 2001) it has been largely ignored. The key premise of the Resource Based View is that under certain conditions a firm's unique bundle of resources and capabilities can generate competitive advantage (Barney, 1991) More recent literature also focuses on the development of dynamic capabilities and knowledge as drivers of competitive advantage (Grant, 1996, Teece, Pisano, & Shuen, 1997). So why has a theory that offers so much potential been underused in the study of the MNE? We argue that the level of analysis constitutes the primary concern. The resource based view implicitly assumes that resources and capabilities are developed in one large firm, whereas the reality in the MNE is that resources are dispersed around the firm, at the parent and subsidiary levels.

In our search for a new conceptual framework to address these concerns, we need to more deeply examine the strategy processes which underlie resource deployment and capability development at the subsidiary level.

### **Developing Strategy to Drive Subsidiary Development**

Considering the depth of subsidiary management research it is unusual that from a strategy perspective there are no clear insights to guide both researchers and subsidiary managers (Dörrenbächer & Geppert, 2009, Scott, Gibbons, & Coughlan, 2010). One of the factors behind this has been the confusion over what constitutes subsidiary strategy and what are its main components? A distinction is commonly made in the literature between the concepts of subsidiary strategy and subsidiary role. A subsidiary's role is assigned to it by the parent company, whereas subsidiary strategy suggests some level of choice or self determination on the part of the subsidiary (Birkinshaw & Pedersen, 2009). The underlying premise of

subsidiary strategy is that despite the constraints placed on subsidiary management by headquarters and the marketplace, they still make decisions of their own volition, not simply on behalf of HQ.

We argue that it is inappropriate to include competitive advantage as the objective of subsidiary strategy development, as the subsidiary is only one part of the corporation and competitive advantage is commonly argued to arise as a result of the unique configuration and coordination of a corporation's activities (Porter, 1996). The important elements of subsidiary strategy as identified by Birkinshaw and Pedersen (2009), are the market positioning component and the resource development component. Strategy is about how these two components are brought together taking into account that subsidiaries' customers and competitors are very often with the MNE network in a model of co-opetition (Luo, 2005). To study strategy development at the subsidiary level it is important to analyse how well subsidiary managers identify with the two components of strategy and secondly how many of the components of subsidiary strategy are actually under the control of the subsidiary manager?

Subsidiary strategy development must recognise the range of constraints on its behaviour and in its ability to develop strategy. The *dual embeddedness* constraint relates to their operation within two parallel webs of differentiated networks, the internal web that includes all the other units of their parent MNE, and the sometimes overlapping, but often separate complex external local network of customers, suppliers and other institutions (Nohria & Ghoshal, 1994). The *domain constraint* comprises the typically pre set business domain limiting their market positioning options (Birkinshaw & Hood, 1998). The *resource constraint* refers to their

inability to act independently in acquiring or utilising resources, and their need to maintain lateral relations with other units of the MNE (Birkinshaw & Morrison, 1995).

### *Market Positioning*

There are significant trends underway which look set to further limit the freedom at which subsidiaries shape their market position. The emergence of global customers for products has meant that subsidiaries are no longer required to develop products for the specific needs of a particular market (Mudambi, 2008). Outsourcing and offshoring of activities has also led to subsidiaries playing smaller roles within global supply chains (Buckley, 2009). Mudambi (2008) describes how corporate headquarters may decide on the particular location for value creation within their value chain, consigning the remaining subsidiary units to fulfil their specific role with little additional input. Increased access to information has also reduced knowledge deficit in MNEs, giving headquarters unprecedented access to the activities of their subsidiaries, reducing the potential autonomy of the subsidiary (Yamin & Sinkovics, 2007). In fact most subsidiaries actually have far less control over their market positioning than the traditional approach would suggest.

### *Resource Development*

Resources are defined as the stock of available factors owned or controlled by the firm, and capabilities are a firm's capacity to deploy resources, usually in combination, using organisational processes to effect desired end (Amit & Shoemaker, 1993). If a subsidiary is to be taken as a unit of analysis in its own right is it possible to split up resources and capabilities between the subsidiary and the MNE? Taking resources first, Birkinshaw and Pedersen (2009) argue that most tangible resources are held at the subsidiary level, while most intangible resources are held at the firm level. There are obvious exceptions to this

analysis but the crucial point is that it is possible to identify a difference in resources. To make such a split with capabilities is a much more difficult task. Some capabilities are definitely held at the firm level and are distributed across the network of subsidiaries. Others emerge at the subsidiary level for example and are particular to individual subsidiaries. The majority, however, are located somewhere between the firm level and the subsidiary level making them very difficult to separate.

This highlights the difficulties in studying strategy development at the subsidiary management level and we develop a new approach to address these shortcomings. Rather than applying a single theory to the study of subsidiary strategy it is proposed in this article that due to the difficulties associated with taking the subsidiary as the unit of analysis combining elements of two theoretical approaches could offer the greatest avenue for the field to develop.

### **A STRATEGIC THEORY OF THE SUBSIDIARY**

The difficulties in applying theory to the study of subsidiaries highlight the need for strategy researchers to develop a framework. In his review of the strategy field, Foss (1999) contends that strategy research has been heavily influenced by both economic theories of the firm and the resource-based view. Rumelt (1984 p.557) proposes that the obvious future for the study of business strategy is to ‘rest it on the bedrock foundations of the economist’s model of the firm’.

Foss (1999 p.727) outlines that the ‘strategic theory of the firm’ should be focused on addressing the following four areas:



1. The existence of the firm – namely, why do firms exist as distinct mechanisms for resource allocation in a market economy?
2. The boundaries of the firm – namely, what explains why certain transactions are governed in house while others are governed through market relations?
3. Internal organisation – namely, why do we observe different types of (formal and informal) organisational structure, and accompanying phenomena, such as internal labour markets, job ladders, profit centres etc?
4. Competitive advantage – namely, which factors amount for superior rent earning capability? Ultimately, this issue concerns why firms are heterogeneous.

Foss used this comprehensive criterion to evaluate the economics of organisation and the resource based view. His findings confirmed that the economics of organisation was strong on issues .1, .2 & .3 and the resource based view was strongest on issue .4. The reason for this is more than likely based in the historical development of both theories. Whereas the economics of organisation began with issues .1, .2 and .3 (existence, boundaries and the internal organisation of the firm) and then moved to being applied to issue .4 (competitive advantage), the resource based view began with the analysis of issue .4 and has, in more recent times moved on the addressing the other issues. Is this paragraph necessary?

When studying subsidiary strategy, competitive advantage (issue 4) is not the sole concern as the subsidiary is only one part of the corporation and competitive advantage is commonly argued to arise from the entire organisations activities. Issues such as the boundaries of the firm and the internal governance of the firm however, are crucial as they have a direct impact on the strategic options available to subsidiary management.

This highlights the less than straight forward task for subsidiary strategy research. Foss (1999) proposes two approaches available to researchers, 'isolationism' and 'integrationism'. The first of these research strategies isolationism, which he argues is incomplete, implies that the strategic theory of the firm should be founded on either the Resource based view or the economics of organisation alone. The second research strategy, 'integrationism', implies that research on the strategic theory of the firm should be based on ideas from both the economics of organisation and the resource based view. Foss defends this approach, by arguing in particular that when there are interaction effects between governance and knowledge considerations, there is a strong argument in favour of integrationism, while isolationism is likely to produce a biased view. It is argued in this paper that the study of subsidiary management has so far followed an isolationist approach ignoring the constant interaction of governance and knowledge constraints placed on subsidiary managers, but why has this been the case?

In response, we analysed the theory of the multinational enterprise (MNE), which has been predominantly developed in what Foss would describe as the 'isolationist' approach (1999). Modern transaction cost theory of the MNE (Buckley and Casson (1976), and Teece (1977), Rugman (1981), Williamson (1981), Hennart (1982). However, according to a number of prominent management scholars predominantly associated with a more Resource Based perspective (Bartlett & Ghoshal, 1989, Birkinshaw, 2000, Doz & Prahalad, 1991, Ghoshal & Moran, 1996, Hedlund, 1994), this type of international business literature is often viewed as largely peripheral to obtaining an in depth understanding of the actual functioning of complex organisations such as MNEs. For protagonists of a transaction cost perspective it is a baffling situation, where despite its foundation, the transaction cost approach to the analysis of the

functioning of the MNE, is regarded by some to have little to contribute to the understanding of the internal functioning of the MNE (Rugman & Verbeke, 2003).

One of the problems for TCE is that it is always associated with a classic problem of international business research, the choice of an MNE to enter a market. Largely influenced by TCE, traditional studies treat particular entry as a “transaction”(Anderson & Gatignon, 1986), and a key concern is whether to rely on external market measures (e.g. exporting) or to internalise operations (e.g. FDI) (Buckley & Casson, 1976). In contrast, the other predominant theory raises the level of analysis from the transaction to the firm, suggesting that a particular entry decision cannot be viewed in isolation, but in relation to the overall strategic posture of the firm (Hill, Hwang, & Kim, 1990), but has had little application beyond the management of the MNE and its network of subsidiaries.

The RBV highlights the crucial strategic challenges facing managers within organisations, understanding the functionality of the resources under their control, and understanding those resources under the control of other firms. But Perteraf and Bergin (2003) note that managers may be poor at understanding the range of functions from their resource bases for a number of reasons, one of which being the problems with bounded rationality as defined by Williamson (1975). This bounded rationality problem is magnified in a modern Multinational corporation with a network of subsidiaries in dispersed locations. Corporate headquarters are faced with a decision of whether to insist on high levels of control over their subsidiaries in order to reduce risk (Chang, 1999) or to allow greater levels of subsidiary autonomy as outlined by Burgelman (1983a) and developed further by Birkinshaw and Morrison (1995). Etemand and Dulude (1986) contend that it is the subsidiary’s relative autonomy that allows it to determine strategy and thus ultimately control over local returns and performances. To allow this

situation to develop there is a transaction cost challenge for top management, which calls for the introduction of transaction cost economising tools so that bounded rationality problems can be reduced at the subsidiary level (Rugman & Verbeke, 2003).

However, recent evidence suggest that developments in ICT, and increased off shoring and outsourcing, are enabling corporate headquarters to reasserted much of their control over, their network of subsidiaries (Yamin & Sinkovics, 2007). Value is now being created in smaller pockets of the MNE, and the power of the subsidiary unit seems to be on the wane (Mudambi, 2008). This raises critical questions about the resource based theories of the role of the subsidiary and the potential for these units to influence the power structure of the MNE (Andersson, Forsgren, & Holm, 2007, Birkinshaw & Hood, 1998, Birkinshaw, Hood, & Jonsson, 1998, Bouquet & Birkinshaw, 2008b). A change is now underway that suggests that the most recent developments in the MNE, such as the emergence of the global factory (Buckley, 2009), are more closely aligned with the transaction cost / internalisation thinking of Buckley and Casson (1976).

Rugman and Verbeke suggest that perhaps a complementary resource based and transaction cost perspective, is required to describe the actual processes of resource combinations into competences and capabilities within the MNE (Rugman & Verbeke, 2001, Rugman & Verbeke, 2003). Verbeke (2003) proposes that economising on internal transaction costs is the crucial management task facing management with MNEs. The internal firm specific problems of governing knowledge generation and exploitation, resulting from imperfect markets which are highlighted by TCE analysis, remain as valid and important to managers today, as they did when Buckley and Casson (1976) first highlighted them.

## **Towards an Integrating Framework**

It is proposed that an isolationist approach (Foss, 1999), applying one stand alone theory to the study of subsidiary strategy results in an incomplete picture. A complementary analysis employing both transaction cost and resource based considerations has the potential to greatly enhance this emerging field of research. This type of analysis has been previously employed by Rugman and Verbeke (2003, 1992) and has also been utilised by Madhok (2002) in the study of inter firm collaborations. While the relation between the RBV and TCE is both rival and complementary, it is really more of the later than the former (Williamson, 1999).

The insights provided by applying this approach to subsidiary strategy development enable us to propose the following conceptual framework. We believe it represents the first tentative steps towards a comprehensive subsidiary theoretical foundations, capturing the nuances of the complex position of the subsidiary unit of analysis.

### **Diagram to be included and discussed.**

From a resource based perspective subsidiary strategy is based on developing the resources and capabilities which are under the control of subsidiary management. However, as Birkinshaw and Pedersen (2009) acknowledge the goal of this strategy is not to achieve a competitive advantage in the traditional resource based approach. Instead the focus of subsidiary strategy is to develop resources and capabilities which are highly valued, and as a result are internalised within the MNE ensuring the subsidiaries survival and future development. This approach to subsidiary strategy is more in line with the Transaction Cost / Internalisation thinking of Buckley and Casson (1976) and Rugman and Verbeke (2001, 2003, 1992). To truly unravel all the full picture of subsidiary strategy a theoretical basis combining

resource based and transaction cost considerations has the potential to increase the relevance and validity of research to both theory and practice.

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