

## Team Production & the Multinational Enterprise

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### I. INTRODUCTION

Margaret Blair and Lynn Stout's path-breaking article, *A Team Production Theory of Corporate Law*, advances a dual thesis: first, that team production theory does a better job than its competitors (in particular, principal-agent theory) of explaining the advantages of the public corporation and key features of corporate law; and second, that, as a matter of corporate law, corporate boards are charged with advancing the collective interest of all the contributors to the corporate enterprise rather than the shareholders' interests alone.<sup>1</sup> Its central insight is that the role of the independent, or insulated, corporate board is to serve as a "mediating hierarch" among the contributors to firm value.<sup>2</sup> As new crises of corporate accountability over the past decade have been met with policies centered on corporate boards and shifts in the balance of power within the corporation, these propositions have moved beyond the academy and into the center of policy debates on the nature and purpose of corporate law.<sup>3</sup>

This Article looks back at *Team Production Theory* and considers its implications for the governance of global multinational enterprises (MNEs). It argues that team production problems in fact arise at multiple levels within global firms and that, therefore, team production theory, as

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1. Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 255–56 (1999).

2. *See id.* at 253. Blair and Stout use the term "independent" board not to refer to one composed largely or entirely of independent directors, but rather to what other commentators have referred to as an "insulated" board: one with the discretion to act independently of the shareholders. *See* Lucian Bebchuk, *The Myth That Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637 (2013) (referring to the "insulated board").

3. The literature addressing the board-centric and stakeholder-oriented dimensions of their arguments are vast. The poles of the debate were recently surveyed by Delaware Chief Justice Leo E. Strine, Jr., *Can We Do Better By Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114 COLUM. L. REV. 449 (2014).

well as principal–agent theory, is necessary to explain MNE governance. Admittedly, Blair and Stout’s work focuses on public corporations, most of which are global firms, and their work also assumes that shareholders and other contributors to the corporate enterprise are both individuals and legal entities. However, in order to more simply articulate how corporate governance rules reflect a team production approach, their account depicts the corporation as a freestanding legal entity formed by a team of (real) people and governed by a single board as the intermediary between the shareholders, managers, and other constituencies.<sup>4</sup>

In actuality, as they acknowledge,<sup>5</sup> the firm is not a single legal entity, but is instead a complex economic organization, or corporate group, composed in some cases of hundreds or thousands of legal entities, not all of which adopt the corporate form. The corporate group is typically defined by a parent corporation’s ownership or control of the equity of direct and indirect subsidiaries, each with a separate legal identity.<sup>6</sup> For corporate groups that operate globally, the distinct legal entities that comprise the MNE have characteristics defined by their jurisdiction of incorporation, which may differ from the jurisdiction of the corporate parent.

Given these realities, Blair & Stout’s conclusions raise several interesting questions when applied to the MNE and other complex corporate groups. First, where do team production problems arise within the MNE? Even limiting the scope of the inquiry to corporate entities, does team production theory account for governance rules only of parent corporations, or of subsidiaries as well? Does the answer depend on the functional role of the entity? How does team production theory inform firm governance if there are multiple “mediating hierarchs” within a corporation? Which board(s) within the MNE are “mediating hierarchs”? Although Blair and Stout advanced team production theory as the best explanation of the governance of the publicly held Berle–Means firm, might team production dynamics also dominate in non-Berle–Means firms, such as controlled entities within the MNE, where principal–agent theory might be expected to apply most directly? If the public corporation should instead be viewed as a unitary enterprise, which stakeholders

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4. See, e.g., Blair & Stout, *supra* note 1, at 280 fig.2 (depicting the structure of a single corporation).

5. See Lynn A. Stout, *The Toxic Side Effects of Shareholder Primacy*, 161 U. PA. L. REV. 2003, 2006 (2013) (noting that leading work on the theory of the firm has treated the public company as little different from small, closely held companies).

6. The corporate group does not have independent legal status under state corporate law. See Virginia Harper Ho, *Theories of Corporate Groups: Corporate Identity Reconceived*, 42 SETON HALL L. REV. 879, 886 (2012).

should be viewed as the contributors to the corporate enterprise? The ultimate, local stakeholders of the firm's affiliates, dispersed around the globe, the affiliate entities themselves, or perhaps only the immediate constituencies of the ultimate corporate parent within its jurisdiction?

The answers to these questions have important theoretical and practical implications. First, at the level of theory, the strand of corporate governance scholarship dealing with the relationship between shareholders and management typically focuses on the rights of dispersed shareholders in the public corporation, and so does not consider the role of directors and officers of the firm's subsidiaries and other affiliates.<sup>7</sup> Similarly, corporate governance rules protecting minority shareholders assume that controlled subsidiaries will generally behave as mere agents following the dictates from the peak of the corporate pyramid.<sup>8</sup> In either case, agency relationships, rather than the contracting problems associated with team production, necessarily dominate. However, if team production theory is limited to the boards of publicly traded corporations at the helm of the corporate group, then corporate law is of less relevance *within* the MNE, and it is less clear that team production theory outpaces principal-agent theory at either a descriptive or predictive level. We might expect, though, that if team production theory best explains corporate law, its basic rationales should hold regardless of whether the corporation is a free-standing entity, incorporated within a given state, or is affiliated with other entities as part of a larger firm. Second, as discussed below,<sup>9</sup> corporate law is more ambiguous with regard to the corporate objective function of subsidiaries than of parent entities, so the evidence presented here that subsidiary boards also serve as mediating hierarchs lends support for Blair and Stout's more general claim about the fundamental stakeholder-oriented nature of corporate law.<sup>10</sup>

Finally, if corporate boards at different levels within the MNE serve as mediating hierarchs, then subsidiary boards and their relationships with one another and with their parent(s) take on greater importance

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7. Corporate scholarship has tended to focus on either the agency conflict between the firm's shareholders and its managers (the parent level of the public corporation) or on the agency conflict between controlling and minority shareholders (the subsidiary level of the firm), but rarely on the two as a whole. On the agency problems that ground corporate law, see John Armour, Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies*, in *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 35, 36 (Reiner Kraakman et al. eds., 2d ed. 2009).

8. The heightened duty of entire fairness protects the minority from exploitation by the controlling shareholder when the subsidiary board cannot establish its decisional independence. *See, e.g., Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983).

9. *See infra* Part III.B.

10. *See* Blair & Stout, *supra* note 1, at 315.

within corporate law. Of course, many subsidiaries are formed in order to achieve a certain tax status, facilitate a specific transaction, or play an otherwise passive role in the MNE; in these cases, the subsidiary board, if it exists at all, forms a largely place-holding function. However, recent work by management and strategy scholars has identified a range of subsidiary roles with varying degrees of autonomy and authority within the MNE. These studies find that the horizontal relationships and roles of affiliates may in fact be more important to firm value than vertical parent–subsidiary relationships.<sup>11</sup> Traditional understandings of global firms as simple hierarchies, characterized by unidirectional, top-down governance and control, have given way to organizational structures that shift flexibly between hierarchy and “heterarchy.”<sup>12</sup> This complexity and its implications for firm governance and regulation have not been well examined in the legal literature.

This Article responds by extending Blair and Stout’s work explicitly to the MNE—a project that necessarily involves multiple dimensions. The first, taken up in Part II below, is to unpack findings from strategic management and organizational theory to better understand the organizational structure of these complex global firms. The second, which is the focus of Part III, is to consider how team production theory applies to organizations that exhibit “multiplex” governance, that is, firms with multidimensional, multijurisdictional, and intersecting governance structures. In these firms, there are multiple, overlapping principal–agent relationships and coordination among them may require the cooperation of multiple mediating hierarchs. This complexity suggests that greater attention should be directed toward the role of subsidiary boards and management.

A full treatment of the implications of these findings for corporate law, or for the broader regulation of global firms, is beyond the scope of this paper. However, this Article contributes to that effort by laying a foundation for further research. It concludes by suggesting areas in which legal rules might better reflect these organizational changes in

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11. See, e.g., Alan Rugman, Alain Verbeke & Wenlong Yuan, *Re-conceptualizing Bartlett and Ghoshal’s Classification of National Subsidiary Roles in the Multinational Enterprise*, 48 J. MGMT. STUD. 253 (2011) (finding that horizontal relationships matter more than vertical ones); Kendall Roth & Allen J. Morrison, *Implementing Global Strategy: Characteristics of Global Subsidiary Mandates*, 23 J. INT’L BUS. STUD. 715 (1992) (analyzing subsidiary roles in coordination and central control). See also *infra* Part III.

12. The term “heterarchy” refers to the role of organization and internal contracting as an alternative to external markets. See, e.g., OLIVER WILLIAMSON, *MARKETS & HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS* (1975). On the distinctions between hierarchical and heterarchical organizational structures, see *infra* Part II.B.

global firms and identifying remaining questions regarding MNE structure. The role of active subsidiary boards within the MNE deserves greater attention from scholars of U.S. corporate law, given the number of U.S. firms that are targeted by foreign acquirers or that are undertaking inversion transactions that introduce a foreign parent corporation but retain operational control in a U.S. subsidiary, not to mention the dominant role that many U.S. subsidiaries play within global MNEs.

Like Blair and Stout's work, this Article limits its focus to the role and function of corporate entities and their boards, even though corporate groups also include noncorporate business entities. However, this inquiry differs from Blair and Stout's work in two important ways: by examining the internal governance of the MNE, it considers the extent to which team production theory applies to nonpublic corporations and to wholly or partially controlled corporations that are part of, but are not themselves, Berle–Means corporations. This effort confirms Blair and Stout's observations that team production problems are ubiquitous and that they arise within firms with different, and perhaps more concentrated, ownership characteristics.<sup>13</sup>

## II. MULTINATIONAL ENTERPRISES AS ORGANIZATIONS

At a fundamental level, Blair and Stout's work resonates so powerfully, fifteen years later, because it contributes to our understanding of how and why organizational structures, such as the corporate board, matter in the firm and how these structures both reflect existing law and shape its future development. Blair and Stout demonstrate, for example, that the historical emphasis on principal–agent theory as a primary lens for understanding corporate law has led to an emphasis on vertical governance relationships—shareholders and boards, directors and officers—while team production theory emphasizes horizontal relationships among the contributors to the corporate enterprise.<sup>14</sup> A second insight of relevance to the governance of corporate groups is their observation that the corporation's separate legal personality makes it a political, as well as an economic, actor, and one with internal and external power relations.<sup>15</sup>

As discussed below, the emerging literature on MNE governance confirms these intuitions. It makes clear that MNE organizational structures have now evolved beyond the simple hierarchies that corporate law scholarship often assumes. As organizational forms change, principal–

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13. See Blair & Stout, *supra* note 1, at 256.

14. Blair & Stout, *supra* note 1, at 269–70.

15. *Id.* at 257, 323–24.

agent theory and property-based conceptions of the firm remain relevant, but in today's global firms, contractual, lateral, relational, and organic intrafirm ties are as important as hierarchical incentive and control structures in effective firm governance.<sup>16</sup> In this context, team production theory offers a richer understanding of the governance of these large, global firms. This Part begins by exploring how MNEs differ from the Berle–Means firm and where corporate law matters within the MNE. It then explains how the structural evolution of MNEs renders team production problems more common within the firm and subsidiary governance more important.

#### *A. Global Corporate Groups & the Berle–Means Firm*

The evolution and dominance of MNEs worldwide offers some of the most compelling evidence of the advantages of the corporate form.<sup>17</sup> As it happens, however, the Berle–Means corporation, which is the focus of *Team Production Theory*, represents only a subset of the corporations that make up large global firms. In the Berle–Means firm, widely dispersed ownership creates a separation of ownership and control between the shareholders and the board of directors, which is charged with managing the corporation.<sup>18</sup> Within the MNE, only constituent entities of the firm that are publicly traded or otherwise held by widely dispersed shareholders may be characterized as Berle–Means corporations. These corporations are most often positioned at the level of the ultimate parent, but may also be subsidiaries elsewhere within the corporate structure. In addition, concentrated ownership structures that do not fit the Berle–Means paradigm are typical outside the United States;<sup>19</sup> yet, even within the United States, changing ownership patterns and governance shifts that empower shareholders suggest that the Berle–Means corporation is more a paradigm than a description of the dominant U.S. corporate governance model.<sup>20</sup>

Again, in the United States and in most other jurisdictions, the corporate group is typically defined by a parent corporation's ownership or

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16. See *infra* Part III. Blair and Stout likewise acknowledge that hierarchical governance in corporations is important, in part in streamlining decisionmaking and as a means of mediating horizontal disputes among team members. See Blair & Stout, *supra* note 1, at 264.

17. See *infra* notes 79–81 and accompanying text.

18. See generally ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

19. See Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737 (1997).

20. On the changes in ownership patterns, see generally MATTEO TONELLO & STEPHEN RABIMOV, *THE CONFERENCE BD.*, 2010 INSTITUTIONAL INVESTMENT REPORT 22 tbl.10 (2010).

control of other direct and indirect subsidiaries, each with a separate legal identity.<sup>21</sup> Although common equity ownership is not the only means for the parent corporation to exercise control over its affiliates, nor is equity ownership the only way for firms to benefit from cooperative economic activity; the parent corporation at each tier of the corporate group often owns a whole or controlling interest in its immediate subsidiaries.<sup>22</sup> Many foreign jurisdictions require the incorporation of a formal subsidiary, and the firm may elect to do so as a matter of overall strategy or for tax or regulatory reasons.

Within this structure, the firm's headquarters serves as the seat of direction, control, and coordination, or as the "nerve center" of the firm.<sup>23</sup> Many firms establish multiple headquarters in addition to the global or corporate headquarters.<sup>24</sup> One study of 21,000 U.S. headquarters found that the average firm in the study had fifteen different headquarters.<sup>25</sup> Not every entity that owns equity in another affiliate of the firm also functions as a headquarters, and the ultimate parent (and its board) may not be associated with the same legal entity as the corporate headquarters. For example, over sixty percent of Fortune 500 firms are incorporated in Delaware, but only two are also headquartered there.<sup>26</sup> In addition, a parent entity may be a holding company without any operational or oversight role,<sup>27</sup> or it may be an intermediate subsidiary itself that nonetheless serves as a global, regional, or divisional headquarters. The function and role of the headquarters and subsidiaries are discussed in Part III, *infra*. For present purposes, it is sufficient to note that the

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21. See *supra* note 6 and accompanying text.

22. Harper Ho, *supra* note 6, at 887–88.

23. *Hertz Corp. v. Friend*, 559 U.S. 77, 92 (2010) (defining the "principal place of business" for jurisdictional purposes).

24. For a definition of the corporate headquarters, see *infra* notes 88–89 and accompanying text.

25. See Vanessa Stauss-Kahn & Xavier Vives, *Why and Where Do Headquarters Move?*, 39 REGIONAL SCI. & URBAN ECON. 168 (2009) (analyzing headquarters relocation decisions for 30,000 U.S. firms between 1996 and 2001).

26. These figures are reported by the Delaware Sec'y of State, Div. of Corps., *Why Businesses Choose Delaware*, STATE OF DELAWARE, [http://corplaw.delaware.gov/eng/why\\_delaware.shtml](http://corplaw.delaware.gov/eng/why_delaware.shtml) (last visited Aug. 21, 2014). Information on corporate headquarters was obtained from the Dun & Bradstreet Hoovers database, at <http://www.hoovers.com> (last visited Aug. 21, 2014). I follow the management literature here and use the term "headquarters board" to refer to the board with direct oversight of the corporate headquarters.

27. Prechel & Boles define the holding company as "an entity with a small centralized administrative office that is in a position to control one or more other corporations by virtue of ownership of their securities." Harland Prechel & John Boles, *Capital Dependence, Financial Risk, and Change from the Multidivisional to the Multilayered Subsidiary Form*, 13 SOC. F. 321, 352 (1998).

term “parent” simply refers to the position of an entity within the corporate structure, not to its functional role.

Another challenge in extending *Team Production Theory* to the MNE is that MNEs are, by definition, corporate groups that operate transnationally, and no single corporate law (or other regulatory) regime governs the firm as an enterprise.<sup>28</sup> Therefore, any treatment of the role of corporate governance within the global firm must consider the limits and reach of domestic corporate governance rules. In particular, U.S. state law, whether of Delaware or another state of incorporation, will only govern the internal affairs of the specific entity incorporated within the state. If this entity holds functional authority over the firm as a whole, serves as a regional or divisional headquarters, or otherwise oversees other subsidiaries, then state corporate law will directly or indirectly govern the affiliates under its control.<sup>29</sup> This influence will be more limited if the U.S. corporation has no intermediate role and is controlled by a corporation formed in a foreign jurisdiction.

Finally, corporate law’s reach within the firm is limited to the governance of legal entities. Firms may instead elect to organize their operations into divisions, which have no independent legal status unless they are also formally incorporated as a subsidiary. By forming or acquiring a subsidiary instead of forming a division, a firm has chosen to constitute a new legal entity, and if that entity is a corporation, a corporate board. A subsidiary board may be required by foreign listing rules or by other local regulations, although there is wide variation in local legal requirements, the autonomy given to the board, and the strategic considerations that may drive the decision to create a subsidiary board where one is not legally required.<sup>30</sup> As a result, the resolution of team production problems within the MNE may depend not only upon the headquarters board, but also on the intermediation of the subsidiary board or of local management.

While concentrated share ownership distinguishes the MNE from the Berle–Means corporation, the corporate governance of MNEs (and other corporate groups) cannot be usefully analogized to the closely held corporation. This is because each corporation within the group is, itself, a legally independent firm capable of owning its own assets, is governed

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28. See *supra* note 6.

29. See Virginia Harper Ho, *Of Enterprise Principles and Corporate Groups: Does Corporate Law Reach Human Rights?*, 52 COLUM. J. TRANSNAT’L L. 113 (2013) (arguing that the application of the internal affairs doctrine to a parent entity gives state corporate law enterprise-wide reach).

30. See Yadong Luo, *How Does Globalization Affect Corporate Governance and Accountability?*, *A Perspective From MNEs*, 11 J. INT’L. MGMT. 19, 23–24 (2005).



by its own board and management, possesses unique informational capital that is not known to its shareholders, and is responsible for maintaining its own factors of production. Unlike closely held corporations, in which there is no separation of ownership and control, most corporate groups have multiple ownership tiers with varying degrees of equity control over subsidiaries. Moreover, because the formal authority of the parent firm may not equate to real authority over the subsidiary, vertical agency problems remain to a far greater extent than in the closely held firm, and even controlled lower-tier subsidiaries may enjoy some degree of functional autonomy.<sup>31</sup>

In sum, corporate boards are positioned both *within* the global firm at various subsidiary levels, as well as at the level of the ultimate parent(s) of the corporate group. This complexity creates the prospect that corporate boards may emerge as the mediating hierarchs of team production at multiple “nodes” of authority within the firm. As discussed below, the formal structure of the firm as an organization and the existence of a corporate board at multiple tiers of the organization does not diminish the role of corporate boards at the headquarters or ultimate parent level in shaping strategy and decisionmaking, nor does it ignore the importance of hierarchical control within MNEs. Nonetheless, the diversity of role, authority, and power of the entities that comprise the corporate group is precisely what motivates an understanding of team production at the firm level as the coordination of organizations, not only individuals, and the role of multiple corporate boards in that process.

### *B. Evolving Firm Structures: Beyond Hierarchy & Heterarchy*

Historically, research on the emergence and comparative advantage of modern MNE structures has drawn on the same paradigms considered by Blair and Stout in their analysis of fundamental corporate governance rules: principal–agent theory, property perspectives, and contract-based theories. The agency literature emphasizes the hierarchical nature of the firm’s internal governance structures and the *ex ante* agency costs needed to align incentives and monitor performance at each level of the princi-

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31. As various contributors to this symposium noted, degrees of board independence and shareholder control are not dictated by entity form, but rather reflect a continuum in which ownership structure is but one factor. *See also* Philippe Aghion & Jean Tirole, *Formal and Real Authority in Organizations*, 105 J. POL. ECON. 1 (1997) (distinguishing formal and real authority and their sources). Similarly, the subsidiary’s formal authority to control its assets may not reflect the real authority of a controlling parent to dominate subsidiary decisionmaking. *See id.* at 2 (noting the limits of authority conferred by asset ownership).

pal-agent chain.<sup>32</sup> Theories of the firm based on transaction cost economics similarly explain its emergence as a result of the efficiencies derived from hierarchical control over the factors of production relative to external markets.<sup>33</sup> Other literature emphasizes property rights, defining the firm as a portfolio of assets that it owns or controls.<sup>34</sup> These conceptions focus on the advantages of asset specification and risk shielding offered by the corporate form,<sup>35</sup> but, as Margaret Blair has noted in other work, theories of the firm have only recently recognized the importance of information as a key asset of the firm, and one that may be transferred laterally or from the bottom of the organization as much as from the top-down.<sup>36</sup>

Much of the corporate governance literature rests on a number of related assumptions that build on these views of the firm, all of which focus attention on the ultimate parent of a corporate group. The first is an assumption that MNEs and other large firms adopt primarily pyramidal structures based on chains of dyadic principal-agent (i.e., parent-subsidary) relationships.<sup>37</sup> Subsidiary governance is of less interest because the (ultimate) parent level is where strategy is set and where ultimate decisionmaking authority lies. The MNE, therefore, can be viewed largely as a unitary organization under central coordination. The second, related assumption is that principal-agent theory best explains internal firm governance. As long as the parent corporation respects the separate legal identity of its subsidiary, appropriate monitoring and incentives are in place to reduce agency costs, and the subsidiary board treats any minority owners fairly, controlled subsidiary boards contribute to the corpo-

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32. See generally Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

33. See generally OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING* (1985) (Williamson's explanation of the origins of the firm draw on Ronald Coase's seminal work). See generally Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937).

34. See Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. POL. ECON. 691, 693 (1986).

35. See FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 40-62 (1991) (discussing these rationales); see also Mike Geppert & Christoph Dorrenbacher, *Politics and Power Within Multinational Corporations: Mainstream Studies, Emerging Critical Approaches and Suggestions for Future Research*, 16 INT'L. J. MGMT. REV. 226, 228 (2014) (discussing gains to the MNE from control over specialized assets).

36. See Margaret M. Blair, Erin O'Hara O'Connor & Gregg Kirchoefer, *Outsourcing, Modularity, and the Theory of the Firm*, 2011 BYU L. REV. 263, 276-79 (2011).

37. For example, cases articulating the fiduciary duties of controlling shareholders and related commentary necessarily focus on specific binary control relationships between the parent and its subsidiary, or, in the case of common control, between the parent and each affiliate. See, e.g., *Kahn v. Lynch Comm'n Sys., Inc.*, 638 A.2d 1110, 1116 (Del. 1994) (discussing controlling shareholder fiduciary duties).

rate enterprise by following the marching orders of their parent.<sup>38</sup> Both of these assumptions challenge a team production approach. They also suggest that corporate law may speak to the majority–minority shareholder agency conflict, but will otherwise have little else to say to subsidiary boards. Finally, corporate law scholarship has largely assumed that the Delaware corporation is the publicly traded, ultimate parent of the corporate group, and therefore, that the governance of the firm can be understood solely with reference to state corporate law, rules on U.S. exchanges, and federal securities law with little reference to foreign corporate and securities laws or listing requirements.

However, since the 1990s, international management scholars have observed a shift in that field “away from a dyadic, hierarchical view of the MNC headquarters and its subsidiaries, toward a perspective in which the multinational organization is viewed as a web of diverse, differentiated inter- and intra-firm relationships.”<sup>39</sup> This literature recognizes the MNE as a hybrid organizational form that merges elements of market and hierarchy.<sup>40</sup> Various theories of the relationship among MNE headquarters and subsidiaries have also emerged that share a common focus on the lateral relationships within corporate groups.<sup>41</sup> These findings suggest that corporate governance and accountability structures *within* global firms are responses to the internal contracting and coordination problems that are at the core of team production theory.

### 1. The Emergence of the Multidivisional Form

The economic historian Alfred Chandler has traced the emergence of the modern corporate form in the 1800s to the massive technological developments of the late nineteenth century.<sup>42</sup> Throughout the early part

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38. On the application of veil-piercing doctrine to the corporate group, see Harper Ho, *supra* note 6, at 889–90. On the entire fairness standard, see *supra* note 8. In fact, the prospect of entire fairness review may actually encourage subsidiary board independence. See *infra* note 152 and accompanying text.

39. Sharon W. O’Donnell, *Managing Foreign Subsidiaries: Agents of Headquarters or an Interdependent Network?*, 21 STRATEGIC MGMT. J. 525, 526 (2000) (surveying the literature).

40. See Sharon Belenzon, Andrea Pataconi & Bennet Zelner, *The Nebulous Nature of the Firm: An Empirical Study of Corporate Group Structure in 16 Developed Economies*, at 1–2 (Sept. 5, 2013) (unpublished manuscript), available at <https://docs.google.com/viewer?a=v&pid=sites&srcid=ZGVmYXVsdGRvbWFpbmRyZWZwYXRhY2Nvbml8Z3g6MTgxYzE0OGY1NzFmNGVmMQ>. (This conclusion follows from prior work recognizing the market dynamics within firms.) See, e.g., George G. Triantis, *Organizations as Internal Capital Markets: The Legal Boundaries of Firms, Collateral and Trusts in Commercial and Charitable Enterprises*, 117 HARV. L. REV. 1102 (2004).

41. See *infra* Part III.

42. Chandler observed that the expansion of railroads necessitated organizational changes, namely the emergence of hierarchical organizational forms capable of managing a complex system

of the twentieth century, corporate groups were primarily organized in a centralized “U-form” or unitary structure, with functional departmentalization but centralized management, or alternatively, in holding company (“H-form”) structures.<sup>43</sup> Because the holding company is simply a corporate shell, both structures retained centralized operational control. This concentration of operational management at the central level resulted in management overload and cumbersome and incomplete contracting. Both proved inefficient as firms grew larger and more complex.<sup>44</sup>

In response, as Williamson explains, DuPont and General Motors developed an “M-form” (i.e., multidivisional) structure with “semiautonomous operating divisions . . . organized along product, brand, or geographic lines”; central executives were responsible for strategy, resource allocation, and monitoring, while divisions handled operational matters.<sup>45</sup> In M-form organizations, the headquarters is responsible for identifying “separable economic activities within the firm; . . . according quasi-autonomous standing [to each]; . . . awarding incentives; . . . allocating cash flows to high-yield uses,” conducting strategic planning, and monitoring the performance of all divisions.<sup>46</sup> Each corporate division, unlike a subsidiary, is not a separate legal entity but is instead an operating unit contained within the parent corporation. Although it may have its own officers, or in some cases, even a divisional board, because it is not incorporated, it cannot issue stock or own its own assets. As Williamson explains, “[t]he M-form structure is thus one that *combines* the divisionalization concept with an internal control and strategic decision-making capability”; operational decisionmaking, generally of a short-term nature, occurs at the divisional level, while long-term strategic decisionmaking occurs at the headquarters.<sup>47</sup>

Other major corporations followed the lead of DuPont and GM, and the M-form was eventually adapted to manage diversified assets through the conglomerate, and to foreign direct investment through the MNE.<sup>48</sup> By the 1970s, studies of MNE management were emphasizing the role of

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in a way that market transactions could not do. See WILLIAMSON, *supra* note 33, at 274–75 (presenting Chandler’s conclusions). As Williamson relates, transaction costs, rather than technology itself, drove pressure for railroads to develop a coordinated hierarchy through contract to manage new, complex networks. *Id.* at 295.

43. Williamson’s account of the emergence of the integrated firm referenced here and following draws heavily on Chandler’s work. *Id.* at 280–81 (citing ALFRED D. CHANDLER, *STRATEGY AND STRUCTURE: CHAPTERS IN THE HISTORY OF THE INDUSTRIAL ENTERPRISE* 38–83 (1962)).

44. WILLIAMSON, *supra* note 33, at 280, 295.

45. *Id.* at 281.

46. *Id.* at 284.

47. *Id.* at 284 (emphasis in original). See also *id.* at 296.

48. *Id.* at 296.

headquarters and the centralization of power in the MNE.<sup>49</sup> Throughout the 1980s, as well, studies continued to portray MNE structures as formal hierarchies under the control of a central board.<sup>50</sup>

## 2. Beyond Hierarchy & Heterarchy

The M-form MNE remains the dominant organizational form in the United States.<sup>51</sup> However, by the late 1990s, studies found a decline in the use of the M-form and a shift toward a multi-level subsidiary form.<sup>52</sup> This trend represents a change in the formal ownership and governance structure of the firm, because unlike divisions, subsidiaries are legally distinct corporations. As such, they are capable of owning separate pools of assets, shielding the parent from liability, and facilitating enterprise-level risk management.<sup>53</sup> Again, subsidiaries are also headed by a board of directors, while remaining under the control of the corporate parent. Subsidiarization therefore creates the potential for multiple boards to facilitate coordination, control, and conflict resolution within the MNE.

In addition to the shift toward more widespread use of subsidiary forms, the 1990s also saw the emergence of alternative conceptions of the MNE that emphasized “heterarchy” over hierarchy.<sup>54</sup> Various models emerged as scholars began to see the M-form hierarchy as too simplistic to capture how MNEs really worked<sup>55</sup>: the “multifocal firm,”<sup>56</sup> the

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49. See Geppert & Dorrenbacher, *supra* note 35, at 227.

50. Kirsten Foss, Nicolai J. Foss & Phillip C. Nell, *MNC Organizational Form and Subsidiary Motivation Problems: Controlling Intervention Hazards in the Network MNC*, 18 J. INT'L MGMT. 247, 248–49 (2012) (surveying the literature).

51. See Markus Menz, Sven Kunishch & David J. Collis, *What Do We Know About Corporate Headquarters? A Review, Integration, and Research Agenda* 1 (Harvard Bus. Sch., Working Paper No. 14-016, 2013), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2316198](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2316198) (citing a 2004 study reporting that the M-form accounted for sixty percent of output in the U.S.).

52. See Prechel & Boles, *supra* note 27, at 328, 351–52 (“[R]esearchers continue to assume that firms have the same [multi-divisional] form that was introduced in the 1920s.”). This study was based on data from the top 100 public companies between 1987 and 1993. See *id.* Prechel and Boles note that subsidiarization is a cheaper way to obtain control over assets and suggest that the shift may have been prompted by tax reform in the 1980s that encouraged restructuring to capture these efficiencies. See *id.* at 333–34.

53. *Id.* at 353.

54. Foss et al., *supra* note 50, at 5–6 (surveying this literature). See generally Gunnar Hedlund, *The Hypermodern MNC—A Heterarchy?*, 25 HUM. RESOURCE MGMT. 9 (1986) (distinguishing the two and identifying intersections).

55. See also Foss et al., *supra* note 50, at 249 (surveying the literature); Sumantra Ghoshal & Christopher A. Bartlett, *The Multinational Corporation as an Interorganizational Network*, 15 ACAD. MGMT. REV. 603 (1990) (surveying the literature).

56. See generally C.K. PRAHAHLAD & YVEZ DOS, *THE MULTINATIONAL MISSION: BALANCING LOCAL DEMANDS AND GLOBAL VISION* (1987).

interorganizational network,<sup>57</sup> the geocentric model,<sup>58</sup> the “matrix” firm,<sup>59</sup> and the federated firm.<sup>60</sup> All of these terms emphasize the presence of multiple centers of information, control, and coordination. In heterarchical firms, “resources, managerial capabilities, and decisionmaking [power] are dispersed throughout the organization, rather than concentrated at the top,” lateral relationships among subsidiaries are encouraged, and “activities are coordinated along multiple dimensions, typically geography, product and function.”<sup>61</sup> In addition, these firms “strongly delegate[d] decision rights to subsidiaries, while retaining some [decision rights] at the [headquarters]. [They are] often characterized by a low degree of formalization, extensive lateral communication, and knowledge transfer.”<sup>62</sup> As Andersson, Forsgren, and Holm observe, in heterarchical or networked firms, the headquarters is “one player among others,” which cannot unilaterally exercise its authority, but must balance the influence and power of subsidiaries.<sup>63</sup>

More recent work calls for an integrated approach that recognizes the complexity of modern corporate organizations. On the one hand, international management scholars observe the “emergence and diffusion of more decentralized and less formalized ‘network forms’ of the [MNE] . . . in response to increased dynamism and heterogeneity in [MNE] environments.”<sup>64</sup> Others emphasize that MNEs are in fact dynamic power structures that can shift between hierarchy and heterarchy across different business areas and contexts, as well as over time, as subsidiary operations expand and mature.<sup>65</sup> This dynamism is fueled only in part by top-down directives from the headquarters. Instead, subsidiaries themselves are often sources of entrepreneurship, innovation, and “mandate

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57. See Ghoshal & Bartlett, *supra* note 55. Other authors have used the term “differentiated network” to describe similar features of MNE structures. See, e.g., NITIN NOHRIA & SUMANTRA GHOSHAL, *THE DIFFERENTIATED NETWORK: ORGANIZING MULTINATIONAL CORPORATIONS FOR VALUE CREATION* (1997).

58. See H.V. Perlmutter, *The Tortuous Evolution of the Multinational Corporation*, COLUM. J. WORLD BUS., Jan.–Feb. 1969, at 8–18 (coining this phrase).

59. See generally Hedlund, *supra* note 54.

60. See Ulf Andersson, Mats Forsgren & Ulf Holm, *Balancing Subsidiary Influence in the Federative MNC: A Business Network View*, 38 J. INT’L BUS. STUD. 802 (2007).

61. Julian M. Birkinshaw & Allen J. Morrison, *Configurations of Strategy and Structure in Subsidiaries of Multinational Corporations*, 26 J. INT’L BUS. STUD. 729, 737 (1995).

62. Foss et al., *supra* note 50, at 249.

63. Andersson et al., *supra* note 60, at 808.

64. Foss et al., *supra* note 50, at 248.

65. Hedlund, *supra* note 54, at 12–20, 23–24. See also Geppert & Dorrenbacher, *supra* note 35, at 230 (noting that heterarchy is determined in part by the “strategic choices and roles of subsidiaries, which cannot be fully controlled by the [headquarters]”).

change.”<sup>66</sup> Although certain resources and core functions, such as finance, legal, and human resource functions, remain centralized in many firms,<sup>67</sup> coordination and centralization of function can happen at the subsidiary level (which may or may not be a publicly traded corporation), not only at the level of the ultimate parent.<sup>68</sup> Because technological integration has facilitated multiple centers of leadership and integrated decisionmaking structures, multiple regional and even global headquarters may have overlapping areas of authority and power.

This reality stands in clear contrast to the centralized, vertical, principal-agent model of decisionmaking in the hierarchical firm. Organizational scholars have also recognized “the trade-offs between multiple stakeholders and multiple perspectives” within the MNE.<sup>69</sup> These developments confirm that team production problems arise at all levels of the firm. They also suggest that subsidiary boards might have a role to play in mediating the explicit and implicit contracts among their shareholder(s) and other firm constituencies.

### III. MEDIATING HIERARCHS & MULTIPLEX GOVERNANCE

As Blair and Stout explain, team production problems arise when “1) several types of resources are used[;] . . . 2) the product is not the sum of the separable outputs of each cooperating resource[; . . . and] 3) not all resources used in team production belong to one [contributor].”<sup>70</sup> From this perspective, the “public corporation is a team of people who enter into a complex agreement to work together for their mutual gain.”<sup>71</sup> However, the core challenge of team production is that, because the product of their collective effort is joint and nonseparable, team members cannot allocate the output of team production in advance in a way that incentivizes optimal contributions by each team member to the collective enterprise.<sup>72</sup> The formation of the corporation therefore requires that the contributors to the corporate enterprise voluntarily contract to cede con-

66. See Julian Birkinshaw, *How Multinational Subsidiary Mandates are Gained and Lost*, 27 J. INT’L. BUS. STUD. 467 (1996) (defining mandate change as the scope of responsibilities of the subsidiary beyond its national market).

67. See Andreas Schotter & Paul W. Beamish, *Performance Effects of MNC Headquarters–Subsidiary Conflict and the Role of Boundary Spanners: The Case of Headquarter Initiative Rejection*, 17 J. INT’L MGMT. 243 (2011) (referring to these cross-firm functions as “boundary spanners” that promote integration within the MNE).

68. O’Donnell, *supra* note 39, at 541; Roth & Morrison, *supra* note 11, at 718.

69. See Geppert & Dorrenbacher, *supra* note 35, at 227.

70. Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777, 779 (1972), adapted in Blair & Stout, *supra* note 1, at 265.

71. Blair & Stout, *supra* note 1, at 278.

72. See *id.* at 266–69.

trol over the enterprise outputs and their own firm-specific inputs to an authority or “hierarchy” that is independent of the team members. In the corporation, this role is filled by the board of directors.<sup>73</sup>

The contributors agree to this arrangement in order to secure the cooperation and firm-specific investments of the other contributors, which would be difficult to obtain if they believed that the board was not insulated from the shareholders, putting their investments at risk of expropriation.<sup>74</sup> Team production theory therefore offers a useful explanation for why corporate law gives boards of directors so much discretion.<sup>75</sup> The answer, in short, is that corporate law views corporate directors as trustees, not agents of the shareholders. Instead, the board is the “mediating hierarchy” among all of the contributors to the corporate enterprise, who contract implicitly and explicitly for the benefits provided by the board’s oversight, coordination, and strategy setting.<sup>76</sup> Importantly, the presence of the corporate board also creates a procedural mechanism for resolving costly conflicts among team members.<sup>77</sup> Accordingly, incentivizing mutually beneficial contracting, constraining shareholder opportunism, and limiting shirking or rent-seeking by other team members become the key challenges of corporate law, rather than minimizing agency costs. Indeed, Blair and Stout acknowledge that the team production approach may in fact *increase* agency costs.<sup>78</sup>

MNEs are complex organizations that coordinate deployment of capital across national borders where contributors of other critical inputs—such as labor capital, local knowledge centers, and natural resources—are located. Thus, they engage in team production almost by definition. They do so by harnessing the corporate form at multiple levels of the firm’s structure precisely because the corporate form offers particular advantages that incentivize team production, including the limited liability of each affiliate and asset partitioning. Limited liability incentivizes the parent’s investment in the subsidiary by limiting its risk of loss, and asset partitioning facilitates the investments of the parent and subsidiary creditors by enabling specialized monitoring of collateral and “bun-

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73. *See id.* at 276–77.

74. *Id.* at 277–78; Stout, *supra* note 5, at 2016.

75. Blair & Stout, *supra* note 1, at 253.

76. *Id.* at 276–79. “Rather, the directors are trustees *for the corporation itself*—mediating hierarchs whose job is to [preserve] the productive coalition . . .” *Id.* at 280–81 (emphasis added).

77. *Id.* at 278.

78. *Id.* at 253, 255.



ding” of discrete contractual claims (as well as assets and liabilities) for more efficient future transfer.<sup>79</sup>

Most critically from a team production perspective, the corporate form also provides capital lock-in. Capital lock-in isolates the assets of the corporation in a separate legal entity that is subject to external markets and various creditor protections, such as legal restrictions on dividends, fraudulent conveyance law, and the like. These limits incentivize other contributors to make firm-specific investments to the subsidiary because they constrain *ex ante* the controlling shareholder’s ability to deplete corporate assets at the expense of other contributors to the corporate enterprise.<sup>80</sup> Kenneth Ayotte has argued that this feature of the subsidiarization decision is also directly tied to innovation; when firms create separate subsidiaries to house assets associated with specific new ventures, unit managers not only have greater decisional independence, but also have stronger incentives to invest in the commercialization of the assets. Creating a separate entity signals that the parent does not have competing uses for the assets and is less likely to interfere in the project.<sup>81</sup> Subsidiarization is therefore value-enhancing to both the subsidiary and the larger firm precisely because the legal independence between the parent and its subsidiary facilitates team production.

When the firm forms a corporate subsidiary, state corporate law in the United States and domestic corporate law in other host jurisdictions typically mandate that to achieve these benefits, the corporation must form a board as its governing body. This choice has legal consequences, some of which encourage a greater degree of subsidiary board independence. Consistent with veil-piercing doctrine, the subsidiary board must play at least a formal functional role, because the parent must respect the legal independence of its affiliates.<sup>82</sup> In addition, in related party transac-

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79. See generally Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387 (2001). On contract bundling, see Henry Hansmann & Kenneth Ayotte, *Legal Entities as Transferable Bundles of Contracts*, 111 MICH. L. REV. 715 (2012) (emphasizing that free transferability incentivizes the parent company’s investment in the subsidiary). Separate legal personhood and the ability to hold ownership interests in other entities are the other defining characteristics of the corporation that are essential to the existence of the corporate group. Harper Ho, *supra* note 6, at 884–86, 948.

80. See Margaret Blair, *Locking In Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 UCLA L. REV. 427 (2003) These protections apply more weakly in wholly owned subsidiaries. See *infra* notes 148–149.

81. In short, this structure may reduce the risk of parent shareholder opportunism. See Kenneth Ayotte, *Subsidiary Entities and the Innovator’s Dilemma* 2–3 (Northwestern Univ. Sch. of Law, Working Paper No. 2012-017, 2011), available at [https://www.law.northwestern.edu/research-faculty/searcenter/workingpapers/documents/Ayotte\\_Sub subsidiary\\_Entities\\_Innovators\\_Dilemma.pdf](https://www.law.northwestern.edu/research-faculty/searcenter/workingpapers/documents/Ayotte_Sub subsidiary_Entities_Innovators_Dilemma.pdf).

82. See *supra* note 38.

tions, courts give business judgment rule deference to subsidiary boards that establish their decisional independence.<sup>83</sup> Although the actual functions of these boards vary widely, the global firm, therefore, emerges as a “multiplex” governance system with multidimensional, multi-jurisdictional, and intersecting internal governance structures. Explaining these systems from a corporate governance standpoint adds complexity to Blair and Stout’s foundational account.

Most obviously, in the modern firm, the key contributors to the corporate enterprise include not only individuals, but entities. In Alchian and Demsetz’s original work on team production theory, the corporate board’s relationship to the other firm constituents is analogous to the hub and spokes of a wheel; the mediating hierarch is a single common contracting party to a set of bilateral contracts.<sup>84</sup> Once the MNE is understood as an integrated firm of firms, however, its management and governance must take account of the relationships among multiple teams and multiple hierarchs. If each constituent entity’s board mediates the contributions of its own constituencies or team members, then the modern firm must be viewed not as a single team, but more accurately as a team of teams.

Wherever there are multiple principals, coordination and other team production issues become paramount. As John Armour and colleagues have previously noted, coordination challenges intersect with agency problems. Specifically, coordination challenges make principals more likely to delegate decisionmaking to agents, but delegation increases monitoring and related agency costs.<sup>85</sup> Although subsidiaries are not legally agents of their immediate parent, the complexity of relationships among affiliates within the corporate group may cause a subsidiary board to exercise a role as a mediating hierarch even as it remains subject to some degree of control by its parent or one or more affiliates. This expectation is borne out by evidence, discussed below, of the functional role of many subsidiary boards.<sup>86</sup>

One apparent challenge to a team production account of MNE governance is that, under Blair and Stout’s approach, “team members volun-

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83. See *Gantler v. Stevens*, 965 A.2d 695 (Del. 2009). More recent case law now authorizes business judgment rule review of certain transactions involving controlling shareholders if certain procedural mechanisms are in place to safeguard the independence of the subsidiary board’s approval. See *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) (en banc), *aff’g In re MFW S’holders Litig.*, 67 A.3d 496 (Del. Ch. 2013).

84. See Alchian & Demsetz, *supra* note 70, at 794; *cf.* Blair & Stout, *supra* note 1, at 269–70 (critiquing Alchian and Demsetz’s work for its focus on vertical principal–agent relationships).

85. Armour et al., *supra* note 7, at 37.

86. See *infra* notes 111–113 and accompanying text.

tarily choose to submit themselves to the hierarchy as an efficient arrangement that furthers their own self-interest.”<sup>87</sup> In contrast, with the exception of acquisitions, subsidiaries may be created unilaterally by their parent-shareholder, which also determines their authority and autonomy, at least initially. In other words, these subsidiary boards can be expected to act much more like agents because they are generally *not* insulated from their shareholder(s) to the same extent that the board of the MNE ultimate parent is insulated from its shareholder(s).

However, as discussed below, team production rationales still apply within the MNE even though subsidiary boards lack the autonomy of the headquarters or public company board. In part, this is because the team members of the subsidiary and the headquarters are not identical. From a team production standpoint, the function of subsidiary boards is to incentivize the firm-specific contributions of its own (local) constituents and its shareholder-parent. In contrast, the function of the headquarters board is to motivate the firm-specific contributions of each team in a way that will maximize overall firm value for the enterprise as a whole.

A final observation about the extension of team production theory to the MNE is that corporate governance *within* the firm takes diverse forms. Some subsidiaries serve a passive role, governed by hierarchical controls that comport more with principal-agent theory and property-based understandings of the firm. This is particularly true for wholly owned subsidiaries and those with a high degree of board interlock, where subsidiary directors are also executives or directors of the parent. Other subsidiary boards serve critical coordination and control functions and behave more like trustees than agents. In addition, the degree of authority or autonomy that subsidiaries enjoy is often a matter of formal or informal contract rather than fiat.

This Part draws on the considerable literature from within strategic management, particularly from international management studies, that sheds light on the pervasiveness of team production dynamics and the diverse governance and functional relationships within the MNE. It begins by considering the mediating role of headquarters boards and then the circumstances under which subsidiary boards may fit within a team production model.

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87. Blair & Stout, *supra* note 1, at 254 n.17. See also *id.* at 274 (“[T]eam members submit to hierarchy not for the hierarch’s benefit, but for their own.”).

*A. Headquarters Boards*

Blair and Stout's account of a corporate board that is independent, or insulated, as a matter of corporate law from its widely dispersed shareholders fits most closely as an account of the governance of the "corporate" or global headquarters of the corporate group.<sup>88</sup> The corporate headquarters may be defined 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. . . . [and] includes the CEO . . . and top-management team . . . ."<sup>89</sup> As management scholars have observed, the primary role of the headquarters is "to organize effectively the idiosyncratic sets of value added activities distributed among national subsidiaries"—in other words, to serve as a mediating hierarch among multiple contributors to the success of the global enterprise.<sup>90</sup> Large MNEs also have multiple business unit headquarters organized around divisional, geographic, or functional lines.<sup>91</sup> Expanding research on the diverse roles of regional headquarters in recent years emphasizes their power and contribution to MNE value, regardless of their formal status as subsidiaries lower down in the corporate network.<sup>92</sup> Regardless of their position within the MNE, these headquarters boards are responsible for centralized decisionmaking within their scope of authority.<sup>93</sup>

The board of the ultimate parent of the MNE enjoys the right to determine its organizational structure and, therefore, the scope of authority of any subsidiaries. These decisions are a core part of corporate strategy that often carry important tax and regulatory consequences.<sup>94</sup> This power

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88. See Blair & Stout, *supra* note 1, at 276–81. Although the ultimate parent and the corporate headquarters are often one and the same, this is not always the case.

89. Foss et al., *supra* note 50, at 247 n.1.

90. Rugman et al., *supra* note 11, at 274 (citing the case of Nestle as a firm with multiple management models, even in a single country).

91. See Julian Birkinshaw et al., *Why Do Some Multinational Corporations Relocate Their Headquarters Overseas?*, 27 STRATEGIC MGMT. J. 681, 686 (2006) (noting that some of these are publicly traded, while others are wholly owned subsidiaries of a higher-level entity within the corporate structure).

92. See Francesco Ciabuschi et al., *The Role of Headquarters in the Contemporary MNC*, 18 J. INT'L MGMT. 213 (2012) (introducing a series of studies on the roles and functions of headquarters within the MNC).

93. Again, a headquarters of a public corporation may be formally a subsidiary board rather than the ultimate parent of a Berle–Means firm.

94. Foss et al., *supra* note 50, at 250 (noting that organizational structure and control are integral to creating incentive structures); Yan Du, Marc Deloof & Ann Jorissen, *Active Boards of Directors in Foreign Subsidiaries*, 19 CORP. GOVERNANCE: AN INT'L REV. 153 (2011) (identifying the strategic use of subsidiary boards). Subsidiaries that are noncorporate pass-through entities for tax

derives directly from the decisional rights conferred by corporate law, namely the right of shareholders to control the corporate board.<sup>95</sup> Therefore, even in network or heterarchical MNEs, the headquarters holds ultimate rights of fiat relative to its subsidiaries.<sup>96</sup>

At first blush, the power of the headquarters to define the corporate structure and unilaterally form a subsidiary in which it holds a controlling equity interest might suggest that the existence and authority, if any, of subsidiary corporate boards is strictly a matter of delegated authority governed by core agency principles rather than a voluntary contract among firm contributors as described by Blair and Stout.<sup>97</sup> However, from a team production perspective, the decision to form a separate legal entity is itself beneficial in incentivizing firm-specific contributions to the subsidiary and the enterprise.<sup>98</sup>

Even if done unilaterally, these decisions are also inherently contractual and must take into account the incentives of the employees, managers, creditors, other stakeholders of the subsidiary, as well as other affiliates who contribute resources to the success of the MNE. Corporate law gives the parent control rights and enforcement rights over its subsidiary, but, in exchange, the parent agrees to assume fiduciary duties to any minority shareholders, to contribute its initial investment in the assets of the subsidiary, and perhaps to provide or subsidize certain centralized administrative functions for the subsidiary. The formation of a subsidiary by the parent shareholder also involves explicit contracting with the incorporating jurisdiction's government and with minority investors in the subsidiary, as reflected in the subsidiary charter. If the subsidiary is acquired, the scope of the subsidiary's authority post-closing raises even more obvious team production questions about the appropriate allocation of joint output and is therefore explicitly negotiated to take into account the interests of employees, managers, key suppliers and customers, and other constituents to induce them to continue to make firm-

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purposes are widely used within MNEs but are not the focus of Blair and Stout's work, which is concerned solely with explaining the comparative advantages of the corporate form.

95. Blair & Stout, *supra* note 1, at 293–94. Blair and Stout observed that key features of corporate law (in Delaware) that appear to preference shareholders, such as derivative litigation, voting rights, and fiduciary duties should be understood as inuring to the benefit of the corporation as a whole, while giving shareholders the instrumental role of using these mechanisms to promote or preserve value in the corporation for the benefit of all its stakeholders. *Id.*

96. Foss et al., *supra* note 50, at 249.

97. This Article does not assume that all headquarters have this power; for example, the global headquarters as shareholder-parent may have reserved the right to veto or approve the formation or acquisition of subsidiaries at the regional headquarter level.

98. See *supra* notes 79–81 and accompanying text.

specific investments that will increase value to the subsidiary and its shareholder(s).

Most importantly, the decision to constitute a corporate board at the subsidiary level encourages firm-specific investments at the subsidiary level by introducing an important source of monitoring and control that can discourage shirking or rent-seeking by the local and global contributors to the MNE.<sup>99</sup> In fact, this authority is essential to the board's role in avoiding unnecessary internal and external transaction costs, coordination failures, and negative externalities.<sup>100</sup> To maintain the power to exercise these rights, the headquarters must reduce agency costs, which it does through market-based mechanisms such as interlocking directorates, the use of independent directors, and cross-shareholdings, as well as through managerial performance incentives, information systems, codes of conduct, internal audits, and cultural and social ties across the firm.<sup>101</sup> Blair and Stout's core claim is that the allocation of decisionmaking control to corporate boards and the determination of the scope of board oversight are themselves part of the implicit contract among the team members and are critical to the efficiency advantages of the corporate form.<sup>102</sup> This logic applies with equal force to the MNE as well.

### B. Subsidiary Boards

Part of the challenge in conceptualizing MNE governance is that the formal structure of global firms says little about their function as organizations. Over the past several decades, however, leading studies in international strategic management have expanded understandings of the diversity of subsidiary roles that provide clear evidence of the important roles subsidiaries and their boards play in resolving team production problems. These studies observe that the internal and external resources of the subsidiary—including its geographic location, competencies, position and integration within the MNE, and its innovation—can determine the subsidiary's power, authority, and autonomy within the interdepend-

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99. On the monitoring function of the subsidiary board, see *infra* notes 142–146 and accompanying text. The creation of a subsidiary board also allows for the participation of independent directors, which can provide additional assurance to team members.

100. Foss et al., *supra* note 50, at 249–50.

101. See Yadong Luo, *Corporate Governance and Accountability in Multinational Enterprises: Concepts and Agenda*, 11 J. INT'L. MGMT. 1, 6–11 (2005) (discussing these mechanisms); Matthias Mahlendorf et al., *Influencing Foreign Subsidiary Decisions Through Headquarter Performance Measurement Systems*, 50 MGMT. DECISION 688 (2012).

102. Blair & Stout, *supra* note 1, at 322.

ent MNE network and, therefore, its role or “mandate.”<sup>103</sup> Consistent with a team production approach, subsidiaries add value by developing subsidiary-specific advantages that can become firm-specific advantages for the MNE, and several studies have found that their power is strongest when they make firm-specific contributions to the MNE that are recognized by the headquarters.<sup>104</sup>

To be sure, MNE governance depends on the ability of the headquarters to effectively coordinate the contributions of the MNE’s affiliates, align affiliate incentives to achieve the headquarters’ goals, and generally achieve effective integration among its divisions and affiliates. Because of the information asymmetries between subsidiaries and corporate headquarters and the complexity created by the dual embeddedness of the subsidiary both locally and within the MNE, understanding how MNEs reduce agency costs is a dominant focus of international management scholars.<sup>105</sup>

However, the diversity and power of subsidiaries suggests a number of limits of agency theory that have already been explored in the strategic management literature.<sup>106</sup> Most critically, agency theory “assumes a simple, dyadic, hierarchical relationship between headquarters and the . . . subsidiary[, which] often is not the case.”<sup>107</sup> Instead, subsidiary–parent or subsidiary–headquarters relationships within the firm are defined by the presence of multiple principals and multiple agents, depending on the relationship in question.<sup>108</sup> In addition, agency theory assumes subsidiary opportunism should be restrained; however, opportunism is, in fact, often a valuable source of innovation for the firm.<sup>109</sup> These observations echo

103. Rugman et al., *supra* note 11, at 254 (surveying the literature and developing a new framework). *See also* Geppert & Dorrenbacher, *supra* note 35, at 230–31 (identifying internal relationships within the MNE, external relationships with stakeholders, and its ability to leverage these resources as a source of power in the subsidiary); Ulf Andersson, Mats Forsgren & Ulf Holm, *Balancing Subsidiary Influence in the Federative MNC: A Business Network View*, 38 J. INT’L. BUS. STUD. 802 (2013); Alan M. Rugman & Alain Verbeke, *Subsidiary-Specific Advantages in Multinational Enterprises*, 22 STRATEGIC MGMT. J. 237 (2001).

104. Rugman & Verbeke, *supra* note 103, at 243–47; Geppert & Dorrenbacher, *supra* note 35, at 226; Julian Birkinshaw, Neil Hood & Stefan Jonsson, *Building Firm-Specific Advantages in Multinational Corporations: The Role of Subsidiary Initiative*, 19 STRATEGIC MGMT. J. 221 (1998).

105. *See, e.g.*, Luo, *supra* note 30, at 22–23 (reviewing this literature).

106. *See* O’Donnell, *supra* note 39, at 542 (finding that measures of intrafirm interdependence offer better predictors of foreign subsidiary control than agency theory).

107. *Id.* at 541. *See also* Yvez Doz & C.K. Prahalad, *Managing DMNCs: A Search for a New Paradigm*, 12 STRATEGIC MGMT. J. 145, 149 (1991) (surveying dominant theoretical views).

108. O’Donnell, *supra* note 39, at 542 (“[S]ubsidiary managers have a web of relationships with different managers, both at headquarters and at other foreign subsidiaries.”).

109. *See* Sumantra Ghoshal & P. Moran, *Bad for Practice: A Critique of the Transaction Cost Theory*, 21 ACAD. MGMT. REV. 13, 38 (1996) (“[O]pportunism is difficult to distinguish ex ante from entrepreneurship and leadership . . .”).

Blair and Stout's critique of the oversimplification of principal-agent theory. As they point out in *Team Production Theory*, principal-agent theory misses the reality that information flows, control, and even the choice about the scope of the agents' autonomy, is not unidirectional. The agent may, in fact, have an informational advantage over the principal, which can allow it to inform or direct the principal.<sup>110</sup>

Because many MNEs are characterized by "decentralized centralization," where activities are globally integrated but managed by the subsidiary instead of by headquarters,<sup>111</sup> the coordinating and monitoring functions typically exercised by corporate headquarters are often in fact centered at a local or regional level instead of (or also) at the global level.<sup>112</sup> Recent empirical studies observe that corporate headquarters are increasingly electing to allocate certain headquarters or "corporate" functions to dispersed affiliates and are blurring the dividing lines between the corporate and operating unit levels.<sup>113</sup> Subsidiaries may also play a role in obtaining access to resources, which is another function typically associated with the headquarters.<sup>114</sup> Team production theory, therefore, usefully describes not only the role of headquarters boards, but the role of at least some subsidiary boards as well.

The subsidiary board is uniquely positioned to serve as a mediating hierarch because it is simultaneously embedded both within the MNE and in its local context. Indeed, the subsidiary board must constantly strike a balance between local adaptation and integration with the larger firm of which it is a part,<sup>115</sup> balancing the expectations of multiple headquarters and affiliates and, depending on its role, some mix of local and global stakeholders.<sup>116</sup> This type of coordination by subsidiary boards encourages the subsidiary's team members to continue to make firm-specific investments in the subsidiary and directly or indirectly in the MNE as a whole.

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110. See Blair & Stout, *supra* note 1, at 258–59.

111. Birkinshaw & Morrison, *supra* note 61, at 734 (describing the "active" or "world mandate" subsidiary).

112. Rugman et al., *supra* note 11, at 273; Ciabuschi et al., *supra* note 92, at 216; O'Donnell, *supra* note 39, at 541 (noting that centralization of function can occur at the subsidiary level). Because most of these studies focus on foreign, rather than domestic, subsidiaries, they may identify, on balance, higher degrees of subsidiary autonomy than would be found in higher-tier domestic subsidiaries.

113. Menz et al., *supra* note 51, at 25 (reviewing this literature).

114. See Birkinshaw et al., *supra* note 104.

115. Foss et al., *supra* note 50, at 249. See also Klaus E. Meyer, Ram Mudambi & Rajneesh Narula, *Multinational Enterprises and Local Contexts: The Opportunities and Challenges of Multiple Embeddedness*, 48 J. MGMT. STUD. 235 (2011).

116. Luo, *supra* note 30, at 24.



However, there is considerable variation in the degree to which the subsidiary board has the capacity to function as an independent mediating hierarch within the MNE in the same way as a parent or headquarters board.<sup>117</sup> Subsidiary boards may be formed solely as a legal formality, with the parent retaining full direct control over the subsidiary. Such boards are typically composed entirely of local managers or parent executives, who may also report to senior management of the parent corporation.<sup>118</sup> If a formal board is not legally required, the parent may elect to retain full control over the subsidiary CEO and management, but constitute an advisory board to improve information exchange and monitoring at the subsidiary level.<sup>119</sup> Other subsidiary boards, described by Kiel et al. as “dual reporting” boards, have greater responsibility for local oversight and strategy by virtue of a clear division of authority between the subsidiary and parent boards. In these firms, local CEOs report both to the subsidiary board and to the parent board or management.<sup>120</sup> Finally, a subsidiary board may have full local autonomy and authority over the subsidiary, and perhaps other affiliates, while still being accountable for its financial performance and other outcomes to the shareholder-parent.<sup>121</sup>

Limited research has been done to determine the prevalence of these different models for different jurisdictions, industries, and ownership structures, and precise measures are difficult to find.<sup>122</sup> However, some generalizations can be made. For example, subsidiaries that are wholly owned will be controlled by the parent and generally composed largely or entirely of its executives.<sup>123</sup> In contrast, subsidiaries that are strategically important, large (relative to the MNE), or tasked with global responsibility are more likely to have an active or autonomous board.<sup>124</sup> This is illustrated by many of the recent inversion transactions, which result in a formerly U.S.-domiciled corporation being reincorporated

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117. See Geoffrey C. Kiel, Kevin Hendry & Gavin J. Nicholson, *Corporate Governance Options for the Local Subsidiaries of Multinational Enterprises*, 14 CORP. GOVERNANCE: INT’L REV. 568, 572–74 (2006) (discussing archetypal approaches).

118. *Id.*

119. *Id.* at 573.

120. *Id.* at 572–73.

121. *Id.* at 574.

122. A notable recent exception is Belenzon et al., *supra* note 40. However, even this study does not focus on the particular function of subsidiary boards.

123. See, e.g., *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971) (detailing composition of the controlled subsidiary board).

124. See Du et al., *supra* note 94, at 155–56, 160. This study also suggests that Anglo-American firms may make use of subsidiary boards less frequently than firms headquartered elsewhere. See *id.* at 160.

abroad, but often retaining the original corporate headquarters at the (newly constituted) subsidiary level.<sup>125</sup> Numerous studies have found that the boards of international joint ventures play active roles in setting strategy, monitoring performance, accessing resources, resolving conflict, and coordinating with parent corporations.<sup>126</sup>

Whether team production, property, or principal-agent rationales best describe the role and authority of the subsidiary and its board depends not only on the subsidiary's position within the MNE, but also on the particular functional role at issue and the characteristics of the given subsidiary or parent entity.<sup>127</sup> For example, subsidiaries with global authority (known as "global" or "world mandate" subsidiaries in the literature) often have direct responsibility for worldwide product management and also play a greater role in central control.<sup>128</sup> Other subsidiary boards may operate under tighter central control and serve largely as advisors on local strategy.<sup>129</sup>

Since the early 2000s, empirical studies have also demonstrated how changes in information technology and internal coordination have allowed subsidiaries across geographic and jurisdictional boundaries to simultaneously assume passive and active roles for different functional activities. For example, a national subsidiary might be a "strategic leader" for the MNE with regard to sales activities but play a passive role in R&D innovation.<sup>130</sup> As a result, a single subsidiary may serve as a headquarters with respect to an administrative function, such as regional compliance, as a passive asset with respect to local resources and relationships, and as a passive agent with respect to certain production functions.<sup>131</sup> Functions involving greater financial commitments, global strat-

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125. See DONALD J. MARPLES & JANE G. GRAVELLE, CONG. RESEARCH. SERV., R43568, CORPORATE EXPATRIATION, INVERSIONS & MERGERS: TAX ISSUES 2-3 (2014) (describing common inversion structures).

126. See Igor Filatochev & Mike Wright, *Agency Perspectives on Corporate Governance of Multinational Subsidiaries*, 48 J. MGMT. STUD. 471, 479 (2011) (reviewing this literature).

127. See, e.g., Birkinshaw & Morrison, *supra* note 61 (identifying a typology of subsidiary strategies: the "local implementer," "specialized contributor," and "world mandate" subsidiaries). See also Bongjin Kim, John E. Prescott & Sung Min Kim, *Differentiated Governance of Foreign Subsidiaries in Transnational Corporations: An Agency Perspective*, 11 J. INT'L MGMT. 43 (2005) (arguing for differentiated corporate governance of foreign subsidiaries based on their strategic roles).

128. Roth & Morrison, *supra* note 11, at 716, 718, 720.

129. One early study in the 1980s found that North American subsidiaries with active boards tended to serve in this more limited role and that subsidiary boards were generally underutilized. See Mark P. Kruger, *The Increasing Role of Subsidiary Boards in MNCs: An Empirical Study*, 9 STRATEGIC MGMT. J. 347 (1988).

130. Rugman et al., *supra* note 11, at 255-56 (surveying the literature).

131. See Hedlund, *supra* note 54, at 21.

egy or coordination, higher risk, or standardization will require greater involvement or control at higher-tier headquarters.<sup>132</sup> The greater the autonomy of the subsidiary with respect to broad corporate functions or strategy, the more likely its board is to serve as a trustee or mediating hierarch;<sup>133</sup> the less its autonomy with regard to a given function, the more the subsidiary will resemble an agent of the affiliate (not necessarily the corporate parent) that has authority and autonomy with respect to that function.

The dynamic, negotiated nature of the subsidiary–headquarters relationship itself confirms the utility of team production theory as applied to the MNE, as well as the need for a more complex understanding of the nature of team production in complex organizations. Empirical studies of subsidiary autonomy, which examine the extent of their strategic and operational decisionmaking authority, offer the clearest evidence of these interactions.<sup>134</sup> These studies observe that at the headquarters level, boards and senior management must weigh the tradeoffs between subsidiary control and autonomy: high autonomy makes direct monitoring more difficult and less effective, but it facilitates subsidiary responsiveness to local conditions and more efficient use of subsidiary resources.<sup>135</sup> Traditional tools used to tighten control and reduce agency costs, such as incentives and monitoring, can discourage value-adding collaborations among affiliates within the MNE network or even generate resistance to headquarters.<sup>136</sup> In addition, headquarters may be unable or unwilling to exercise full control via top-down incentives and monitoring, particularly in subsidiaries that result from mergers or acquisitions.<sup>137</sup>

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132. See Tomasz Golebiowski, *Positioning of Foreign Subsidiaries in Multinational Enterprise Network: Does the Local Embeddedness Matter?*, 14 J. ECON. & MGMT. 36 (2013) (identifying factors that determine the division of roles and power among corporate headquarters and foreign subsidiaries).

133. As Aghion and Tirole’s seminal work notes, factors that increase the real authority of a subordinate may be broadly observed within MNE subsidiaries; these include the span of the subsidiary’s range of control, the presence of multiple principals, and the ability of its superior to utilize performance measurement as a remote monitoring strategy. See Aghion & Tirole, *supra* note 31, at 27.

134. O’Donnell, *supra* note 39, at 528.

135. See *id.* at 528, 537, 540 (finding support for this hypothesis and concluding that as autonomy increases, there is less monitoring by headquarters). See also Yvez Doz & C.K. Prahalad, *Patterns of Strategic Control Within Multinational Corporations*, 15 J. INT’L BUS. STUD. 55, 55–58 (1984) (discussing this tradeoff).

136. O’Donnell, *supra* note 39, at 542. O’Donnell notes that alternative social controls, such as greater integration within the MNE, are often more costly. *Id.* Foss et al. note that hierarchical, bureaucratic internal controls are rigid and restrain flexibility, adaptation, and innovation, and may block information transmission to the headquarters. Foss et al., *supra* note 50, at 24–25 (discussing the negative effects of headquarters intervention).

137. See Geppert & Dorrenbacher, *supra* note 35, at 233–37.

Importantly, the degree of autonomy and the subsidiary's role are not only "formally conferred by the [headquarters], [but are] also (informally) driven by the subsidiary's internal bargaining power"<sup>138</sup>—in other words, the subsidiary's role may be "assumed" as well as "assigned."<sup>139</sup> Maximizing local resources and power gives the subsidiary greater autonomy, but the subsidiary must also contribute value to the enterprise or lose the authority and mandate conferred on it by the headquarters.<sup>140</sup> As local environments or subsidiary conditions change, the power dynamic shifts, which effectively requires a renegotiation of the subsidiary's relationship to the various constituencies of the MNE. Similarly, the degree of authority ceded to the subsidiary board is, like the parent company board, subject to the willingness of the shareholder(s) to cede control in order to secure the investments of other (here, local) contributors.

This empirical evidence confirms Blair and Stout's conclusion that contracting and coordination problems are at least as critical as agency problems within the MNE.<sup>141</sup> Interestingly, the presence of the subsidiary board addresses both of these dimensions, facilitating both hierarchical control and horizontal coordination in the MNE network. On the one hand, a primary advantage of adopting the corporate form at the subsidiary level is that the subsidiary board can serve as an intermediary between local stakeholders, other affiliates, and the central headquarters.<sup>142</sup> Active subsidiary boards—those with full local authority, to use Kiel et al.'s framework—are those most likely to serve as mediating hierarchs because of their greater autonomy.<sup>143</sup> On the other hand, MNEs also use active subsidiary boards in order to strengthen internal organizational governance, in addition to or in lieu of personnel controls and executive compensation.<sup>144</sup> The composition of the subsidiary board also reflects the extent of the parent's need to mitigate agency concerns; for example, larger subsidiary boards or those with outside directors may provide

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138. Foss et al., *supra* note 50, at 251 (citations omitted). *See also* Stephen Young & Ana Teresa Tavares, *Centralization and Autonomy: Back to the Future*, 13 INT'L BUS. REV. 215, 227 (2004) (noting that subsidiary roles and strategies may be either assigned by the parent or assumed by the subsidiary).

139. Julian Birkinshaw & Shameen Prashantham, *Initiative in Multinational Subsidiaries*, in HANDBOOK OF RESEARCH ON INTERNATIONAL STRATEGIC MANAGEMENT 155, 156 (Alain Verbeke et al. eds., 2012). Much of this literature focuses on foreign, rather than domestic subsidiaries, which may exhibit somewhat different patterns of autonomy and control. *See id.*

140. *See generally* Birkinshaw, *supra* note 66.

141. *See* Blair & Stout, *supra* note 1, at 251–53.

142. *See* Menz et al., *supra* note 51, at 14.

143. *See generally* Du et al., *supra* note 94 (analyzing eighty-three Belgian subsidiaries of companies in fourteen countries).

144. *Id.*

more effective monitoring of subsidiary management and reduce agency costs.<sup>145</sup> In more hierarchically structured MNEs, subsidiary boards may be subject to tighter agency controls and more direct vertical integration, while in flatter MNE structures, lateral relationships may dominate, with vertical controls playing a more limited role.<sup>146</sup>

Although their embeddedness within the MNE means that team production problems can also emerge in wholly owned subsidiaries, corporate law has not recognized the wholly owned subsidiary board as a mediating hierarch independent of its parent-shareholder. The issue does not readily present itself because parent companies are unlikely to sue an affiliate. However, the functional autonomy of many MNE subsidiaries suggests that their boards are in fact independent of their controlling shareholder(s).<sup>147</sup> In contrast, corporate law in Delaware follows a strict principal-agent approach to the wholly owned subsidiary. For these subsidiaries, shareholder primacy is effectively mandated, because courts have emphasized that these boards owe fiduciary duties to the parent corporation as the sole shareholder, and as a practical matter, the fiduciary duties owed to the subsidiary itself can only be enforced by the parent.<sup>148</sup> State law here follows the guidance of the Supreme Court, which has held in the antitrust context that a parent corporation and its wholly owned subsidiary have a “complete unity of interests.”<sup>149</sup> Nonetheless, it is possible that a subsidiary board formally under total equity control of its parent may perhaps serve as a mediating hierarch by virtue of its functional role(s) within the MNE, the degree of autonomy reflected in its charter, and its implicit contract with its parent-shareholder.

For non-wholly owned subsidiaries incorporated in Delaware, core common law principles work to ensure that Blair and Stout’s general

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145. Kim et al., *supra* note 127, at 55–57. If the subsidiary is publicly traded, local listing requirements may also mandate board independence. *Id.*

146. See Birkinshaw & Morrison, *supra* note 61, at 735–36, 738–39.

147. The findings surveyed here, however, derive primarily from research on foreign subsidiaries. There is little information on the prevalence of functionally independent subsidiary boards among domestic subsidiaries. These should be more common in acquired subsidiaries rather than those formed independently by the parent.

148. See, e.g., *Anadarko Petroleum Corp. v. Panhandle E. Corp.*, 545 A.2d 1171, 1174 (Del. 1988) (“[I]n a parent and wholly-owned subsidiary context, the directors of the subsidiary are obligated only to manage the affairs of the subsidiary in the best interests of the parent and its shareholders.”). See also *Trenwick Am. Litig. Trust v. Ernst & Young*, 906 A.2d 168, 200 (Del. Ch. 2006). These cases should, however, not be read broadly to imply that subsidiary directors and officers do not owe any duty to the entity they serve. See, e.g., *In re Scott Acquisition Corp.*, 344 B.R. 283, 286–87 (Bankr. D. Del. 2006) (rejecting this interpretation). See also J. Haskell Murray, “*Latchkey Corporations*”: *Fiduciary Duties in Wholly Owned, Financially Troubled Subsidiaries*, 36 DEL. J. CORP. L. 577, 593–600 & n.61–62 (2011) (surveying these authorities).

149. *Copperweld Corp. v. Indep. Tube Corp.*, 467 U.S. 752, 771 (1984).

claims about the independence of the mediating hierarch from the shareholders also applies to subsidiary boards, even though controlled subsidiary boards differ markedly from the super-independent monitoring boards that are mandated for public corporations.<sup>150</sup> For example, common law fiduciary duties for the board of a subsidiary organized under Delaware law are no different from those of other corporations, and these duties run to the corporation (i.e., the subsidiary) and its shareholders.<sup>151</sup> The board's functional independence from the controlling shareholder is bolstered by the controlling shareholder's fiduciary duty to the minority, and by courts' insistence on heightened entire fairness review in transactions involving a controlling shareholder.<sup>152</sup> The common law therefore clearly looks to non-wholly owned subsidiary boards to play the same mediating role within the MNE as the boards of the public corporations examined by Blair and Stout.

One final, but important, issue is that, while the body responsible for oversight of the subsidiary and for mediating among the contributors to the subsidiary is its board, not all subsidiaries have a formal board, and not all boards may have the decisional authority necessary to serve as a mediating hierarch.<sup>153</sup> In these cases, either the board at the parent or headquarters level, or senior management at the subsidiary level, may fill the mediating role for those levels below. Studies of subsidiary management have observed that the subsidiary's CEO or other top manager is often the key point of contact for the corporate headquarters and also has a significant effect on the subsidiary's perception of, response to, and implementation of headquarters' directives.<sup>154</sup> Much of the literature on subsidiary initiative and influence within the MNE similarly emphasizes the effort of subsidiary managers in leveraging local resources, infor-

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150. Their reduced independence may make them less effective at policing conflict of interest transactions that an outsider-dominated, part-time board is best suited to monitor. *See generally* Usha Rodrigues, *A Conflict Primacy Model of the Public Board*, 2013 U. ILL. L. REV. 1051 (2013).

151. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (stating the general standard). *See also supra* note 148.

152. *See Kahn v. Lynch Comm'n Sys., Inc.*, 638 A.2d 1110, 1116 (Del. 1994) (explaining and applying the entire fairness standard); *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971) (limiting the entire fairness standard to cases where the fiduciary duty is accompanied by evidence of parent self-dealing).

153. *See Luo, supra* note 30, at 22–23 (noting variation in legal requirements for foreign subsidiaries). Even under Delaware law, a nominal board may be appointed, and the corporate charter may authorize the corporate parent to take on statutory authority otherwise reserved by the board. *See* DEL. CODE ANN. tit. 8, § 141(a) (2014).

154. Foss et al., *supra* note 50, at 248 n.4.

mation, and innovation to gain resources or power within the MNE that benefit the subsidiary and its stakeholders.<sup>155</sup>

Whether team production is mediated by a board or by management does not limit the applicability of the theory to subsidiaries. Early foundations of team production theory contemplated that internal coordination and mediation among stakeholders would be achieved by an entrepreneur or manager, not necessarily by a corporate board.<sup>156</sup> Although Blair and Stout's primary insight is that the corporate board is uniquely positioned to fulfill this role, they also recognize that this can be achieved to some extent by delegation to executives and managers, who are presumably equally subject to the parent's control.<sup>157</sup> In such cases, creditors and other participants in the business of the subsidiary will contribute to the subsidiary with knowledge of the shareholder's control and the subsidiary's limited autonomy; if they are concerned about the ability of the controlling shareholder to withdraw capital from the subsidiary or otherwise impair their ability to share in the gains on their investment, they can protect their interests by contract.<sup>158</sup> The effectiveness of the mediating hierarch may depend, then, on its perceived insulation from the shareholder, suggesting that independence and effectiveness are a matter of degree. This points, again, to the strategic and governance implications of organizational form.

#### IV. HETEROGENEITY IN MNE GOVERNANCE & THE CORPORATE OBJECTIVE FUNCTION

Another dimension of Blair and Stout's work that poses a challenge to traditional corporate law theory is their conclusion that shareholder primacy is neither mandated nor supported by Delaware corporate law.<sup>159</sup> Because the board of directors is a mediating hierarch, its goal is to maximize "the joint welfare function" of the firm—that is, total firm value—

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155. See, e.g., Birkinshaw et al., *supra* note 104, at 279 (noting the interplay between parent directives and managerial initiative).

156. For example, in Coase's original account, a unitary entrepreneur provides the internal coordination that defines the firm and substitutes for external market transactions. See Coase, *supra* note 33, at 388.

157. See Blair et al., *supra* note 36, at 275.

158. The literature on creditors use of cross-guarantees within corporate groups confirms this. See, e.g., Richard Squire, *Strategic Liability in the Corporate Group*, 78 U. CHI. L. REV. 1 (2011) (describing the role of intragroup guarantees as a type of shareholder opportunism).

159. Blair & Stout, *supra* note 1, at 299. Cf. Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 22 J. APPLIED CORP. FIN. 32 (2010) (arguing that shareholder primacy provides a single objective standard for managerial performance); Strine, *supra* note 3, at 453 (pointing to shareholder voting and enforcement rights as promoting shareholder primacy).

and to motivate firm-specific contributions by all of the contributors to the corporate enterprise, not only its shareholders.<sup>160</sup>

Defining the corporate objective function becomes complicated once we look into the MNE's internal governance structure. In Delaware, for example, the directors and officers of a wholly owned subsidiary are obligated to serve the best interests of the parent-shareholder as well as the subsidiary.<sup>161</sup> However, even in this case, maximizing shareholder (i.e., the immediate parent's) value is not necessarily the same as maximizing total firm or enterprise value. Nor is it inevitable that decisions maximizing subsidiary value will maximize firm or enterprise value. An obvious example is the case of a subsidiary whose sole role is to produce tax losses that will offset income elsewhere in the corporate structure.<sup>162</sup> Shareholder primacy is also at odds with the management literature on subsidiary formation, which suggests that in many large firms, the value-added contribution of the subsidiary to the firm is precisely its ability to facilitate stakeholder engagement.<sup>163</sup>

The orthodox justification for the priority that corporate law gives shareholder interests over other corporate constituents is that the shareholders are residual claimants of the firm and not protected by other bodies of law. This rationale is attenuated, if not moot, in the context of a controlled subsidiary. Because subsidiaries are subject to the direct or indirect control of other MNE affiliates, these affiliates can easily (though not costlessly) protect themselves by monitoring or by contract *ex ante*. Moreover, the choice to maintain a subsidiary rather than a division represents a contract to obtain limited liability that will shield the parent from risk of loss.<sup>164</sup> In fact, under Delaware law, the parent corporation of a wholly owned subsidiary has fewer incentives than the subsidiary's employees and other constituents to maximize its value because the parent corporation is free, subject to dividend rules and other creditor protections, to exploit the resources of the wholly owned subsidiary for the parent's benefit.<sup>165</sup>

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160. Blair & Stout, *supra* note 1, at 315.

161. *See supra* note 148.

162. *See* Bruce A. McGovern, *Fiduciary Duties, Consolidated Returns and Fairness*, 81 NEB. L. REV. 170 (2002) (observing that courts have generally been unwilling to find a breach of fiduciary duty by a parent who exploits its subsidiary's tax benefits).

163. *See supra* notes 126–127 and accompanying text.

164. While this is true for all corporations, the power of the parent to structure its subsidiaries so as to shift risk to other shareholders and to creditors is a persistent concern within bankruptcy law and the primary reason why creditors are considered the key residual claimants once the entity is insolvent.

165. *See* *Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168, 192 (Del. Ch. 2006) (noting that a parent cannot be held liable either for causing a solvent, wholly owned subsidi-



Finally, because the MNE (which includes most publicly traded firms in the United States) spans jurisdictional boundaries, its various headquarters and subsidiaries will be subject to different corporate codes and listing standards, and shaped by different institutional structures and ownership patterns. These rules will all influence the explicit and implicit contracts of the firm. For example, boards under concentrated ownership, as is common throughout Europe and Asia, are likely to be less insulated from shareholders than they are under Delaware law. However, in most jurisdictions outside the United States, corporate governance rules obligate boards to weigh the interests of a broad range of stakeholders.<sup>166</sup> Accordingly, boards are not viewed solely as agents of the shareholders, but are required, as a matter of law, to serve as mediating hierarchs whose mission is to maximize the joint value of the firm as a whole.<sup>167</sup> In order to retain their “social license” to operate, MNEs also face market pressures to demonstrate their commitment not only to the global stakeholders of the corporate headquarters, but also to the local stakeholders of global affiliates.<sup>168</sup> Subsidiary boards play a critical role in engaging and responding to these local and global stakeholders.<sup>169</sup> From a comparative perspective then, a team production understanding

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ary to sell key assets to pay off the parent’s debt or for using the subsidiary’s assets to finance or offset the parent’s broader strategy). Similarly, the courts have applied business judgment rule deference to claims by subsidiary shareholders and creditors challenging a parent corporation’s use of subsidiary tax attributes without allocating value to the subsidiary. *See generally* McGovern, *supra* note 162 (reviewing this precedent). *See also* Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883, 887 (Del. 1970) (explaining that the business judgment rule applies to these tax cases because the consolidation of the parent and subsidiary is established by federal law, not by the conflicted controlling parent).

166. *See, e.g.*, Virginia Harper Ho, “Enlightened Shareholder Value”: *Corporate Governance Beyond the Shareholder–Stakeholder Divide*, 36 J. CORP. L. 59, 77–80 (2010) (discussing fiduciary duties under the U.K. Companies Act). Leading jurisdictions in Europe and Asia have expressly adopted stakeholder-oriented perspectives. *See* Virginia Harper Ho, *Corporate Governance as Risk Regulation in China: A Comparative View of Risk Oversight, Risk Management, and Accountability*, 4 EUR. J. RISK REG. 463 (2012) (comparing European and Chinese approaches).

167. Interestingly, this stakeholder orientation of corporate law coexists in much of the world with patterns of higher ownership concentration than are common in the United States. *See* Lucian A. Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, in CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 69, 73 (Jeffrey N. Gordon & Mark J. Roe eds., 2004).

168. *See* Salman Kimiagari et al., *The Cooperation Complexity Rainbow: Challenges of Stakeholder Involvement in Managing Multinational Firms*, 22 INT’L J. BUS. MGMT. 50, 51–53, 57 (2013) (“The MNC as a whole needs to be concerned not only with its shareholders, but also the stakeholders in different levels dispersed wherever it has at least one subsidiary organization.”).

169. Some of these stakeholders, such as specialized component suppliers, will make firm-specific contributions through the subsidiary. Others, such as local creditors, will make subsidiary-specific contributions, and others, such as employees and local governments, may contribute to both the subsidiary and the firm as a whole.

of the corporate board offers a better fit with corporate law guidelines in other jurisdictions that also extend beyond the Berle–Means firm.

#### V. THE LAW OF CORPORATE GROUPS: A RESEARCH AGENDA

Since 1999, when *Team Production Theory* was published, long-standing debates on the nature and purpose of the corporation have taken center stage among policymakers and the broader public, as governments and business leaders have struggled to restore public confidence in corporations. The past decade and a half has also witnessed major changes in the corporate governance landscape in the United States that may be leading to the demise of the Berle–Means firm. These developments do not, however, diminish team production theory's force as a powerful explanation of corporate law and of corporate boards.

The first of these changes is the increased power of shareholders in corporate governance, through regulatory changes, such as proxy access, say on pay, and the elimination of broker nonvoting. These developments have occurred simultaneously with a decades-long shift toward more highly concentrated ownership among public firms. As a result, the formal independence of board decisionmaking under the business judgment rule is increasingly constrained by various forms of shareholder voice and active engagement.<sup>170</sup> Given these changes, the autonomy of public company boards, which were the initial focus of *Team Production Theory*, and of controlled boards within the MNE, now differs largely in degree. Moreover, the examination here of the role of corporate boards within global firms suggests that the decline of the Berle–Means firm does not lessen the importance of corporate boards as mediating hierarchs among the various constituencies of the firm.

The second marked change in the corporate governance landscape is the continued proliferation of heterarchical governance structures within large firms. Here too, this Article has demonstrated the continued explanatory power of Blair and Stout's work. Indeed, the dominance of the MNE as a complex organization cannot be explained without resort to team production theory.

However, further research is needed at the intersections of organizational management and corporate governance to explore how frequently firms utilize active boards in the domestic context, what factors influence that decision, and under what conditions active board governance at the subsidiary level adds value. Although wholly owned subsidiaries are presumably most widely used, broader evidence of the relative extent of

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170. See Bebchuk, *supra* note 2.

minority ownership might usefully inform understandings of domestic subsidiary roles. Similarly, little is known about the extent to which wholly owned subsidiaries incorporated in the United States take on regional or global functional roles and the extent to which this level of responsibility correlates with the presence of active boards.

The complexity, integration, and dynamism of MNEs, as well as their power and influence in economies and societies worldwide, also calls for renewed attention to identifying where the transformation of corporate structure matters in corporate and securities law. In other words, where do assumptions of hierarchy within the firm and of dyadic and uniform parent–subsidiary or headquarters–subsidiary relationships affect legal obligations?

Compliance oversight is an obvious starting point. Team production explains that the joint output of the constituencies of the firm is greater than the sum of their respective inputs. If this is so, then joint outputs can include not only innovation, goods and services, employment, and capital, but can also include negative externalities that are greater because of the joint contributions across the firm.<sup>171</sup> Public company boards are already under enhanced pressure from investors and regulators to engage in active, enterprise-wide monitoring and control over global compliance, so these functions are more likely to be centralized within the firm and subject to the direct oversight of the corporate headquarters.

However, the diffuse nature of information, innovation, and strategy-setting in global firms means that efforts to charge headquarters boards, alone, with responsibility for operational oversight and risk management strategy will be inadequate and may actually be value-reducing to the firm.<sup>172</sup> Because intrafirm, interunit relationships are just as critical as headquarters' control in implementing global strategies,<sup>173</sup> risk management and risk oversight obligations, as well as the implementation of many areas of direct regulation, are as likely to depend as much on subsidiary governance as on the “tone from the top.” This also implies that shareholder derivative litigation, direct claims by other stakeholders, and regulatory enforcement action at the subsidiary level will continue to raise new jurisdictional challenges and require continued reliance on cross-border cooperation by regulators and courts.

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171. See Simon Deakin, *The Corporation as Commons: Rethinking Property Rights, Governance, and Sustainability in the Business Enterprise*, 37 *QUEEN'S L.J.* 339, 351 (2012) (“[T]he firm’s organizational capacity also means that it can absorb, control and diffuse the risks of harm to third parties (negative externalities) more effectively than any single individual or group of individuals.”). See also *id.* at 351 n.29.

172. See Foss et al., *supra* note 50, at 250.

173. O’Donnell, *supra* note 39, at 542.

A further conclusion is that subsidiary governance and autonomy are more important than state corporate law has previously recognized. Although full consideration of how corporate law might respond is beyond the scope of this Article, one possibility is that Delaware and other states might usefully distinguish between the fiduciary duties of corporate officers and directors in a way that recognizes the heightened responsibility of corporate officers, as some commentators have urged.<sup>174</sup> Because subsidiary boards tend to be composed, in part, of parent company officers, such a move would also require courts to more squarely address the obligation of all corporate directors and officers, even those on the board of a wholly owned subsidiary, to advance the interests of the corporation for whom they serve as trustee for—rather than agent of—their corporate parent. As firms move to adopt more complex structures, including matrix structures, dual reporting lines, functional specialization within individual subsidiaries, and the like, this shift in tone (though not in doctrine) would provide clarity for subsidiary directors who at present are left to balance the interests of the two.<sup>175</sup>

Clearer guidance regarding the proper allegiance of subsidiary officers and directors might also encourage greater parent-level responsibility for decisions that have competing effects on the subsidiary and the enterprise as a whole. Subsidiary directors and officers could then more effectively weigh the interests of their (controlling) shareholder(s) and other firm constituencies as other boards are permitted to do.<sup>176</sup> As more U.S. firms are acquired by foreign firms, shift their headquarters abroad, or develop globally integrated decisionmaking structures, these questions may become more pressing.

Moreover, if global firms cannot be viewed solely as principal-agent chains governed from the top-down, but instead as part hierarchy, part heterarchy, then legal doctrine must even more directly confront how concepts of control or delegation influence the attribution of responsibility and liability between subsidiaries and headquarters (or among subsidiaries). Agency law is certainly useful in resolving questions of

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174. See, e.g., Megan W. Schaner, *Restoring the Balance of Power in Corporate Management: Enforcing an Officer's Duty of Obedience*, 66 BUS. LAW. 27 (2010); Lyman P.Q. Johnson & David Millon, *Recalling Why Corporate Officers Are Fiduciaries*, 46 WM. & MARY L. REV. 1597 (2005). At present, Delaware law asserts that directors and officers have equivalent fiduciary duties. See *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009) (citing *Guth v. Loft*, 5 A.2d 503, 510 (Del. 1939)).

175. See E.J. Gouvin, *Resolving the Subsidiary Director's Dilemma*, 47 HASTINGS L.J. 287 (1996).

176. Prior discussions of the challenges under current law are found in Gouvin, *supra* note 175, and Stefan J. Padfield, *In Search of a Higher Standard: Rethinking Fiduciary Duties of Directors of Wholly Owned Subsidiaries*, 10 FORDHAM J. CORP. & FIN. L. 79 (2004).

attribution from individual officers or employees to the entity. However, notions of control may become less relevant than they have been historically in grounding the liability of entities. More useful, perhaps, are existing doctrines that acknowledge collaboration, joint decisionmaking, and horizontal relationships, such as joint and several liability, aiding and abetting, and contributory negligence in civil cases, or accessory liability and conspiracy under criminal law.

Finally, there have been a number of calls for MNEs to make existing disclosures regarding corporate structures more accessible to investors.<sup>177</sup> Because much greater authority and power lies within the MNE than has previously been acknowledged, the public disclosure currently required under federal securities laws regarding the firm's consolidated subsidiaries may not be presented in a way that adequately communicates the effect of subsidiary governance on risk oversight and risk management.

Since *Team Production Theory* was published, modern MNEs have evolved even more deeply into organizations where the coordinating, mediating, contractual role of corporate boards at all levels has become central to value creation. The scope of this Article does not permit the full consideration of new approaches within and beyond corporate law to better facilitate innovation and organizational change within the MNE. Its goal, instead, is to highlight some of the many areas where fundamental changes in the structure of global firms have legal consequence. The breadth and depth of team production across the MNE calls for further research investigating the role and impact of corporate governance *within* the MNE on overall firm value, firm-level decisionmaking, and regulatory incentives.

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177. See, e.g., *Action Plan: European Company Law and Corporate Governance—A Modern Legal Framework for More Engaged Shareholders and Sustainable Companies*, at 18 & para. 4.6, COM (2012) 740 final (Dec. 12, 2012) (regarding disclosures on the structure of groups of companies).