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Controlling Intervention Hazards in the Network MNC**

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CONTROLLING INTERVENTION HAZARDS IN THE NETWORK MNC**

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Abstract

The MNC literature treats the (parent) HQ as entirely benevolent with respect to their perceived and actual intentions when they intervene at lower levels of the MNC. However, HQ may intervene in subsidiaries in ways that demotivate subsidiary employees and managers (and therefore harm value-creation). This may happen even if such intervention is benevolent in its intentions. We argue that the movement away from more traditional hierarchical forms of the MNC and towards network MNCs placed in more dynamic environments gives rise to more occasions for potentially harmful intervention by HQ. Network MNCs should therefore be particularly careful to anticipate and take precautions against “intervention hazards.” Following earlier research, we point to the role of normative integration and procedural justice, but argue that they also serve to control harmful HQ intervention (and not just subsidiary opportunism).

Keywords: The network MNC, MNC HQ, managerial intervention and opportunism, normative integration, procedural justice.

INTRODUCTION

In the extant literature on the multinational corporation (MNC), the parent headquarters (HQ) plays a wholly benevolent role.¹ It is recognized that the HQ may be ill-informed, for example because of information overload (Egelhoff, 1991, 2010), radical uncertainty (Forsgren & Holm, 2010), or sheer ignorance (Forsgren, Holm & Johanson, 2005), and may suffer from “bounded reliability” (Verbeke & Greidanus, 2009). These problems may give rise to managerial errors in decision-making, such as failing to recognize synergies between lower-level units, implementing badly designed reward systems, and cannibalizing product lines. Such errors harm value-creation at the level of subsidiaries and the MNC.

However, there is little or no questioning in the literature that the HQ is somehow motivated to add value to the overall MNC network and is perceived as such by other units in the MNC.² Thus, the literature specifies how the HQ engages in strategic planning, assists the subsidiaries with various support functions, transfers useful knowledge to the subsidiaries, orchestrates lateral knowledge transfers across the MNC network, and reduces latent or manifest incentive problems by deploying means of organizational control (e.g. Ghoshal & Bartlett, 1989; Gupta & Govindarajan, 2000; O’Donnell, 2000; Doz & Prahalad, 1984). Furthermore, the HQ is supposed to differentiate its coordination and control mechanisms according to the specific subsidiary situation, while not sacrificing firm-level performance for sub-unit gains (Nohria & Ghoshal 1994). Such acts of intervention, either directly or by creating organizational infrastructure, add to MNC-wide value

¹ We follow the usual understanding of the HQ as the entity at the top of a firm that assumes responsibility for functions like strategic planning, corporate communications, tax, legal, marketing, finance, human resources and information technology. HQ includes the CEO and other members of the top-management team, support functions for top-management team, corporate policy making functions, and corporate services of all kinds.

² To illustrate, none of the contributors to a recent edited volume titled *Managing the Contemporary Multinational: The Role of HQ* (Andersson & Holm, 2010) question the assumption of fundamentally benevolent HQ, although Benito and Tomassen (2010) implicitly raise the conceptual possibility of opportunistic HQs in their discussion of bonding costs between the HQ and the subsidiaries. Similarly, none of the contributors to a recent special issue (*Management International Review*, 50: 4) on the topic of “How do MNC Headquarters Add Value?” question the benevolence assumption.

creation, save for those instances where errors turn out (retrospectively) to have been made. If they have any direct impact on subsidiary motivation, it is a positive one.

We argue that this assumption of general (perceived) HQ benevolence is one that needs substantial modification, particularly because of the emergence and diffusion of more decentralized and less formalized “network forms” of the MNC that have emerged in response to increased dynamism and heterogeneity in MNC environments. We argue that HQ may intervene in subsidiaries in a manner that demotivates subsidiary employees and managers, even if such intervention is entirely benevolent in its intentions. Interventions by HQ often amount to breaking with existing routines and procedures—which often function as truces (Nelson & Winter, 1982)—, overriding existing instructions of employees or subsidiaries. In those MNCs where subsidiaries enjoy considerable autonomy, HQ intervention may amount to overruling decisions that units have made on the basis of decision rights that have been delegated to them (see Hofstede [1967] for the case of budgets). Or, intervention may consist of directly reducing the level of autonomy of the subsidiary. Motivational problems with far-reaching and negative implications for productivity, extra-role behaviors, and, by consequence, subsidiary- and MNC-level value creation can arise when subsidiary managers and employees perceive such intervention as ill-intentioned or simply as meddling. In fact, they may overwhelm any positive effects the intervention may otherwise have. In analogy to the notion of “contractual hazards” in the economics of the firm (Williamson, 1985) we refer to managerial interventions that harm motivation and have negative implications for value creation an “intervention hazard.”³

We argue that the movement away from more traditional hierarchical forms of the MNC and towards network-based forms gives rise to *more* occasions for potentially harmful HQ intervention. Such forms are typically based in uncertain environments that may motivate intervention by HQ

³ Note that this construct includes both those situations where net value creation is harmed and those where it is only gross value creation that is harmed (i.e., the intervention harms motivation but still creates net value). Presumably, it is desirable to avoid harming motivation in any case.

(Williamson, 1991). Any firm faces the problem of promoting beneficial HQ intervention, while constraining intervention hazards. However, we argue that the problem is particularly pressing to network MNCs; therefore, they should be particularly careful to anticipate and take precautions against intervention hazards.

We thus contribute to answering the question that Kim and Mauborgne (1993) described as one of the most compelling ones in international management: How can MNCs motivate their sub-units?⁴ Although almost two decades have passed since this issue was raised as a crucial one; and yet, research on it still remains scarce. We relate to Kim and Mauborgne (1993) and Nohria and Ghoshal (1994) by invoking normative integration and procedural justice as mechanisms that may reduce the incidence and severity of intervention hazards. However, we turn their argument around: While these two constructs have been treated as means to manage and control subsidiaries, we argue that they might serve as means to control the HQ. Note the counterfactual nature of our argument: Because network MNCs are more likely to be plagued by intervention hazards than more hierarchical MNCs, they are also more likely to make use of normative integration and procedural justice to control latent intervention hazards.

THE NETWORK MNC AND THE THEORY OF THE FIRM

Research Framework

Our overall research framework is depicted in Figure 1. We seek to link a specific organizational form of the MNC, the network form, to the incidence of intervention hazards. Selective intervention influences the motivation of MNC subunits, which in turn has performance consequences. In the following we work our way from the left towards the right in the figure,

⁴ Throughout our analysis we operate with two assumptions which we deem necessary for reasons of simplicity and theoretical rigor. First, we assume that the MNC operates only with two hierarchical layers, that is, with the corporate HQ and the subsidiary level. Second, we assume that the motivation of a subsidiary is to a large extent represented by the motivation of the subsidiary top manager. This is appropriate based on the idea that the subsidiary top manager is probably one of the key contact persons for the corporate HQ while she/he also influences to a large extent how the rest of the subsidiary perceives, deals with, and implements corporate directives.

describing each key construct in the process and explaining the causal links between them. As indicated in the figure we draw on three distinct bodies of literature. First, our overall conceptualization of the MNC in its various forms is informed by the MNC literature (e.g., Hedlund, 1986; Ghoshal & Bartlett, 1989; Gupta & Govindarajan, 2000; Egelhoff, 2010). We argue, however, that this literature is characterized by a research gap; specifically it fails to systematically address the link between HQ interventions and subsidiary motivations and the consequences of this. Economic theorists of the firm highlight how opportunism may sometimes be exercised by managers (Dow, 1987; Kreps, 1990; Baker, Gibbons & Murphy, 1999), harming productivity and value creation (Williamson, 1985; Kreps, 1990; Miller, 1992; Aghion & Tirole, 1997; Baker, Gibbons & Murphy, 1999; Foss, 2003). Thus, like Egelhoff (2010) we draw on the economics of the firm for the purpose of understanding the role of the HQ, but go beyond the uni-dimensional treatment of motivation in this research stream. We provide a richer view of motivation and how it is influenced by management action. Specifically, we draw on the literature in the organizational behavior field that explores the negative motivational consequences of such intervention in the context of employment relations (e.g. Brockner, Tyler, Cooper & Schneider, 1992; Coyle-Shapiro & Kessler, 2000).

Insert Figure 1 Here

New Network Forms of the MNC

MNC structures have traditionally been analyzed as formal hierarchical structures (e.g. Stopford & Wells, 1972, Daniels, Pitts & Tretter, 1984; Gates & Egelhoff, 1986). In the last decades, new network-like forms of MNCs have been discussed intensively and have been positioned as alternatives to the traditional hierarchical model (Malnight, 1996). Network structures

cover a variety of conceptualizations in the MNC literature, such as the heterarchy (Hedlund, 1986), the multifocal firm (Prahalad & Doz, 1987), the inter-organizational network (Ghoshal & Bartlett, 1990), the transnational firm (Bartlett & Ghoshal, 1989), or the geocentric model (Perlmutter, 1969). No single clear definition of what a MNC network structure really is exists. However, the above concepts share the assumption that hierarchical and highly formalized organizational structures with a high degree of specialization and decision-making power concentrated on the top are less suited for meeting the organizational and management challenges of learning organizations in turbulent environments. In contrast, a high degree of decentralization, relatively little formalization, lateral communication and knowledge transfer between loosely coupled units, and a variety of “integrating mechanisms,” such as normative integration and project teams (O’Donnell, 2000) complement traditional authority mechanisms in coping with such challenges (e.g. Malnight, 1996).⁵ Drawing on the above contributions, we proffer the following definition:

Definition: *A network MNC strongly delegates decision rights to subsidiaries, while retaining some decision-rights at the HQ. It is often characterized by a low degree of formalization, extensive lateral communication and knowledge transfer. Its subsidiaries are often resource-rich, hence powerful. It is a change-oriented organization situated in high-dynamism environments in which local adaptation as well as integration pressures coexist.*

The HQ in the Network MNC

While the network model has arguably been prompted by dynamic environments, key elements of hierarchies, such as centralized decision-making for specific activities (e.g., overall strategy making, branding issues, organizational design decisions, etc.) remain. In other words, there is still an important role for the HQ in the modern network MNC. However, as Egelhoff

⁵ A parallel trend in organization theory similarly argues that traditional hierarchies increasingly give way to “internal hybrids” that are better suited to deal with the challenges of dynamic contexts (Zenger & Hesterly, 1997).

(2010: 404) points out, the literature on the network MNC "... has tended to ignore both the general role of hierarchy and the more specific role of a parent HQ in MNCs." The literature on the network MNC places relatively more emphasis on the subsidiary level, notably the role that subsidiaries play within the MNC (Birkinshaw & Pedersen, 2009). Thus, research has examined the "mandates" of subsidiaries, what makes for an "entrepreneurial" subsidiary, lateral knowledge flows between subsidiaries, and so on (e.g., Birkinshaw, 1997a, 2001). In fact, in this literature there has been a tendency to regard the HQ as merely one unit among many others that does not necessarily have neither the knowledge nor the power to effectively exercise authority over subsidiaries (Andersson et al., 2007; Doz et al., 2001; Tallman & Koza, 2010). This tendency may have contributed to the literature being less forthcoming about the role of the HQ in a network MNC.

Authority in the Theory of the Firm

We are uncomfortable with this tendency. Within the MNC, as in any firm, the HQ is the holder of ultimate decision rights, or authority (Baker, Gibbons & Murphy, 1999). Specifically, it holds rights of *fiat* relative to other MNC units, notably the subsidiaries. A key theme in the theory of the firm since Coase (1937) is that the exercise of managerial fiat, or authority, in response to changes in the environment provides a reason why firms exist (Casson, 1994; Williamson 1996). In Coase (1937; see also Simon, 1951) authority means that the manager (or, in the present context, the HQ) picks a well-defined action from the employee's (or, subsidiary's) action set and instructs him to carry out this action. Obviously, this presupposes that the manager (HQ) is more informed than the employee (subsidiary) about which action should rationally be chosen, and that the manager (HQ) has full knowledge of the employee's (subsidiary's) action set. Both assumptions are clearly unrealistic, given the increasing importance of geographically distant subsidiary units that are included in the MNC portfolio, often for exactly the reason that they possess knowledge advantages relative to the rest of the MNC.

However, Simon (1991: 31) points out authority may be understood more broadly, namely as a command that takes the form of a result to be produced, a principle to be applied, or goal constraints, so that “[o]nly the end goal has been supplied by the command, and not the method of reaching it.” However, even this is arguably too narrow. Usually, some aspects of “the method of reaching” an end goal are specified, so that employees are seldom granted full discretion. Indeed, a function of authority is placing restrictions on the decision rights that are granted to employees with respect to *how* they reach an end goal (Holmström, 1999). This function of authority is exercised in order to avoid costs associated with unwanted externalities that may arise from employee discretion, such as moral hazard or coordination failures (e.g., scheduling problems, duplicative efforts, cannibalization of product markets, etc.). It is this kind of authority that a MNC HQ usually seeks to exercise relative to subsidiaries.

Delegation of Decision Rights

Network forms of the MNC are ostensibly oriented towards “innovation, renewal, and change” (Hedlund & Ridderstråle, 1996: 329), and are adopted in environments calling for such a dynamic stance. The reason that the MNC network form arguably fits dynamic and diverse environments is mainly that it goes much further than traditional hierarchical MNC forms with respect to delegating decision rights, that is, the right to make decisions over MNC resources. MNCs delegate decision rights for many reasons.

A subsidiary may be better *informed* than the HQ with respect to, for example, the design and execution of competitive strategies in local markets, dealing with authorities, etc. Often such superior knowledge is costly to communicate to the HQ (Casson, 1994), and delegation reduces the costs of processing and transmitting information from MNC units to the HQ (Egelhoff, 1991; Nobel & Birkinshaw, 1998; Wolf & Egelhoff, 2002). Early work on the network MNC argues that higher complexity in the subsidiary environment makes it impossible for the HQ to keep decision-making

rights as the HQ lacks the knowledge required for the decision at hand (e.g., Nohria & Ghoshal, 1994). *Learning* or *entrepreneurship* may also be a reason of delegation, because delegation may lead to the discovery of new knowledge that would not be discovered in the absence of delegation (cf. Foss, Foss & Klein, 2007). For example, a subsidiary might find *new* ways of approaching and mastering market challenges, such as overcoming competitors' moves (e.g., Birkinshaw, 1997b, 2001). *Motivational* reasons have also been highlighted (Deci & Ryan, 2000). Thus, delegation of discretion to subsidiary managers may raise perceived self-determination and thus strengthen autonomous motivation, including intrinsic motivation (Osterloh & Frey, 2000; Gagnè & Deci, 2005). An increase in creativity in the pursuit of goals may follow; expert knowledge is better utilized, and learning is fostered. In contrast, decreasing the level of delegated discretion reduces perceived self-determination and crowds out autonomous motivation.⁶

Managing Delegation

Even in a network MNC, the HQ is still needed to define the decision rights of subsidiaries (i.e., give them “mandates”), to build an information infrastructure, set up reward systems, coordinate subsidiary actions (if lateral consultation cannot take care of this), and engage in overall strategy making (e.g., Egelhoff, 2010). Therefore, there are limits to decentralization and the organizational design issue is deciding on the optimal choice between centralization and decentralization (e.g., Wolf, 1997).

An important HQ function is to reduce costs from delegation. These are the well known agency costs (O'Donnell, 2000), but also coordination failures that may arise because of the decentralization that delegations implies (Egelhoff, 2010). Given that there are costs as well as benefits for MNCs of delegating discretion to subsidiaries, HQ confront a trade-off with respect to

⁶ Such reasoning is the basis in some MNC literature for measuring subsidiary motivation with the proxy of subsidiary autonomy (e.g., O'Donnell, 2000; Gupta & Govindarajan, 2000).

the choice of delegation (Jensen & Meckling, 1992). Under norms of rationality, MNCs seek to implement the optimal trade-off. This is manifest in the specific organizational form adopted by the MNC, as well as the instruments of organizational control that are deployed to support the optimal trade-off. Thus, defining the organizational structure of the MNC implies defining the decision rights of subsidiaries. To control the information and incentive issues that delegation gives rise to, MNCs implement management information and reward systems (Jensen & Meckling, 1992; Egelhoff, 2010).

Once implemented, an optimal trade-off can persist as long as contingencies (technology, tastes, competitive conditions, etc.) remain stable. When they change, the optimum trade-off also changes. Changes in contingencies are likely to change the optimum degree of delegation. For example, research has demonstrated that the discretion levels of foreign R&D units change when the local environment changes (e.g., Asakawa 2001). Birkinshaw and Hood (1998) propose that local environmental dynamism increases the likelihood of parent- or subsidiary-driven charter change for the subsidiary, that is, the scope of activities for which the subsidiary has responsibility and discretion. Arguably, such phenomena are driven by perceived benefits of changing discretion being larger than the perceived costs. However, in order to fully understand the benefits and costs of changing the decision rights that are granted to subsidiaries, we submit that it is necessary to consider motivational and incentive considerations more fully. Specifically, we need to consider intervention hazards.

Motivation and Incentive Problems

Motivation and incentive problems have often been discussed in the MNC literature. Most contributions investigate the type of incentives used by HQs and their antecedents and consequences. For example, Gupta and Govindarajan (2000) discuss the motivational dispositions of knowledge receivers and transmitters within MNCs. They find that incentives based on MNC

network gains do not influence knowledge outflows but only inflows from the HQ.⁷ They also regard subsidiary autonomy as one element of the subsidiary's motivational disposition and they find that such autonomy has a negative effect on inflows from the MNC corporate HQ. Minbaeva et al. (2003) find support for the idea that certain incentive types drive subsidiary employee motivation which in turn positively moderates the relationship between employee ability and knowledge transfer. Mudambi and Navarra (2004) report that subsidiaries with high bargaining power tend to appropriate high levels of rents. They conclude that while subsidiary autonomy might be formally conferred by the HQ, it is also (informally) driven by the subsidiary's internal bargaining power *vis-à-vis* the HQ. They suggest that strong organizational culture and mechanisms that may foster intrinsic motivation at the level of subsidiary employees may serve to constrain such rent-seeking.

Overall, these papers have in common that they equate decentralized decision-making with subsidiary motivation, and that they address problems of moral hazard, with the HQ in the position of the principal and subsidiaries in the positions of agents. There is, however, no mention of the possibility that the HQ may act opportunistically relative to subsidiaries (or, at least, be perceived of acting opportunistically).

The possibility of management opportunism has been discussed by Williamson (1985, 1996) under the heading of "selective intervention." As Williamson clarifies, selective intervention by a firm's top-management may break commitments, and be harmful for this reason. The problem is that the option to intervene "... can be exercised both for good cause (to support expected net gains) and for bad (to support the subgoals of the intervenor)" (Williamson 1996: 150-151), and it may be difficult to verify the nature of the cause. Williamson casts this in terms of a credible commitment when he notes that there may be problems of "... *credibly* [promising] to respect autonomy save for

⁷ The scope of incentives is defined as a continuum between incentives based on subsidiary-specific performance vs. incentives based on firm-level performance.

those cases where expected net gains to intervention can be projected” (Williamson, 1993: 104). A further problem is that even if intervention is “exercised for good cause,” levels lower in the organization may still believe that the intervention is undertaken to “support the subgoals of the intervenor.” Thus, cross-level dynamics of intentions and beliefs seem essential to understanding the motivational impact of HQ intervention.

A Taxonomy of Headquarters Intervention

These cross-level dynamics can be mapped with a 2x2 matrix that juxtaposes the HQ’s intentions (intervention for good and bad cause) and the subsidiaries’ perceptions (correct perception of HQ intentions and incorrect perceptions); see Figure 2.

Insert Figure 2 Here

Cell I represents the extant MNC literature in which it is assumed that the HQ is benevolent and succeeds in making it credible that its actions are undertaken for good cause. Cell IV represents a situation in which the HQ acts opportunistically, and is perceived as such. In Cell III the HQ intervenes because of real net gains to be achieved by the intervention, but the subsidiary does not perceive it as such.⁸ In Cell II the HQ intervenes for bad cause, but this is not perceived by subsidiary managers. Cell II and III may represent unstable situations, because the subsidiaries may eventually find out that the HQs were intervening for bad (good) causes. Note, that of all cells, only Cell I creates unambiguously positive effects on MNC performance. Hence, Cells II, III, and IV represent situations of what we call “intervention hazards”.

Why Harmful Intervention?

⁸ This suggests that there may be instances where, although the HQ is “in the know,” they should not intervene because this is harmful to subsidiary motivation.

These situations represent hazards because they have the potential of harming subsidiary motivation, with harmful repercussions for subsidiary and eventually MNC level value creation. It may be asked why HQ would intervene such that motivation is harmed in subsidiaries and/or value is destroyed (Cells II-IV). The following reasons may be offered. First, HQ may derive a private benefit (in whatever form) from managerial intervention that destroys value. For example, to the extent that subsidiary autonomy is associated with slack, HQ may reduce autonomy and the associated slack because this makes them look good in the eyes of owners of the MNC. This may work when the negative consequences for value creation only arrive after a significant delay, or if it is very difficult to trace these consequences to the managers' behavior. A second reason relates to the time inconsistency problem (Kydlund & Prescott, 1977). In the context of delegation, such behavior may consist in, first, delegating substantial autonomy to subsidiaries. When subsidiaries, enthused about their new extended discretion, come up with value-increasing ideas, HQ may harvest these, decide that the MNC already has its hands full with implementing the ideas, and that the level of delegated discretion may be usefully reduced in order to save costs. Third, HQ may wish to teach what they think are recalcitrant subsidiaries an example. Fourth, HQ may act on (actual or perceived) superior information. This situation might also include that the HQ acts with good intentions but that the assumptions on which the intervention effects are calculated do not hold, for example, because of wrong perceptions or bounded rationality. This is commonly described in the literature on parenting in which it is documented that HQ managers frequently overestimate, for example, synergy potential between subunits which is why they intervene (Goold, & Campbell, 1998). It also includes situations of Cell III, that is, "objectively" it is entirely warranted that HQ intervenes, and it does so with the best possible intentions. Nevertheless, these intentions are misread and interpreted as demotivating meddling.

Perceived and Actual HQ Opportunism and Motivation at Subsidiary Level

Research on organizational behavior suggests that employee motivation can be badly harmed by managerial intervention. Heath, Camerer and Knez (1993) argue that in an employment relationship, employees develop implicit and explicit expectations to the contract governing the relationship, and particularly to the benefits that they believe they deserve under the implicit contract, that is, their “entitlements”. Such expectations may be represented by “status quo” points, that is, what employees believe are their entitlements. The discretion that is delegated to employees may become part of their perceived entitlements, and negative motivational consequences follow from managerial intervention that interferes with these entitlements. Other parts of psychological research points to the related phenomenon of loss aversion, that is, a loss relative to a status quo is seen as more undesirable than a gain relative to the same point is seen as desirable (Kahneman, Knetsch & Thaler, 1991). This means that subsidiaries will develop a bias against reducing their autonomy, and that they can be expected to resist such changes, as well as suffer a loss of motivation if the change is, in fact, forced upon them (Foss, Foss & Vazquez, 2006).

A substantial body of work in organizational behavior on psychological contracts relates directly to these issues. In the present context, this work suggests that HQ intervention that is perceived of by subsidiaries as being unfair, arbitrary, and in other ways break with what is perceived of as established psychological or implicit contracts (i.e., it is opportunistic) is likely to harm motivation (Rousseau, 1989; Rosseau & Parks, 1992).¹⁰ Rousseau and Parks (1992: 36) state that “... contract violation erodes trust [and] undermines the employment relationship yielding lower employee contributions (e.g. performance and attendance) and lower employer investments (e.g., retention, promotion).” In particular, organizational citizenship behavior—that is, employee behavior (“extra-role behavior”) that promotes organizational efficiency but is not explicitly recognized by an organization’s reward system—may suffer from managerial intervention

(Robinson & Morrison, 1995). Empirical work has reached similar conclusions (Robinson, 1996; Foss, 2003; Foss, Foss & Vazquez, 2006). Finally, research in motivational psychology (i.e., “self-determination theory”) suggests that individuals have fundamental needs for autonomy, competence, and relations (Deci & Ryan, 2000; Gagné & Deci, 2005). Work settings that allow these needs to be fulfilled typically also tap into the autonomous motivation of individuals. Handling certain tasks, notably those related to the exercise of creativity and problem-solving, require this kind of motivation (Amabile, 1996, 1998; Oldham & Cummings, 1996). External motivators, like the blatant exercise of authority (i.e., intervention), risk harming autonomous motivation because they reduce autonomy and competence.

Consequences of Motivation Losses

For the MNC, intervention that harms motivation at lower levels in the MNCs is a problem to the extent that loss of motivation leads to managers and employees cutting back on effort (both in their job roles and in their extra-role behaviors), and on firm-specific investments in human and social capital. In particular, extra-role behaviors are likely to suffer. Such behaviors are difficult to measure and directly reward. However, they may be essential to activities such as discovering, creating, sharing and integrating new knowledge within and between MNC units; investing in building and maintaining relations and information channels to other employees or units in the MNC; and supplying the extra intelligent effort that may be required to efficiently cope with changing external contingencies. Notice that these activities are all at the core of the network MNC. Thus, the network MNC may be particularly vulnerable to the kind of HQ intervention that is perceived of as demotivating. We examine this in the following section.

THE NETWORK MNC AND SELECTIVE INTERVENTION HAZARDS

For the following discussion of HQ intervention we make use of the research model that is depicted in Figure 3. Our key point is that implementing a network MNC has an influence on both

dimensions of Figure 2: the extent to which HQs intervene, as well as how subsidiaries perceive interventions.

Insert Figure 3 Here

Intervention in the Network MNC

Network MNCs are chosen over more hierarchical forms in highly dynamic environments and involve delegating substantial decision autonomy to subsidiaries. Such environments may cause misfit between the organization of the firm and its environment, as new and different contingencies arise. For example, Hedlund (1986) suggests that the hierarchical relationships within network organizations are of a temporary nature, and that they can frequently change direction, that is, decision rights can *de facto* be transferred to the subsidiary to such an extent that the HQ has very limited influence over the subsidiary. However, this might also go the other way round and HQs might feel the need to intervene. As a consequence, the structuring of the coordination and control system, including the delegation of decision-rights, is at any point in time likely to be imperfect (e.g., Hedlund, 1986; Nickerson & Zenger, 2005; Piekkari et al., 2010).

The impact of environmental changes in driving HQ intervention is reinforced by the fact that the network MNC is characterized by an often substantial dispersion of knowledge and the HQ decision problems are shrouded in uncertainty (Forsgren & Holm, 2010). The HQ may suffer from a lack of information about the subsidiary context and the knowledge controlled by the subsidiary. Complemented with bounded rationality and radical uncertainty, such lack of information suggests that the HQ in actuality is unable to perfectly design the organization of the MNC, and especially the delegation of decision-rights, and will have to approximate it through a process of groping. Such groping may be manifest in frequent redesigns of the structure. In sum, the likelihood is high that

HQs need to or feel the need to intervene on a frequent basis in the network MNC, and more so than in more traditional hierarchical modes of the MNC.

This would be less of a problem if that additional intervention was firmly placed in Cell I (Figure 2), because, although errors would still be made, at least subsidiary motivation would not be harmed. However, much of the additional intervention will take place in Cells II, III and IV. For example, a member of the top-management team may decide to act tough and slash costs in a subsidiary, because this benefits her own career. Because a MNC is in general characterized by strong spatial dispersion and uncertain environments, a manager may get away with this kind of behavior, as tracing costs and managers' behaviors might be a big challenge. For example, the behavior of a regional manager who behaves opportunistically against regional subsidiaries in Asia might be unnoticed by the HQ in Europe, and the costs of this intervention might be misunderstood because of cultural and communication issues. Hence, it may well be that such an opportunistic manager is not punished for his interventions.

Relatedly, HQ managers can be inclined to intervene in subsidiaries because they think that exemplary intervention may show to very powerful subsidiaries "who the boss is". Goold and Campbell (1998) argue that senior managers attribute the right to make decisions and to overrule to their status within the firm, that is, managers might feel redundant in a system which allocates substantial decision rights to lower levels of the firm. Recent literature has shown that subsidiaries can sometimes be very powerful in the sense that they are able to reject HQ orders, influence corporate decisions, and appropriate rents on the subsidiary level which would have created more benefits if the sources of these rents could have been exploited within the whole MNC (Andersson et al. 2007; Mudambi & Navarra 2004). In such a situation, HQ managers might more likely feel the need to overrule decisions and to intervene in order to strengthen their position *vis-à-vis* the

subsidiaries even if this is not to the benefit of the whole corporation. The above reasoning gives rise to the following proposition:

Proposition 1: *The more the MNC has implemented a network organization, the higher the frequency of HQ intervention (for good cause and for bad cause).*

While MNC network organizations are more prone to intervention overall, intervention that is understood and/or accepted to be for good cause does not lead to motivation problems *per se*. Yet, chances are that such intervention is perceived as an undue breaking of commitment by the HQ. The reason is that it is difficult to verify the nature of the cause of intervention or that the communication that comes along with the intervention is imperfect. The network MNC has barriers to successful vertical communication (e.g. O'Donnell 2000), for example, because of a lower degree of formalization than in more hierarchical forms. The uncertain and fast-changing environments that the network MNC is typically located in increase the likelihood that communication of intervention is not synchronized with actual events that lead the intervention in the first place. Finally, powerful subsidiaries might request a lot of very detailed explanations regarding the background of interventions while the complex lateral interdependencies between the units means that no single unit probably has a good overview and understanding of the issues at hand. In sum, this results in misperceptions and, in the worst case, a general bias at the subsidiary level of assuming that any intervention is for a bad cause. In other words:

Proposition 2: *The more the MNC has implemented a modern network organization, the more likely the subsidiary perceives HQ intervention as being for bad cause.*

By definition, intervention for good cause is intended to lead to higher MNC performance because it is undertaken only when the HQ manager identifies real net gains from intervening. For example, the HQ might intervene and standardize a product offering across countries because standardization gains across all countries are higher than adaptation gains. Yet, the motivation of

subsidiaries might still be harmed when intervention for good cause is misperceived by the subsidiary managers. For example, Birkinshaw, Holm, Thilenius, and Arvidsson(2000) have shown that when HQ perceptions and subsidiary perceptions differ, it will eventually have a negative effect on cooperation. We argue that communicating effectively the reasons and needs for good cause intervention is very difficult within the modern network MNC. Hence, we expect that frequent miscommunication and misperceptions influence the relationship between good cause intervention and MNC performance in a negative way.

By contrast, HQ interventions for bad cause do not produce negative motivational effects in case the subsidiaries do not recognize the true cause of the intervention (Cell II), at least not immediately. This might be the situation when the HQ is able to create a false picture of the intervention and since the MNC context makes it very difficult to verify the nature of the intervention, subsidiaries might believe the HQ managers. However, even if effects on subsidiary motivation is absent, bad cause intervention is negatively related to MNC performance since it is, by definition, an intervention which is not made to realize net gains for the whole MNC. This negative effect is likely to be even stronger when the subsidiaries correctly identify the intervention as being for bad cause. Hence, we formulate the following two propositions:

P3a: The extent to which subsidiaries perceive good cause intervention as for bad cause negatively moderates the positive relationship between good cause intervention and MNC performance.

P3b: The extent to which subsidiaries perceive bad cause intervention as for bad cause negatively moderates the negative relationship between bad cause intervention and MNC performance.

MANAGEMENT AND ORGANIZATIONAL RESPONSES TO SELECTIVE INTERVENTION HAZARDS

All firms, MNCs included, face intervention hazards, but we argue that the modern network MNC is particularly prone to such hazards. Hence, the motivation and incentive problems of the modern MNC organization go beyond managing subsidiary moral hazard and opportunism. This is a serious problem given that subsidiary motivation is supposed to be a key driver of network MNCs' performance in the first place (Kim & Mauborgne, 1991). An important organizational design and management problem therefore concerns keeping intervention hazards at bay. In the following, we discuss three distinct yet interrelated ways to manage these hazards. We link the established issues of “normative integration” and “procedural justice” to the issue of intervention hazards, and we discuss structural remedies.

Normative Integration

Normative integration has received much emphasis in research on MNC organization (Nohria & Goshal, 1994). It is argued that common values and beliefs provide harmony of interests and diminish the danger of opportunistic behavior inside the firm, particularly from employees (Ouchi, 1980). Thus, normative integration acts as an implicit contract that instructs organizational members about appropriate behavior and in particular about how to react to new contingencies (cf. Kreps, 1990). In the MNC literature it is featured as an alternative way of how the HQ can “control” the behavior of the subsidiaries. Under normative integration, subsidiary managers are imbued with the values and goals of the MNC and thus act in accordance with them (Ouchi & Maguire 1975; Edström & Galbraith 1977). This effectively reduces the need for control by the HQ (Hedlund, 1986).

However, normative integration has to our knowledge exclusively been characterized as a tool available to the HQ to manage its subsidiary network. We argue that normative integration is also

one way of how intervention hazards can be managed. First, the implementation of a strong organizational culture based on a shared understanding of goals, norms, and beliefs, requires efforts over a relatively long period of time. The success of these efforts is based largely on how consistent and credible the key issues of the culture are communicated as this facilitates their adoption at lower levels. This has the effect that HQ managers themselves identify more with this culture over time; they get socialized as well. Since it is very unlikely that the corporate culture openly features HQ intervention for bad cause, it is very likely that HQ managers investing strongly in corporate culture also refrain from bad cause intervention. In other words, a shared normative context has the effect of enhancing the sense of mutual interdependence between HQ and subsidiary level (Nohria & Ghoshal, 1994) with HQ opportunism being restrained very much in the same way that subsidiary opportunism is restrained.

P4: MNCs that are high in normative integration will have fewer incidences of intervention for bad cause.

While HQ managers might refrain from opportunistic intervention under conditions of high normative integration and shared values, it might not be eradicated completely. However, we argue that even if HQ managers sometimes act opportunistically, the effect on subsidiary motivation and consequently on MNC performance might be less severe under conditions of high normative integration than under conditions of a lack of strong organizational culture. This is due to the fact that subsidiary managers simply do not expect the HQ to act opportunistically which in turn influences their perceptions of the interventions positively. Since the verification of the true causes of the intervention is difficult, as are the costs, this might have a strong impact. As long as such interventions occur seldom, subsidiary motivation might not be harmed. Similarly, a strong organizational culture is likely to be based on the promotion of good cause intervention only. This

improves subsidiary perceptions in general and hence moderates the effect that true good cause intervention has on MNC performance.⁹

P5a: The extent to which the MNC is high in normative integration positively moderates the negative relationship between intervention for bad cause and MNC performance.

P5b: The extent to which the MNC is high in normative integration positively moderates the positive relationship between intervention for good cause and MNC performance.

Procedural Justice

Similarly to the normative integration concept, the concept of procedural justice has been discussed as a tool to control and influence the behavior of subsidiaries as opposed to managing potential opportunism at the HQ-level. It was introduced to the MNC literature mainly by Kim and Mauborgne (1991; 1993; 1995). Procedural justice can be defined as the perceived fairness of formal procedures governing decisions involving the treatment and benefits of participating partners (Luo 2009). In the context of the MNC, this perceived justice is based on a consistent set of procedures for decision making in which HQ decisions are accompanied with extensive bilateral communication between the HQ and the subsidiaries, and the opportunity for subsidiaries to challenge HQ views (Kim & Mauborgne, 1991). They argue that the increasingly network-like organization of MNCs decreases the opportunities for HQs to use “hierarchy”, that is, fiat, monitoring, and appraisal capability, to make subsidiary managers implement global strategies. This is based on the idea that subsidiary managers in network organizations are the most important “implementers,” but that they are likely to have a stronger sense of their own goals and they are often resource-rich and powerful. Hence, in order to be able to successfully implement global strategies, the motivation of the subsidiary managers are required. They conclude that one key element in maintaining such motivation is procedural justice in decision-making processes which

⁹ We acknowledge that in rare cases the detection of intended bad-cause intervention can have very severe consequences for motivation. This might be because subsidiary managers see the stark contrast between the organizational culture and the bad-cause intervention.

they, in principle, interpret as a driver or a complement of normative integration. Under conditions of high procedural justice, subsidiary managers are motivated to comply with top management decisions even if they are unfavorable for the specific subsidiary, that is, when MNC-wide gains prevailed over subunit optimization.

We argue that procedural justice has two important effects. First, similarly to the effect of normative integration, the extent to which the modern network MNC has implemented a system of procedural justice reduces the likelihood that HQ managers act opportunistically, that is, intervene for bad cause. A system of procedural justice is based on the fact that the HQ is supplying a justification for their behavior and potential interventions as well as accepting challenging and refuting from the subsidiary managers (Kim & Mauborgne 1991). Hence, it is more likely that opportunistic behavior is detected and finally sanctioned in one way or another. The opportunity to HQ managers to hide their behavior and the effects of their interventions is limited in such a system¹⁰.

P6: The higher the MNC is in procedural justice, the less frequent is HQ intervention for bad cause.

Second, a system of procedural justice is the basis for high quality communication in which HQ managers acknowledge the information requirements by subsidiaries, provide the necessary details and reasons, and specifically take into account the potential negative effect on subsidiary motivation in case the HQ decision is perceived as being unfavorable for the subsidiary. Hence, we suggest that a formalized decision system decreases the likelihood that intervention for good cause is misperceived by subsidiary managers.

P7: The higher the MNC is in procedural justice, the less likely that the subsidiary perceives HQ intervention as being for bad cause.

¹⁰ Kim and Mauborgne (1995) provide some support for the idea that a procedural justice system improves also the content of strategies. This is aligned with our reasoning that bad cause intervention (intended or due to bounded rationality) is less likely to occur.

Structural Mechanisms

For both normative integration as well as for procedural justice systems we have argued that they constrain primarily HQ intervention *for bad cause*. Research in political economy suggests that it is often in an organization's long-term interest to avoid later period actions that break promises (with respect to delegation), and that avoiding such behavior may be accomplished by credibly constraining the flexibility of managers in such a manner that the initial promise becomes credible (Kydlund & Prescott, 1977). Normative integration and procedural justice may serve these functions because they commit HQ to certain lines of action and rule others out.

However, in principle, constraining the flexibility of the HQ to selectively intervene in general can also help to reduce harmful selective intervention (not only those that are for bad cause). Since we have argued that especially network-like MNCs are prone to selective intervention (cf. Proposition 1) different organizational forms might remedy the issue of intervention hazards. MNCs struggling with intervention hazards in the network organization could be tempted to alter their organizational form altogether. To this end, Milgrom (1988) argues that employee rent-seeking that aims at influencing hierarchical superiors to selectively intervene to the benefit of the rent-seeking employees will be constrained by rigid, hierarchical structures which makes such rent-seeking more costly. Furthermore, a strong increase in formalized procedures and the implementation of strict rules and policies by definition limits the scope for selective intervention. “(manuals), standing orders, standard operating procedures, etc.” (Ghoshal & Nohria 1998, p. 335) reduce variance in how decisions are taken, i.e. these mechanisms formally fasten decision rights as well as inputs to decision making on both the HQ as well as the subsidiary level. Hence, this adds to the arguments in favor of more hierarchical structures in MNCs listed by Egelhoff (2010).

Another reason why hierarchical structure may constrain managerial intervention is that the hierarchy is not just a structure of authority, but also one of information (Galbraith, 1973; Egelhoff

1991). The informational distance between HQ and subsidiaries influences the basis for exercising judgment with respect to decisions whether to overrule lower levels in the MNC or not. All else being equal, the more hierarchical layers that information has to pass through before reaching the exercising authority, the less adequate is this basis likely to be. If the HQ realizes that because of information loss, bounded rationality, and ignorance about subsidiary conditions, it is not in a position to rationally decide whether to selectively intervene or not, it should not intervene (Aghion & Tirole, 1997). Thus, somewhat paradoxically, the HQ may decide to commit itself by delegating even more decision autonomy to the subsidiaries and by deliberately refraining from gaining certain kind of information (i.e, making itself ignorant).

In sum, firms could be tempted to constrain HQ intervention in general by modifying the organizational form altogether.

P8: The more the network MNCs struggle with keeping intervention hazards at bay the higher the likelihood of a change of organizational form towards either more hierarchical, formalized structures or towards even more strongly decentralized, multidomestic structures.

The Inherent Trade-offs of the Network Model

Obviously, the structural remedies discussed in Proposition 8 come at high costs. First, there are limits to how far HQ can constrain itself, because a complete hands off strategy may also mean sacrificing the benefits of integrating subsidiaries under the MNC umbrella, i.e. of achieving integration benefits. This could have severe consequences in transnational environments. Second, more hierarchical approaches forego benefits due to flexibility and adaptation.

What emerges is a picture of the network MNC with a number of deep trade-offs that includes also the previously discussed remedies of normative integration and procedural justice. First,

establishing procedural justice and normative integration may be quite costly in terms of defining basic normative rules, disseminating them, exercising the symbolic management that can maintain and enforce them, etc. This is particularly likely to be the case in MNCs that are very large and dispersed in many different contexts (Egelhoff 1999; Kim & Mauborgne 1993). The costs of these mechanisms should be balanced against the benefits from reducing motivational loss by constraining selective intervention. This may tilt the trade-off in favor of more traditional structures: A traditional hierarchical structure likely entails lower costs in terms of setting up and running systems for conflict resolution and socializing instruments (Williamson, 1985).

Second, and relatedly, the MNC literature forwards that in a turbulent environment network structures are required to adapt quickly to changing circumstances. An internal justice system might delay decision-making because subsidiary and HQ input has to be heard and evaluated. Such delays could be very costly. Somewhat paradoxically, the need for procedural justice is greater in network organizations, but at the same time, it makes the implementation of procedural justice more difficult (Kim & Mauborgne 1993).

These trade-offs seem inherent to the network model. Identifying them and the costs and the benefits that give rise to trade-offs, help MNC managers in selecting organizational forms and mechanisms that are least second-best, that is, the best that can be done given the circumstances.

CONCLUDING DISCUSSION

The strong emphasis of recent MNC literature on the subsidiary-level has implied a certain neglect of HQ activities and rationales (Egelhoff, 2010). What is particularly missing in the current body of literature is a theoretically grounded understanding of how the HQ can manage acts of intervention that it—*qua* its HQ status—must perform smoothly, efficiently, and in such a way that little or no harm to subsidiary motivation is caused (unless such harm is overwhelmed by beneficial consequences of the intervention). For example, Hedlund's (1986) notion of multiple, frequently

changing hierarchies bypasses this question. He does not raise issues related to whether the HQ has the required knowledge and understanding to engage in organization changes, or how such changes might be initiated, motivated, explained, sanctioned, and perceived by lower levels in the MNC network. These issues remain under-researched, in spite of recent attention to HQ ignorance (Forsgren et al., 2005), uncertainty of decision-making (Forsgren & Holm, 2010), and the political dimensions of MNC network organization (Mudambi & Navarra, 2004; Andersson et al., 2007). However, even such work still emphasize the power and interests of subsidiaries and does not focus explicitly on the HQ and its role in initiating and managing differentiated and flexible discretion arrangements across the MNC.

We contribute to this gap in a number of ways. By merging relevant work in the fields of international management, economics of the firm, and organizational behavior, we have developed a theoretical framework that links MNC network characteristics to selective intervention hazards (and ultimately MNC performance). Hence, we have suggested a new set of items for research in the function and consequences of the HQ in MNCs. The starting point for our argument is that the HQ is not always benevolent as is routinely assumed in the MNC literature. We argue that the network MNC is subject to more frequent selective HQ intervention, is more prone to suffer from HQ opportunism, and that it is more likely that subsidiaries misperceive even intervention for good cause. In other words, intervention hazards are more rampant in the network MNC. Thus, we argue that the dominant assumption of the MNC literature that corporate HQs are benevolent is a strong assumption, as selective intervention hazard may be substantial.

However, managerial and organizational means exist that can handle intervention hazards. First, we argue that HQ activity can be influenced by normative integration and procedural justice. These mechanisms can help reducing the incidence of bad cause HQ behavior and the risk that lower levels in the MNC mistake good cause intervention for bad cause intervention. This is an

important contribution to the literature as both mechanisms have exclusively been discussed as a means to manage subsidiaries. We show that these mechanisms might also work “upwards” to manage reverse incentive issues. Hence, both mechanisms might be even more important for network MNCs than usually conceived in large parts of the literature.

Second, both mechanisms suggest important conclusions for the tasks of the HQ and the concept of the differentiated network MNC (Ghoshal & Nohria, 1989). Normative integration and procedural justice are both mechanisms that require MNC wide standardization and to some extent also formalization. Yet, the differentiated network MNC is defined as an organization which requires different ways of coordination and control for every single subsidiary (Nohria & Ghoshal 1997). If normative integration and procedural justice are of such high importance then the HQ’s key task is much more about standardizing across the whole MNC than about differentiating its activities according to the subsidiary context. Of course, the outcome of individual decisions can still be adapted to a local subsidiary’s context, yet, the HQ’s role lies in creating a robust and efficient procedural justice system so that perceptions and intentions of interventions are such that hazards are reduced. Furthermore, we have highlighted a number of crucial trade-offs. By and large, the literature seems to argue that the specific context of network MNCs requires both mechanisms while it creates simultaneously huge constraints on its effective implementation. Thus, it seems to be a particular ability of the MNC to resolve this trade-off—an ability which is arguably located at the HQ-level.

Third, we discuss structural mechanisms to manage intervention hazards. We argue that, paradoxically, one way of keeping intervention hazards under control is either the strong increase of hierarchy in the sense of additional hierarchical layers—or, the near complete abolishment of hierarchy by granting even more discretion to the subsidiaries. This is an important implication, since both mechanisms move, in effect, the MNC structure away from the network MNC. A

strengthening of the hierarchical structure turns the network MNC more into a formal “global” organization. Rendering even more discretion into the hands of the subsidiaries turns the MNC into a multi-domestic MNC in which benefits from integrating the subsidiaries within the MNC are more strongly neglected. Hence, given the tremendous difficulties firms face when they try to build systems of normative integration and procedural justice, as well as the structural tendencies to remedy network-related intervention hazards with non-network structures, it is not surprising that some researchers suggest that MNC networks are inherently unstable organizations, that they are rarely observed empirically (e.g. Wolf 1997), and that firms might often modulate between organizational structures (Nickerson & Zenger 2005).

Future Research

To our knowledge, this paper is the first to be concerned with intervention hazards in MNCs. While we think that this soil is potentially very fertile research-wise, it has basically not been ploughed so far. More research is therefore needed in a number of areas.

First, more conceptual work could be done by adding complexity to our matrix of intervention situations, e.g. by varying the level of knowledge and understanding of HQ (cf. Forsgren & Holm 2010) that allows them to identify true intervention opportunities. Furthermore, future work could link intervention hazards to the scope of the MNC based on our reasoning that complete hands-off strategies for certain subsidiaries might be effective remedies to intervention hazards while they make it more likely that such a subsidiary does not remain long within the MNC portfolio. Finally, it might be valuable to complement our analysis and to engage into differentiating further the effects of HQ interventions especially in terms of *net* value creation.

Second, empirical work could validate our key constructs in this paper, notably those of selective intervention for good and bad causes. It could also further propositions that may be distilled from our reasoning. For example, the harmful effects of selective intervention for bad

cause could be further elaborated. For instance, it may be an empirically open question whether powerful subsidiaries stimulate more or less HQ intervention. One argument (that we have developed here) is that it is more likely that HQ intervene to teach a subsidiary “a lesson” when the subsidiary is strong than when it is less strong. A contrary argument is that HQ will refrain from intervening vis-à-vis powerful subsidiaries that can retaliate in various ways. Note also that our argument is essentially a multi-level one (the relevant variables in our argument are placed on HQ as well as subsidiary levels). Thus, empirical tests of our reasoning should in principle involve multi-level data sampling and the application of multi-level methods.

Theoretically, more research is needed on the set of organizational mechanisms that influence the decision of MNC managers to selectively intervene or not. First, more precise arguments are needed, and perhaps even the kind of formal modeling exercise undertaken by Argyres and Mui (2007) who, like us, are taken up with issues of credible commitment in corporate hierarchies. Second, theorizing is needed to make us better understand what are the relations between different kinds of mechanisms inside hierarchies that handle intervention hazards. For example, are normative integration and procedural justice substitutes or complements for more hierarchical structures with respect to taming intervention hazards? While much needs to be done empirically and theoretically, we are confident that intervention hazards in MNCs is a new exciting angle on internal organization issues in MNCs.

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Figure 1: Overall Research Framework

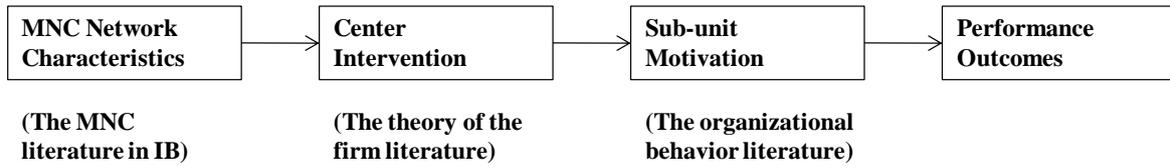
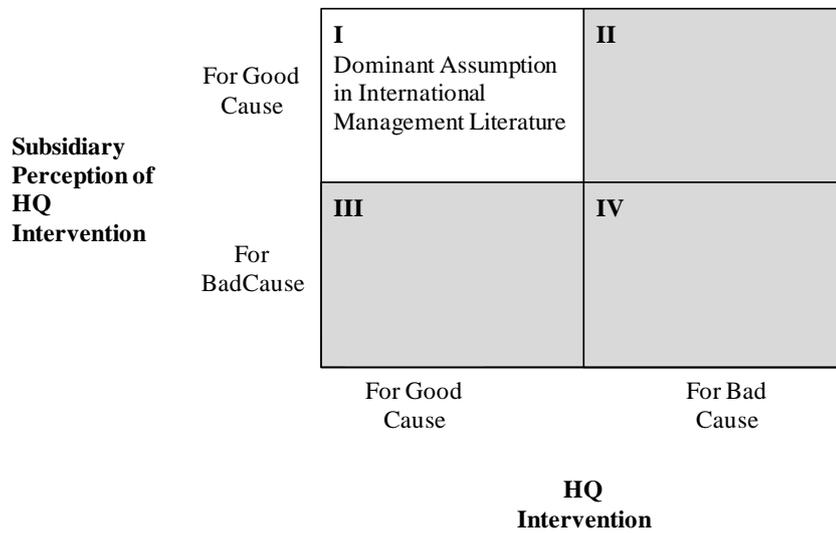
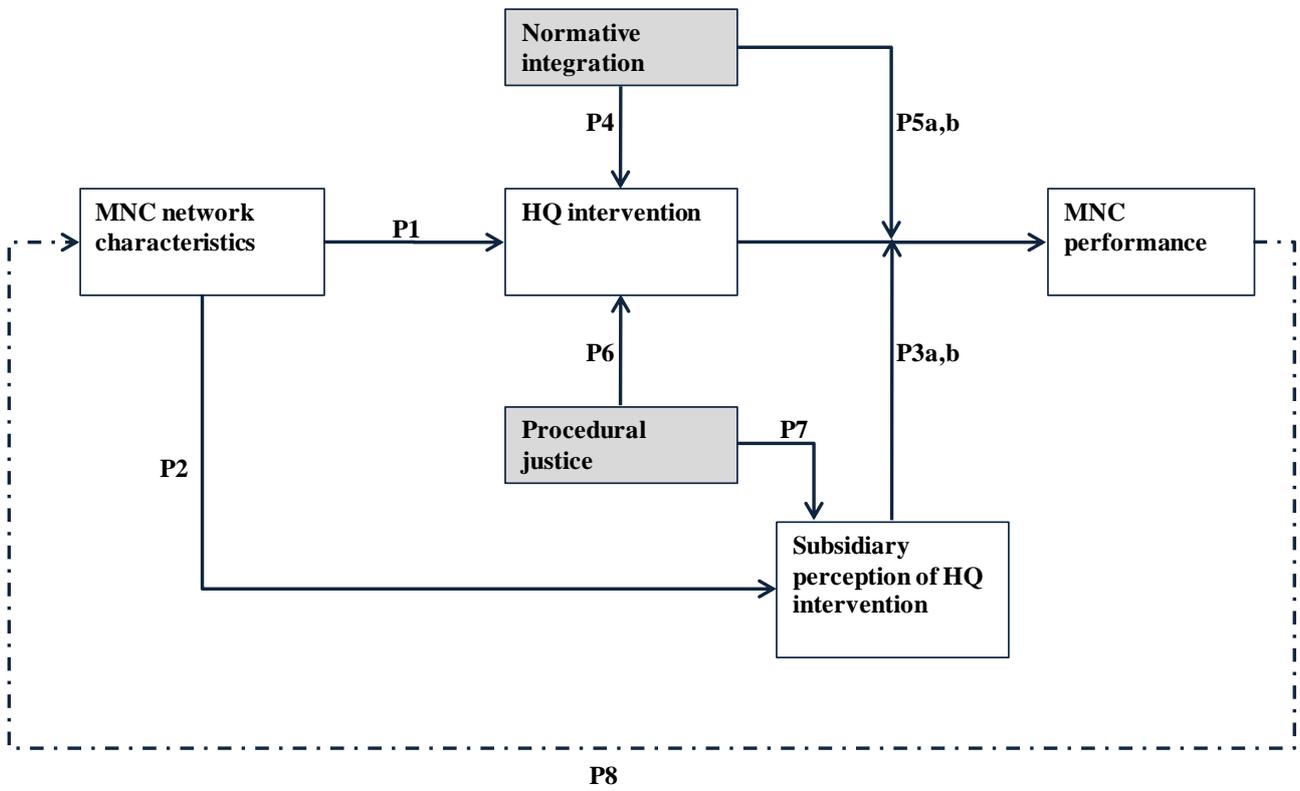


Figure 2: Typology of HQ Interventions and Their Perceptions



Selective Intervention Hazards

Figure 3: Key Constructs and Their Relationships



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