

The MNE Headquarters-subsidary Relationship, Subsidiary
Strategy and Performance: An Empirical Examination in China

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DECLARATION

To the best of my knowledge and belief, this thesis contains no material previously published by any person except where due acknowledgement has been made. This thesis contains no material which has been accepted for the award of any other degree or diploma in any university.

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ABSTRACT

Since 2010, China has become the second largest economy in the world, providing a more attractive environment for enterprises doing business than most other countries. Many multinational enterprises (MNEs) have set up subsidiaries to seek resources and opportunities in China. Since there are often cultural and institutional differences between home and host countries, MNEs usually face some management problems when doing business in a host country. How to develop corporate strategy to better support subsidiary performance becomes an important question for MNEs entering developing countries like China.

Given China's unique business environment, MNEs face many challenges in adapting to this local marketplace. They need time to develop and apply local capacity, such as relational networks, namely *guanxi*. They also need to determine the entry mode according to the social system of China. Finally, one of the most important questions for an MNE entering China is how to design its subsidiary strategy.

This research seeks to identify the mechanisms that influence the operating performance of MNE subsidiaries in host countries. It addresses the following questions: (1) How does the MNE subsidiary strategy develop and what are the main influencing factors? (2) How is an MNE's China subsidiary strategy influenced by its international business strategies and vice versa? (3) How is the subsidiary's performance affected by the subsidiary strategy and why? (4) How does the MNE's headquarters-subsidiary relationship and headquarters control mediate the process and why?

To answer these questions, strategic contingency theory is applied to study the effect of the headquarters-subsidiary relationship on subsidiary strategy and performance. The object of this qualitative research is an international corporation, UST Group of companies.

The findings are summarized in the form of a framework which shows that (1) the MNE's internal and external environments, i.e. the host market conditions, competitors, institutions and uncertainties, tend to directly influence its subsidiary strategy; (2) the MNE's environment can also influence subsidiary strategy indirectly through the relationship between the headquarters and the subsidiary, which means that the headquarters-subsidiary relationship acts as a mediator between environment and subsidiary strategy; (3) forms of informal control such as flexible control and personal connections significantly affect subsidiary strategy and performance in China; (4) the subsidiary's strategy, particularly its strategic motives, entry strategy and human resource management, tend to influence its financial and non-financial performance in the host country.

The main conclusions are: (1) MNE environment is the principal factor to be considered when entering a host country; (2) subsidiary strategy is determined by the MNE environment and headquarters-subsidiary relationship; (3) the MNE environment influences the subsidiary environment through the headquarters-subsidiary relationship. The managerial implications of this research are that it will help MNEs to do better business in China and to achieve better performance.

Keywords: MNE, strategy, subsidiary, environment, relationship, control, performance

Chapter 1 Introduction

1.1 MNE subsidiary strategy: a topic for research

Since the 1980s, increasing numbers of enterprises have grown and developed by moving some of their business operations from the home country to a foreign host country (Barkema, et al., 1996). This phenomenon is known as the internationalization or globalization of enterprise. This research addresses one aspect of business globalization: corporate strategies for internationalization and the host-subsidiary relationships that affect its success. Of particular interest is the impact of subsidiary strategy on business performance.

In the process of an enterprise's internationalization, it will normally create an environment that makes industries in which the multinational enterprise (MNE) competes become more globalized (Roth & Nigh, 1992). This globalized industry context means that the management of the linkages or relationships between different business units within a MNE becomes critical for its overall competitiveness (Porter, 1986). One prominent linkage is between the host country subsidiary unit and the unit from the home country.

Although early MNE-related research which focused on topics at the level of the host country and took MNEs themselves as the objects of study, more recent attention has been focused on understanding the subsidiary units. According to the network perspective, MNEs can be viewed as interorganizational networks (Ghoshal & Bartlett, 1990). MNE subsidiaries are organized and managed through interdependent exchanges

(Birkinshaw, Holm, Thilenius & Arvidsson, 2000), which are critically important in understanding how MNEs and their subsidiaries function (Johnston & Menguc, 2007). This means that one needs to gain a better understanding of both corporate strategy and subsidiary strategy.

The concept of MNE corporate strategy is based on the assumption that when successful, it can support and create a competitive advantage for the MNE as a whole. However, this view is not fully applicable when the research targets the subsidiary level. The subsidiary unit is only one part of the MNE, and the overall competitive advantage of the MNE is commonly connected to the actions and efforts of the MNE as a whole, so it would be inappropriate to select overall competitive advantage as the focus of study when the aim is to better understand the subsidiary strategy (Porter, 1996). At a minimum, important insights about the subsidiary strategy will likely be overlooked if attention is directed only to the global activity of the MNE.

MNE subsidiary strategy has a different meaning from the MNE's home strategy, as it does not fully depend on interests and designations from headquarters. In the research completed for this thesis, MNE subsidiary strategy is defined as follows: MNE subsidiaries still make decisions according to their own agenda and interests, not simply on behalf of MNE headquarters, despite the limitations imposed on subsidiary management by headquarters and by the market. MNE subsidiaries engage in strategy development, at least at a local level, with the intention of building or at least maintaining their own resources, independent of benefitting headquarters directly. Thus, one needs to identify what important elements and strategic activities focus on at the MNE subsidiary level.

When the research target shifts from the home-base level to the MNE subsidiary level, the headquarters can then be treated as an external factor. The adoption of the MNE subsidiary as unit of analysis allows researchers to learn more about the strategic roles of subsidiaries (Paterson & Brock, 2002). A prominent issue to be addressed is identifying the main components of subsidiary strategy in MNE management.

The management of the various business units of the MNE—in particular the management of the vertical relationship between headquarters and subsidiary—is one of the most critical corporate strategic concerns of an MNE (Porter, 1987). It is also an important factor that needs to be taken into consideration when studying MNE subsidiary strategic issues. One of the most significant aspects of the study of MNE business internationalization (Johnston, 2005) is the headquarters-subsidiary relationship, which has attracted much research attention from academic scholars over the past few decades.

The MNE headquarters-subsidiary relationship can affect the ways headquarters internalizes its global activities within the organization and how interorganizational resource flows help the subsidiary to alleviate the disadvantages it faces as a foreign entity (Luo, 2003). When MNEs operate overseas, it is difficult for headquarters to use formal control and coordination mechanisms to manage the subsidiaries, because of geographic distance and economic, cultural and political differences between host and home country. Therefore, MNE headquarters needs to rely to a greater extent on less formal mechanisms, such as high quality inter-unit relationships, for more effective coordination and control (Kostova, 1998).

Management of the headquarters-subsidary relationship is always one of the most important factors in MNE strategic management and has a major influence on subsidiary strategies. In strategic business management, the well-accepted philosophy of the contingency viewpoint assumes that there is no universal set of strategies that will be suitable for all organizations and situations (Ginsberg & Venkatraman, 1985) and that the optimal strategy will be determined by the firm's organizational and environmental conditions (Miles et al., 1978). In the present research, the contingency approach to enterprise strategy is adopted in organizing the design, analysis and interpretation of the results. That is, it is the assumption of this study that the MNE subsidiary strategy does not have a universal set of rules and conditions. Rather, it will be under the influence of a group of endogenous and exogenous factors concerning the MNE and the subsidiary, in both the home and host countries (Gates & Egelhoff, 1986; Ghoshal & Nohria, 1989; Ito & Rose, 1994; Luo, 2003; Roth & Nigh, 1992).

Given the complex and multidimensional nature of MNE subsidiary strategies, previous studies have addressed different dimensions of the topic, such as headquarters control (Doz & Prahalad, 1984; Prahalad & Doz, 1981) and subsidiary autonomy (Ginsberg & Venkatraman, 1985), focusing on the locus of control and how much decision-making autonomy a subsidiary may have (Nohria & Ghoshal, 1994). The transfer of knowledge between headquarters and subsidiary has also been studied (Gupta & Govindarajan, 2000). Researchers into these issues have examined them via diverse theoretical frameworks and perspectives, applying them to different empirical settings.

The research reported in this thesis takes an MNE subsidiary in China as the target of study. Within this context, it explores factors that influence MNE subsidiary strategy

and how the headquarters-subsidiary relationship and control affect the management of subsidiary strategy and performance issues in China. It adopts the contingency view to study MNE operational strategy and importantly, its performance implications in China.

1.2 Definitions

1.2.1 MNE

MNEs, also known as MNCs, are business organizations that conduct business activities across country boundaries. There are various definitions based on different points of view.

From an organization-structure point of view, Phatak (1989) defines an MNE as an enterprise partially or wholly owned by one or more foreign partners and having a network of production, R&D, or marketing affiliates located in a number of countries. MNEs defined as such are typically structured with their headquarters located in their home country and their subsidiaries located there and/or in other (host) countries. MNEs can thus be conceptualized as a group of geographically dispersed organizations that typically conduct business across country boundaries and have disparate goals (Ghoshal & Bartlett, 1990).

Other definitions of MNEs arise from different perspectives. Forsgren (2002) describe a MNE as “one of the most significant institutions of modern societies” and define it from a resource-control point of view as an entity that allocates, controls and operates resources over various countries. As a typical MNE functions and operates across

country boundaries, the whole organization will always be exposed to and have to deal with more than one type of external home- and host-country environment. Therefore, it must be equipped to respond effectively and efficiently to the complex political, economic, social, cultural, technical and legal environments of home and host countries.

The management structure and corporate governance mechanism of MNEs have continued to develop. Various studies have sought to explain MNE structures using agency theory (Galbraith & Nathanson, 1978), which conceptualizes MNE subsidiaries as agents of headquarters that operate in various countries (Roth & O'Donnell, 1996; Chang & Taylor, 1999). Other theories represent the structure of MNEs in terms of a more 'federal' model, where the enterprise is composed of freely operating and relatively autonomous subsidiaries, each deciding its own strategic objectives and operating activities. Such MNEs operate more like independent networks than hierarchically run bodies. In this model, subsidiaries will play different roles in different countries (Nohria & Ghoshal, 1994; Rugman & Verbeke, 2003).

1.2.2 Subsidiary strategy and subsidiary role

When studying MNE subsidiaries, it is important to distinguish the concepts of subsidiary strategy and subsidiary role. The role of an MNE's subsidiary is typically designated by the parent company: the subsidiary takes its lead from headquarters, which imposes a general direction on it. By contrast, the subsidiary strategy is typically derived internally, giving the subsidiary itself some level of autonomy or self-determination (Birkinshaw & Pedersen, 2009).

MNE subsidiaries typically specify different roles based on their unique resources and capabilities, and some subsidiaries enjoy a considerable degree of autonomy, responsible for the development of their own roles (Bartlett & Ghoshal, 1986). MNE subsidiaries usually develop in stages, starting with a preliminary investment which leads to higher quality investments over time (Kogut, 1983; Chang, 1995; 1996). During this process, MNE subsidiaries do not passively rely on headquarters to incrementally allocate resources. They can proactively drive their development internally by taking initiatives, or externally by accepting investments from the parent company or other entities (Young & Tavares, 2004). In reality, as MNE subsidiaries develop, they do not just passively follow instructions or simply adopt mandates from headquarters. They are encouraged to develop their activities proactively and to seek new ways to add value to the MNE's overall business (Crookell & Morrison, 1990; Birkinshaw, 1997; Birkinshaw & Hood, 1998a). As an MNE expands globally, it needs to operate with increased constraints and overcome more challenges (Buckley & Ghauri, 2004; Buckley, 2009; Mudambi, 2008). Modern MNE subsidiaries must deal with internal challenges, such as embeddedness in the different networks within the MNE, and external challenges, such as those involving suppliers, customers and other institutions (Nohria & Ghoshal, 1994). MNE subsidiaries typically operate within a pre-set business domain according to the MNE's global strategy for its products and services, which limit the available options (Birkinshaw & Hood, 1998a). MNE subsidiaries must also deal with their headquarters' resource constraints in establishing relations with its other subsidiaries (Birkinshaw & Morrison, 1995).

In their analysis of MNE internal networks and patterns of information flow between subsidiaries and their headquarters, Gupta & Govindarajan (1991; 2000) recognize that

developing the internal embeddedness of the MNE network may be the most important strategic choice available to the manager of the subsidiary. Garcia-Pont, Canales & Noboa (2009) describe three hierarchical levels of internal embeddedness that subsidiaries can develop within the MNE: operational level, capability level and strategic level embeddedness. These play a role in subsidiary strategy design.

Externally, MNE subsidiaries endeavour to strengthen their links to or relationships with their local environment. Some studies have shown that MNE subsidiaries draw from and contribute to the knowledge pool of their local environment (Almeida, 1996; Almeida, 1999; Frost et al., 2002; Phene & Almeida, 2003). Others have determined the extent to which subsidiaries are embedded in the local environment and how their embeddedness affects their internal network relationships and performance (Grabher, 1993; Andersson et al., 2002; Foss & Pedersen, 2002; Cantwell & Mudambi, 2005). Some researchers (Solvell & Zander, 1998; Enright, 2000; Birkinshaw & Solvell, 2000) have focused on the subsidiary as a leading industry cluster and the interface between leading MNEs. All of the above studies provide evidence of the capacities of subsidiaries and the specific roles they play in MNE strategic management. All come to the same conclusion: Subsidiaries also need to develop their own strategies for dealing with both internal and external embeddedness.

According to Birkinshaw & Pedersen (2009), resource development and market positioning are the most important strategic elements for MNE subsidiaries, although they have some limitations. For example, subsidiaries' managers have increasingly less freedom to shape their market position, due to increasing numbers of global customers (Mudambi, 2008) and trends in information exchange which allow headquarters easy

access to their subsidiaries (Sinkovics et al., 2011; Yamin & Sinkovics, 2007). As to the resource development component, Birkinshaw & Pedersen (2009) argue that most of the tangible resources are occupied at the subsidiary level, whereas most of the intangible ones are held at headquarters level.

The model applied by Luo (2001) uses local responsiveness (LR) and global integration (GI) to determine which strategy is the most relevant for MNE subsidiaries. Within the GI-LR model, GI and LR represent two dimensions that determine types of MNE internationalization strategies and strategic roles of subsidiaries. LR is primarily driven by situational contingencies occurring locally at the subsidiary level, whereas GI is basically determined by the need for internationalization and coordination from the perspective of corporate headquarters (Ghoshal & Nohria, 1989). GI leverages the firm-specific advantages of MNEs in order to save costs and achieve global efficiency (Chen & Cannice, 2006). Thus, GI might be a potential key source of the competitive advantage for an MNE's worldwide activities, increasing efficiency among its subsidiaries. The integration of activities over the host countries is necessary for MNEs if they are to benefit from an optimal economic scale applied broadly (Fayerweather, 1982).

The arguments presented above highlight the distinct challenges that researchers face when studying strategic management at the subsidiary level. They also emphasize the need for further in-depth analysis of how MNE subsidiary strategic management is implemented, provide the rationale behind subsidiary strategic management and shed light on what influences subsidiary performance.

1.2.3 Headquarters-subsidary relationships and subsidiary control

MNEs typically develop different internationalization business strategies for different countries and thus have different objectives and considerations for each country. An MNE's decision to invest abroad is based on whether to acquire firm-specific assets resulting in ownership advantage, or whether to acquire location-specific assets resulting in host-country location advantage, or both (Dunning, 1988; 1998). Overseas host countries usually differ in strategic importance for MNEs. They can be viewed as the potential markets to exploit firm-specific advantages and they have the capability to generate benefits for the MNE by collecting resources and increasing assets (Ghoshal & Bartlett, 1998). Some host countries may enable the MNE to develop both market potential and resource seeking, which is usually deemed highly important and which favours the adoption of a mixture of asset-exploiting/market-seeking and asset-seeking strategies.

An MNE can also focus on a single internationalization strategy, such as the asset-exploiting approach. During expansion, it can focus on increasing its investment and obtaining resources from the host country, such as knowledge development and research capabilities in the foreign environment (Cantwell & Hodson, 1991; Doremus et al., 1998).

MNE subsidiaries in different host countries are always designated with different roles and strategies specific to the host countries. This arrangement normally requires MNE headquarters to adopt different control mechanisms (Bartlett & Ghoshal, 1989; Ghoshal & Nohria, 1989; Martinez & Jarillo, 1991). From the beginning, MNEs are typically

structured and shaped by their home contexts, where they develop from their original resource endowments, growing with their international expansion strategies. Thus, the resource endowment of a company's original context drives its global expansion process (Tan & Meyer, 2010).

There are two dominant ways of examining the mechanism of headquarters-subsidary control (Yu et al., 2006): The network perspective explores how to build subsidiaries to tap local resources (Chen & Chen, 1998; Ghoshal, 1986), while the agency perspective conceptualizes the headquarters-subsidary relationship as a principal-agent relationship. From the latter viewpoint, the main goal of subsidiary control is to reduce the agency cost of the target inconsistency and information asymmetry between the headquarters and its subsidiary (O'Donnell, 2000).

Building on comparative national culture frameworks and agency theory, Chang & Taylor (1999) investigated factors determining the degree and type of control that a home company exerts on its subsidiaries. They found that two characteristics affect headquarters control: (1) the degree of the MNE's ownership, which affects the amount of control, and (2) the nationality of the MNE's headquarters, which will affect the type of control exerted. Additionally, subsidiary size will moderate the relationship between the degree of ownership and amount of output control that headquarters exerts.

Regarding the MNE headquarters-subsidary relationship and the control mechanism, headquarters exerts its influence through structural management routines, such as lines of compensation and reporting, and through resource allocation, investment in new plants, use of knowledge, etc., to change the subsidiary's resource profile (Birkinshaw

& Hood, 1997). According to resource-dependence theory, subsidiaries' considerable reliance on headquarters for the allocation of resources leads to a requirement for control. Headquarters usually adopts two types of control: formal and informal. Formal control includes centralized, formalized, structural processes and output control and planning, while informal control involves mainly socialization and networks (Martinez & Jarillo, 1989).

However, subsidiaries can usually also develop their own local capabilities and their bargaining power with headquarters, probably being familiar with the capabilities of the headquarters. The extent of overlap is relevant to country-specific and subsidiary-specific dependency characteristics (Birkinshaw & Hood, 1998). Thus, while MNE headquarters usually has ownership authority, the extent to which it can translate this into workable property rights depends in each case on bargaining between headquarters as principal and the subsidiary as agent (Foss & Foss, 2005). Several factors can limit the effectiveness of headquarters control and coordination functions. Knowledge flow can be impeded by the size of the company and there are cognitive and resource limits to what MNEs can do (Pavitt, 1998). It is also a challenge for headquarters managers to shepherd subsidiaries towards 'dual embeddedness', where they are simultaneously embedded in the MNE's corporate internal network and culture and in the external host environment (Narula & Dunning, 2010).

For MNE subsidiary operations in China, establishing and maintaining a headquarters-subsidiary relationship relates closely to the stage of development of the given subsidiary. Thus, communication is essential in order to maintain a sound headquarters-subsidiary relationship. There are four main factors that affect functions and success in

this context: headquarters commitment, bringing China to headquarters, bringing headquarters to China and the ‘corporate clout’ of the head of the China subsidiary operations (Fernandez & Underwood, 2006).

1.2.4 Subsidiary performance

Different rules exist for measuring MNE subsidiary performance from different points of view and when considering how subsidiary performance is influenced by MNE subsidiary strategies. There are also numerous measures of performance, including growth indicators (e.g. sales growth and profit growth) and indicators of financial (e.g. ROA and ROE) and stock market performance (e.g. Tobin’s Q) (Hewett et al., 2003). Such indicators capture various aspects of a company’s performance and their use will reveal MNE headquarters’ strategic position to its subsidiaries in specific markets. For Chinese subsidiaries, it will become clear that our data show that headquarters are more likely to use growth indicators to measure the performance of their Chinese subsidiaries. Additionally, it is our experience that headquarters are open to give these subsidiaries a measure of autonomy in taking a more influential role, since the local market has huge potential. Specifically, to assess subsidiary performance, headquarters often relies largely on measuring growth in terms of sales and profits.

The mechanisms mediating subsidiary control have critical implications for subsidiary performance. Luo (2003) defines control flexibility as the extent to which a parent firm’s organizational control over subsidiary activities can be flexible. In his analysis of the effects of control flexibility on subsidiary performance, he found that the flexibility of a parent firm’s control exerted a substantial influence on subsidiary

performance. Ambos, Andersson & Birkinshaw (2010) investigated how a subsidiary's operating track record contributes to its bargaining power and how headquarters' response (e.g. giving attention to or monitoring the subsidiary) affects the realization of the subsidiary's goals. Subsidiaries cannot increase their influence through initiatives unless they attract the attention of headquarters. They also found that a subsidiary's track record and experiences directly affect its autonomy. Increased autonomy, however, evokes increased monitoring by headquarters, which in turn reduces the subsidiary's autonomy.

Ambos & Birkinshaw (2010) investigated how the attentiveness of headquarters affects its subsidiaries' performance and found that subsidiaries which perform better than their peers will not only have a high level of strategic choice, but will also receive more attention from headquarters. More specifically, the interactions of subsidiaries' autonomy, inter-unit power and initiatives with attention from headquarters were found to improve the subsidiary's performance. Hewett et al. (2003) investigated the effect on foreign subsidiaries' performance of the extent to which they were responsible for the development and implementation of marketing activities and found that the roles played by headquarters and subsidiaries in marketing activities were aligned with relational, industry and market conditions. The closer the relationship between headquarters and its subsidiaries, the greater the market share tended to be.

1.3 MNE Subsidiaries in China

Since the inception of its ‘Reform and Opening-up’ policy in the late 1970s, Mainland China has experienced dramatic social and political reform, as well as rapid economic development and growth.

This environment has made China an attractive target for MNE investments and the establishment of local subsidiaries of MNEs. This research, which addresses issues relating to the MNE headquarters-subsidiary relationship and subsidiary strategies, focuses on China as a major destination for MNEs. It seeks to clarify the interrelationship mechanism underpinning the headquarters-subsidiary relationship and subsidiary strategies in China. In addition, it intends to look into and shape the hypothesis that the quality of the headquarters-subsidiary relationship between Chinese subsidiaries and their parent MNEs is influenced by factors related to the institutional environment, social exchange and managerial cognition.

Emerging markets have been described as “the biggest growth opportunity in the history of capitalism” (Atsmon et al., 2012), with China being the front-runner amongst these markets (O’Neill & Goldman, 2001). Not only did China overtake the United States to become the world’s largest trading nation in 2012, but it also showed greater resistance to the global financial crisis of 2008 (Bloomberg, 2013). A variety of local markets are responsible for this strength.

China has become one of the largest markets for raw materials, products and services, such as iron ore, crude oil, motor vehicles and steel, for example. Many companies have

become alert to the possibilities in exploiting these. Indeed, China has received considerable foreign direct investment (FDI) from MNEs outside China which aggressively target fast-growing markets with the aim of increasing their local foothold. These firms hope to expand and secure new market opportunities (Dunning, 2000; 2009). Many companies initially came to China because of its low labour costs and now see it as having become a huge market where the cost of production has increased dramatically (The Economist, 2013). In the 1990s, almost 80% of FDI in China was aimed at seeking new markets (Luo & Park, 2001).

China enforces strict requirements on the proportion of local content in its exports and of FDI in the balance of foreign exchange. On the way to building a market economy, China has eliminated the government's implementation of the central planning of distribution, wholesale and retail operations (Luo, 1998). In pursuit of the goal of meeting World Trade Organization (WTO) requirements, China began in 2001 to implement a new trade and foreign investment policy with the objective of removing export mandates for foreign subsidiaries. In 2005, China further opened its domestic market to foreign investors, giving them trade and distribution rights. These policy changes were intended to cultivate a more market-seeking, FDI-friendly institutional environment, encouraging MNEs to take advantage of new opportunities in the Chinese market to sell their products made in China. Many MNEs reacted quickly when these restrictions were lifted or relaxed, enabling them to shift products targeted for export into local sales instead. Along China's trajectory towards a market economy and full WTO membership, many MNEs were also active in persuading the government to open up the domestic market (Child & David, 2001; Ramamurti, 2001). Foreign firms able to adapt proactively to institutional changes by developing strategies in emerging

markets can improve their performance through increased legitimacy and greater efficiency in complying with the new institutional developments (Peng, 2003).

China has also undergone significant institutional changes, from central control to a market economy. In 2001, to create a more open atmosphere towards FDI and to attain WTO membership, the government made it easier for foreign-owned companies to sell their products locally by loosening production restrictions (Chang, 1995). Nonetheless, given China's unique business environment, foreign firms face particular challenges in adapting to this local marketplace. They need time to develop and apply local capacity, such as relational networks, namely *guanxi*, which is a necessary and strategic resource for doing business in China (Luo, 1997; Luo & Park, 2001; Pan & Chi, 1999; Peng, 2003). London & Hart (2004) refer to *guanxi* as an extra capability, a sort of social embeddedness, that allows MNEs to understand and leverage the strengths of the local market environment. Even though *guanxi* networks require time and painstaking patience to cultivate and maintain, their advantages far outweigh these costs, because once it is developed, a *guanxi* network gives an MNE and its local subsidiaries a valuable competitive edge in the local marketplace. Furthermore, the longer an MNE operates in China, the more its own *guanxi* grows (Luo & Park, 2001). Another challenge facing MNEs in China is that business environments can be very different from region to region (Benito et al., 2003). This might seem paradoxical, given that China is a monolithic nation-state with uniform laws, and one might expect the business arena to mirror this uniformity regardless of location within the nation.

The goal of any MNE is to enhance the performance of its subsidiaries, doing so often translates to an overall enhancement of performance for the entire company and

ultimately to increased overall market value. Several performance-enhancing mechanisms can be applied. One is the strategic fit paradigm, focusing on the fit between strategy and structure, which affects performance (Venkatraman & Camillus 1984). In this paradigm, ownership structure plays a vital role in drafting and employing value-generating strategies that can strengthen the performance of local subsidiaries (Brouthers & Hennart, 2007). To generate value from an emerging market, an MNE must act in a fit-enhancing manner, using its resources and absorptive capacities (local resources, talents and contexts) so as to generate more business and increase productivity, both of which result in improved performance. Conducive to this aim is adopting an ownership structure that is more in tune with the firm's market-seeking orientation, so that it can focus on market dynamics and flexibility, readily curtail conflicts with local partners, protect valuable assets and ensure full control.

Joint ventures (JVs) and wholly owned subsidiaries effectively work in opposing fashions for the benefit of MNEs (Brouthers & Hennart, 2007). A JV structure is a way of pooling and using valuable, established local resources with local partners. This type of structure is particularly useful where a company faces roadblocks in obtaining resources through more standard methods like market exchanges, mergers and acquisitions (Das & Teng, 2000). One way in which JVs might mitigate such difficulties is that partners can interchange insightful information and country-specific knowledge (Luo, 1997; 1998). This type of organizational structure also encourages partners to learn from and about each other, which in turn can prevent discord between the foreign subsidiary and its host-country partners (Ouchi, 1977).

1.4 Business environment in China

Among other things, formal institutions include laws and regulations established by relevant authorities. These serve as the context in which embedded organizations operate (Scott 1995), including the subsidiaries of MNEs. Formal institutions tend to be somewhat volatile in novel or emerging markets and as such, tend to change more frequently (Peng, 2003; Hoskisson et al., 2013). Frequent changes in host-country laws and regulations can generate confusion and setbacks for MNEs and their foreign subsidiaries. On the other hand, they can present opportunities for astute managers. To be successful, then, both the headquarters of an MNE and its foreign subsidiaries need to be poised to adapt promptly to formal-institution fluctuations.

In 1979, the Chinese government initiated economic reforms with the intention of encouraging foreign companies to come to China. To this end, formal institutions have been established and repeatedly revised in order to create an attractive business environment for foreign companies, one that would generate capital inflow and promote advanced technology benefiting Chinese firms (Björkman & Osland, 1998). These changes, however, albeit well intentioned, create an uncertain, challenging business environment for companies wishing to establish subsidiaries in China. These firms are faced with the daunting tasks not only of learning and understanding the changes in China's formal institutions, but also of adapting to them in ways that will not jeopardize their bottom line. Foreign companies wishing to do business in China, therefore, need to establish a long-term approach to these institutions and how they function in China (Beamish & Jiang, 2002; Boisot & Child, 1999). The relationship between institutional changes in the host country and the market entry behaviour of a firm is not static, but evolves over time (North, 1990). The dynamics of this process are affected not only by

the type of institutional changes but also by how the foreign company reacts and adapts to these changes (e.g. their market knowledge and commitments) (Rosenzweig, 1991). The research reported in this thesis contributes to the evolving discussion of the internationalization of firms and how changing sociopolitical conditions affect it (Meyer & Gelbuda, 2006). Foreign companies are not left in the lurch. Rather, they can proactively involve themselves in the process (Oliver, 1991), thereby improving their network position—referred to in China as *guanxi*—in the host market (Johanson & Vahlne, 2009).

Foreign market entry is a multifaceted process comprising three basic stages: initial market entry, local market expansion and globalization (Douglas & Craig, 1989). Various models have been proposed and applied to analyse foreign market entry. Employing a transaction cost argument, Buckley & Casson (1998) conclude that firms should make rational decisions to maximize profits when entering new foreign markets. In their view, each market entry decision is made independently and there is no learning effect from one decision that guides the next. Buckley & Casson (1998) make the assumption that the firm's decisions are closely tied to its unique capabilities and that the host government does not intentionally target the firm's entry. Unfortunately, this model does not allow for path dependency in a firm's foreign market entry process, since each decision step is independent and cannot be directly observed as it unfolds. Furthermore, it ignores the potential relationship between a firm's behaviour and its institutional environment, precluding a long-term, dynamic view. By contrast, the Uppsala internationalization model views a firm's foreign market entry as a gradual process, during which it continuously acquires market knowledge and makes incremental commitments to the host market by means of ongoing entry activities

(Johanson & Vahlne, 1977). These activities then further influence subsequent market knowledge and market commitment (Forsgren, 2002). Thus, firms' market entry behaviour depends on their local market history (Johanson & Vahlne, 1990).

In the Uppsala model, market knowledge is a determining factor in the foreign market entry process (Eriksson et al., 1997). Firms entering foreign markets regulated by weak and fluctuating institutions may face challenges in obtaining market knowledge and information, which could affect their performance (Luo, 2003; Luo & Peng, 1998; 1999; Peng, 2003). However, firms are attracted by the strong growth potential of these markets and may also enter with the aim of learning and gaining experience (Forsgren, 2002). Foreign companies, therefore, need to reflect on what they have learned during the market entry process in order to adapt to the institutional environment (Calof & Beamish, 1995). As emerging markets by nature lack market-supporting institutions, foreign companies face difficulties and require time and resources to acquire adequate host-market knowledge (Khanna & Palepu, 1997).

Executives of MNEs are wise to consider many specific challenges related to social, political and business factors when building a position in certain emerging markets (Ghauri et al., 2012). In theory, organizations are often assumed to adapt to and comply with different institutional arrangements in order to achieve legitimacy (DiMaggio & Powell, 1983; Ranson et al., 1980). However, many authors studying international firms have concluded that they have strategic choices and may be able to influence institutional arrangements in foreign markets (Boddeyn & Brewer, 1994; Child & Tsai, 2005). Indeed, a main theme in the business literature is to what extent corporate

practices will be adopted by subsidiaries in culturally different markets (Kostova & Roth, 2002).

1.5 Additional considerations

Overseas host countries tend to differ in strategic importance to MNEs. Foreign countries can be thought of as potential markets for exploiting firm-specific advantages in their capacity to generate benefits to MNEs by collecting resources and assets (Ghoshal & Bartlett, 1998). Other countries may provide a platform for MNEs to develop both market potential and resource seeking, which is usually viewed as highly important and biased towards adopting an approach to utilize a mixture of asset-exploiting/market-seeking and asset-seeking strategies. The internationalization strategy of an MNE can initially be focused on a single approach, such as asset-exploiting, then as it expands, it can increase its investment and attempt to obtain other resources from the host country, such as knowledge development and research capabilities in the foreign environment, among other things (Cantwell & Hodson, 1991; Doremus et al., 1998).

Originally, studies of MNEs' strategic management mainly conducted their analyses from the headquarters' stance, viewing the MNE holistically. Researchers traditionally took a hierarchical, centre-dominated perspective, assuming that the strategy and structure originating from headquarters would be implemented by the subsidiary, which was viewed simply as a tool with specific roles designated by headquarters (Jarillo & Martinez, 1990; Bartlett & Ghoshal, 1986; Porter, 1986). However, MNE subsidiaries often have unique access to key resources and operate with far more decision-making

and operational latitude than is officially condoned, while formal structure is often less important than management systems or culture as a means of control (Doz, 1976; Prahalad, 1976; Bartlett, 1979; Prahalad & Doz, 1981; Hedlund, 1986). Ghoshal (1986) studied the role of a MNE subsidiary in the diffusion of innovation across the organization.

1.6 Research questions, aims and overall objective

Although the pioneering study by Kostova (1998) proposes that the quality of the headquarters-subsidary relationship is a source of competitive advantage for the firm and can thereby positively influence the performance of its subsidiary, it does not address the determinants of the quality of this relationship. This thesis focuses on these determinants for MNEs operating in China.

This study aimed to find out that : (1) What are the determinants of the quality of the headquarters-subsidary relationship; and more specifically, (2) What are these determinants when viewed from different theoretical perspectives? This leads to the overall research objective- To determine the significant variables that influence the quality of the headquarters-subsidary relationship of MNE subsidiaries in China. Three specific research objectives under this umbrella are:

- 1) To determine the impact of differences in institutional environments between host and home countries on the quality of the headquarters-subsidary relationship; and further, to determine how the impact of these institutional environmental differences are contingent upon the extent to which headquarters' practices are institutionalized in their subsidiaries.

- 2) To determine the impact of organizational and managerial exchanges between headquarters and subsidiaries on the quality of the headquarters-subsidiary relationship; and further, to determine how these organizational exchanges are contingent upon MNE's headquarter ownership in the subsidiary and the entry mode of the subsidiary. At a deeper level, the objective is to determine how the impact of managerial exchanges between headquarters and subsidiary on the quality of the headquarters-subsidiary relationship is contingent upon the level of the subsidiary managers' organizational identity with the subsidiary.
- 3) To determine the impact of the subsidiary managers' global mindset and perceived differences between host and home countries on the quality of the headquarters-subsidiary relationship; and further, to determine how the impact of the subsidiary managers' global mindset is contingent upon the flexibility of the subsidiary managers' personality and their study experience outside China.

Guided by these thoughts above, this research focuses on the following significant but not yet fully addressed research questions:

- How does the MNE's subsidiary strategy develop and what are the main influencing factors?
- How will the MNE's China subsidiary strategy be influenced by its corporate international business strategies and vice versa?
- How will the subsidiary's performance be affected by the subsidiary strategies and why?

- How and why will the MNE's headquarters-subsidary relationship and headquarters control mediate the process?

The research undertaken for this thesis will contribute to a broader and deeper understanding of the strategic processes of the Chinese arm of a case-study MNE and relevant major issues. Moreover, the results of this research are expected to have implications for performance from both the local and overall corporate perspectives. It also seeks to shed new light by proposing a conceptual framework for the improvement of MNEs' strategic management of their subsidiaries and their performance.

1.7 Structure and process of the study

The qualitative methods adopted in this research were scientifically designed and systematically conducted. Eight steps were performed to complete the work:

- 1) Identification of the research problem
- 2) Background study and literature review
- 3) Establishment of a conceptual framework
- 4) Development of a data collection instrument
- 5) Data collection and organization
- 6) Data analysis
- 7) Collation of results in a form facilitating interpretation and discussion
- 8) Writing of the thesis.

The first step was to identify possible research questions, which included the identification of the research problem and its significance, and 'crystallization' of the

main research objective. This was followed by performing a background study of China's outward FDI and an extensive literature review of theories and empirical studies related to the headquarters-subsidiary relationship. In the second step, secondary data were collected, including information on government policies and regulations, on statistics and on corporate matters. The first two steps of the research interacted with each other, since the identification of the research problem defined the scope of the literature review and background study.

The results of the literature review and background study assisted me in fine-tuning the details of the research problem and objectives. They also laid the foundation for the third step: establishing a conceptual framework on the basis of extant literature, then formulating several hypotheses accordingly. Next, in step four, two questionnaires were developed to collect management data for hypothesis testing. After the questionnaires had been finalized and pilot-tested, a survey was carried out, based on a self-constructed sample frame; this collected primary information from senior executives at the headquarters of the chosen MNE and in its subsidiaries in China.

The collected data were entered into a computer and analysed with various statistical tests (see Section 3.5). The results of statistical analysis were then organized and distilled into a form to be discussed in the context of the research questions. Once all of these steps had been completed, the present thesis was written.

Chapter 2 Literature Review

2.1 Introduction

This chapter offers an extensive discussion of existing theoretical and empirical papers related to the field of MNE research. The aims of this literature review are to identify the relationships among various factors and to develop some constructs from published research results. Existing MNE and related research is mainly concerned with the internationalization of MNEs, their environment and their operating strategies in host countries.

Research into the internationalization of large corporations tends to focus on the core elements of the country as the main determining factors. Early research by Sun et al. (2012) discussed the benefits of internationalization for MNEs from the perspective of cross-border trading. More recently, researchers have begun to focus their interest on multinationals' subsidiaries, which are treated as part of their corporate organizational structure. Birkinshaw & Pedersen (2009) found that a substantially better understanding of an MNE's behaviour was obtained by focusing on its subsidiaries.

Existing studies of MNEs focus mainly on their environment, their headquarters and their subsidiaries. This chapter will discuss all three of these interrelated factors by means of an extensive literature review, seeking to develop the meanings of the important constructs evoked in existing studies and to determine the interrelationships among these three factors, in order to achieve a clear understanding of the phenomena under study.

There is a range of different philosophies behind the construction of social theory. Eisenhardt (1989) holds that theoretical research should be based on inductive methods and philosophy, whereas Gummesson (2000) suggests that researchers should take advantage of existing theory by adopting a deductive theoretical stance. Perry (1998) postulates a philosophy lying between these two perspectives. He believes that pure induction may have a negative impact on existing theory, while purely deductive methods can prevent the creation and development of new and useful theories.

Many prior studies have examined aspects of MNE headquarters and host country subsidiaries, including the process of internationalization, the parent-subsidiary relationship and control, as well as the strategy and performance of multinational subsidiaries. In making a new contribution to this body of research, the present study seeks to balance the perspectives of induction and deduction. This balanced research approach is adopted in the hope of deriving robust research findings from a comprehensive data collection process, taking account of both new and existing evidence while imposing no restrictions on data analysis or interpretation.

Given the above considerations, Section 2.2 discusses the background to the study and the environment in which MNE subsidiaries operate in China. Section 2.3 then reviews the relevant theoretical and empirical studies of MNEs and Section 2.4 turns to MNE subsidiaries and related research topics. Next, Section 2.5 offers an analysis of MNE-related problems and discusses ways of solving them. The MNE subsidiary performance index is examined in Section 2.6, then Section 2.7 addresses the headquarters-subsidiary relationship and the relevant theoretical perspectives, including a discussion of the important issues of MNE headquarters' control over its

subsidiaries. Section 2.8 summarizes the review and identifies the research gap which the present study seeks to fill. Finally, Section 2.9 derives the conceptual framework of this research.

2.2 Background of China as MNE subsidiary host country

2.2.1 China's market environment and MNE market seeking strategies

In the past few decades, China has been one of the most attractive developing countries for MNEs to target as a host country, thus attracting a large influx of FDI (Davies, 2012). This is mainly because several decades of development have made China the world's most important market for iron ore and other raw materials, with very strong demand for crude oil and many products such as steel, machinery and automobiles. MNEs now not only see China as an important sales market and export destination, but are also increasingly keen to set up subsidiaries to produce locally in China, with the aim of enhancing sales in China and acquiring market opportunities (Dunning 2000, 2009). Many MNEs initially came to China for the purpose of low cost and abundant resources, but many have recently changed their approach to develop a long-term strategy and maintain competitive advantage. The Chinese market is so vast that market positioning dictates that MNEs would want to stay there even if production and other related costs increased significantly (The Economist, 2012). The search for markets has always been a major strategic driver for MNEs to invest in developing countries, thus gaining local market opportunities and growth potential (Luo 2001; Luo & Park 2001).

When China operated a planned economy before the 1980s, its rules on trade and investment were typically strict. The government applied regulations to control companies' exports, the percentage of local content and the use of foreign currencies. As this planned economy transits to a market economy, China has gradually relaxed various aspects of government control over activities such as wholesale, retail and distribution (Luo 1998). When China acceded to the WTO in 2001, the government instituted a new set of trade and foreign investment policies to meet WTO requirements, including the removal of strict export restrictions on MNE subsidiaries. In 2005, China further loosened its policy on market entry by foreign investors and gave MNEs the right to trade and distribute in the domestic market. This series of regulation changes created a friendlier institutional environment for FDI, allowing market-seeking MNEs to acquire more opportunities in China by selling local products. During China's transition towards a market economy and its WTO entry, many MNEs have also made suggestions to the Chinese government on creating a friendlier investment environment in the domestic market (Child & Tse 2001; Ramamurti 2001).

Dunning (2000) lists four basic strategic motivations for developed economy MNEs to conduct outbound investments abroad. These strategies are resource seeking, efficiency seeking, market seeking and strategic asset seeking. In recent years, more and more MNEs have transferred their market-seeking strategies to emerging countries. As developed markets have become more saturated, MNEs have increasingly turned their attention to these key emerging locations for future growth (London & Hart 2004). The capacity and the wealth growth of emerging economies are critical factors for MNEs to decide whether such markets are attractive. Thus, the main factors considered by MNEs are whether a particular emerging market can create opportunities for new investors,

support higher investment returns, offer more potential and allow economies of scale (Wilkinson et al., 2008).

In the past four decades of transformation from a planned to a market economy, China's markets for industrial products and consumer goods have increased substantially in size. Many MNEs operating in the Chinese market have integrated downstream production with upstream distribution and marketing operations to create a whole chain of industrial activity and this extensive practice has proved to be successful (Douglas & Craig, 1989). The market-seeking strategy of MNEs is intended to deliver market share and growth through the sale of products in China and many have indeed maintained rapid growth in the consumer and industrial sectors for decades (Wilkinson et al., 2008; Luo & Park 2001). As a result, the majority of MNEs have maintained a high proportion of domestic sales in China in the growth of their total revenue (Pan & Chi, 1999).

Typically, the search for market strategies requires MNEs to have a better and broader understanding of host countries (Nachum & Zaheer, 2005). MNEs pursuing a market-seeking strategy in foreign markets usually require subsidiaries there to monitor local market conditions, so that they can decide what kind of strategy to follow in any such market, such as how to determine the product portfolio and how to use market innovation, mature products and advanced technology to occupy each host country market (Luo & Park 2001). MNEs often follow a market penetration strategy and take advantage of their strengths in traditional products, technologies and home markets. They will also need to consider how to adapt these to suit local markets and local consumers (Pan & Chi 1999). In emerging markets that are more flexible and volatile, the local management team will usually be granted greater autonomy to ensure rapid

decision making. When seeking markets, MNEs usually try to maintain concentration, which requires the development of a strong local network in the host country market, investment in research and development (R&D) capacities and the development of local production and sales. Market seeking requires MNEs to develop lifecycle capacities for products and to seek optimal returns on technological advances (Pan & Chi 1999).

Given China's special environment in terms of both culture and business models, MNEs need to make great efforts to overcome the challenges of adapting to the Chinese market, patiently taking the time to develop and mature local capacities. In China, with its long history and great regional diversity, it is particularly important to develop guanxi networks of business relationships, which can become important strategic resources for MNEs (Luo & Park 2001). Although the whole country has uniform commercial laws, the business environment varies across the regions and there are many local rules which regulate models and operational approaches (Du et al., 2008). Guanxi, which has been described as a kind of extra capability for social embeddedness (London & Hart, 2004), will need time to develop strategically (Luo & Park, 2001).

2.2.2 The institutional perspective on MNE subsidiaries in China

From the institutional point of view, we focus here on the dynamic interaction between the institutional environment and the organization, examining how this interaction impacts on the actions of the organization (Peng, 2002). Firms' behaviours can be shaped both formally and informally by the government and its agents (Scott, 2002). The institutional perspective therefore provides a suitable theoretical lens for studying

how the institutional environment shapes MNEs and their subsidiaries in China, and how their interactions might influence the headquarters-subsidiary relationship.

An analysis of the local host country context usually has two dimensions: institutional frameworks and resources endowments. In its operation and management, an MNE must pay close attention to “multi-level and multi-aspect embeddedness” across the organization, as this gives rise to complex interactions with subsidiaries which can present major challenges (Meyer et al., 2011). To explore the influence of institutional frameworks on the business operations and behaviour of companies, scholars have developed the concept of institutional economics (North, 1990) and institutional theory (DiMaggio & Powell, 1983). These seek to explain how aspects of the institutional environment such as legal frameworks and regulatory systems will affect the business operations and strategy of both local companies (Peng, 2003) and MNEs (Meyer & Nguyen, 2005).

MNEs will usually consider it to be highly important to operate in countries which have the market potential for significant growth and the resources to fuel it. This makes them inclined to adopt a combination of asset-exploiting, asset-seeking and market-seeking strategies. Many, having originally adopted a single strategy such as asset exploitation, have then found it advisable, in order to expand and increase their investment, to seek local resources such as knowledge development and research activities in the host environment (Cantwell & Hodson, 1991). MNEs typically adopt asset development and market seeking as the core of their internationalization strategy. They need to take advantage of international operation to minimize transaction costs, by making use of their home-based, firm-specific advantages abroad. Asset-seeking MNEs tend to create

the best value based on their own preferences, by making use of external resources in different external environments. Therefore, the asset-exploiting strategy needs to be focused on the existing resources of the transaction, while the asset-seeking strategy is more focused on external factors and attempts to develop knowledge and expand the company's resource base (Wang et al., 2014). As discussed, an MNE's internationalization strategy will exert a major influence on its management structures and on its headquarters-subsidiary relationships, and will determine the mode of internal resource transactions (Taylor et al., 1996).

Institutional theory postulates that an organization must obtain legitimacy through isomorphism with the institutional environment in which it is embedded in order to survive (DiMaggio & Powell, 1983). In the business context, it focuses on the social and political aspects of organizational embeddedness affecting a firm's internationalization (Child & Rodrigues, 2005). Scott (1995) defines an institution as a highly resilient social structure having regulative, normative and cultural-cognitive dimensions. Institutions can be either formal or informal (North, 1990); formal institutions are dominated by the regulative element, comprising regulations and laws, whereas informal institutions are characterized by the normative and cultural-cognitive elements of norms, values and beliefs (Peng et al., 2009).

In a given organizational context, the institution can determine well accepted and normally practiced models or structures of operation (DiMaggio & Powell, 1983). An MNE doing business in a culturally different host country must derive external legitimacy from complying with its normally practiced institutional rules, such as business models, organizational structures and operational practices. Therefore, it is

easy to understand that all MNEs are under institutional pressure to comply with the norms of each country in which they operate. Institutional distance is caused by the differences in institutional environment between home and host countries (Pache & Santos, 2010). Formal institutional distance is captured by the regulative distance that stems from the variance in regulatory environment between host and home countries, whereas informal institutional distance stems from variance in normative and cognitive factors, represented mainly by cultural distance (Chao & Kumar, 2010). The increased liability of foreignness increases the institutional pressure on MNEs to obtain the legitimacy of various host-country institutions. The process of legalization is largely determined by the organization's communication and commitment (Suchman, 1995) and it will influence the level of trust (Morgan & Hunt, 1994) and satisfaction (Selnes, 1998) among different organizational units.

Institutional distance, consisting of regulative and cultural elements, will influence both the institutional pressure on an MNE and its legitimization process. It can also influence the quality of the headquarters-subsidary relationship, in terms of mutual trust level, communication, satisfaction etc. (Johnston & Menguc, 2007).

MNEs' subsidiaries often seek to achieve legitimacy, not only externally with host operating environments, but also internally within the MNEs themselves (Westney, 1993). The internal legitimacy of a subsidiary refers to the degree of acceptance and recognition by other units of the MNE, especially its headquarters. The subsidiary can usually only achieve such internal legitimacy by conforming to the institutional practices required by headquarters, which may include the use of a specific set of organizational structures, policies and practices (Kostova & Zaheer, 1999).

High levels of internal legitimacy will enable a subsidiary to access the MNE's resources, such as capital and knowledge (Pfeffer & Salancik, 1978) and thence to implement suitable strategies to respond to external institutional pressures, instead of merely conforming to them (Oliver, 1991; Suchman, 1995). This shows that subsidiaries' internal institutionalization activities in achieving internal legitimacy can affect their responses to external institutional pressures, providing a mechanism by which institutional distance may influence the quality of the headquarters-subsidiary relationship.

The roles of subsidiaries within the MNE structure will differ among host countries and this will lead MNEs to adopt different control mechanisms (Bartlett & Ghoshal, 1989; Martinez & Jarillo, 1991). China's status as an emerging market has enhanced its potential and importance, hence the urgent need for MNEs to open the market. MNEs need to learn and understand the environment of this marketplace, in terms of its consumers, global and domestic competitors, upstream and downstream distribution systems, etc.

As China is transitioning from central planning to a market-oriented economy, the intentions of Chinese managers of local MNE subsidiaries can exert a heavy influence on the firms' strategic behaviour (Cui et al., 2013). These Chinese managers face more uncertainties in the domestic market arising from this transition than those confronting their counterparts operating in well-developed market environments. This implies that the Chinese managers may have different mindsets and thence different information-processing capabilities.

2.2.3 Management and cultural style in Chinese subsidiaries

MNEs establish subsidiaries to fulfil certain goals and objectives set by headquarters, making this a principal-agent relationship (Mudambi & Navarra, 2004). This paradigm explains why many MNE subsidiaries in China and their Chinese managers depend largely on their personal relationships to deal with contingencies both inside the MNE and outside, e.g. with customers (Child, 1994).

Based on the operating principle of dynamic reciprocity, in MNE subsidiaries in China, *guanxi* between headquarters managers and subsidiary managers will influence the quality of the headquarters-subsidiary relationship (Chen & Chen, 2004). As the cornerstone of Chinese society, *guanxi* is vital for good communication and has a profound influence on social and economic interaction (Yang, 1967). Chinese reciprocity is characterized by long-term relationships, i.e. the payback or return of a favour is not immediate (Yang, 1994). In the context of the headquarters-subsidiary relationship, this means that the MNE will need a long time to develop and maintain the necessary *guanxi*, which will depend on effective long-term communication among the parties. Reciprocity is also characterized by unequal exchange, whereby the favour as returned will be greater than that which was received (Hampden-Turner & Trompenaars, 1997). Such *guanxi*-informed interpersonal relationships are also widely accepted and practiced when MNE subsidiaries operating in China deal with clients.

Given the long Confucian tradition of collectivism in China (Earley, 1993), it is argued that the communication between headquarters and subsidiaries has a strong impact not only on interpersonal dynamics, but also on interorganizational dynamics, such as the

headquarters-subsidary relationship. When personal exchange is used by the organization for whatever purpose, it will have an impact at the organizational level (Luo, 1997). Personal networks and ties not only help exchanges at the individual level between the subsidiary and headquarters managements, but also stimulate the exchange of information and resources at an organizational level. As discussed by Peng & Luo (2000), good managerial relationships with clients or other firms may facilitate interorganizational collaboration and implicit collusion at the organizational level.

Social identity theory suggests that an individual who identifies with a social group will adopt the group's norms and values, acting in accordance with the prototype of social groups (Hogg & Terry, 2000). When a manager of a subsidiary has a relatively weak organizational identity with the subsidiary and a stronger one with headquarters, his/her perception of headquarters managers may be less a matter of 'us and them' and more of an inclusive 'we'. The subsidiary manager is then more likely to share a common organizational membership with headquarters managers and become more cooperative.

A stronger association with headquarters in the home country means more resource endorsement, which can increase managers' power, prestige and compensation (Jensen & Murphy, 1990; Shleifer & Vishny, 1989). Under the heavy influence of Confucian ideology, MNEs' Chinese subsidiaries will always seek closer ties with headquarters, tending to give more salience to subsidiary managers' dual organizational identity with both headquarters and the subsidiary, which is the key to building cooperative interorganizational relations (Ashforth & Mael, 1989; Hogg & Terry, 2000).

2.3 Studies taking the MNE as core unit of analysis

2.3.1 Motivations for MNEs to expand abroad

The MNE is characterized by having subsidiaries located in different countries. The development of MNEs' international operations suggests that there must be transactional advantages to this. Compared with the model whereby each business exercises control separately, the central control model probably has advantages (Caves, 1982). Hymer (1976) was one of the first to take the MNE as unit of analysis and to air the concept of firm-specific advantage. He found that by investing in the ownership of foreign assets, MNEs can internalize or replace the market to get a higher return. Williamson (1975) developed the internalization theory based on transaction cost, explaining the reasons for the development of MNEs.

Rugman (1981) notes that each MNE develops a specific set of capabilities or firm-specific advantages (FSAs), such as in technology, production or brand reputation. By taking advantage of such FSAs at an international level, a company can enjoy country-specific advantages. This phenomenon arises when an MNE operates the internationalization of the motivation, deployment and use of its FSAs through the structure of its subsidiaries (Rugman, Verbeke & Nguyen, 2011).

At an early stage, many MNEs operated in a limited domestic market and when they needed to expand into overseas markets, they simply replicated their domestic business abroad (Mathew, 2006). Such MNEs were therefore structured and shaped from the beginning by their originating home contexts. It remains true that MNEs tend to develop

from their original resource endowments, which thus drive their global expansion (Tan & Meyer, 2010). Studies of FDI and trade show that the variation in resource endowments from region to region will affect investment decisions. MNEs will base their investment decisions on their specific assets and specific location advantages (Dunning, 1988; 1998). According to Dunning (2000), there are four motivations for firms in developed economies to conduct outbound investment abroad, which are resource seeking, efficiency seeking, market seeking and strategic asset seeking.

An MNE's management structure and corporate governance mechanisms must be maintained for it to keep developing. Many MNEs establish a federal type of structure, allowing their subsidiaries to operate independently, each with its own strategic objectives and business activities. The subsidiaries of such MNEs operate within various networks, not in a hierarchical structure requiring subsidiaries in different countries to adopt similar roles (Nohria & Ghoshal, 1994; Rugman & Verbeke, 2003). Nevertheless, strategic management studies tend to consider MNEs from a hierarchical, centre-dominated perspective, where strategic management and structure emanate from headquarters and are implemented by each subsidiary according to its designated role (Jarillo & Martinez, 1990; Bartlett & Ghoshal, 1986). Therefore, studies of MNE subsidiaries have mainly focused on topics related to their management, such as headquarters' decisions (Garnier, 1982), subsidiaries' roles (Hedlund, 1981) and the central control and coordination of subsidiaries (Baliga & Jaeger, 1984; Gupta & Govindarajan, 1991).

More recently, various alternative models of the MNE have emerged. Some assume that an MNE is not structurally a hierarchy, where all decisions must ultimately be made at

the centre (Hedlund, 1986), but a heterarchy or network, where multiple decision-making centres can exist. In any case, all of these studies, the role of the subsidiary is based on its ability to maintain and develop its local businesses through MNE headquarters. There is also a version of agency theory which conceptualizes each MNE subsidiary as a kind of agent of the headquarters (Chang & Taylor, 1999).

In contrast to the generally accepted definitions, this research conceives each MNE subsidiary as a whole enterprise, since each usually has its own special way of obtaining key resources. The formal structure of an MNE is often less important than the management system or culture (Prahalad & Doz, 1981; Hedlund, 1986). Ghoshal (1986) studied the role of the MNE subsidiary in innovation and its spread across the organization, recognizing that MNE subsidiaries are usually designated by headquarters with various different roles according to their unique resources and capabilities, but that some can have considerable autonomy to develop their own roles (Bartlett & Ghoshal, 1986).

An MNE will normally consist of a group of geographically dispersed subsidiaries, each of which can be designated with different objectives and purposes. MNEs operating in the fiercely competitive environment of the global market are faced with the dual imperatives of global integration and local responsiveness, which have become more important than ever before for the success of MNE operations (Bartlett & Ghoshal, 1989; Doz & Prahalad, 1991; Roth & Morrison, 1991). GI means that different units need to coordinate across countries to strengthen efficiencies and optimize the advantage of similarities. On the other hand, LR involves efforts to address the specific needs of different host countries. Every foreign subsidiary must be flexible and adapt

to the local culture, business environment, market and rules of the host country. However, such flexibility must be coordinated within the MNE's structure so that other operational practices will support the maximization of overall performance (Jarillo & Martinez, 1990; Prahalad & Doz, 1987).

GI and LR can be seen as standing at the two ends of a continuum, but their determinants are not necessarily the same (Doz & Prahalad, 1991); while the extent of GI is basically determined by the strength of need for it at MNE headquarters, LR is typically more strongly influenced by the contingencies of the various subsidiaries (Ghoshal & Nohria, 1989). To balance global integration and local responsiveness, headquarters managers must be sensitive to local managers' concerns, since they are in a better position to screen and evaluate market opportunities and threats (Birkinshaw, 1997).

The above GI-LR paradigm has been shown by a sizeable body of research to be a persuasive tool to explain and analyse MNE strategies at both headquarters and subsidiary level (Doz & Prahalad, 1991; Prahalad & Doz, 1987). Empirical research has demonstrated that GI and LR are two opposing dimensions explaining types of MNE strategy or the strategic roles of MNE subsidiaries; it is therefore important to identify their underlying determinants (Bartlett & Ghoshal, 1989). Kobrin (1991) found that technological and advertising intensity and transnationality were important drivers of GI, while market demand, competitive behaviour and national advantage also influenced the degree of global integration. Johnson (1995) lists some factors determining local responsiveness. Their assessment can impact a MNE's decisions on

strategic marketing, resource allocation and the autonomy of subsidiaries (Gupta & Govindarajan, 1991).

MNE subsidiaries have varied roles and activities, depending on whether they are required to focus on and develop competence in R&D, production, sales and marketing, administration or whatever (Rugman et al., 2011). The major determinants of such activities are likely to be the strategic approach of the MNE and its focus. Luo (2001) discusses which factors will most significantly influence MNEs' strategies concerning their internationalization and the strategic roles of their subsidiaries, according to the GI-LR model. An MNE which adopts an LR strategy will be influenced by situational contingencies at the subsidiary level, while the adoption of a GI strategy will require greater coordination between each subsidiary and the headquarters (Ghoshal & Nohria, 1989). Adopting a GI strategy shows that the MNE intends to exploit the strategic advantages of foreign subsidiaries to control costs and achieve overall efficiency (Chen & Cannice, 2006). GI, or coordination and unification, supports the acquisition of a potential source of firm-specific advantage for the MNE's worldwide activities and creates efficiencies throughout the organization. Global integration delivers the benefits of optimal economic scale (Fayerweather, 1982). If instead the MNE is more interested in the benefits of seizing local market opportunities, it must improve its local response strategy (Luo, 2003).

2.3.2 MNEs' foreign expansion

As noted above, an MNE's original resource endowments are drivers of global expansion (Tan & Meyer, 2010). The internationalization of MNEs is usefully

elucidated by product lifecycle theory, whereby Vernon (1966) found that enterprises located in developed countries, specifically in the US, developed advanced skills which were the source of firm-specific advantage, while their home market operations generated country-specific advantages. In early stages of the product lifecycle, these advantages are mainly evident in the home market, then once the product life cycle becomes more mature, international efforts can produce benefits. Johanson & Vahlne (1977; 1990) developed a model of the internationalization of an MNE's businesses activities. They found that for all businesses, this was a long, stepwise, international process. Their work was the first to treat corporate internationalization as a process.

Johanson et al. (1988) explain this process from another angle, exploring the international network phenomenon from the perspectives of stakeholders, suppliers, competitors and regulators. They describe an MNE's internationalization as a process of altering and adjusting its network position abroad. Among the different strategies available to an MNE are developing new networks abroad, connecting current networks in different places and penetrating current networks to achieve advantages. From this point of view, the theory of networks can be used to examine the operations and environment of businesses in the process of internationalization. Macharzina and Engelhard (1991) found that enterprises which internationalized their business had the characteristics of incremental development and fundamental change, which were interchangeable over time.

The resourced-based view leads to the belief that principles based on capabilities and resources are the most important factors in determining the competitive advantage of an enterprise (Barney, 1991). From this perspective, Teece, Pisano & Shuen (1997)

developed the concept of the competitive positioning of a company, which depends on its dynamic capabilities. In this context, ‘dynamic’ refers to continuous change in the environment of a company and ‘capabilities’ to meeting the challenges of strategic management in the process adapting, integrating and adjusting the internal environment of the MNE. In order to strengthen its competitive position in the market, it will need not only to develop unique capabilities and resources, but also to constantly adapt its capabilities to environmental changes. The resource-based view considers the process of enterprise internationalization to be determined by its resources, more specifically by its capacity and competence for resource building and for leveraging the developed resources abroad (Luo & Tung, 2007).

2.4 The importance of MNE subsidiary studies

Birkinshaw & Hood (1998) advanced the field of MNE subsidiary research by proposing three complementary streams of research: head office assignment, which emphasizes control by headquarters, local environment, which analyses the implications of local environmental factors, and subsidiary choice, which seeks to identify the roles of MNE subsidiaries.

As an MNE expands globally, it must operate with increased constraints and overcome more challenges (Buckley & Ghauri, 2004; Buckley, 2009; Mudambi, 2008). Modern MNE subsidiaries must deal with the challenges of embeddedness in differentiated networks, internally within the MNE and externally with suppliers, customers and other related institutions (Nohria & Ghoshal, 1994). Each subsidiary usually has a predefined business scope, combined with the MNE’s global strategy for its products and services,

which limits the available options (Birkinshaw & Hood, 1998). It will also need to face headquarters' resource constraints in positioning laterally with other subsidiaries (Birkinshaw & Morrison, 1995).

Bartlett & Ghoshal (1989) earlier suggested the 'transnational solution' as a preferred design for MNEs, proposing that an MNE's structure should fit its strategy. As the strategy itself was usually developed at headquarters level, little consideration would be given to the role of subsidiaries in the process. Other researchers, however, have turned their attention to MNE subsidiaries and their potential independent contribution, rather than being concerned only with headquarters control. With the realization that MNE subsidiaries can acquire autonomy and build up influences (Paterson & Brock, 2002) comes the notion that subsidiaries could potentially engage in strategy development at a local level.

2.4.1 General subsidiary roles

Early research into MNE subsidiaries focused mainly on strategy and organizational structure (Stopford & Wells, 1972; Daniels et al., 1984). When Otterbeck (1981) raised the topic of the relationship between the transnational parent and its subsidiary companies, the study of multinational subsidiaries began to be seen as a distinct field of research.

As MNEs' activities have matured, so their subsidiaries have developed in size and capabilities, attracting increasing attention to their roles. Bartlett and Ghoshal (1986) point out that MNE subsidiaries do not always merely fulfil headquarters' instructions

passively, but in some cases play an active role. When the subsidiary itself becomes the target of research and the focus of the analysis, then MNE headquarters is regarded as an external factor. This perspective offers researchers different models to examine the range of strategic roles that subsidiaries can have (Paterson & Brock, 2002).

The subsidiary's role is thus not restricted to the implementation of headquarters' strategy or even its adaptation; indeed, its contribution may go beyond taking the initiative to participate in activities, to include taking strategic responsibility, such as by providing strategic leadership. Any such contribution will need to meet certain criteria, including financial profitability and alignment with headquarters' strategic intentions. Birkinshaw & Morrison (1995) propose a threefold typology of subsidiary roles: local implementer, specialized contributor and world mandate. As global competitiveness intensifies, MNEs must meet the challenge of introducing their new products to all major markets efficiently and in a way that will meet the distinctive needs of these markets. Pearce & Papanastassiou (1997) argue that MNE subsidiaries need to enhance the role and use of local resources in developing the technical capability to support the overall growth of knowledge within the MNE. In most cases, the original functional and geographical scope of a foreign subsidiary is decided by MNE headquarters. However, changes to these parameters over time may be driven by initiatives not only from headquarters but also on the part of local subsidiary management (Birkinshaw & Hood, 1998). Considering its position within the MNE network and the business context in which it operates, the subsidiary can develop as a centre of excellence based on the characteristics of its internal resources (Andersson & Forsgren, 2000).

Dörrenbächer & Gammelgaard (2010) consider the development of subsidiaries' roles in terms of changes in their product, market and value-added scope, attributing changes in these roles to three interrelated factors: the capabilities of the subsidiary, the local advantages of the host country and the strategies of MNE headquarters. They argue that MNE strategy is a decisive factor in role development in peripheral host countries. The headquarters-subsidiary relationship and the bargaining process will also influence the development of a specific subsidiary's role (Dörrenbächer & Gammelgaard, 2010). It has been realized that subsidiary managers need to deal with the complex organizational identification of roles involving the interests of both the MNE and the subsidiary in question (Vora & Kostova (2007).

Rugman, Verbeke & Nguyen (2011) assert that MNE subsidiary roles can range across the whole spectrum of value chain activities. Their analysis indicates that the roles assigned to a subsidiary may range from R&D to sales, via production-related matters such as purchase and storage, marketing, services and other administrative support activities. Birkinshaw & Pedersen (2009) have also greatly advanced the study and understanding of MNEs' foreign subsidiaries, which they characterize as developing and having the capacity to create "value-adding activities outside the home market". Indeed, the contribution of the subsidiary to increasing the firm's value can cover the whole value chain (Kutschker & Schmid, 2011).

2.4.2 Determinants of subsidiaries' roles

As an MNE expands more and more globally, it needs to increase constraints and overcome more difficulties (Buckley, 2009; Mudambi, 2008). On the subject of internal

networks, Gupta & Govindarajan (1991; 2000) observed the patterns of information flow between MNE subsidiaries and headquarters, leading to the recognition that developing internal embeddedness within the MNE structure can be the most important task for subsidiary managers. Garcia-Pont et al. (2009) have identified three hierarchical levels of internal embeddedness that subsidiaries may develop within the MNE, which are the operational level, the capability level and the strategic level.

Externally, MNE subsidiaries always seek to strengthen their linkages with the local environment, from which they can acquire knowledge to contribute to the growth of their business (Frost et al., 2002). Cantwell & Mudambi (2005) have researched the extent to which MNE subsidiaries are embedded in their local contexts and how this impacts the internal network structures and performance of the MNE. All the of the above research provides evidence that the capacities of subsidiaries can play a role in the strategic management of MNEs.

MNE headquarters and subsidiaries often have different perceptions and opinions about the role of the subsidiary within the enterprise. Such differences have important implications for the relationship between the managements of the headquarters and its subsidiaries. Birkinshaw et al. (2000) found that subsidiary managers tended to overestimate their role and influence, thus stimulating greater headquarters control, which in turn reduced the level of headquarters-subsidiary cooperation within the MNE.

Andersson, Forsgren & Holm (2001) investigated the embeddedness of MNE subsidiary businesses in the local environment and networks, then discussed their role at headquarters level. The researchers suggest that embeddedness in a network of

business actors will benefit the subsidiary's performance, which may explain why certain subsidiaries achieve better performance than others. Their results indicate that a subsidiary's external embeddedness can support its market performance and the development of competence.

Meyer et al. (2011) suggest that because a subsidiary is simultaneously embedded in both the MNE structure and the host environment, its strategic role should be defined by its relative positions in and contributions to the MNE and host country networks. Wang & Suh (2009) link MNEs' internationalization strategies with different subsidiary roles and performance. They argue that the proper alignment of headquarters' strategies with subsidiary roles will contribute to the success of overseas subsidiaries.

2.4.3 Subsidiary initiative

MNE subsidiaries do not usually just passively follow instructions from headquarters, but are also encouraged to be proactive in developing their businesses, thus increasing their value to the MNE as a whole (Birkinshaw, 1997; Birkinshaw & Hood, 1998a). Thus, subsidiaries commonly pursue entrepreneurial opportunities for local and global application, often independent of the parent organization (Birkinshaw, 1997; Ghoshal & Bartlett, 1988).

Subsidiary initiatives can be defined as autonomous, proactive and risk-taking activities originally proposed by an MNE subsidiary and initiated by actors in the subsidiary. Subsidiary initiatives have two common forms: internally and externally focused (Birkinshaw & Riddlerstrale, 1999). Internally focused subsidiary initiatives are based

on opportunities identified within the MNE and are normally raised through a bottom-up process, whereas externally focused subsidiary initiatives arise from opportunities outside the MNE and in the external marketplace. Birkinshaw (1997) explores this topic and classifies subsidiary initiatives into four types, which are local, global, internal and global-internal hybrid. He concludes that subsidiary initiatives can be seen as a kind of internal entrepreneurship, with the potential to enhance the local responsiveness, worldwide learning and global integration of the subsidiary. On the other hand, the model for creating differentiated subsidiary roles in an MNE has limitations and each type of initiative can be facilitated in different ways (Birkinshaw, 1997).

Birkinshaw, Hood & Jonsson (1998) investigated how MNE subsidiaries can contribute to the development of firm-specific advantages for the whole MNE. Their study reveals that the combination of internal subsidiary resources and initiative taking will support this contributory role. Initiative taking by a subsidiary is strongly related to its leadership and entrepreneurial culture, while its contributory role is strongly connected with its autonomy and inversely related to the level of local competition (Birkinshaw et al., 1998).

Bouquet & Birkinshaw (2008) discuss how MNEs' foreign subsidiaries should attract the attention of headquarters and conclude that the degree of attention is partially determined by the structural position of the subsidiary in the overall system, which represents the 'weight' of the subsidiary. Another factor is the 'voice' with which the subsidiary is able to attract attention. There also appear to be factors which mediate between a subsidiary's voice and headquarters attention, such as the subsidiary's geographic distance and downstream competence (Bouquet & Birkinshaw, 2008).

In addition, the subsidiary's past initiatives can influence its bargaining power with headquarters. MNE subsidiaries are not normally able to increase their influence through initiative taking, unless they gain the attention of headquarters. However, a subsidiary's initiatives will have a direct effect on its autonomy. In some cases, these initiatives will provoke more monitoring by headquarters, thereby reducing the subsidiary's autonomy (Ambos et al., 2010).

2.4.4 Subsidiary autonomy

Researchers have consistently noted that MNE subsidiaries potentially have independent considerations, rather than being concerned only with enterprise-wide and headquarters interests. It has been realized that MNE subsidiaries can attain a certain level of autonomy and that this will influence their decision making to some extent (Paterson & Brock, 2002). From this recognition has emerged the notion that subsidiaries could potentially engage in strategy development at local level.

The results of an investigation of the relationship between subsidiary size and autonomy within the MNE indicate that increasing subsidiary size is accompanied by a demand for more inputs of resources and of managerial experience and expertise, thus increasing the extent of interaction and interdependence between the subsidiary and other units of the MNE (Johnston & Menguc, 2007). Williams & van Triest (2009) developed and tested a model of the allocation of decision making to subsidiaries, exploring the issue from the perspective of the MNE's internal corporate culture and that of external national cultures. They found that innovation culture will lead to the decentralization of decision making and the acceptance of greater subsidiary autonomy.

Research into the relationship of subsidiary autonomy with MNEs' internal networks (such as for R&D) and with external networks (such as for supply and distribution) found that reduced autonomy will be accepted by a subsidiary which has a stronger internal network with greater range, whereas it is likely that more autonomy can be granted to a subsidiary with greater external network range and strength (Chiao & Ying, 2013).

Another recent study concludes that a subsidiary's perceptions of autonomy do not influence its performance and that subsidiary autonomy will be granted more extensively when technology is changing rapidly and unpredictably (Kawai & Strange, 2014). The researchers suggest that the effectiveness of autonomy in promoting the performance of overseas subsidiaries is enhanced by high levels of expatriate involvement.

It has been realized that many factors can influence the effectiveness of headquarters' control and coordination of subsidiaries. Once the enterprise grows beyond a certain size, knowledge flows are impeded and there are cognitive and resource constraints on the MNE's decision making (Pavitt, 1998). It is also a challenge for headquarters managers to shepherd subsidiaries toward 'dual embeddedness', whereby they are embedded both in the MNE's internal network and culture in the external host environment (Narula & Dunning, 2010).

2.4.5 Stages of subsidiary evolution

Sargeant (1990) was one of the first scholars to study MNE subsidiary development by dividing the process into three evolutionary phases: childhood, adolescence and adulthood. Although it appears simple and lacks empirical proof, this three-stage model makes the process easy to understand. In its childhood, the subsidiary is strongly dependent on headquarters' guidance and its business activities are limited to sales, service or production responsibilities. Adolescence comes with the growth of the subsidiary in terms of sales, asset volume and headcount level, allowing it to perform more increasingly complex administrative tasks. With further growth, the subsidiary reaches the final evolutionary stage, its adulthood.

Malnight (1995) later developed a more elaborate model, dividing the evolutionary path of an MNE subsidiary into the four stages of appendage, participation, contribution and integration. At the appendage stage, the subsidiary can only exploit those resources and capabilities for which permission is granted by headquarters in a particular host market. At the participation phase, subsidiaries are permitted to carry out more extensive tasks and begin to exercise their competence to serve individual local needs. When it reaches the contribution stage, each subsidiary can generally benefit from an upgrade of its particular local resources and global challenges. Finally, at the integration stage, the subsidiary seeks to combine various activities through an integrated support network to enhance the MNE's global competitiveness.

The evolution of a subsidiary may be marked by an increase or decrease in its capabilities and associated with changes in its charter. Building on this characterization,

Birkinshaw & Hood (1998) analyse the relationship between capability and charter change, which they identify with five generic subsidiary evolution processes. Based on evolutionary economics, Phene & Almeida (2003) investigated the evolution of subsidiaries' innovative capabilities, then explored changes across time in patterns of knowledge sourcing and sharing with other parts of the MNE. Their research suggests that as they mature, MNE subsidiaries are more deeply embedded in host-country knowledge networks, through which they increasingly learn and share knowledge locally.

Cantwell, Dunning & Lundan (2010) examined the tendencies of MNEs' activities and of both their external and internal institutions. They argue that the main motivations of institutional entrepreneurship can be attributed to the increasing autonomy of MNE subsidiaries. Agency problems arise from decentralized forms of structures and MNEs' international networks, while the development of competence and creativity can be facilitated by synergy with local institutions (Cantwell, Dunning & Lundan, 2010).

Another view of the stages through which the developing MNE subsidiary usually passes is that this evolution is initiated by a preliminary investment, leading to higher quality investment over time (Kogut, 1983; Chang, 1996). Other researchers have found that MNE subsidiaries do not rely passively on headquarters for the incremental allocation of resources, but often try to drive their own evolution proactively by taking initiatives internally or by responding to external forces (Young & Tavares, 2004).

A staged model can also be used to explain the MNE internationalization process (Johanson & Vahlne, 1977). MNEs usually develop their overseas businesses step by

step, starting, for example, with selling via an agent, then establishing subsidiaries to exercise the sales function, followed by direct investment and more extensive functional activities. Thus, MNE internationalization is described as a process of making use of home-based FSAs and gradually developing new capabilities abroad as the enterprise grows (Zaheer, 1995).

2.4.6 Knowledge transfer, innovation and learning

MNE operations can also be viewed from a knowledge transfer perspective. MNEs can be seen as social communities that support the creation of a system to transfer knowledge. An MNE grows not only because of its ability to transfer knowledge, but also because of the greater efficiency of its cross-border expertise transfer capacity. Replication at multiple sites is the key to its success, as the MNE uses knowledge transfer to obtain competitive advantage. Within the MNE, the traditional role of headquarters as prime source of knowledge and competencies has changed. Increasingly, headquarters acts as a receiver of knowledge from its international subsidiaries located in various host countries (Ambos, Ambos & Schlegelmilch, 2006).

Recent studies have focused increasingly on the determinants and consequences of knowledge transfer between headquarters and subsidiaries. Gupta & Govindarajan (2000) tested a theoretical framework of intra-organizational knowledge transfers and found that knowledge flows from a subsidiary were positively associated with its value, while knowledge flows into a subsidiary would support the development of its capacity to absorb new knowledge.

Wang, Tong & Koh (2004) developed a two-stage model to explain knowledge transfer from an MNE's headquarters to its Chinese subsidiaries. The first stage concerns the factors affecting the extent of knowledge developed by the headquarters for transfer to the subsidiary, while the second addresses the factors determining the extent of knowledge received by the subsidiary from the host country market.

Having explored the impact of organizational mechanisms on knowledge flows within the various units of an MNE, Björkman, Barner-Rasmussen & Li (2004) contend that MNEs can influence knowledge transfer by planning with the objectives of their subsidiaries in mind and by exploiting corporate socialization mechanisms. Ciabuschi, Forsgren & Martín (2011) investigated MNE headquarters' value-adding role in knowledge transfer and found that headquarters can have either a positive or a negative influence on the efficiency and effectiveness of the process.

Gnyawali & Singal (2009) argue that the ties among subsidiaries are an important factor influencing the MNE's networks and the flow of knowledge through them. They propose a multilevel model consisting of subsidiary characteristics, dyadic dynamics and salient contextual factors to explain collaboration among subsidiaries for the development and exchange of knowledge. Their study advances the understanding of subsidiary knowledge network capability, meaning the MNE's capacity to form, manage and leverage a network for the acquisition and sharing of knowledge. Such a capability is critical in achieving competitive advantage for MNE subsidiaries and by extension the MNE as a whole (Gnyawali et al., 2009).

Grounded in knowledge-based theories of the MNE and building on organizational learning literature, Colakoglu, Yamao & Lepak (2014) developed and tested a model of knowledge creation capability as a joint function of knowledge inflows to subsidiaries and their knowledge stocks (i.e. their internal human, social and organizational capital). They found that knowledge inflows to a subsidiary are more effective in enhancing its knowledge creation capability than global knowledge inflows from other units of the MNE (Colakoglu et al., 2014).

As to the transfer of capabilities, having studied the pattern of capability transfers from headquarters to the subsidiary, Chen, Chen & Ku (2012) state that a triangular power play between the headquarters, the subsidiary and local networks will determine the extent to which firm-specific capabilities transfer abroad. They conclude that capabilities will never transfer completely.

In response to the increasing need to balance the pressures of global integration with local responsiveness, MNEs' foreign subsidiaries must play a prominent role in the creation of knowledge that is valuable to the MNE as a whole. Reverse knowledge transfer is a key managerial problem related to the balance between coordination mechanisms and knowledge flows from the subsidiary to the parent company. Several studies have investigated the reverse transfer of practices in MNEs.

Subsidiaries are simultaneously embedded in two knowledge contexts: the internal environment of the MNE, comprising headquarters and other subsidiaries, and the external environment of regional or host country firms. Therefore, Almeida and Phene (2004) studied the influence of external knowledge on innovation in MNE subsidiaries

and identified three factors having a positive impact on innovation: (a) the technological richness of the MNE, (b) the subsidiary's knowledge linkages to host country firms and (c) technological diversity within the host country (Phene & Almeida, 2003).

Consideration of the resource development component, one of the most important strategic elements for an MNE subsidiary, suggests that the above conclusions may not be accurate. As the company's market position changes and as a subsidiary has more global customers, it will need a higher degree of freedom of management (Mudambi, 2008). Modern information technology also gives headquarters easy access to the subsidiaries (Sinkovics et al., 2011; Yamin & Sinkovics, 2007). On the subject of resource development, Birkinshaw & Pedersen (2009) argue that an MNE's tangible resources tend to be concentrated at subsidiary level, whereas control of most of intangible resources is exercised by the headquarters.

2.5 Subsidiary strategies

Structurally, an MNE consists of headquarters in the home country and subsidiaries in multiple host countries. Early MNE strategic management studies took a mainly hierarchical and centre-dominated perspective, with strategic management and structure emanating from headquarters and being implemented by each subsidiary, seen as a tool with its particular designated role (Jarillo & Martinez, 1990; Bartlett & Ghoshal, 1986). However, in real business, MNE subsidiaries do not merely follow instructions from headquarters passively, but are also encouraged to take initiatives and to work proactively to add value to the MNE's overall business (Crookell & Morrisson, 1990; Birkinshaw & Hood, 1997; 1998).

The concept of subsidiary strategy explored here refers to the strategic stance of an MNE subsidiary. Although headquarters typically places constraints on the actions of subsidiary management and despite the limitations of the local market, each subsidiary will still try to make use of the resources available to it so that it can make decisions in its own interest, rather than simply serving headquarters' interests. Given the definition above, a distinction can be made between the concepts of an MNE subsidiary's strategy and its role. The latter is typically assigned or designated by MNE headquarters, whereas the notion of subsidiary strategy means that subsidiaries always have some degree of choice or freedom to make decisions (Birkinshaw & Pedersen, 2009).

2.5.1 Network and relation-based strategies

It has been realized that MNE subsidiaries can be granted a certain level of autonomy and can also determine what kind of autonomy they can acquire (Paterson & Brock, 2002). The notion that subsidiaries could potentially engage in strategy development at a local level has also emerged. Considering the MNE as a whole to be the only valid unit of study and analysis would ignore the fact that subsidiaries often have unique access to key local resources, operating with far greater freedom than would be apparent from their officially designated role. Furthermore, a formal structure is often less influential than management systems or culture as a way of controlling a business unit (Doz, 1976; Prahalad & Doz, 1981).

In order to account for the emergence of subsidiary strategy, Garcia-Pont, Canales & Noboa (2009) developed the concept of internal subsidiary embeddedness as a key element of the nurturing environment. Their research identifies three hierarchical levels

of embeddedness, beginning with operational embeddedness, which relates to interlocking day-to-day relations. The second level is capability embeddedness, which concerns the development of competitive capabilities for the multinational as a whole. Finally, strategic embeddedness refers to the subsidiary's participation in setting the MNE's strategy. Garcia-Pont et al. (2009) present embeddedness not merely as an outcome of the institutional setting in which a subsidiary is situated, but as a resource that it can manage by manipulating dependencies or exerting influence over the allocation of critical resources. A subsidiary can thus modify its embeddedness to change its strategic restraints. In this way, the development of subsidiary embeddedness becomes an integral part of subsidiary strategy.

From the perspective of the development of the MNE's capabilities and competencies, its foreign subsidiaries are often regarded as platforms whose objectives are to absorb new resources and capabilities from their respective local external environments and then to integrate these capabilities into the MNE. The development of key capabilities within these subsidiaries is driven not only by internal corporate players, but also by external players. MNE subsidiaries can benefit from various internal and external network players in very different ways and thus develop their competence (Schmid & Schurig, 2003).

Manev (2003) studied the influence of the management network of an MNE over the resource profiles of its subsidiaries, arguing that the network exerts its effect through two distinct mechanisms: isomorphism of resource allocation practices and horizontal specialization. When managers interact in a network, their decisions on resource

allocation within the MNE may influence the configuration of resources across its subsidiaries as well (Manev, 2003).

Several other studies have explored the importance of relational embeddedness in external networks as a strategic resource for performance and competence development in MNEs. Andersson, Forsgren & Holm (2002a) identify two types of relational embeddedness at the subsidiary level, termed business embeddedness and technical embeddedness, both of which will influence the subsidiary's market performance as well as its importance in competence development across the MNE (Andersson et al., 2002a).

Structurally, an MNE can be perceived as a kind of network whose nodes are the headquarters, located in the home country, and various subsidiaries which are scattered among various other countries and are hierarchically organized to support the MNE's overall strategic objectives and agenda (Vahlne, Schweizer & Johanson, 2012). According to this concept, the MNE as a whole is embedded in its external network and must manage its interactions with this environment. MNEs are thus typically subject to 'multiple embeddedness' across heterogeneous contexts at both headquarters and subsidiary levels. The headquarters will need to manage the whole company effectively, taking account of differences and similarities among multiple host locations. At the subsidiary level, the enterprise must meet the challenge of managing its external embeddedness in the various host environments. As a whole, the MNE has to balance each subsidiary's strategic role within the firm's internal structure with its local identity and local linkages. The MNE's ability to manage multiple embeddedness can thus

create both business opportunities and operational challenges to performance (Meyer, Mudambi & Narula, 2011).

In the study of MNE subsidiaries embedded in the local environment, it is also noted that there is the phenomenon of headquarters' linkages to the local context, creating dual embeddedness. Nell, Ambos & Schlegelmilch (2011) propose a model to explain why MNEs develop overlapping linkages with local subsidiary networks. They found that MNEs build and maintain more overlapping networks because their subsidiaries, in contrast to purely domestic firms, are quite important for strong performance, hold important resources, operate in turbulent environments and are closely connected to multinational actors.

Because each subsidiary is part of an MNE network and simultaneously embedded in its host country environment, the study of the dual embeddedness of MNE subsidiaries is important. Schleimer & Pedersen (2013) explain that a subsidiary's absorptive capacity is formed as a purposeful response to this dual embeddedness and that MNEs can assist their subsidiaries to compete in competitive and dynamic local markets by forming specific organizational mechanisms which are conducive to the development of subsidiaries' absorptive capacity.

In emerging markets, volatile environments represent a key source of instability and risk for MNE subsidiaries. Such environments and institutions can restrict the performance of significant or key transactions, constrain the acquisition of local resources and limit business opportunities (Luo & Peng, 1999). Drawing on the factors of dynamic capability, market strategy, institutions and social networks in a discussion

of MNE subsidiary strategies, White et al. (2014) explain how MNEs operating in volatile emerging market environments can deploy relation-based strategies with key nonmarket and market actors to obtain competitive advantage (White et al., 2014).

2.5.2 Institutional influences and local responsiveness

MNE subsidiaries must have local responsiveness to interact with the external environment of the host country, enhancing the MNE's economic efficiency by taking advantage of the host country location, factor endowments and demands (Dunning, 1981; Porter, 1990). When product differentiation and customer response are exploited to gain a local competitive advantage, the local response becomes part of the MNE's organizational competitiveness, fostering business success (Porter, 1990).

Maintaining local responsiveness helps to optimize subsidiary initiatives and supports the seeking of new business opportunities in a manner consistent with the MNE's strategic objectives (Birkinshaw, 1996). It encourages subsidiary managers to establish sustained and solid relationships with local stakeholders and partners, such as customers, suppliers, distributors, competitors and governmental bodies, which in turn can create more competitive opportunities for the MNE as a whole (Ghoshal & Nohria, 1989).

In determining which strategy is most relevant for MNE subsidiaries, Luo (2001a) discusses theories concerned with the degree of global integration and local responsiveness. Within the GI-LR paradigm, GI and LR represent the extreme opposite types of MNE strategies vis-à-vis overseas investment and the strategic roles of

subsidiaries. LR is mainly influenced by situational contingencies at the subsidiary level, whereas GI is basically determined by the need for internationalization and coordination from the perspective of corporate headquarters (Ghoshal & Nohria, 1989). GI takes advantage of the MNE's FSAs, helping to save costs and achieve global efficiencies (Chen & Cannice, 2006). GI or unification is a potential source of competitive advantage for the MNE's worldwide activities and creates efficiencies among different subsidiaries. The integration of activities worldwide is necessary to obtain the benefits of optimal economic scale on a broader basis (Fayerweather, 1982), while to achieve the benefits of national market opportunities, heightened local responsiveness is needed (Luo, 2003).

The factors that affect LR can be summarized as operating at three levels: environmental, structural and organizational. Environmental complexity and the uniqueness of business culture heighten local responsiveness, which is also elevated by structural factors such as competitive status, demand characteristics and component localization. A subsidiary's local market orientation and the establishment of strong networks with the business community and governmental agencies also support LR. Finally, there is a stronger relationship of environmental and industrial factors with responsiveness for firms seeking local market expansion than for those pursuing export growth (Luo, 2001a). On the topic of relationships with host country governments, Luo (2001b) argues that resource commitment, personal relations, political accommodation and organizational credibility are four building blocks for improving an MNE's cooperative political relationships. He underscores the importance of these blocks in shaping MNE-government relations and the importance of these relations in supporting the improved performance of MNE subsidiaries.

From the perspective of foreign subsidiaries in a dynamic environment, Luo (2002) explores the relationship between organizational dynamics and an MNE's overall global integration. While previous empirical studies have found that overall global integration is determined by environmental and industrial pressures, Luo proposes that it is also affected by strategic capabilities, organizational infrastructure and the strategic needs of foreign operations.

Hillman & Wan (2005) propose a model to explain the development of political strategies used by MNEs' foreign subsidiaries. They adopt institutional theory and recognize that subsidiaries are subject to the pressures of internal legitimacy within the MNE structure and of external legitimacy in the host country, so that their model takes into account the influence of subsidiary, host-country and parent-related factors in determining political strategy.

On the ownership structure of MNE subsidiaries, Chan & Makino (2007) suggest that where there is strong pressure to conform to host country and local institutional environments, MNEs tend to take a lower ownership stake in exchange for external legitimacy in the host country. It is clear that the institutional environment can strongly influence the operation and strategies of subsidiaries when MNEs invest in foreign countries; they often develop their political strategies to deal with host country environments and this helps to confer competitive advantage on the MNE itself and on its subsidiaries, especially those in high-risk locations (Feinberg & Gupta, 2009).

2.6 Subsidiary performance

2.6.1 Factors influencing MNE performance

Prior studies have used a number of measures of subsidiary performance, including financial performance (Anand & Delios, 1997; Luo & Park, 2001; Birkinshaw, Hood & Young, 2005; Fang, Wade, Delios & Beamish, 2013), subsidiary growth (Riaz, Glenn Rowe & Beamish, 2014), subsidiary mortality/survival (Bradley, Aldrich, Shepherd & Wiklund, 2011; Dhanaraj & Beamish, 2009; Gaur & Lu, 2007). There have also been found to be various interrelated factors which can exert a significant influence on the performance of MNE subsidiaries.

Park & Luo (2001) explored the environment-strategy-performance relation in MNE investment, again stressing the importance of understanding the local market for an MNE to develop proper strategies for its market-seeking subsidiaries, especially in an emerging economy like China.

Birkinshaw, Hood & Young (2005) conceptualize the MNE subsidiary as a semi-autonomous entity with entrepreneurial potential, within a complex competitive environment comprising an internal structure of other subsidiaries, internal customers and suppliers, and an external structure of customers, suppliers and competitors. The strength of these competitive environmental elements shapes the subsidiary's options and it is then up to the subsidiary's managers to take the initiative and work on threats and opportunities in order to secure improved performance (Birkinshaw et al., 2005).

Successful international expansion requires MNE headquarters to distribute knowledge resources simultaneously within the organization, then for each subsidiary to absorb and utilize this knowledge effectively at the local level. Fang et al. (2013) examined the correlations of multiple knowledge resources (technological and marketing knowledge) with the relationship between headquarters and subsidiaries, and subsidiary performance. They found that subsidiary performance improved with the integration of an MNE's technological and marketing knowledge resources.

The proper transfer of technology from the parent to a local subsidiary is the basis for the success of local market operations. A significant positive relationship has been found between technology transfer and subsidiary performance (Cui, Meyer & Hu, 2014). Tran, Mahnke & Ambos (2010) developed a model to explain how the quality, quantity and timing of knowledge flows from headquarters will influence subsidiary performance. They found a positive quality and performance relationship and a curvilinear quantity and performance relationship, indicating that too much knowledge sharing can be detrimental to the receiving subsidiary. Additionally, they showed that the timing of a knowledge flow significantly affects subsidiary sales performance.

MNE strategies, which can also substantially influence subsidiary performance, are influenced by the institutional characteristics of the host country and the corporate-level strategy of the MNE in its individual host-country markets (Hillman & Wan, 2005).

Based on the strategy-environment alignment framework, Hada et al. (2013) assess the influence of MNE global strategies (global efficiency, multinational flexibility and worldwide learning) on subsidiaries' channel commitment and discuss the moderating

influence of the host-country environment. By conceptualizing a subsidiary's channel partners as extensions of the MNE's internal network, they argue that foreign subsidiaries can take advantage of such external partners to support the MNE's global objectives. On the other hand, the subsidiary's adaptation and execution of the MNE's global strategies will also influence the subsidiary's channel relationships and performance (Hada et al., 2013).

Research has shown that business relatedness, which in this context is defined as the extent to which a foreign subsidiary's activities are related to its parent's core business, is positively correlated with subsidiary performance (Tang & Rowe, 2012). Earlier research into the relationship between human resource management (HRM) and performance found that investment in HRM can substantially help to improve performance (Fey & Bjorkman, 2001).

Subsidiary control mechanisms have critical implications for subsidiary performance. For instance, Luo (2003) examined the effects on subsidiary performance of control flexibility, which he defines as the extent of a parent firm's organizational control over subsidiary activities. He reports that control flexibility exerts a strong and substantial influence on subsidiary performance.

Ambos & Birkinshaw (2010) investigated the combined effect of autonomy and headquarters' attention on subsidiary performance, finding that subsidiaries which both exercised a high level of strategic choice and received more attention from headquarters performed better than their peers. When Hewett et al. (2003) examined the effects on foreign subsidiaries' performance of the extent to which they were responsible for the

development and implementation of marketing activities, they found that the roles of headquarters and subsidiary in marketing activities were aligned with relational, industry and market conditions. The closer the relationship, the greater the market share tends to be.

Luo (2003) suggests that stronger headquarters-subsidiary structures and connections will effectively offset threats in emerging markets by reducing external dependence and that enhancing their local responsiveness can help subsidiaries to grasp emerging market opportunities. He concludes that flexibility of control and commitment of resource investment by MNE headquarters, combined with local responsiveness, will exert a strong and positive influence on subsidiary performance.

Andersson, Forsgren & Pedersen (2001b) link subsidiary environment to subsidiary performance. Their research into organizational learning, knowledge absorptive capacity and embeddedness in business networks indicates that local subsidiary embeddedness has a positive and direct influence on the market performance of MNE subsidiaries and a positive but indirect effect on their organizational performance.

Li, Liu & Thomas (2013) investigated the impact of market orientation, embeddedness and autonomy on the performance of MNE subsidiaries hosted in emerging economies, finding that external embeddedness has a positive impact on the specialized resources of MNE subsidiaries and that such resources will positively influence their performance. In contrast, internal embeddedness was found to have a negative impact on subsidiaries' specialized resources, thus weakening their performance.

2.6.2 Subsidiary growth

The growth rate of a subsidiary is also an important criterion of its performance. The question of what kind of factors will support or damage the growth of an MNE subsidiary is of theoretical and practical importance. While there are both internal and external factors that should be considered, Penrose (1959) addresses the fundamentals of the organization's internal administrative capacities, meaning the collective skills and experiences of the senior management for developing and deploying the organization's resources in pursuit of productive opportunities. These resources include the organization's top management and its technical personnel. Penrose (1959) considers how these administrative capacities can determine the extent of organizational growth. They are in a position to provide the basis for evaluating an MNE's existing resources and external opportunities (Lockett et al., 2011). During the initial stages of setting up international subsidiaries, the MNE's administrative capacities mostly comprise its expatriate employees who are assigned to perform important managerial and technical tasks (Goerzen & Beamish, 2007; Tan & Mahoney, 2006). Riaz, Rowe & Beamish (2014) investigated the relationship between levels of expatriate deployment and the growth of international subsidiaries over time. They found that higher subsidiary growth over the long term was achieved by maintaining a higher proportion of expatriates on the payroll.

2.6.3 Subsidiary mortality/ survival

A critical dimension of subsidiary performance is subsidiary mortality/survival. Prior studies have mainly focused on the effects on this of institutional environment,

institutional distance and ownership. Gaur & Lu (2007), for example, explored the influence of MNE ownership, institutional distance and host country experience on subsidiary survival. They report that the effect of ownership is contingent on institutional distance and host country experience, so that subsidiaries in institutionally distant countries have better survival chances if the foreign parents have more ownership. Dhanaraj & Beamish (2009) examined the effect of the institutional environment on the mortality of overseas subsidiaries and found that the sociopolitical context had a strong influence on subsidiary mortality. Applying an evolutionary model, Bradley et al. (2011) found that subsidiary organizations had lower mortality rates than independent ones, but that their mortality rates increased more rapidly during a severe economic downturn. They conclude that their findings strengthen the notion that organizational adaptation is linked not only to ecological and strategic processes but also to organizational structure.

2.7 The headquarters-subsidary relationship

Given the complexity and multidimensionality of the headquarters-subsidary relationship, scholars have studied many different aspects of this topic. Examples are headquarters control (Doz & Prahalad, 1984; Prahalad & Doz, 1981), subsidiary autonomy (Ginsberg & Venkatraman, 1985), which concerns the locus of control and how much decision-making power is granted to a subsidiary (Nohria & Ghoshal, 1994), and knowledge transfer between MNE headquarters and its subsidiaries (Gupta & Govindarajan, 2000).

2.7.1 The significance of managing the headquarters-subsidary relationship

As an MNE grows and its activities become more global, the management of its various units becomes more important for its international competitiveness (Porter, 1986). For most MNEs, the management of both horizontal and vertical internal relationships is regarded as among the most critically important strategic concerns (Porter, 1987). The interorganizational headquarters-subsidary relationship is one of the factors most strongly affecting the survival and performance of the subsidiary, because it influences how headquarters internalizes its global activities within the MNE and how the subsidiary overcomes disadvantages by obtaining resources from other parts of the MNE (Luo, 2003).

Johnston (2005) concurs that the headquarters-subsidary relationship is central to understanding the operation of an MNE, adding that the effective management of this relationship is regarded as one of the key challenges for MNEs. The effectiveness of the relationship can be assessed either through the conflict between headquarters and subsidiary, or through the two key processes of integration between them, which are coordination and control (Roth & Nigh, 1992). The mutually dependent relationships within an MNE require the integration of its subsidiaries' activities, and integration within any large and complex organization depends mainly on the processes of coordination and control (Baliga & Jaeger, 1984; Cray, 1984).

Coordination usually refers to collaborative actions taken to achieve a unity of effort within the organization (Lawrence & Lorsch, 1967). Scholars have suggested several dimensions of MNE coordination; Cray (1984), for example, identifies breadth (the

number of subsidiaries in a coordinated network) and diversity (the extent to which functional activities are coordinated). Given the existence of mutual dependency between headquarters and its subsidiaries, integration is usually characterized by a high degree of cooperation and problem solving (Ghoshal & Nohria, 1989).

Once coordination is established, the subsidiary should recognize that the joint effort with headquarters will help it to achieve a result beyond what either could achieve alone, because coordination is a process of negotiation and has been found to be positively related to a subsidiary's financial performance (Cheng, 1983; Cray, 1984).

Even when the importance of headquarters-subsidiary coordination is accepted, there will remain conflicts that need to be properly managed. Headquarters-subsidiary conflict is defined as the level of disagreement between these two social units (Anderson & Narus, 1990). Any interdependence or interaction between organizational units is likely to involve an element of conflict (Aiken & Hage, 1968). Considering the complex international context within which MNEs operate, conflict has always been an issue affecting headquarters-subsidiary relationships (Doz & Prahalad, 1981; Prahalad & Doz, 1987). In their daily business, MNEs' foreign subsidiaries must be responsive to the demands of integration (Hymer, 1976). However, a foreign subsidiary must also respond to the local environment (Hamel & Prahalad, 1983). Thus, the headquarters-subsidiary relationship often becomes "strained or even adversarial" (Bartlett & Ghoshal, 1986) as the subsidiary attempts to respond to both independent and interdependent interests.

Nohria & Ghoshal (1994) discuss two contrasting approaches to managing the headquarters-subsidary relationship, the first being differentiated fit, meaning the extent to which an MNE differentiates the formal structure of its headquarters-subsidary relationship to fit the contexts of its various subsidiaries. The second approach is to enhance the MNE's performance by ensuring a high degree of shared values between headquarters and the subsidiaries. The authors emphasize that these alternative approaches are not mutually exclusive ways of managing headquarters-subsidary relations but can be effectively combined.

Kostova (1998) suggests that the quality of the headquarters-subsidary relationship is a source of competitive advantage for the MNE and can positively influence the subsidiary's performance. She identifies four aspects of the quality metric, which are communication effectiveness, headquarters commitment, mutual trust and satisfaction, concluding that to achieve more effective coordination and control, MNE headquarters should rely on less formal but higher quality inter-unit relationships.

It is essential to have a good understanding of the functioning of MNEs (Johnston & Menguc, 2007). An MNE can be viewed as an interorganizational network (Ghoshal & Bartlett, 1990) whose subsidiaries are organized and managed by means of interdependent exchanges (Birkinshaw, Holm, Thilenius & Arvidsson, 2000). The headquarters-subsidary relationship can thus affect how the headquarters internalizes its global activities within the MNE and the interorganizational resource flows that help the subsidiary to overcome the disadvantages it faces as a foreign entity (Luo, 2003). Furthermore, when firms operate overseas, it is difficult for the headquarters to rely solely on formal control and coordination mechanisms to manage the subsidiaries, due

to geographic distance and economic, political and cultural differences between home and host countries.

Gupta & Govindarajan (1991; 2000) propose a model of information flow between MNE subsidiaries and headquarters, concluding that developing internal embeddedness within the MNE network is one of the most important strategic options available to subsidiary managers. Garcia-Pont et al. (2009) identify three levels of internal embeddedness that MNE subsidiaries can develop, these being the operational, capability and strategic levels.

2.7.2 Perspectives on the headquarters-subsidary relationship

The headquarters-subsidary relationship and related topics can be understood and explained from a variety of theoretical perspectives, each suitable for one or more given environments. In order to be able to construct a conceptual framework for the present study, the following subsections explore the principal-agent theory and the institutional perspective, then these two perspectives are used to discuss the relevant research topics.

Structurally, an MNE can be conceived as a network of exchange relationships among different organizational units (Ghoshal & Bartlett, 1990), within which the subsidiaries can be seen to function as agents of the headquarters as principal, performing the tasks designated by the parent company. Jensen & Meckling (1976) first used agency theory to explore MNE topics, defining an agency relationship as “a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to

the agent” (p. 308). Thus, principal-agent theory can be seen to focus on influential factors internal to the MNE to study agency in the relationship between MNE headquarters and its subsidiaries. By contrast, institutional theory takes account not only of such internal factors but also of external ones, recognizing the influence of both the internal and external institutional environments (Kostova & Roth, 2002).

2.7.2.1 The principal-agent perspective

The principal-agent perspective is directly applicable to the relationship between headquarters and subsidiaries, thus extending organizational theory. Addressing the two main elements of the research target, principal-agent theory explains how MNE headquarters exercises control and what kind of decision-making autonomy should be given to each subsidiary (Nohria & Ghoshal, 1994). According to this theory, MNE headquarters usually takes the role of principal and delegates work to its subsidiaries, which usually perform the tasks assigned by headquarters (Eisenhardt, 1985).

Principal-agent theory is a useful perspective from which to resolve the so-called agency problem, which is manifested in two main forms: moral hazard or implicit behaviour, and adverse selection or hidden information. According to Darrough & Stoughton (1986), moral hazard occurs when actions implemented by the agent cannot be observed and have a differential value to the agent as compared to the principal. Adverse selection problems arise when the agent has more information than the principal. One aspect of the agency problem is due to the principal’s limited ability to verify that the agent has behaved as expected, given the high cost of verification and the potential for goal incongruence. Another agency problem may be caused by a

difference between principal and agent in their risk preferences, which leads them to behave differently (Eisenhardt, 1989). There are three primary types of measures to keep the above agency problems under control, which are cultural, behavioural and output controls (Eisenhardt, 1989; Ouchi, 1981).

Applying agency theory to the general context of the MNE and especially to the headquarters-subsidary relationship, agency problems may arise when subsidiary management makes decisions that are not congruent with those desired by headquarters, due to disagreement on objectives (O'Donnell, 2000). In order to minimize agency problems, headquarters management may use various instruments such as headquarters supervision (e.g. by expatriates) and management monitoring mechanisms (e.g. monthly reports). In addition, it can apply financial incentives to adjust corporate and subsidiary interests (O'Donnell, 2000). Principal-agent theory can be used to explain the balance between headquarters control and subsidiary autonomy (Chang & Taylor, 1999). It has also been employed to predict the headquarters-subsidary relationship in both developed and developing economy MNEs (Chang & Taylor, 1999; O'Donnell, 2000).

Taking into consideration the complexity of the subsidiary's local market environment and its possession of local resources, Nohria & Ghoshal (1994) propose that MNE headquarters' control over the subsidiary can be achieved via different control levels, as well as creating shared values and beliefs among headquarters and subsidiary managers (Nohria & Ghoshal, 1994). Headquarters control is a combination of centralization and formalization, where centralization refers to the extent to which headquarters exerts its hierarchical authority over the subsidiary's decisions (Pugh,

Hickson, Hinings & Turner, 1968; Williamson, 1985) and formalization is the extent to which decisions are made according to management rules, routines and procedures (Nelson & Winter, 1982; Pugh et al., 1968). The modified framework shows that the instruments of differentiated fit and shared values are both effective in managing an MNE's headquarters-subsidary relationships. It also suggests that an effective way for MNEs to manage these relationships is to adopt a differentiated formal structure to fit each subsidiary's local context, which can positively influence the MNE's performance as a whole. An alternative means of achieving the same results is to develop a higher level of shared values with subsidiaries.

O'Donnell (2000) tested the effectiveness of the principal-agent perspective in explaining headquarters' control over subsidiaries. The results indicate that although the principal-agent perspective can be used as a basis to predict the adoption of monitoring mechanisms and incentive compensation, it is insufficient to account for the complexity of managing MNE subsidiaries. It will be more effective when intra-organizational interdependence is taken into consideration and social control mechanisms such as vertical and lateral integration are used. It has also been suggested that the principal-agent perspective can provide only a limited explanation of subsidiary control, while intra-organizational interdependence has greater predictive power. Thus, even if MNE headquarters represents the owner, the extent to which this can be converted into viable property rights still depends on negotiation between headquarters and the subsidiaries (Foss & Foss, 2005).

Mudambi & Navarra (2004) take the principal-agent perspective as a framework to study how the subsidiary's bargaining power influences the distribution of MNE

resources. They suggest that subsidiaries are viewed as the agents of headquarters and that their acquired knowledge gives them strategic independence and intra-firm bargaining power, which subsidiary managers can use to pursue their own goals.

The factors that affect the bargaining power of the subsidiary include its knowledge output, which can affect the bargaining power of MNEs in different ways depending on the knowledge output and direction of the knowledge flow. Björkman, Barner-Rasmussen & Li (2004) studied the influence of headquarters control mechanisms on the knowledge output of a local subsidiary from the principal-agent perspective. They conclude that the greater the total knowledge output from the subsidiary and the outflow from the subsidiary to the rest of the MNE, the greater the bargaining power the subsidiary will have. Other factors which can positively influence its bargaining power include the duration of the subsidiary's operation and the level of process control that it exercises.

While principal-agent theory has been an effective tool in understanding the headquarters-subsidiary relationship, it has certain limitations. First, its focus is restricted to internal factors within MNEs, such as the firm's goals and interests; it offers no account of how factors external to the enterprise may affect the relationship. Since a firm's survival and success are also subject to the legitimacy that its institutional environment confers on it (Kostova & Zaheer, 1999), external forces are liable to play a significant role in shaping the reactions of headquarters and subsidiaries, which could in turn affect the headquarters-subsidiary relationship.

The second limitation is that the focus of agency problems is the firm's self-interest and goal incongruence (Eisenhardt, 1989), so it may have less explanatory power for headquarters-subsidary relationships where both sides have similar interests and goals, such as in highly socialized or clan-oriented firms (Ouchi, 1979). Other scholars have criticized the principal-agent perspective for implicitly assuming the centrality of headquarters, weakening its value in explaining headquarters-subsidary relationships in diversified MNEs that consist of a web of interrelationships, rather than a set of separate one-to-one relationships (Doz & Prahalad, 1991). Given these limitations, later explanatory theories have been developed to complement the principal-agent perspective.

2.7.2.2 The institutional perspective

In contrast to the narrow focus of the principal-agent perspective on agency problems and factors internal to the MNE, institutional theory extends to a consideration of external factors, such as firms' internal and external institutional environments (Kostova & Roth, 2002). This view is now used as a theoretical lens in strategic MNE management studies (Peng, Sun, Pinkham & Chen, 2009).

According to institutional theory, an MNE's survival and success depend on the legitimacy conferred by the institutional environments in which it exists (DiMaggio & Powell, 1983; Kostova & Zaheer, 1999). Hence, the primary focus of institutional theory is to explore how to attain legitimacy, rather than to achieve efficiency or resource possession.

The explanation of the MNE headquarters-subsidary relationship offered by the institutional perspective is derived from institutional theory, which holds that interactions between MNE headquarters and its subsidiaries are influenced by both home and host-country institutional environments (Kostova & Roth, 2002). The institutional environment is depicted as comprising three pillars: the regulative pillar consists of formal rules and regulations; the normative pillar involves social norms and values; and the cognitive pillar pertains to the established cognitive structure that is taken for granted throughout the organization (Scott, 1995; Yiu & Makino, 2002).

In addition to accounting for the legitimacy derived from the external system, institutional theory also explains the influence of the internal legitimacy of the units within the organization (Westney, 1993). Internal legitimacy refers to the acceptance and approval of one sub-unit by the other sub-units in the organization, especially by the headquarters (Kostova & Zaheer, 1999). It also has implications for interactions between headquarters and subsidiaries, as each subsidiary's internal legitimacy allows it to access organizational resources from other parts of the organization, including the headquarters (Pfeffer & Salancik, 1978).

The institutional perspective is helpful in explaining management problems in the complex MNE environment. Kostova & Roth (2002) investigated the adoption of headquarters practice by a subsidiary from the institutional perspective. Two contexts were identified in the study: the host country institutional profile and the relational context between headquarters and subsidiary. The authors argue that favourable host-country institutional profiles in regulative, normative and cognitive institutions, as well

as relational factors such as dependence, trust and the subsidiary's identification with headquarters, can positively influence its adoption of headquarters' practice.

Fenton-O'Creevy, Gooderham & Nordhaug (2008) also adopted the institutional perspective when investigating the determinants of subsidiary autonomy in the context of HRM in an MNE. They examined the strategic background and the system positioning effect of the subsidiary, arguing that the autonomy of the subsidiary is related both to the headquarters-subsidary relationship and to the local institutional environment. Their data analysis reveals increased centralization of control over HRM in those subsidiaries operating in global markets, in coordinated market economies and with low union densities.

Feinberg & Gupta (2009) studied the headquarters-subsidary relationship in terms of the subsidiary's operational integration within the MNE's global trading network. They suggest that when operating in high-risk host countries, subsidiaries can mitigate institutional hazards by strengthening their operational integration within the MNE's global trading. The integration of the subsidiary also increased its asset specificity, assurance of demand for its products, the socialization of its managers within the headquarters' managerial network and the ability of headquarters executives to routinely monitor events and actions within the subsidiary. The analysis of a large sample of subsidiaries demonstrates that they increase their operational integration by having more within-firm sales when they face institutional hazards and that this operational integration will be weaker when the MNEs are more experienced at deploying political strategies.

So far, institutional theory has been applied in studies focusing on the transfer of practices from headquarters to subsidiaries (Björkman, Fey & Park, 2007; Ferner, Almond & Colling, 2005; Kostova & Roth, 2002) and on headquarters-subsidiary integration (Feinberg & Gupta, 2009). The contribution of the institutional perspective is that it offers insights into how the external and internal institutional environments influence the headquarters-subsidiary relationship. As institutional environments differ from one country to another, so the differences in institutional environments between home and host countries make it difficult for MNEs to understand their subsidiaries' legitimacy requirements (Kostova & Zaheer, 1999). Furthermore, the fact that legitimacy requirements in the host country differ from those at home can create difficulties for the subsidiary in attaining external legitimacy in the host country while maintaining its internal legitimacy within the MNE. In such cases, institutional theory can illuminate the influence of the dual legitimation process on the headquarters-subsidiary relationship and thus offer a useful alternative explanation to the principal-agent theory.

According to institutional theory, MNE subsidiaries' formal structure is captured by the regulative pillar, which refers to the rules and laws that exist for social stability and order (North, 1990). When MNEs invest in a foreign country, their subsidiaries have to follow the host country's regulatory restrictions (Gatignon & Anderson, 1988), which include legal systems, information systems, regulatory regimes and enforcement systems related to institutional practices (Meyer, Estrin, Bhaumik & Peng, 2009). Because MNEs must comply with the regulatory system's declared requirements (Murtha & Lenway, 1994), MNE subsidiaries therefore operate in the environment of coercive legal pressure from their host countries.

Since MNE subsidiaries must comply with the regulatory requirements of the host country, any violation of laws and regulations will have a significant negative impact. This regulatory demand can influence firms at the ideological level, setting the limitations and boundaries that they have to respect (Pache & Santos, 2010). Therefore, regulatory demand operates at the goal level and its degree of negotiability for subsidiaries is low. In addition, different host country regulatory requirements can be obtained through members of the organization, such as legal advisors or board members who adhere to the templates of the regulatory institutions (D'Aunno, Sutton & Price, 1991; Pache & Santos, 2010). In this situation, to achieve legitimacy a subsidiary must fully comply with its host country's regulatory demands by actively obeying regulatory requirements, which will affect the headquarters-subsidiary relationship in MNEs.

The best way to respond to regulatory requirements is through compliance, which is characterized by fully following institutional requirements (Oliver, 1991; Suchman, 1995). Effective communication between headquarters and subsidiaries requires information exchange, which can help to resolve disputes and align perceptions and expectations (Etgar, 1979). A reduced level of disputes and more closely aligned expectations promote trust (Morgan & Hunt, 1994). The commitment of managerial and financial resources between headquarters and subsidiaries can also improve learning, as well as emulating the organizational practices and structures of other firms (Haunschild & Miner, 1997). Therefore, firms are subject to normative and mimetic pressures.

Because informal institutions are tacit and primarily culturally driven (Eden & Miller, 2004), and because the normative and cognitive pillars of institutional theory are

conceptually close to culture (Chao & Kumar, 2010), cultural distance is regarded as a major factor that impedes MNEs from achieving normative and cognitive legitimacy. The greater the cultural distance between the host and home countries, the more difficult it is for MNEs to establish normative and cognitive legitimacy. When operating in culturally distant countries, MNEs are subject to normative pressure and can obtain normative legitimacy by aligning their organizational values to the societal values of the host country (Parsons, 1960). Norms and values determine whether an activity is “the right thing to do” (Suchman, 1995: 579); thus, they exert pressure on MNEs at the functional level, requiring them to adopt appropriate courses of action (DiMaggio & Powell, 1983; Oliver, 1991).

When operating in culturally distant countries, MNEs are also subject to mimetic pressure to follow the taken-for-granted routines of their host countries (Scott, 2001) to attain cognitive legitimacy, which lies at the functional level. It is suggested that firms can use imitative tactics (Oliver, 1991) to model the most prominent local subsidiaries (DiMaggio & Powell, 1983; Tolbert & Zucker, 1983).

The three different modes of imitation which firms can use to acquire cognitive legitimacy are frequency-based, trait-based and outcome-based imitation (Haunschild & Miner, 1997). In frequency-based imitation, subsidiaries imitate actions or practices that have been widely implemented by other organizations (Tolbert & Zucker, 1983). Subsidiaries can also adopt trait-based imitation, which is the limitation of the actions and practices of organizations with traits or statuses regarded as legitimate and successful (Fombrun & Shanley, 1990). Outcome-based imitation allows subsidiaries to imitate actions and practices that have produced positive outcomes for other

organizations (Haunschild & Miner, 1997). Commitment and effective communication can also improve mutual trust (Morgan & Hunt, 1994) and satisfaction (Selnes, 1998) between headquarters and subsidiaries. Therefore, a higher quality headquarters-subsidiary relationship can also be expected from such an imitation process.

The practice of the subsidiary system can improve the internal representation of home country norms, values and beliefs in subsidiaries, because the institutionalization process makes organization members adhere to the home country's normative templates and cognitive structures (D'Aunno et al., 1991; Pache & Santos, 2010). In a culturally distant host country where subsidiaries face strong normative pressure, enhanced internal home country norms, values and beliefs may create a negative social image that will cast more suspicion on the subsidiaries and place them under more scrutiny by host country interest groups. In addition, subsidiaries are expected to strive to establish a positive social image and build reputation and goodwill superior to those of local firms (Kostova & Zaheer, 1999). In this case, firms can use bargaining tactics (Oliver, 1991) and alleviate host-country normative pressures by employing alternative legitimating mechanisms such as negotiating with highly legitimate entities and establishing a positive image through engagement in socially desirable practices in the culturally distant country, by means of corporate social responsibility programmes, for example (Kostova, Roth & Dacin, 2008).

2.7.2.3 Resource dependence theory

Resource dependence theory is rooted in the resource-based view, which suggests that the market activity of a firm is decided by the resources it possesses (Barney, 1991).

This theory views the firm as a coalition that alters its structure and models of behaviour to acquire and maintain external resources, which can help it to reduce its dependence on others and increase others' dependence on it, thus improving its power relations (Pfeffer & Salancik, 1978). In the context of the headquarters-subsidary relationship, resource-dependence theory emphasizes that interorganizational links between units within an MNE are critical for the reduction of dependence on external resources, thus alleviating market threats (Luo, 2003). The more a subsidiary uses internal resources from headquarters, the less it depends on external resources, so that lower economic risks and transaction costs can be expected (Kobrin, 1991). This higher level of dependence on headquarters by the subsidiary also implies improvements in the headquarters-subsidary relationship (Luo, 2003).

Resource dependence theory posits that higher levels of resource support and commitment, as well as intra-network information flow, will improve headquarters-subsidary relationships (Luo, 2003), thus potentially further reducing the subsidiary's dependence on external resources such as natural inputs, infrastructure, marketing and information (Rosenzweig & Singh, 1991). Ghoshal & Nohria (1989) argue that levels of environmental complexity and local host country resources can affect structural elements of the headquarters-subsidary relationship, namely centralization, formalization and normative integration.

Using the resource-based view from the bargaining power perspective, Yan & Gray (2001) investigated the determinants of headquarters control over subsidiaries. Such management control, which has strategic, operational and structural elements, is achieved by negotiation and allocation of critical resources.

A structural equation modelling analysis of primary data by Andersson, Forsgren & Holm (2007) shows that the embeddedness perspective derived from resource-dependence theory is a powerful tool that can effectively explain and predict the headquarters-subsidary relationship in terms of the subsidiary's influence on MNE headquarters' strategic decisions such as investment in research and development or in new product lines. Chen, Park & Newburry (2009) examined parent control in the context of international joint ventures and invoke resource dependence theory to argue that the parent firm's use of control over such ventures is influenced by its level of resource contribution. These findings suggest that resource dependence theory is an effective tool in studying the issues of headquarters control.

Although the resource-based view offers new pathways for scholars to understand headquarters-subsidary relationships, it suffers several limitations. First, the resource perspective focuses mainly on possession and dependence of resources on one side of the relationship (i.e. either the headquarters or the subsidiary), so that it is likely to be viewed as unidirectional, whereas it is in reality a dyadic relationship (Ambos, Andersson & Birkinshaw, 2010). Second, the resource perspective has been challenged by scholars as overlooking other environmental factors such as the firm's physical location and the managers' social class, both of which can affect inter-organizational relationships (Palmer, 1983; Palmer, Jennings & Zhou, 1993). Third, the shift from managerial capitalism to investor capitalism (Useem, 1996) has reduced the discretion of organizations and increased the role of markets (Pfeffer & Salancik, 2003), making the assumption of management discretion in the resource perspective less important and relevant (Davis & McAdam, 2000).

2.7.2.4 Empirical studies from multiple theoretical perspectives

Recognizing that each of the above theoretical perspectives has its particular limitations in explaining the MNE headquarters-subsidary relationship, many researchers have chosen to adopt multiple or combined theoretical frameworks to lend their work a greater breadth of view. Four such empirical studies are reviewed here.

Gencturk & Aulakh (1995) studied internal and external sources of uncertainty and their effects on headquarters' control over subsidiaries in terms of process control and output control. Using a combination of principal-agent theory and transaction cost theory, the researchers conclude that process control can be determined by degree of internationalization and perceived host market attractiveness, while output control can be determined by unit size in addition to these two factors. Output control can also positively influence the subsidiary's performance in terms of the degree to which headquarters managers are satisfied with this performance in the host country.

Chang & Taylor (1999) used both principal-agent theory and cultural frameworks to investigate the factors determining the headquarters-subsidary relationship in terms of the degree and types of control exercised by US and Japanese MNEs over their Korean subsidiaries. They found that the higher the degree of ownership in the subsidiary, the higher the degree of output and staffing control that will be adopted. In comparison to US-owned subsidiaries, Japanese ones exerted a higher degree of staffing control. This shows that both the principal-agent perspective and cultural frameworks are effective tools in predicting levels of headquarters-subsidary control.

Hewett, Roth & Roth (2003) developed a framework based on industrial organization theory and institutional theory to study the factors that influence the roles of headquarters and subsidiaries in their marketing activities and the effects of these roles on subsidiaries' performance in foreign markets. The authors see the two theoretical stances as complementary, as they both suggest that organizations adopt similar practices over time under environmental pressure. Industrial organization theory focuses on technical efficiency, whereas institutional theory emphasizes organizational legitimacy.

To investigate the delegation of autonomy to subsidiaries in the context of emerging economy MNEs, Wang et al. (2014) adopted the springboard and institutional perspectives, arguing that current theory on subsidiary autonomy is inadequate to resolve the issues arising where MNEs are inexperienced in the international market.

2.7.3 MNE subsidiary control

The subsidiary's contribution to the MNE's value added can range from R&D and sales to cover the entire value chain (Kutschker & Schmid, 2011). Dunning (1993) summarizes the intentions and objectives of MNEs to invest across countries, which are to seek markets, resources, efficiencies and strategic assets. Foreign subsidiaries can thus serve MNEs by accessing markets abroad (market seeking), seizing locational advantages (resource seeking), achieving stronger financial outcomes (efficiency seeking) and strengthening the MNE's competitive position (strategic asset seeking).

There are two main streams of research into how headquarters-subsidary control works (Yu et al., 2006). The first widely adopted stance is the network perspective, to explore how MNE subsidiaries are established and enabled to acquire local resources (Chen & Chen, 1998; Ghoshal, 1986). The other major approach is the agency perspective, which conceptualizes the MNE headquarters and subsidiary as having a principal-agent relationship. Agency theory holds that the main object of subsidiary control is to reduce the agency costs which always accrue when there is goal incongruence and information asymmetry between headquarters and the subsidiary (O'Donnell, 2000).

In MNE control mechanisms, headquarters exerts influence through structural management routines such as reporting lines and compensation schemes, as well as through the allocation of resources such as capital, investment, usage of knowledge and so on, determining the resource profile of the subsidiary (Birkinshaw & Hood, 1997).

According to resource dependence theory, subsidiaries' heavy reliance on the allocation of resources leads the need for control. Headquarters usually adopts two types of control, formal and informal. Formal headquarters control includes centralized, formalized, structured process and output control and planning, while informal control mainly involves socialization and networks (Martinez & Jarillo, 1989).

In the MNE headquarters-subsidary relationship, management integrating mechanisms are constraints to the purpose of directing or managing subsidiary activities. Such mechanisms normally include rules, policies and procedures, and the setting of objectives or performance targets. They generally constitute direct intervention in subsidiary activities and are considered the easiest way to manage and control

subsidiary activity (Galbraith & Nathanson, 1978). Building on agency theory, Chang & Taylor (1999) discuss the factors determining the extent and type of control, concluding that the two main ones are the degree of the MNE's ownership, which can influence the amount of control, and the home country of the MNE, which will affect the type of control. Finally, the size of the subsidiary in relation to the MNE was found to moderate the relationship between the degree of ownership and amount of output control.

The managers of a subsidiary can greatly affect its strategy and performance. Therefore, one target of subsidiary control is to develop measures to control subsidiary managers. MNEs are concerned with the difficulty of monitoring their foreign subsidiaries' top management (their agents) because of significant information asymmetries between headquarters and subsidiaries. In order to reduce agency costs, headquarters may use variable compensation schemes for subsidiary top managers (Björkman & Furu, 2000). As noted by Bartlett (1983), subsidiary managers are at the conflict centre of global integration and local responsiveness. They must balance the conflicting demands of local customers, employees and government officials, as well as those of headquarters managers who seek to ensure that each subsidiary plays its designated role in the MNE's strategy and operations. In this sense, the instructions that a subsidiary receives from headquarters may be viewed as just one of the many external constraints upon it.

Luo (2003) examined the impact on subsidiary performance of control flexibility, defined as the extent to which the organizational control of MNE headquarters over subsidiary activities can be accepted. He found that headquarters control flexibility had a strong and substantial influence on subsidiary performance.

The extent to which an MNE's Chinese subsidiary operates to establish and maintain the headquarters-subsidary relationship is related to its location in China. In general, an MNE's operations in China can be divided into the three stages of infancy, youth and adulthood. According to Fernandez & Underwood (2006), infancy represents the new subsidiary's launch in China, youth is a period of fast growth and adulthood represents maturity and autonomy. They also suggest that communication is central to the MNE headquarters-subsidary relationship. The four main factors that affect it are headquarters commitment, bringing China to the headquarters, bringing the headquarters to China and the corporate clout of the China head (Fernandez & Underwood, 2006).

2.7.3.1 Control variables

The percentage and volume of an MNE's sales in the global market are used to measure its multinationality and in particular its market diversification (Tallman & Li, 1996), indicating the strategic importance of the firm's foreign business and the strength of its activities in foreign markets, as well as its dependence on overseas markets for its revenue (Gomes & Ramaswamy, 1999).

The level of participation and dependence of an MNE's operations overseas can be expected to have impacts on the headquarters-subsidary relationship, as a higher level of involvement and dependence on overseas operations can be a significant predictor of superior performance (Geringer, Beamish & DaCosta, 1989).

Subsidiary size has been commonly used as a control variable in organization studies (Björkman et al., 2004). From the resource-based viewpoint, subsidiary size indicates the assets, resources and capabilities that a firm can make use of (Penrose, 1959). The size of a subsidiary is associated not only with its value to the headquarters, but also with the complexity of interorganizational coordination, which requires inputs of management expertise and experience, as well as the subsidiary's connections with headquarters, which are expected to influence the headquarters-subsidiary relationship (Johnston & Menguc, 2007).

The percentage of Chinese and parent ownership in the subsidiary is also included as a control variable, since ownership reflects the 'weight' of a subsidiary to the headquarters. The more weight the subsidiary has, the more attention it receives from headquarters (Bouquet & Birkinshaw, 2008). It is also suggested that the larger the subsidiary, the more attention headquarters will pay to it (Bartlett & Ghoshal, 1989). This has implications for internal legitimacy within the MNE and may affect the quality of the headquarters-subsidiary relationship.

2.7.3.2 Subsidiary control methods

The control and coordination of geographically and culturally dispersed subsidiaries is one of the most difficult challenges for MNE management. MNEs adopt a wide range of mechanisms to control their foreign subsidiaries. Such measures and systems may include allocating the share of capital, assigning expatriates, designating members of the board of directors, appointing staff to key positions, in-job training and the

socialization of employees (Jausaud & Schaaper, 2006). Below is a summary of commonly used control methods.

Process vs. output control: When Yu, Wong & Chiao (2006) investigated the relationship between headquarters' adoption of process controls and subsidiaries' local context, they found that subsidiaries used local context to lessen the adoption of controls by headquarters. Longitudinal case studies reported by Brenner & Ambos (2013) show that headquarters will use social controls to institutionalize and legitimize their process and output controls. Lovett et al. (2009) found that subsidiary performance was inversely related to the extent of control that headquarters exerted on the subsidiary.

Ownership control: The allocation of ownership levels for subsidiaries is an important issue in the research literature, because ownership structure has strategic implications for subsidiary control and performance (Peng, 2012). Ownership is a critical control mechanism for the following reasons: first, ownership carries the right to control strategic decision-making and key operational actions in subsidiaries; second, ownership is a governance mechanism that can protect an MNEs' specific advantage in the host country; third, ownership reflects the resource commitment made by the parent to the subsidiary.

Staffing control: MNEs also control their foreign subsidiaries through expatriate staffing. A study by Chang & Taylor (1999) based on agency theory investigated determinants of the type and degree of headquarters control over MNE subsidiaries. It identified two characteristics of MNEs that can affect such control. The degree of MNE ownership will affect the amount of control, while the home country of the headquarters

will affect the type of control that it is inclined to exert. The scale and importance of the subsidiary can moderate the degree of ownership and the amount of output control in comparison with the whole MNE (Chang & Taylor 1999). As an important measure of subsidiary management, staffing control affects subsidiaries' performance and capability development (Gaur, Delios & Singh, 2007; Harzing, 2002). Peng (2012) found a correlation between subsidiary size and the MNE's expatriate staffing level. Smaller MNE subsidiaries tend to have proportionally higher expatriate staffing levels than larger subsidiaries. Wilkinson et al. (2008) investigated the diminishing influence of national cultural distance on expatriate staffing. Their findings suggest that cultural distance has a more significant influence on expatriates in newer subsidiaries than older ones.

Strategic vs. operational control: Operational control means that specific tasks or transactions are executed according to planned decisions (Lovett, Pérez-Nordtvedt & Rasheed, 2009). It focuses on achieving short-term financial targets, whereas strategic control is more concerned with long-term objectives and may include considerations of competition and social factors (Goold & Quinn, 1990).

2.8 Summary and research gap

This chapter seeks to use information from the existing literature and other sources on MNEs' operating practice in China to summarize the current status of research, to identify a gap in research on MNE's operating practice in developing countries like China and thence to construct a conceptual framework for the present study and to review the research questions. This provides the direction for this research.

2.8.1 Research gap

Although it is recognized that the strategic initiatives of MNE subsidiaries can have some influence on their own future, many aspects of how this actually takes place remain obscure. Strategy at the subsidiary level is a neglected research area in need of both academic and empirical input, a gap which this research hopes to fill.

The literature review indicates that MNEs typically operate across national boundaries and thus always have more than one type of external home and host country environment. Therefore MNEs must respond efficiently and effectively to a complicated set of environmental factors in the home and host countries, in the institutional, economic, political, social, legal, cultural and technological dimensions. Both internal and external environmental factors will influence all MNEs' subsidiary strategies and these will have implications for performance. On the other hand, the headquarters-subsidiary relationship and headquarters control will also influence various aspects of subsidiary strategic management. All such strategic management processes will have significant implications for the performance of MNE subsidiaries.

2.8.2 Research thoughts

The main objectives of this research are to address MNE subsidiary strategic management initiatives within the Chinese environment, to explore the determining factors and identify implications for subsidiary performance. It explores the research questions on MNEs' China subsidiary strategies from two main angles: the influence of the MNEs' internal and external environments, and the moderating effects of

headquarters-subsidary relationships and headquarters control. Specifically, this study explores the following significant research thoughts:

- Why and how does an MNE's environment influence the development of its headquarters-subsidary relationship, especially in regard to the external factors of a subsidiary host country like China?
- How is the strategy of an MNE's China subsidiary affected by the MNE's overall internal and external environment? Why does it function like this? How is subsidiary strategy constituted and what are the main factors affecting it?
- How does an MNE's headquarters-subsidary relationship, especially the control mechanisms employed by headquarters, i.e. control methods, control flexibility etc., influence subsidiary strategies?
- How do MNE subsidiary strategies affect subsidiary performance in emerging economies like China?

It is hoped that this study will shed light on the new concepts underlying the proposed conceptual framework to be developed, to enhance understanding of the strategic management and performance factors affecting MNEs. It also aims to contribute to a broader and deeper analysis of the formation and implementation of strategy by MNE subsidiaries in China and the implications for performance. Empirically, it seeks to contribute to the strategic management of MNEs and to their structural and strategic planning being considered in the process of developing headquarters-subsidary relationships and control schemes.

2.9 Conceptual framework

So far, this chapter has reviewed the relevant literature, summarized the research gap and offered some research thoughts. The focus of this study is on factors influencing the strategy of MNE subsidiaries and the effects of these factors on their performance.

Figure 2-1 depicts the conceptual framework for the study, comprising four important interrelated elements: the environment, the headquarters-subsidiary relationship and subsidiary control, the subsidiary's strategy and its performance. The core elements of the conceptual framework, with which this research is largely concerned, are the headquarters-subsidiary relationship and the subsidiary strategy within MNEs. Within the framework, operational environmental factors drive an MNE's headquarters-subsidiary relationships and subsidiary control as well as subsidiary strategies, which in turn influence both by the MNE's operational environment and by headquarters control. In the end, each subsidiary's performance is influenced by the MNE's strategy in the market. This study examines various determinants of MNE subsidiary strategies in the Chinese market. It proposes and validates an account of the impact of factors affecting subsidiaries in China at three levels: environmental, structural and organizational.

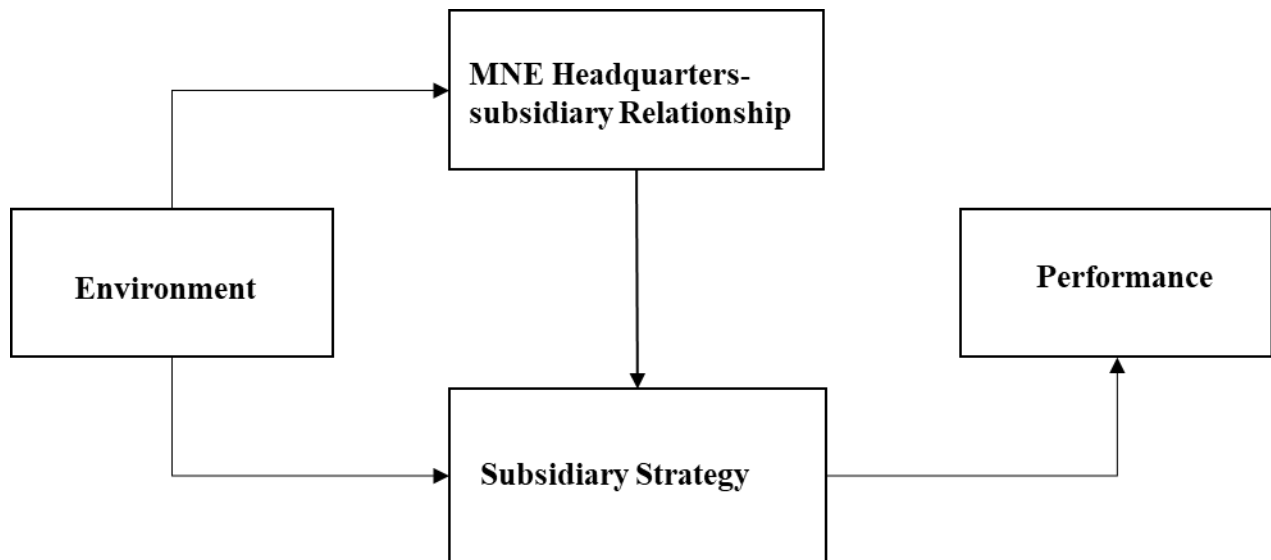


Figure 2- 1 A Conceptual Framework for Environment, Corporate Control, Strategy and Performance

Environmental factors derive from both the internal environment of the MNE and the external environment in which it is located and operates. The case examined in this research is that of an MNE headquartered in Norway and setting up a number of subsidiaries in China. It examines how the operation of these subsidiaries is affected and defined by the institutional environments of both home and host countries. Internally, according to the principal-agent theory, the Norwegian headquarters is the principal, defining the roles of its subsidiaries and delegating tasks to them, while each subsidiary acts as an agent, performing these designated tasks (Eisenhardt, 1985).

To deal with agency problems, it is necessary for MNE headquarters to adopt various types of control, including cultural control, process control and output control (Eisenhardt, 1989; Ouchi, 1981). These controls are mainly enacted through company policies and rules such as the functions of departments, HR policies, finance and so on, in order to monitor and control each subsidiary's operation. Intervention can take the

form either of output control, where headquarters simply assesses the final results over a given period, or process control, where the subsidiary has to report progress against a series of milestones. This distinction can be taken as a model to predict the adoption of subsidiary control mechanisms.

As discussed above, an important factor affecting an MNE subsidiary's strategy is that notwithstanding the constraints placed on its management by the headquarters-defined mandate and by its guidance, subsidiaries still make decisions in their own interests, not simply on behalf of headquarters. At the local level at least, subsidiaries engage in strategic development, seeking to build and to maintain their resources. This points to the need to identify the most important elements with strategic meaning at the subsidiary level. In discussing subsidiary strategy, the research will focus on strategy implementation, strategy resistance, strategy adaptation, strategy motivation and personnel turnover.

An MNE subsidiary's strategy influences its performance, which needs to be assessed from the dual perspectives of headquarters and of the subsidiary itself. From the MNE headquarters' perspective, performance can be measured by the extent to which the subsidiary fulfils its designated role or meets its assigned targets. However, from the subsidiary's perspective, any assessment of performance needs to consider whether the subsidiary's concerns have been properly taken into consideration and achieved. Furthermore, any measure of performance needs to have both financial and non-financial components.

2.9.1 Environment and MNE headquarters control

An MNE's operational environment influences headquarters-subsidary relationships and headquarters control. Factors internal to the MNE operate in both formal and informal contexts. Formal organizational contexts may include factors such as management and organizational structures, decision-making processes, management processes, working rules and procedures, working standards and those which are formalized and fixed by company documents and orders. Such formal contexts is typically enforced and all persons in the organization are obliged to follow them. Within an MNE there are also various informal contexts such as company culture which can also contribute to internal factors. As to the external factors, these are related to the MNE's institutional status in its home country and other aspects of the environment in which the enterprise operates. External factors affecting a subsidiary also include the institutional environment of the host country where it operates.

Agency theory can be applied to the principles determining decision-making in an MNE and how information asymmetry affects objective inconformity (Eisenhardt, 1989). The agency problem occurs when MNE subsidiary managers make their own decisions that are not anticipated by headquarters, because of information asymmetry and objective inconformity between headquarters and the subsidiary. According to agency theory, a greater distance between home and host countries increases agency problems in the headquarters-subsidary relationship and therefore leads to a tightening of control by headquarters (Chang & Taylor, 1999; O'Donnell, 2000). Principal-agent theory thus provides a well-defined perspective to explore MNE-internal factors.

Institutional theory is increasingly used in management studies to offer explanations from the institutional perspective. Applying institutional theory to MNEs highlights their characteristic institutional complexity. Institutional theory focuses not only on the firm's internal factors, but also on external factors, i.e. on both its internal and its external institutional environments (Kostova & Roth, 2002).

Various factors need to be considered when accounting for the details of MNE headquarters control. In terms of overall policy, from the viewpoint of MNE headquarters, it needs to ensure that subsidiaries operate in the way that headquarters wants, even though each subsidiary may have its own concerns and priorities. MNE headquarters may also need to decide how to control a subsidiary, either via process control, which monitors how the subsidiary undertakes particular tasks, or by means of output control, which pays more attention to the results of the work. Human resources can also be part of the control scheme that headquarters needs to consider, for decisions such as whether it needs to send an expatriate to take on a particular role in a subsidiary, or whether it should rely more on locally recruited staff.

When MNEs expand their operations into different host countries, they are entering a diversified and unfamiliar business environment. Due to unfamiliarity and lack of experience in the foreign markets, their subsidiaries will face different challenges and incur extra costs, referred to as the liability of foreignness (Hymer, 1960, 1976). It thus becomes critically important for MNEs to manage the relationships between headquarters and subsidiaries, in order to minimize these disadvantages and maintain their competitiveness (Fenton-O'Creevy, Gooderham & Nordhaug, 2008). In this

context, an MNE's headquarters-subsidary relationships and subsidiary control can be seen as strategic management processes which will influence its overall performance.

2.9.2 MNE headquarters control and subsidiary strategy

Subsidiary control has been a focus of international business management and a major research topic for decades (Werner, 2002). Control mechanisms are manifold; MNE headquarters exerts its influence through the use of structural management routines such as lines of reporting and compensation, as well as the allocation of resources including capital, investment plans, usage of knowledge and so on, in order to change the resource profile of the subsidiary (Birkinshaw & Hood, 1997). According to resource dependence theory, as subsidiaries rely on headquarters' resource allocation, this needs headquarters control. Headquarters usually adopts two types of control, formal and informal. Formal headquarters control includes centralized, formalized, structured process and output control and planning, while informal control mainly refers to the exploitation of socialization and networks (Martinez & Jarillo, 1989).

Subsidiary control is widely adopted to manage coordination and integration activities within an MNE. Subsidiary control has been defined as "essentially concerned with regulating the activities within an organization so that they are in accord with the expectations established in policies, plans, and targets" (Child, 1973: 117).

Headquarters control affects subsidiary strategies. As typically defined by MNE headquarters, the rationale for setting up a subsidiary in a host country is based on the intention to seek resources, markets, efficiency and/or strategic assets (Dunning 1993).

Thus, an MNE subsidiary must serve its parent company by market access (market-seeking), taking advantage of location (resource-seeking), enhancing its productivity (efficiency-seeking) or strengthening the MNE's competitive positioning (strategic-asset-seeking). The subsidiary's strategic management is driven throughout the whole process by headquarters control and the subsidiary's relationship with headquarters, in the processes of planning, implementation, adaptation and so on.

2.9.3 Environment and MNE subsidiary strategy

The operation of overseas subsidiaries allows MNEs to optimize the allocation of resources and thus to enhance their profits. Such strategic choices which headquarters makes for its subsidiaries are influenced and constrained by the institutional environment and local rules of each host country. As to subsidiaries, each must ensure that its strategic choices comply with the performance objectives set by headquarters, within the constraints of the resources that the host country is able and willing to provide.

Any organization which fits its strategy to its environment tends to achieve better performance (Miller & Friesen, 1983). This applies to the strategy and performance of MNE subsidiaries. Thus, the proposed conceptual framework (Figure 2-1) indicates that the specific environment of any MNE subsidiary, including both external and internal factors, contributes to the subsidiary strategy and hence ultimately affects the performance outcome. As the MNE either operates to achieve global integration, thus taking advantage of firm-specific advantages, or emphasizes local autonomy to achieve embedded benefits, the strategy of each subsidiary needs to be driven by the

environment in which it is embedded. It is easy to see that a large cultural distance between home country and host country tends to make it difficult to manage global integration (Fan, Zhu & Nyland, 2012). In such conditions, the MNE needs to exercise relatively tight control in order to maintain its operations abroad (Kim & Hwang, 1992).

As its various subsidiaries are established in different places, each with its own specific circumstances, the MNE needs to allocate a specific set of strategic tasks to each subsidiary within the organizational structure. It is impossible for any MNE to follow a strategy of complete centralization from headquarters or total autonomy for every subsidiary. In reality, some functions are centralized under firm and formal control, while others are decentralized. The MNE must ensure that its institutional environment and systems allow for appropriate control of these functions, because of the need maintain consistency with strategic demands. The role assigned to each subsidiary within the MNE's global value chain moderates the relationship between the degree of centralization and that subsidiary's performance (Kostova & Roth, 2002).

2.9.4 Subsidiary strategy and subsidiary performance

With the recognition that MNE subsidiaries can be granted a certain level of autonomy and have some input to management (Patterson & Brock, 2002), the notion that subsidiaries could potentially engage in strategy development at a local level has emerged. Taking the whole MNE as a unit of study and analysis shows that subsidiaries often have easy access to key local resources and operate with freedom granted by headquarters, and that this formal management structure is less important than culture

and system as a means of control (Prahalad, 1976; Prahalad & Doz, 1981; Hedlund, 1986).

Prior studies have used several measures to reflect subsidiary performance, including financial performance (Anand & Delios, 1997; Luo & Park, 2001; Birkinshaw, Hood & Young, 2005; Fang, Wade, Delios & Beamish, 2013), subsidiary growth (Riaz, Glenn Rowe & Beamish, 2014), and subsidiary mortality/survival (Bradley, Aldrich, Shepherd & Wiklund, 2011; Dhanaraj & Beamish, 2009; Gaur & Lu, 2007). Although the measures of subsidiaries' performance vary widely, prior studies have found that control mechanisms have critical implications for subsidiaries' strategy and performance. For instance, Luo (2003) found that keeping headquarters control flexible had a strong and positive effect on subsidiary strategy and that this could contribute to performance.

Chapter 3 Methodology

3.1 Introduction

In this chapter, epistemological issues are discussed and different research methods are reviewed and evaluated. In view of the objectives of this study, qualitative research is deemed most appropriate. A qualitative approach can help to penetrate below the surface of a topic, thus enabling one to understand core issues and to explain why things are the way they are and why some things happen while others do not.

After this review, a more in-depth analysis of a longitudinal, single case study is presented, with three aims in mind: (1) to explain the applicability of case studies in general and of the type of case study adopted here; (2) to address the research topics of the interrelationships between uncertainties in the MNE host-country environment, the MNE headquarters-subsidiary relationship and the strategy and performance of Chinese subsidiaries; and (3) to address and answer the related research questions.

Next, the choice of research design is explained and justified in four stages. The first explains the case selection process, in order to give readers an understanding of the circumstances and the environment in which the research was conducted. Second, the overall data collection process is described and various data collection methods are listed. In particular, sources and comments on their relevance to the study as a whole are presented. Third, the data analysis process is discussed in depth and the basic principles of different analytical instruments and techniques are explained. Finally,

there is a discussion of the use throughout the study of quality control and quality assurance techniques and instruments appropriate to qualitative research.

3.2 Philosophical considerations

The philosophical positions that one takes drive all aspects of one's research. These positions therefore need to be explicitly stated to understand clearly the design of the research, the management of data, the kind of evidence required to answer the research questions, how data will be gathered and interpreted, and finally how all of these bear on clearly answering the research questions. The philosophical positions adopted also determine which research designs will work and which will not, and help us to understand the limitations of the research. When conducting research, these considerations guide the creation or adaptation of research designs, according to different subjects or knowledge structures (Easterby-Smith M. et al., 2008).

The topic of the present study and its research questions relate mainly to the strategy and performance of an MNE subsidiary in China and the factors that influence the headquarters-subsidary relationship. The reality of business is not fully objective; it has to be revealed through social constructions and by the people involved adding meaning. Regarding the research objectives, the task is to appreciate the different constructions and meanings that people place upon experience. Focus needs to be directed towards how people think and feel, individually and collectively. We should try to understand and explain why people have such different experiences and interpretations. The purpose of the research is to improve the general understanding of the situation and progress is made by gathering rich data from which ideas can be

developed. The conceptual framework applied to the research should incorporate stakeholder perspectives and the units of analysis should include the complexity of the whole situation. Generalization will occur through theoretical abstraction (Berger & Luckman, 1966).

From an ontological perspective, the research themes, topics under investigation and related experiences and events are crucial to understanding and answering the research questions. Different observers may have different views of what constitutes truth from one time or place to another (Collins, 1988). Facts are basically created by humans and in research, the truth will depend very much on who establishes it. To judge research, we must establish where labels originate and who has influenced their acceptance (Easterby-Smith M. et al., 2008).

For an epistemological perspective, the acceptance of a particular theory of knowledge usually influences one to adopt research methods that are characteristic of that position. For the MNE-China subsidiary strategy and performance topics, reflexive approaches to methodology are particularly relevant when the study considers cultural differences (Anderson, 1993; Cunliffe, 2002). Among the methodological implications of social constructionism within social science are that the aim of research is invention and that one starts from meanings. With reflexivity of design, one uses the techniques of conversation, interpretation and analysis with 'sense making', which produces an understanding of the issues (Easterby-Smith M. et al., 2008).

3.3 Research design

3.3.1 Qualitative research

The main objective of this research is to determine the factors that influence the headquarters-subsidary relationship in relation to its impact on the strategy and performance within a subsidiary of a Europe-based MNE located in China. When one's research objective is to gain a deeper and more comprehensive understanding of a social phenomenon, the case-study approach is often preferred. The research reported in this thesis adopts a conceptual framework as established theory, according to the underlying assumptions in the specific organizational setting, to explore and identify the connections among various aspects of the influential factors. Using a single case study is a suitable approach, as it allows for assumptions to be tested and alternative explanations to be considered (Yin, 2009).

Bischooping (2002) advances several arguments to explain why a qualitative approach facilitates an in-depth analysis. Qualitative research is appropriate when an experimental approach is not feasible or practical. It is also suitable when little is known about the selected phenomenon, and it facilitates the exploration of phenomena that by nature are complex and difficult to investigate via a more experimentally controlled approach. It also allows one to gain deep insights about the behaviour of a group of people or an organization and to reveal how things are perceived to happen from the inside (Bischooping, 2002).

Doz (2011) characterizes the international business of MNEs as an open, rich and complex field of study. Because it is “not only intrinsically rich and complex, but also free from any single core paradigm”, research in this area cannot pursue a single dominant central research question and does not admit the generally accepted simplifying assumptions that will drive the selection of research methods. The research reported in this thesis, then, will produce new insights and will discuss various interpretations of the research questions posed in Section 1.6. As noted by Doz (2011), the researcher needs to be flexible about choosing an approach to the topic of the MNE-subsidary relationship and open to insights into particular relevant issues, rather than expecting to arrive at one definitive answer. He must therefore be able to deal with the uncertainty resulting from the profusion of philosophical perspectives, research techniques, modes of presentation and so on (Johnson, Buehring et al., 2006). Taking a qualitative approach to the present study will facilitate the gaining of rich insights into the MNE-subsidary relationship. According to Van Maanen (1979), the term ‘qualitative method’, as applied to research,

...has no precise meaning in any of the social sciences. It is, at best, an umbrella term covering an array of interpretive techniques, which seek to describe, decode, translate, and otherwise come to terms with the meaning, not the frequency, of certain more or less naturally occurring phenomena in the social world (p. 520).

Qualitative research, according to Cassell & Symon (2004), can be characterized basically as lacking numbers, highlighting meaning instead, focusing on emergent themes, being flexible, using research reflexivity, being sensitive to processes, adopting

a holistic view and referring to people as participants rather than subjects. In accordance with normal case-study practice, the present researcher did not control the behavioural events under study; instead, the main focus was on investigating contemporary events in a selected target MNE within a real-life context, using this approach to identify issues and obtain findings. The aim was to gain novel insights into how and why a given headquarters-subsidary relationship works in a particular way in the context of a specific host country, China.

Adopting qualitative methods for MNE-related research can contribute to an understanding of the topic in several dimensions simultaneously. On a broader scale, using such methods can serve as a catalyst for the development of theories for the study of immature fields which currently lack a viable theory because they have borrowed theories from other disciplines or fields (e.g. transaction cost theory) that may initially appear relevant but turn out to be barriers to understanding instead. This realization seemed relevant for the authors' research into MNE headquarters-subsidary relationships. Secondly, qualitative research is useful in theory testing, examining the phenomenon under investigation through various theoretical lenses and systematically comparing "the nature and extent of the insights provided by these various theories" (Doz, 2011). Finally, qualitative research can contribute significantly to the process of outlining and highlighting multiple theoretical dimensions through a comprehensive description; in this way, it provides a meaningful tool for effective communication of theoretical findings.

Gibbons et al. (1994) conceptualize management and business research in terms of two somewhat opposed approaches: Mode 1 research concentrates on the production of

knowledge by detached scientists focusing on theoretical questions and problems, whereas mode 2 research is characterized by the production of knowledge through direct engagement with social practice and problems. The present research study falls mainly into this latter category.

Upon making choices as to what will and will not be studied in this research, we need to explain and justify what data (in the form of words or numbers) will be collected and how, where it will come from, how to analyse the data and how to provide the answers to the research questions (Easterby-Smith M. et al., 2008). Given that the research questions addressed in this thesis are mainly concerned with how and why certain phenomena occur, the author adopted the well established case study strategy in order to advance the research. This strategy is widely accepted for use in such research and is particularly relevant to the exploration of new concepts and the development of new theory (Yin, 2009).

In tackling the topics of MNE subsidiary strategy and performance, this research assumes that there are different ways to explain and assess outcomes. The study attempts to establish how various claims for truth and reality are to be constructed and explained in a particular real-life case. Writing about qualitative case studies, Stake (2006) notes the existence of unique features that may or may not be generalized to other contexts. By conducting interviews with key actors in the company over a period of years, we inject a longitudinal element into the research in order to better understand both the contextual and historical setting of the company. Such a description implies that a significant amount of qualitative research needs to be done in order to provide answers to 'how' or 'why' research questions around the complex nature the topic

addressed in this thesis. Miles & Huberman (1994) conclude that qualitative research methods—especially those with a longitudinal element—allow the researcher to “preserve chronological flows, see precisely which events lead to which consequences, and derive fruitful explanations”.

Having thoroughly compared the advantages and disadvantages of qualitative and quantitative research methods for the study, we eventually decided to select a qualitative research approach to advance the overall objective of determining the significant variables that influence the quality of the headquarters-subsidary relationship in MNEs operating in China.

3.3.2 Research design considerations

Once a qualitative research strategy has been selected as being appropriate, one then needs to select an appropriate research design in order to proceed. According to Yin (2009), three aspects of scope need to be thoroughly evaluated when selecting a qualitative study method:

- the type of research question(s) being posed;
- the extent of control over actual behavioural events related to the topic under study;
- how much of the research focus will be on contemporary events.

The wording of the four research questions set out in Section 1.6 makes quite apparent the explorative nature of the overall objectives. All defined research questions, regardless of whether they begin with ‘why’ or ‘how’, suggest the use of case study,

historical analysis or experiments, as they “deal with operational links needing to be traced over time, rather than quantitating these as frequencies or incidence” (Yin, 2009). In order to further distinguish between case study, history and experiments, the extent to which the control of behaviour is desired can be taken as a good indicator of what type of design is appropriate. The qualities of each of these and the appropriateness of their application to this research will now be considered in turn.

Experimental methods are usually chosen when researchers can exert a certain degree of influence on behaviour; they are also often applied in the social sciences rather than in phenomenological research, like the present research addressing headquarters-subsidary relationships and the subsidiary strategy and performance of MNEs (Yin, 2009). Because a specific research objective is to understand the reasoning behind the behaviour of the management and decision-making in the context of modern MNEs, this research holds that an experimental design would be inappropriate, which is why it was excluded from the potential research designs.

Histories deal with the ‘dead’ past and rely heavily on historical data sources such as archives, in contrast to contemporary case studies, which generally deal with current events via the direct observation of the phenomenon under study or using interviews with relevant stakeholders in that phenomenon.

This research focuses on a company and its subsidiaries with a clear emphasis on contemporary events, relying on contemporary data sources of primary and secondary data such as annual reports, interviews and company websites. As strongly suggested by Yin (2009), the design of this research accommodates a variety of qualitative research methods

within a case study framework. This design is appropriate for its ability to shed light on relevant MNE subsidiary strategies and performance-related management decisions at the corporate and subsidiary levels. Perhaps the most important aspect of the case study method is its capacity for theory building. Creative insight can be gained from the juxtaposition of contradictory or paradoxical evidence. The second strength of a case study design is that the emergent theory is likely to be testable with constructs that can be readily measured and hypotheses that can be falsified. Its third strength is that the resultant theory is highly likely to be empirically valid, because the theory-building process is so intimately linked with evidence. Moreover, it is very likely that the resultant theory will be consistent with empirical observation (Eisenhardt, 1989). A single case study is thus suitable for the present research, which explores a social phenomenon in a new and/or unusual context (Eisenhardt & Graebner, 2007).

3.3.3 Case selection

Although a case-study research design was selected, a guiding research framework still needs to be proposed. In fact, in this regard, two questions still need to be answered: Should the research use one or several cases, and should it use single or multiple objects for analysis? For the first question, the decision to perform a single or multiple case study is primarily determined by the type of case being studied.

Having selected a case-study research design, it remained for the researcher to adopt a guiding research framework, which entailed answering two questions: Should the research study one or several cases, and should there be a single or multiple objects of analysis? The decision on whether to perform a single or a multiple case study is

primarily determined by the type of case being studied. Yin (2009) lists five rationales that are considered to favour the studying of a single case. Of direct relevance to the present research is the value of studying a representative and typical case to illustrate and explore the research topic, given that the research aims to capture the circumstances of a commonplace situation. When dealing with the topic of an MNE's subsidiary strategy, a single case study would be very constructive for exploring and gaining insight from qualitative data (Martin & Beaumont, 1999). The single case-study method is instructive when contextual issues are involved and are crucially important to interpreting the data (Yin, 2009). Context is an obviously key aspect of this research, as the performance and strategy of the subsidiary would probably be very different if it were located in Brazil, for example, rather than in China. The single-case study method would also allow in-depth longitudinal data to be collected and would make longitudinal data analysis possible. Moreover, it can contribute to a clearer understanding of factors that influence the strategies and performance of an MNE's China subsidiaries, its corporate international business strategy and the relationship of those subsidiaries with corporate headquarters.

Given the above considerations, this research adopts an in-depth longitudinal single-case study design. More specifically, a single case is studied in order to investigate the relationships among the market environment, subsidiary strategies and subsidiary performance. The MNE selected as the research object is a universal system transportation company (UST), which is an anonymity of a multinational corporation that designs, assembles and tests equipment for customers in the marine and offshore industries around the globe. The researcher worked at the case company as General Manager at the time of research. This allowed him to gain access to key interviewees

and materials. In the process of research, the researcher is positioned as an external observer, and avoid to influence opinions and assertions of interviewees. In that aspect, he has no pre-defined propositions with regard to each of the research topics. when conducting interviews, all candidates are introduced to the main purpose of the research and encouraged to express their opinions and comments as what they think is true, and avoid to be influenced by the researcher. By such a definition of position, it also helps the researcher to analyse research questions in objective and independent standings.

To improve local response, UST has established a global network of branches, web services and agents. The UST Group, which had more than 1500 employees at the end of 2014, has its headquarters in Bergen, Norway and is listed on the Oslo Stock Exchange. In order to reduce costs, UST has gradually shifted its operations from high-cost European countries to low-cost Asian ones such as Singapore, China, Vietnam and South Korea.

UST's entry into China was mainly driven by market-seeking motives, however, considering China's huge market size and rapid economic growth. Specifically, China became the world's second largest economy in 2010. Its explosive growth has attracted not only UST but many other international companies, so that an increasing number of foreign MNEs have entered China during the last few decades. The World Investment Report shows that China became the second largest recipient of foreign direct investment (FDI) in the world in 2009; by 2014, it was the largest FDI recipient. UST had strong strategic motives for entering China, because China not only provided a market with great growth prospects but also had an abundant supply of cheap labour.

Since UST was a latecomer in the Chinese market, it adopted an accelerated internationalization strategy in an attempt to capture the potential benefits arising from the strong growth of the Chinese market. Specifically, UST preferred using merger and acquisition (M&A) to ‘green field’ investments. Since company resources were very limited, however, UST used M&A sparingly, in order to set up subsidiaries as quickly as possible. This usually meant that it had partial ownership, which had the effect of motivating local partners to contribute their local resources and to become actively involved in operations. At the business level, subsidiaries used a growth strategy to increase their market share in China. At the operational level, UST used localization to satisfy the needs of local customers, as well as to cut operating costs.

3.3.4 Data collection instrument

The main instrument used to collect qualitative data for the present research was a series of semi-structured interviews. This was considered the best and most appropriate way to allow participants to express their perceptions and give their opinions in their own language. Another benefit of using interviews and posing open-ended questions is that interviewees were enabled to offer views on issues bearing on UST’s subsidiary strategy that may not have been considered before undertaking the research or by previous published research.

The semi-structured interview protocol, reproduced below in Table 3-1, comprised four core questions; interviewees were encouraged to elaborate on their responses to these by the posing of further relevant sub-questions designed to provoke opinions and novel perceptions on the issues under investigation. The interviews were conducted either by

phone or face to face and lasted between 60 and 90 minutes. All interviews were recorded, then transcribed. Transcripts were analysed chronologically and thematically in order to isolate the key issues relating to the case history, the development of the subsidiary's strategies and performance, and their relationship with the MNE's corporate international strategy and headquarters-subsiidiary relationships.

Table 3-1 The basic information of the respondents

Name	Position	Location
ARL	Vice President, Sales and Marketing	Norway
CEF	Manager, Sales	Norway
DAS	Vice President, Finance	Norway
JON	CEO and President, UST Group	Norway
SVH	Senior Manager, Sales and Marketing	Norway
THM	Director, Rig Solution and Sales	Norway
TOF	President, Division	Norway
TOO	Vice President, Operation and Project Management	Norway
LEW	Manager, Project Management, UST China	China
REL	Manager, Finance, UST China	China
TUM	Manager, Technical and Engineering, UST China	China

Source: Author.

The four core interview questions were open-ended and were developed by the researcher from the research questions. They focused on gaps in the existing literature, on the lack of knowledge regarding the subsidiary strategy of MNEs in China and on factors affecting performance. Special attention was given to why and how the uncertainties of the host-country environment (i.e. that of China) influence the

headquarters-subsiidiary relationship and its interrelation with the MNE's corporate strategy. The set of basic interview questions was as follows:

1.

- What are the most important factors that influence strategic decision making in your MNE subsidiary in China?
- Can you explain why?
- How do these factors influence the subsidiary's decision-making?

2.

- What are the main tools adopted by UST headquarters to control the subsidiary?
- Why do you think headquarters made the decision to adopt these tools?
- How do you assess the effectiveness and results of these control tools?
- Are you more concerned about results, or did you also want to understand the processes?
- Given the market in China, is it accepted as an emerging economy and the subsidiary company as the host country?
- Do you see these controls as being flexible, for some reasons or to some of the procedures?

3.

- How do you think your corporate strategy will influence the strategies of the subsidiary and its performance?
- How do you perceive the subsidiary's response to headquarters strategies and headquarters control?

4.

- How do you think the subsidiary's strategies in China will influence the overall

corporate strategy?

- How do you think the relationship between the corporate level and the subsidiary should be developed?

Answers to these questions were supplemented by data retrieved from public and internal company documents, including board-meeting memos, email correspondence and public reports.

3.4 Data sources and collection methods

One of the main advantages of the case study method is its ability to identify connections among a variety of sources and allow ‘data triangulation’ (Eisenhardt, 1989; Yin, 2009). Triangulation refers to the combination of methodologies when studying the same phenomenon in order to obtain a clearer and more confident answer to the research questions (Denzin, 1970: 291). Examining findings gathered by a variety of methods reduces the potential impact of biases that might exist in a single case study (Bowen, 2009). As Patton (2002) points out, triangulation of methods is essential for single case studies to avoid allegations that the findings are the artificial outcome of a single method or source, or are due to the researcher’s bias. According to Glaser & Strauss (1967), gathering data from varied sources makes possible an in-depth analysis from different perspectives. Case studies can involve qualitative data, quantitative data or both (Yin, 2009) and these can be collected by a variety of methods, such as interviews, direct observation or document inspection. Moreover, case-study research can be done by a single researcher or multiple investigators (Eisenhardt, 1989).

As noted above, data were collected for the present study from two main sources, which have been widely adopted in case studies.

- Interviews were conducted with key company employees based in headquarters and others in the subsidiary in China, in order to elicit their different perceptions and opinions based on their varied experience and points of view;
- The researcher also studied published and unpublished material from inside and outside the company, such as the company yearbook, internal documents, books and news reports, among others.

The main data-gathering function of the researcher was as the person in charge of semi-structured interviews, both in the parent company and the subsidiary, which served as the main source of information. Primary data from management layers of the MNE headquarters and its subsidiary are particularly important to the study, as it allowed me to “slice vertically through the organization, obtaining data from multiple levels and perspectives” (Leonard-Barton, 1990). In other words, perspectives from both ends of the MNE were sampled, providing “synchronic primary data source triangulation” (Pauwels & Matthyssens, 2004).

● *Interviews*

Because interviews have important advantages over other methods in gaining a deep understanding of the evolutionary processes and structure of management decisions (Gummeson, 2000), the researcher decided to make interviews the primary data

source. These were conducted with key stakeholders in the parent company and the local subsidiary who were involved in the decision-making process.

Interviews were semi-structured, which was an appropriate approach not only to encourage the interviewees to talk directly about the topics under study, but also to allow them to elaborate freely on their thoughts and opinions. Semi-structured interviews do, however, carry the risk of bias, since the researcher is potentially exerting personal influence on the scope of the data collected and their analysis. Since the data are interpreted subjectively, with a specific personal frame of reference and values, they could potentially be interpreted differently by another person (Yin, 2009). Still, all things considered, it was decided that semi-structured interviews provided the optimal way of accurately answering the research questions.

The selection of interviewees was based on the research topic and theoretical orientation. The purpose of the study obviously required interviews to be conducted with managers from MNE headquarters and the subsidiary, in order to elicit information, opinions and perceptions from both parties to the headquarters-subsidiary relationship. It was important to obtain perceptions and opinions from diverse perspectives in order to limit risk of introducing bias (Eisenhardt & Graebner, 2007). Top management personnel were chosen for the interviews, which were conducted either face to face or by phone.

Before each interview, the interviewee was briefed about its purpose and how it would be structured, and was asked to give written informed consent for it to be recorded. The questions were open-ended and focused on a specific theme. This follows the

recommendations when qualitative data are generated for explorative case studies (Kvale & Brinkman, 2009; Yin, 2009). Eleven interviews were conducted. The interviews with headquarters managers were conducted in English, whereas those with managers of the Chinese subsidiary were conducted in Mandarin Chinese. Table 3-2 lists the positions of the interviewees within the company.

Table 3-2 Positions of interviewees

Unit of the MNE	Roles of Interviewees
Headquarters	<ul style="list-style-type: none"> • CEO and Group President • President, Oil and Gas Division • Oil and Gas Solution VP • Sales VP • Finance VP • Project VP • Sales manager 1 • Sales manager 2
Subsidiary in China	<ul style="list-style-type: none"> • Finance manager • Product and engineering manager • HR manager

Source: Author

Following each interview, the interviewee was sent a transcript and asked to check factual information, together with a request for approval or modification, in order to avoid possible misunderstandings and to strengthen the credibility of the results.

The number of conversations with selected MNE stakeholders in the form of face-to-face meetings, telephone interviews or e-mail correspondence varied from one case to another, but each primary data source was sampled at least twice in order to enable “diachronic primary data source triangulation” (Pauwels & Matthyssens, 2004: 6). In other words, subsequent input from the same source on the same topic was implemented throughout the data collection process. This research thus benefited from the

triangulation of two data sources and the triangulation of synchronic and diachronic main data sources, providing the research methodology with the key pillars of a robust case analysis architecture, as suggested by Pauwels & Matthyssens (2004). It was not possible, however, to strengthen the architecture further by achieving observer or investigator triangulation, because the study was carried out by a single researcher.

- *Documents*

While the principal source of data was the individual interviews, open sources were also used to expand and diversify the dataset, thus introducing additional perspectives. Internal company documents such as press releases, newsletters and annual reports helped to widen the research perspective by providing further evidence of management decision making from the headquarters viewpoint, whereas external sources such as newspaper and magazine articles were included to subject the managers' actions to more objective view. These documents helped to enrich the interviews at the level of the enterprise and affiliated companies, providing a means to obtain a clearer picture of the overall phenomenon being investigated (Marshall & Rossman, 1999).

When using these documents and Web-based information, the researcher was aware that any document may be subject to an individual's purpose and therefore may compromise objectivity (Gummesson, 2000). Overall, emphasis was given to the qualitative data collected from interviews, as they are considered to be the most suitable for understanding enterprise- and subsidiary-level decision processes. Indeed, most of the other sources turned out not to be very fruitful, because they did not provide sufficient depth or detail of the specific strategies of the Chinese subsidiaries and the

performance of MNEs. However, data sources such as annual reports of the corporation and its subsidiaries did help me greatly by providing quick access to a broad understanding of the situation.

Document analysis is a method often used in data triangulation. Documents can provide data on the context in which the research participants operate, in this case, the employees within a company. They can also furnish evidence of past events and background information, as well as historical insights. Such information and insights potentially help the researcher to understand the historical circumstances that may have led up to or affected the current phenomenon being investigated (Bowen, 2009). Bowen (2009) explicitly points out that the data gathered from documents can be used to contextualise the data that are collected in interviews. The newsletters that were examined in this case study were, however, considered to contain insufficient information to motivate a categorization of each theme, as in the analysis of the data collected from interviews.

The preparation for data collection was based on propositions and a priori constructions. Consistent with Yin (2009), this approach was helpful in moving in the right direction at the beginning of the research. It further promoted the preliminary design, for example by guiding the semi-structured interviews and facilitating a more accurate interpretation of the data. Initially, the researcher was unsure of how many interviewees would be needed or how often it would be possible or desirable to seek information from each source, so an attempt was made to maximize the output of each interview and its contribution to the study from the beginning, to ensure adequate coverage. This method is in good agreement with the recommendation of Mintzberg (1979) that qualitative

case study researchers should always “go into organizations with a well-defined focus” and “collect specific kinds of data systematically”. Moreover, if an a priori structure is shown to be important in the course of the study, the researcher “has a firmer empirical grounding for the emergent theory” (Eisenhardt, 1989b: 536).

Based on the research questions and the literature, a priori constructs were developed. The overall information and data on the Chinese subsidiary, including its strategies and performance within the MNE, were relevant for all four research questions, while the other constructs were related only to the assessment of factors that influenced the headquarters-subsidiary relationship and corporate internationalization strategy at the subsidiary level. In addition, the overall data collection process was not limited to the defined constructs, even at the beginning of the study. Given the inductive character of the specific case-study design, this research was open to new findings and theory at all stages and the researcher was guided throughout the study by the principle of continuous iteration between existing theory and the research findings.

In recording the interviews, the researcher followed Yin’s (2009) guidance that audio tapes certainly provide a more accurate rendition of any interview than any other method. Following the initial data acquisition, recorded interviews were transcribed as a Microsoft Word document and uploaded to NVivo, a dedicated suite of qualitative research software, in order to allow subsequent data coding and analysis. All interview transcripts were thoroughly and repeatedly read to ensure that they accurately reflected the interviewees’ perceptions. While the recording and transcription processes produced a large amount of raw data, it was clear from the beginning that only certain parts of each interview were actually related to the subject of the study.

3.5 Data analysis

Eisenhardt and Graebner (2007) point out that case-study analysis can be conducted according to the conditions of the data, the researcher's characteristics and the guidance of existing literature. There is no universally accepted mode of analysis, but its purpose should be clear, whether it is to verify extant theory or to develop new theory.

According to Eisenhardt (1989: 539), data analysis is “the heart of building theory from case studies, but it is both the most difficult and the least codified part of the process”. Qualitative data analysis is made difficult by the limited guidance and fixed procedures available to qualitative researchers. Yin (2009) suggests that analysis much depends much on the researcher's own style of rigorous empirical thinking, along with the sufficient presentation of evidence and careful consideration of alternative interpretations.

Miles & Huberman (1994: 50-89) propose eight early analytical techniques that were fully considered at the beginning of the analysis process. Due to time and resource constraints and because some aspects were considered unsuitable for the work reported in this thesis, the eight methods were not all used extensively. Nonetheless, this approach is in line with the advice of Miles & Huberman (1994), who stress the potential benefits of each technology but do not specify that exhaustive use should be made of them.

Performing within-case analyses was very helpful in dealing with the very large amount of data in the early stages and in allowing the researcher to become familiar with the

individual case (Eisenhardt, 1989b). Throughout the case study, it became clear that many of the proposed techniques supported each other. The contact summary sheet, for example, which was completed immediately after each interview, helped to guide the first- and second-level coding processes. The increasingly interpretative coding of data from both the subsidiary and headquarters levels, by triangulating these two data sources, allowed the researcher to transform initial notes from the contact summary sheet into interim case summaries that were sent out to each interviewee for approval. Other techniques, despite being used to only a limited extent because of time restrictions, helped to improve the interpretation of the initial process.

3.6 Quality control

It can be challenging to draw conclusions from case-study data which can be justified as reflecting the underlying truth and the rules of interpretation; thus it is necessary to maximize the trustworthiness of the study from the outset. Guba (1985) defines trustworthiness in the context of research in the social sciences with reference to the four pillars of applicability, consistency, truth-value and neutrality. It is widely acknowledged that the criteria for assessing the rigour of scientific research differ between the quantitative and qualitative approaches. The trustworthiness of quantitative studies is normally viewed from a positivist stance and is generally evaluated along the dimensions of internal and external validity, objectivity and reliability.

However, qualitative approaches differ in their underlying assumptions and study aims, usually taking a non-positivist epistemological stance, so the judgement of their trustworthiness will require a different set of evaluation criteria (Bradley, 1993).

According to Lincoln & Guba (1985), the trustworthiness of qualitative research depends on four factors: its credibility, dependability, transferability and confirmability. The following subsections discuss each of these factors, their application to this research and the criteria by which they are assessed. They also explain the strategies which have been proposed by scholars to enhance the trustworthiness of qualitative research and their adoption throughout the present study.

3.6.1 Credibility

According to Bradley (1993: 436), credibility entails the “adequate representation of the constructions of the social world under study and can be assessed both in terms of the process used in eliciting those representations and in terms of the credibility of those representations for the community under study”. Although this definition refers to qualitative studies in the field of social sciences, it can also be applied to the present research, which adopts a qualitative approach to the topics of MNE headquarters-subsidiary relationships, subsidiary strategy and performance. The challenge for this thesis is to “demonstrate truth-value” by comprehensively describing to the reader the research subjects, the methods adopted and the findings derived from them (Pauwels et al., 2004: 194). It is thus necessary to ensure a high level of transparency throughout the thesis, an approach which has generally been adopted as a good means of maximizing the overall credibility of any scientific undertaking.

3.6.2 Transferability

In order to meet the trustworthiness criterion of transferability, it is necessary to demonstrate and justify the extent to which the study findings can be applied to different settings or contexts. Bradley (1993) states that

...this is a judgment that can be made only by comparing the two contexts, the burden of which should not fall on the researcher but on those who wish to make the comparison. The researcher's responsibility is to provide enough data, through rich, ample description, to allow these judgments to be made.

The present research has followed the dual approach of building structural relevance and providing a sufficient body of data from interviews and documents to meet the transparency criterion, thus enabling conclusions to be drawn that are adequate in terms of transferability.

3.6.3 Dependability

The criterion of dependability relates to the consistency and stability of findings (Guba, 1981). Satisfying this criterion requires a thorough description of all processes and methods of data gathering, analysis and interpretation that lead ultimately to the research findings. It is then necessary to demonstrate to the reader how the coherence of the internal process has been ensured and to what extent the researcher has accounted for changing conditions within the settings in which the phenomenon has been studied (Bradley, 2003). This means that given the context of a non-positivist epistemological

stance as precondition, research findings cannot easily be replicated in different settings. Achieving a high degree of dependability in qualitative research therefore requires the researcher to demonstrate that the existence of changing parameters has been taken into consideration throughout the research process. This means spending sufficient time and effort in order to obtain a thorough understanding of the phenomenon under study and then to communicate this to the reader.

Confirmability

3.6.4 Confirmability

The criterion of confirmability refers to the level of neutrality and objectivity of the study findings. If confirmability has been achieved, an unbiased reader should be able to “arrive at comparable conclusions given the same data and research context” (Krefting, 1991: 221). This again requires a high degree of transparency throughout the design, conduct and communication of the research.

3.6.5 Discussion

To establish confirmability and dependability, Lincoln & Guba (1985) suggest that researchers should conduct regular audits, to thoroughly describe the overall research process (dependability audit) and comprehensively interpret the findings drawn from data analysis (confirmability audit). This two-stage auditing process should therefore involve the documentation not only of raw data (e.g. in the form of interview transcripts), but also of the theory development procedure (e.g. the successive coding stages, or from time-ordered displays to more reflective case matrixes). Lincoln & Guba

(1985) go on to identify six categories of records that can be subjected to such an audit: (1) raw data, (2) conclusions by data reduction and analysis, (3) data reconstruction and synthesis, (4) process notes, (5) materials relevant to intentions and (6) instrument development information (Lincoln & Guba, 1985).

To achieve the aforementioned criteria of credibility, transferability, dependability and confirmability for social science research, Guba (1981), Lincoln & Guba (1985) and Krefting (1991) offer helpful overviews of possible techniques and methods for enhancing the trustworthiness of qualitative research, such as combining the inputs from various sources. The majority of their suggestions were taken into consideration for application to the present research. Throughout the research and at each of its milestones, most of the quality criteria identified were addressed, starting at the very beginning of the study. Therefore, quality control constituted a most important guiding principle throughout the entire study.

Lincoln & Guba (1985: 290-330) list the core instruments for establishing credibility in qualitative studies, including peer examination, prolonged engagement, triangulation, negative case analysis, member checking and referential adequacy, all of which were adopted during the course of the work reported in this thesis. The overall data-gathering process took more than a year, basically because of repeated exchanges with key stakeholders in the different departments. In order to maximize the advantages of theoretical sampling, interviewees were subsequently added gradually to the study. Finally, the researcher began this study with years of experience of working in the manufacturing industry concerned and of participating in strategy making. Prolonged engagement for the purpose of understanding the operational mechanisms of the case

was therefore not necessary. As to peer review, the researcher benefited from abundant and comprehensive feedback from his supervisor, which encompassed discussion of various aspects of existing theory, research methodology and data interpretation. Multiple member checking was achieved through introductory and follow-up discussions with various headquarters managers. The interview summaries were then circulated to all stakeholders both at headquarters and in the subsidiary in China. Most participants made comments, which are discussed where relevant in later chapters of this thesis.

The study has made use of four different types of triangulation. First, it examined multiple research streams in order to develop a priori constructs at the outset and to interpret findings at a later stage, thus guaranteeing theory triangulation. Second, data were collected from both primary and secondary sources, thus achieving method triangulation. Third, by using multiple sources within the same data collection method (e.g. in the form of interviews at corporate and subsidiary levels) it satisfies the criterion of data source triangulation. Finally, investigator triangulation was ensured by the supervisor's provision of peer examination, although this form of triangulation is limited to data analysis and interpretation. In addition to the above techniques, Guba (1981) recommends structural coherence to enhance the credibility of research. For this thesis, the conceptual framework and a detailed summary of data gathering, analysis and interpretation processes were examined in order to avoid any potential inconsistencies.

As to transferability, since the core objective of the study was not to pursue the generalizability of its findings directly to other cases, the main purpose of this thesis

can be defined as to elaborate an extensive description of all elements of the study so that a third person could execute the desired transfer of its findings (Lincoln & Guba, 1985).

The foregoing paragraphs have shown how six categories of auditing have been applied to enhance the dependability and confirmability of this qualitative research (Krefting, 1991). Raw data in the form of interview records and transcripts were stored by electronic means and could easily be retrieved and read for auditing purposes. Data analysis products in the form of the case summaries referred to above could also easily be use for dependability and confirmability audits.

In the following chapters on case description and data analysis, records of data reconstruction and synthesis products have been organized in the form of time-ordered displays and case dynamics matrices. In addition, some of the key process notes are displayed. Finally, raw materials related to dispositions, intentions and instrument development information are provided by different types of study designs and interview guidelines.

In order to satisfy any future audit requirements, standards of integrity and reliability are described with respect to all process elements, including peer inspection, triangulation and data collection methods. The confirmability of qualitative research methods is strengthened by all four types of triangulation, as explained earlier in this chapter. In summary, the research has adopted various credibility enhancement tools and methods of strengthening reliability, transferability, dependability and confirmability, thus ensuring a high level of scientific rigor in this social research.

Although some instruments and methods, such as various records of publications and website contents, cannot be integrated into this thesis due to capacity constraints, it should be noted that the researcher is willing to provide all necessary information to assess the credibility of this study. Having said this, the researcher also recognizes that various instruments which could have benefited the quality of the study were excluded from the research process, due to overall resource and time constraints.

Finally, it is worth mentioning that a native English editor has been invited to proofread some parts of this thesis, as English is not the author's first language. While the corrections made have contributed significantly to the quality of the presentation of the study, they do not materially affect its content, the methods used or the interpretation of the results.

3.7 Summary

Having reiterated the main object of the present study, to identify the factors that influence the relationships between MNEs' host country headquarters and their subsidiaries in China, this chapter has described the qualitative methodology adopted in this research. As it would have been difficult to gather quantitative data from a variety of MNEs, the researcher decided to use a single case study to gain a deeper and more comprehensive understanding of the phenomena under investigation, allowing for assumptions to be tested and alternative explanations to be considered by the employment of various theoretical lenses.

The chapter has explained the overall research design, the criteria adopted to select the case and the details of the data collection process. It ended by discussing ways of ensuring the quality of the research, mainly by controlling the credibility, transferability, dependability and confirmability of the data. The next chapter offers a description of the MNE selected as the case to be studied.

Chapter 4 Case Description

4.1 UST: Background and History

This thesis reports a single case study, from a historical perspective, adopted as the appropriate way to investigate the relationships among factors of MNE environment, headquarters-subsidiary relationships, subsidiary control, subsidiary strategies and subsidiary performance. This chapter gives an account of the case selected as research object, alias named as the UST group of companies, detailing first its background and history, then its internationalization.

The company was founded in Norway in 1966 under the name of UST. By 2013, UST had become a multinational corporation headquartered in Bergen, Norway, specializing in the design, assembly and testing of equipment in the marine and offshore industries for customers around the globe. The group comprised 25 companies in 13 countries with a workforce of around 1800. UST was by then one of the three largest suppliers in the professional market segments for some of its products. It also provided after-sales service, covering the major shipping regions of the world. UST is listed on the Oslo Stock Exchange.

The UST Group's main goal is to design, develop and deliver high quality processing systems and services to the global maritime and offshore industries. It also aims to increase efficiency and create value for customers through a dedicated focus on efficient project execution, product quality and customer-oriented services, combined with an innovative approach towards utilizing new technology.

Over the decades, one of UST’s most important growth strategies has been not only the adoption of organic growth to enhance competence and capacities, but also the use of M&A to achieve quick growth in strategic countries and industrial segments. During the period 1996-2013 alone, UST made more than 30 acquisitions globally in various industrial segments, thus substantially growing the operations and scale of the company. Its sales have grown strongly ever since its foundation. Figure 4-1 shows growth in sales from 0.26 billion Norwegian krone (NOK) in 1997 to 2.45 billion NOK in 2014.

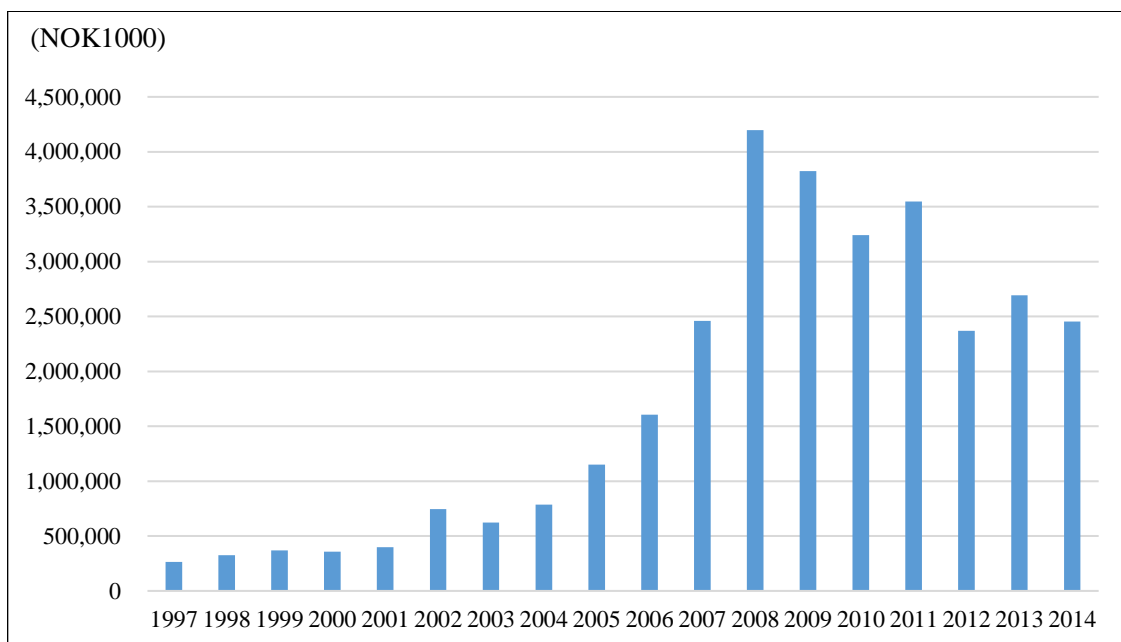


Figure 4-1 Sales of UST from 1997 to 2014

Source: UST annual reports (publicly available)

In order to explore the substantial growth opportunities in emerging market and to control operational costs, towards the end of the last century, UST began to consider the strategy of entering the Asian market. At the beginning of the new century, UST gradually set up various operating companies and established a presence in Asian countries including China, Vietnam and South Korea.

The operations of UST are divided into four business segments, as depicted in Figure 4-2. The marine segment designs, supplies and maintains shipboard handling equipment and delivers a wide range of products and solutions to the maritime industry, including RoRo, pure car and truck carriers, hatch covers and side doors. Among these products and services, UST is one of the most important global suppliers of material handling equipment. In addition, its deck equipment enables operators to carry out tasks efficiently both at sea and in port. The maritime industry is the core industry in which UST has operated since it was founded.

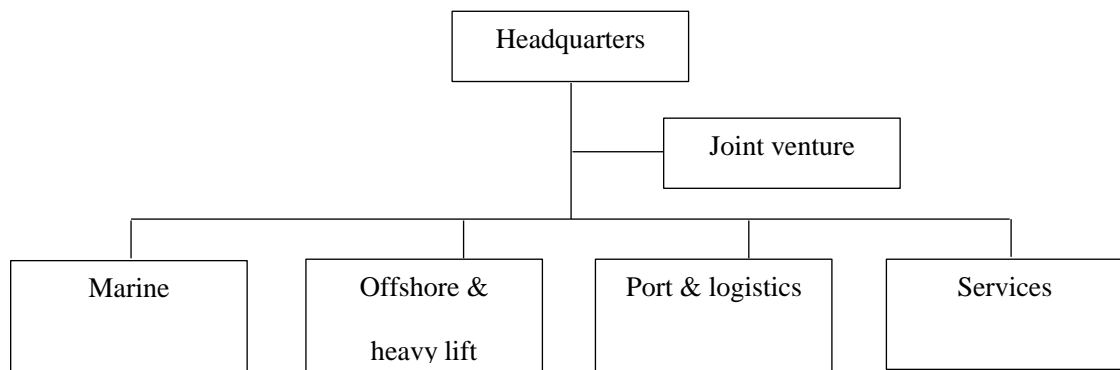


Figure 4-2 The organizational structure of UST

Source: UST annual reports (publicly available)

The second business segment is the offshore and heavy lift division. UST is a leading company in the design and supply of marine and offshore cranes and related solutions, providing all types of cranes with a primary focus on heavy lift and offshore cranes, including advanced active heave compensated cranes. Compared to its competitors, UST is better at subsea load handling in rough and deep waters. In addition, it offers both customized designs and a wide range of standard products. For instance, UST standardized building blocks are able to meet the needs of most individual vessels.

The third business segment is port and logistics. UST offers high-tech solutions to expedite the safe and efficient handling of materials, goods and passengers. For ports and shipyards, UST has a product portfolio ranging from innovative link spans through to some of the world's most forward-looking solutions for moving goods and materials around ports, shipyards and industrial sites. The group delivers a variety of heavy load systems for material handling in shipyards and other industries in addition to cargo handling systems and transport systems for ports. The product range includes various types of transfer systems, ship lifts and other launching and retrieval systems for shipyards.

The final business segment is services. UST has recently invested heavily in supporting its network of qualified, experienced service engineers to provide valuable knowledge and experience to global customers. Its 'service hubs' around the world have improved UST's ability to serve customers quickly and efficiently, thus enhancing its competitive advantage.

4.2 The internationalization of UST

At the turn of the century, as the size of the shipbuilding and oil platform construction market gradually became very limited in Europe, including Norway, these industries gradually shifted to Asian countries such as China, Korea, Singapore and Japan. UST had to consider how to further grow its businesses in terms of scale and market share. While recognizing the need for organic growth, it also needed to ensure a normal level of business operating profits. These factors gave UST a strong incentive to pursue further growth through internationalization.

UST's internationalization path can, however, be traced back as far as the 1970s. In 1974, UST established an international relationship with a leading Chinese shipbuilder by signing a major contract with the China State Shipbuilding Corporation (CSSC), which has provided a unique linkage for UST to enter the Chinese market. As Figure 4-3 shows, UST's internationalization process accelerated markedly in the early years of this century.

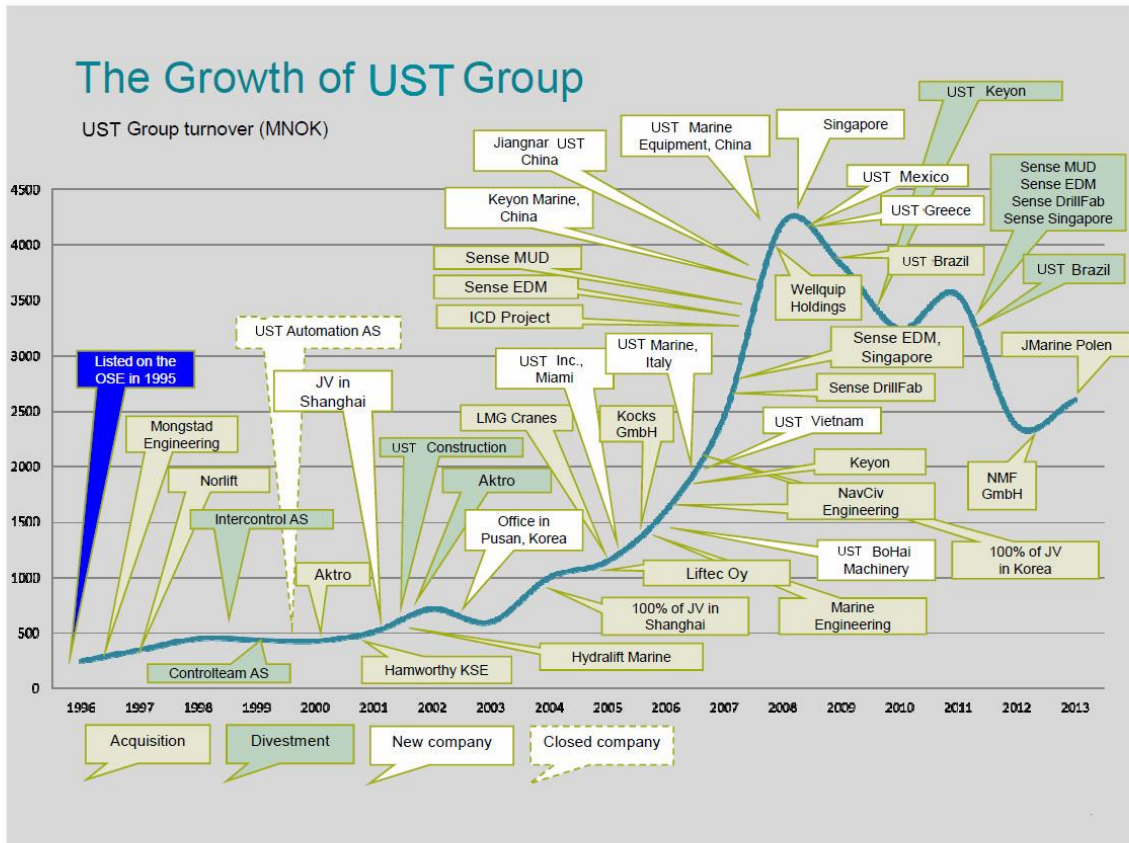


Figure 4-3 The growth of UST Group

Source: Presentation given by JON, Group CEO, 02 October 2013

Table 4-1 lists the key events of this internationalization. UST established UST Marine Inc. in the USA as early as 1994, then set up UST Marine GmbH in Germany in 1997. Of particular relevance to the present study is that UST entered East Asia in 2001 by establishing a joint venture in Shanghai, China. Since then, China has become one of its most important host countries. In 2004, UST acquired the outstanding 50% share of the joint venture and become sole owner of its subsidiaries in Shanghai. In 2005, it established UST BH in Dalian, China. Subsequently, UST established or acquired one or more companies in China in each of the years 2007, 2008, 2010 and 2014. In other words, UST has recently invested heavily in China.

Table 4-1 Key internationalization events of UST

Year	Key events
1994	UST establishes UST Marine Inc. in the USA
1997	UST establishes UST Marine GmbH in Germany
2001	(1) UST acquires a group MNE company, then changes to different companies, which include: UST Marine in Shanghai, China; UST Sweden; UST Ships Equipment; UST Germany and UST HH in China (2) UST set up representative office in Pusan, Korea
2004	(1) UST acquires 100% of joint venture in Shanghai, China (2) UST acquires LMG, Lübeck, Germany (3) UST acquires Liftec Oy, Tampere, Finland
2005	(1) UST establishes UST BH in Dalian, China (2) UST establishes UST Port Equipment AB, Gothenburg, Sweden (3) UST establishes UST Marine Inc. in Florida, USA (4) UST acquires NavCiv Engineering AB, Gothenburg, Sweden (5) UST acquires Kocks GmbH, Bremen, Germany
2006	(1) UST establishes UST Marine s.r.l. in Genova, Italy (2) UST establishes UST Vietnam, Haiphong, Vietnam
2007	(1) UST acquired Sense EDM in Norway and get into drilling product business (2) Establishes Sense EDM Pte. Ltd., Singapore (3) UST acquires 100% of joint venture in Pusan, Korea (4) UST acquires 50% of UST Keyon Marine, Zhang Jia Gang, China
2008	(1) UST establishes Jiangnan UST, Nantong, China (2) UST establishes UST Marine Equipment (Dalian), China
2009	(1) UST establishes UST Greece Ltd., Greece (2) UST establishes UST Singapore Pte. Ltd., Singapore
2010	(1) UST establishes UST Brazil, Brazil (2) UST sells UST Keyon Marine, Zhang Jia Gang, China
2014	UST establishes UST-SCM Marine and Offshore Machinery Co. Ltd., China

Source: UST annual reports (publicly available)

UST also entered other countries in Asia, such as Korea, Vietnam and Singapore. In 2002, it established a representative office in Pusan, Korea and in 2007, it acquired full ownership of a joint venture in Pusan, Korea. UST Vietnam was established in Haiphong in 2006. In Singapore, UST set up Sense EDM Pte Ltd in 2007 and UST Singapore Pte Ltd in 2009. In addition to Korea, Vietnam and Singapore, the company also tried to enter other high growth markets around the world, for example by establishing UST Brazil in 2010.

UST achieved great success through this internationalization process, in terms of the growth of scale, product scope, staff competence and service. By the end of 2014, through direct investment to establish subsidiaries or by M&A deals with other companies in various places, UST had successfully become a multinational enterprise with subsidiaries in 13 countries, namely China, Brazil, Germany, Finland, Italy, Greece, Poland, Norway, Singapore, Sweden, South Korea, Vietnam and the USA. In the process of becoming a real MNE, UST recruited employees of diverse nationalities, so that at the end of 2014, only around a quarter of its 1800 employees were Norwegian, while 74% were from outside Norway. Specifically, 21% were from Germany, 17% from China, 15% from Sweden, 8% from South Korea and 7% from Poland. It is notable that relatively few of these foreign employees were from emerging economies, despite UST's strategic focus on such countries. The percentage of employees recruited from emerging economies is anticipated to increase steadily as UST's business and operational teams expand strongly in those places.

Table 4-2 shows how UST's sales and assets were distributed around the world in 2013 and 2014. It can be seen that around half of sales were generated in Asia, which

represented the most important overseas market for UST, while only about 40% of sales were generated in its home region of Europe. North America represented the third largest foreign market but contributed less than 5% of total sales. The contrast in distribution figures between sales and assets is interesting. Although Europe contributed less than half of total sales, about 80% of total assets were located there. In contrast, Asia contributed half of total sales with only about 20% of total assets. This to some extent illustrates the rationale for UST to view Asia as strategically its most important market and for its strategy of increasing investment there. Given China’s increasingly important role as a major part of the Asian market, UST decided to treat it, according to its strategic message, not as a foreign host market, but as a kind of second home market.

Table 4-2 Distribution of sales and assets

Area	Sales		Assets	
	2013	2014	2013	2014
Europe	42.78%	41.52%	80.10%	78.53%
Asia	48.72%	52.83%	19.46%	20.18%
USA/Canada	1.90%	4.73%	0.44%	1.29%
Rest of the world	6.59%	0.91%	-	-
Total	100.00%	100.00%	100.00%	100.00%

Source: UST annual reports (publicly available)

By the end of 2014, UST had successfully invested in or acquired 25 subsidiaries around the world, listed in Table 4-3, which shows that following the founding of the first two foreign subsidiaries mentioned above, in the USA and Germany, most of its foreign

subsidiaries have been set up or acquired in the twenty-first century as the group has expedited its internationalization process.

Table 4-3 UST subsidiaries

Subsidiary	Country	Founded / Acquired
UST Marine Inc.	USA	1994
UST Ships Equipment GmbH	Germany	1997
UST Marine Shanghai Co Ltd	China	2001
UST HH Ships Equipment Co Ltd	China	2001
UST Marine AB	Sweden	2001
UST Ships Equipment AB	Sweden	2002
UST Liftec Oy	Finland	2004
UST BH Machinery Co., Ltd	China	2005
UST Marine Ostrava s.r.o.	Czech Republic	2005
UST Port Equipment AB	Sweden	2005
UST Marine S.r.l	Italy	2006
Jiangsu UST HH Ships Equipment Ltd	China	2007
UST Marine GmbH Korea Co. Ltd	Korea	2007
UST Marine Equipment Ltd.	China	2008
UST Greece Ltd.	Greece	2009
UST Singapore Pte. Ltd.	Singapore	2009
UST Marine Holding AB	Sweden	2011
UST Port & Logistics Holding AB	Sweden	2011
Shanghai UST HH International Trade Co., Ltd	China	2012
UST Neuenfelder Maschinenfabrik GmbH	Germany	2012
UST Polen SP.Z.O.O	Poland	2013
UST Brazil Services	Brazil	2014
UST BH Trading (Dalian) Co., Ltd	China	2014
UST SCM Marine and Offshore Machinery Co. Ltd	China	2014
UST Vietnam Co. Ltd	Vietnam	2014

Source: UST annual reports (publicly available)

These subsidiaries were almost equally distributed between developing and developed economies, since each type of economy carries essentially different country-specific advantages. The main strategic motives or objectives for investing can also differ among diverse countries. The main purpose of investment in developed countries can be attributed to setting up a global network and seeking technical and human resource advantages, while for investment in emerging countries, the main goals may be access to markets and the reduction of operating costs. By combining various market entry strategies and objectives, UST has been able to make good use of firm-specific advantages, developing and growing its business to obtain the diverse advantages that various local country markets can provide. By a good combination of such country-specific and firm-specific advantages, UST has improved its performance over the decades.

4.3 Summary

This chapter has introduced the research object, the UST Group. As an MNE that designs, assembles and tests equipment for the marine and offshore industries for customers around the world, UST provides a perfect object for the research context, which is the relationship between MNE headquarters and subsidiaries from the point of view of strategy and performance.

An account has been given of UST's internationalization and its performance in its main host-country markets. UST can be taken as broadly representative of MNEs that operate all over the world. It provides after-sales service, covering the world's major shipping areas, and at the end of 2014 had more than 1500 employees all over the world. Like

most MNEs operating in developing countries such as China, UST seeks resources for a lower cost in host-country markets, entailing a gradual adjustment of its operating strategy from high-cost European countries to low-cost Asian ones such as Singapore, China, Vietnam and South Korea.

This chapter has shown that UST provides a perfect object for the research to analyse MNEs operating in developing countries such as China. Thus, it is appropriate to use the UST case to study the headquarters-subsidiary relationship and its strategy in the host country market, investigating how this will affect the performance of the MNE. Chapter five, which follows, presents and analyses the results of this investigation.

Chapter 5 Research Model Analysis

This chapter presents the results of the enquiry into the relationships among MNE environment, the headquarters-subsidary relationship and subsidiary control, subsidiary strategies and subsidiary performance. The data gathered from interviews and documents are discussed with relation to each construct, before a further exploration of the relationships among these key constructs.

5.1 MNE environment

An MNE operates, by definition, both in its home country where the headquarters is located and in the host countries where its subsidiaries are located. Its environment is basically influenced by both internal and external factors. In the case of UST, analysis of the data identifies the following four dimensions of the market environment in China as the host country: (1) market conditions, within which the main factors are market potential, market maturity, the dominance of state-owned enterprises (SOEs) and lower operating costs; (2) market competition, whose salient factors are competition with global players and competing as a latecomer; (3) institutions, where the important factors are formal institutions and informal ones such as culture; (4) environmental uncertainty, in terms of the rapidly changing market, the wide institutional and cultural gaps between China and Europe, and the fierce competition characterising the Chinese market. The following subsections offer a systematic analysis of the data on these environmental components and the factors which influence them, both internal and external to the MNE.

5.1.1 Market conditions

The first dimension of the environment is market conditions. Given the importance for UST of the industrial market in marine and offshore equipment and solutions, the growth potential of China is huge. The Chinese market has expanded rapidly during the last two decades. The majority of UST's key customers are in the shipbuilding industry. According to IHS Fairplay (<http://fairplay.ihs.com/>) Figures, the shipbuilding output of China rose steeply from about 4 million dead weight tonnage (DWT) in 1998 to around 37 million DWT in 2009. Along with this rapid growth in output, the market share of the Chinese shipbuilding industry also grew quickly, giving it a more important role globally. IHS Fairplay data indicate that about 45% of global shipping was built in China in 2009, by which time this percentage had decreased to 1% for European shipbuilders. Thus, China has become one of the most important players in the shipbuilding supply chain, which explains why UST decided to substantially increase its investment in China, as explained in official UST documents:

***10 years of success in China:** China has been a priority area for UST for almost ten years. With regard to added value, UST's wholly owned companies and joint-ventures in the "Middle Kingdom" have become increasingly more important. China is gaining admiration for its efficient handling of the financial crisis, and is about to overtake Japan as the world's second largest economy....., and UST is reaping the benefits of this. (UST Annual Review 2013)*

One of China's official target areas this millennium is shipbuilding. After overtaking South Korea two years ago, China is firmly the world's largest shipbuilding nation with 45% of global orders. (UST Annual Review 2013)

Since it first began to invest there, UST has treated China as a strategically significant potential market. It has specifically designed its headquarters-subsidary relationship to manage issues related to its Chinese subsidiaries and has developed special strategies to manage these subsidiaries.

Its market potential is something different. It's because of the way the Chinese conduct business. And then you need to think about it. I mean, if you think Norwegian, you will not succeed in China. If you think American, you will certainly not succeed in China, okay? (JON, Group CEO)

China is a special case in many, many ways. First of all, it's very, very big. Second, it's cheap and efficient. And it's an emerging market which is growing and is taking over a big part of the offshore market. (ARL, VP S&M)

The second important characteristic of the Chinese market in the industries in which UST operates is its immaturity. Since China is a latecomer to the international market in shipbuilding and offshore platform construction, it will take time for local Chinese players to understand international clients' demands and expectations. Chinese shipyards tend to lack experience, knowledge and expertise in the field in comparison with their counterparts in more mature markets and thus are eager for foreign suppliers to introduce technical skills and to provide customer support and after-sales service.

For UST as a foreign firm, this represents both challenges and opportunities, in terms of its China subsidiary strategies.

In general, our Chinese customers need more support than most of the other customers simply because they are new to the game, and some are kind of lacking experience. So we have to support more in China than we do elsewhere.

(TOF, President, Division)

A third significant difference between China and developed countries is that the market is dominated by SOEs, which are particularly prevalent and play more important roles in the marine and shipbuilding industries. Despite the steep decline in the number of SOEs during China's market-oriented economic reforms, they still play a strategically dominant and controlling role. Prior empirical studies provide ample evidence of this phenomenon. For instance, as of 2015, the manufacturing industrial sectors contribute 40% of China's GDP.¹ At the end of the same year, 920 of China's 1434 public listed firms (almost two thirds) were SOEs.

The oil and gas industries in China are also dominated by SOEs, the three main national oil companies being the China National Petroleum Corporation, the China National Offshore Oil Corporation and the China Petroleum & Chemical Corporation. In 2011, UST predicted that in the coming five years these national oil companies' overall purchase investment would amount to around 46 billion US dollars. In order to succeed

¹ Wikipedia. Industry of China. https://en.wikipedia.org/wiki/Industry_of_China

in China, UST must win the trust and confidence of these SOEs. It will then need to have strategies to differentiate its capabilities and develop unique strengths when entering the Chinese market, whose characteristics mean that UST must prepare a special strategy for its subsidiaries in China and a unique headquarters control scheme to ensure proper response to local clients.

The fourth market consideration is that when UST decided to move into China in the early 2000s, Chinese labour costs were very low. China has the largest population in the world and when it first opened the door to overseas firms, the supply of labour was very abundant, making labour costs correspondingly low. According to UST data, the total operating expenses for a subsidiary in China were about 16% of those in Norway. Within this overall figure, the savings in staffing costs were more significant for front-line workers, at 94%, than for managers, at 82%. Since labour costs were extremely low then, setting up subsidiaries in China would help to save a large percentage of operating costs, thus contributing to a higher profit margin for UST.

5.1.2 Market competition

The second dimension of an MNE's external environment is market competition. UST experienced extremely fierce market competition in China, for two main reasons. First, it had to compete with the top global players, all of which treated this market very seriously and made great efforts to grow. Because of the importance of the Chinese market, competition there was extremely fierce.

Since nearly all global players entered the Chinese market, the competition environment was highly uncertain. (CEF, Sales Mgr.)

Second, UST was actually a latecomer to the Chinese market, arriving after most of its competitors, as the following interview excerpt indicates:

You have to remember when we came to China in 1998, all the competitors of UST were already there. We knew we were latecomers. We were number fifteen coming into this market. So, I think, okay, we want to go to China, because the market has been growing. But to be successful, we have to be, to do things differently. If we only do what others do, we will always be the last one. So that's why we took another approach. (JON, Group CEO)

UST needed to compete with the global top players in a market which its major competitors had all entered. In the drilling product segment for example, UST was mainly competing with the global leading companies National Oilwell Varco and Aker MH, which were well known as world-leading best drilling package brand names and well accepted as reliable suppliers in China. By contrast, as a latecomer, UST lacked market reputation and acceptance among potential local clients, so it would need to work to gradually gain credibility in order to be accepted by them. It would also need time to explore various possibilities. According to one top manager of UST:

We knew what we wanted out of China. But we had very little experience in China. What I have been doing for many, many years is running subsidiaries in the rest of the world. Like I was in Aberdeen, in the Houston office and in the Singapore office. In my previous

positions, we gained a lot of experience in how to run this company. But the past experiences cannot tell me how to run a subsidiary in this very remote region. (ARL, VP S&M)

5.1.3 Institutions

The third dimension of the market environment is its institutions. North (1990a) describes institutions as the rules of the game in a society or, more formally, the constraints of human design on forming human interactions. The institutional environment is an essential part of any host country's market environment. Consistent with North (1990a), the results of the case analysis reveal two broad dimensions of institutional environment: formal institutions and culture. First, the political environment in China differs greatly from that of developed economies, making it very difficult for managers at UST headquarters to understand the political rules governing business in China. According to one manager:

The political decision-making process is totally different. I think we can do it in this way. But it actually cannot [be done] in China. Sometimes they do it differently. We face uncertainty and I don't understand. (TOO, VP, Op.)

More importantly, the institutions of China changed quickly and unevenly during the country's transition from planned economy to market economy. As an emerging economy, China has seen many "fundamental and comprehensive changes introduced to the formal and informal rules of the game that affect firms as players" (Peng et al., 2008). Comprehensive change has generally occurred unevenly in both formal and

informal institutions (Peng, 2003) and regional institutional environments differ widely across China (World Bank, 2006; Fan et al., 2011). For example, institutional development has been stronger in coastal regions such as Shanghai, Zhejiang, Shandong and Guangdong than in the inland regions (World Bank, 2006; Fan et al., 2011). In regions with less institutional development, governmental bodies control a higher percentage of resources and have a higher propensity to intervene in commercial operations (Li, Meng & Zhang, 2006; Fan et al., 2011). To acquire resources and avoid this type of intervention, MNEs need to improve relations with government, especially in regions with low institutional development. Therefore, the unfamiliar and changing formal institutions in China presented a unique challenge for UST managers.

In addition to formal institutions, informal ones such as culture also differ greatly between Norway and China. North (1990b) states that “formal rules, in even the most developed economy, make up a small (although very important) part of the sum of constraints that shape choices” (p. 36). Therefore, the national differences in informal institutions are typically much larger than between formal institutions. One of the most important aspects of variance in informal institutions, according to the top management interviewees and the official documents, is that of culture. UST paid careful attention to the influence of informal institutions and arranged training programmes to help headquarters and subsidiary managers to understand the cultural differences between Norway and China. The company also produced documents entitled “Culture manual: Europeans to China” and “Culture manual: Chinese to Europe”, to sensitize staff at headquarters and in the Chinese subsidiaries to cultural issues and make them aware of cultural differences. Table 5-1 summarizes some of the main differences between Chinese and Western culture as explained in these manuals.

Table 5-1 Differences between Western and Chinese culture

Western	Chinese
Rule by principles	Rule by pragmatism (situation)
Rule of law (law above man)	Rule by law (man above law)
Contracts must be respected	Personal relations respected
Individualism	Collectivism
Fairness most important	Stability most important
Guilt	Shame
Truth	Flexibility (who knows the truth?)

Source: UST culture manual

There are several key distinguishing features of doing business in China that headquarters managers mentioned frequently during their interviews, exemplified in the following extracts. The first is the prevalence of networking and personal relationships, which the literature report as being common in emerging economies, playing central roles in delivering information and promoting cooperation (Xin & Pearce, 1996; Peng et al., 2008).

In China, the personal relationship is extremely important. So you need to really have the same vision and the same understanding with the people that you work with. In Germany, for example, which is ... much more procedural, then the personal relationship is still more important. It's more to do the right thing, so, it's just different aspects. But the main thinking, the main strategy is the same. But the way you conduct it, the way you adopt, it's very different. (JON, Group CEO)

And in China, you need them to do much to be able to have success. For example, in the Western company, you first get the contract and then have to build a network, and then to build trust. In China, you first have to build trust then to build a network. And then you get the contract. You need to spend more time than you do in other countries, but you need to be patient. You need to take your time to build your network and your trust. (THM, Dir. Prod.)

The second point is that it is normal for local Chinese managers and employees to adopt a more indirect type of communication. Some Chinese managers try to avoid direct communication with headquarters colleagues and any potential personal conflicts at work. They strive to maintain relationships and to avoid losing face.

We met with a big problem in the joint venture. I called the CEO of the joint venture. He is a Chinese guy. I told him I will come four weeks later, and discuss this problem. When I came there, he'd already solved the problem because he didn't want to lose face. (JON, Group CEO)

The third distinctive aspect of Chinese culture mentioned by interviewees is the very flexible and pragmatic way of doing things, an approach which they saw as making the China operation more efficient and oriented towards solving problems:

My understanding is that the Chinese way of doing things is very pragmatic, very flexible. If you ... meet an obstacle..., go around it. ... You have to let it go and let the Chinese do [things] in the Chinese way. It's ... impossible to control

the Chinese company [by applying] your strict rules. You cannot implement the Norwegian way of doing things in China. That doesn't work. (JON, Group CEO)

The excerpts above indicate that when UST first entered China, it faced both opportunities and threats. While it derived very considerable opportunities from the huge market potential and sustained rapid growth of the Chinese market, UST needed to overcome a number of challenges in order to bring these to fruition. As a latecomer, it faced fierce competition from both global and domestic players. Its managers also had to offset differences in market conditions, institutions and culture. To achieve business success in China, UST needed to exploit the opportunities while adopting an appropriate and well-designed entry mode and strategies to overcome the obstacles and negative influences of the business environment.

5.1.4 Environment uncertainty

The data indicate that participants saw the environment in China not only as differing strongly from that of other countries in which UST had operated, but also as undergoing very rapid change, thus creating many uncertainties. The following analysis considers these environmental uncertainties in terms of three factors: the market, institutions and competition. The market volume in China has expanded rapidly during the last two decades and the expectations and demands of clients have changed accordingly. The second cause of uncertainties in managing the operational environment of MNE subsidiaries in China is the existence of major institutional and cultural gaps between China and Europe. Finally, as players from almost all parts of the world have now

entered the Chinese market, the competitive environment is extremely fierce, bringing great uncertainty as to competitive status.

Due to the high environmental uncertainty, UST headquarters relied mainly on informal control mechanisms, including communication, soft control and private relationships, to develop the headquarters-subsidary relationship in China. Communication was strengthened to ensure that headquarters could obtain enough information about the host market and the subsidiary, thus making better decisions; a high level of soft control was used to stimulate subsidiary initiatives; private relationships were commonly used to exchange high quality information between headquarters and the subsidiary and to build mutual trust; many subsidiary managers and employees were recruited locally, to benefit from their abundance of information and linkages with local business; high levels of informal control and output control were exercised, since process controls require more information and are more likely to introduce high transaction costs; finally, rules and policy were subject to relatively weak control, although rules and policy are necessary for subsidiary control.

5.1.4.1 Overall market change

As UST's main product portfolio is in shipbuilding, the output of the Chinese shipbuilding industry will determine the market and growth potential of its China subsidiaries. Figure 5-1 illustrates the recent strong growth in output of the Chinese shipbuilding industry. It shows that Chinese shipbuilding capacity began to grow very rapidly in the early years of this century, thus substantially changing the whole market

environment. UST headquarters managers were well aware that these changes were unlike anything experienced by any other country:

... and especially in the market of China where things have changed so quickly. It's a market where things are changing from month to month. It's quite different.
(CEF, Sales Mgr.)

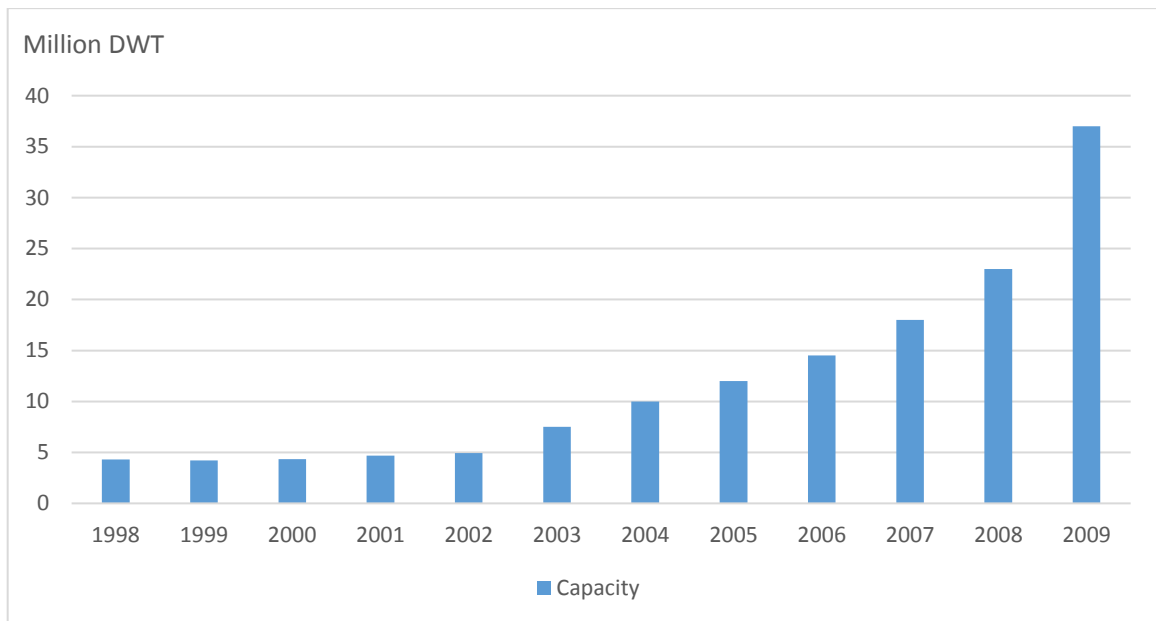


Figure 5-1 Chinese shipbuilding capacity

Source: IHS Fairplay

Not only the market potential but also clients' expectations and demands changed very quickly in China. These factors meant that the company had to pay careful attention to its actual and potential clients, competing to satisfy their expectations.

5.1.4.2 Institutional and cultural gaps, networking and personal relationships

It is widely accepted that it is very important to employ networking or guanxi when doing business in China. This cultural characteristic has remained more or less

unchanged in the three decades since China adopted an open-door policy. This means that there are always some perception gaps between headquarters managers and local staff, injecting uncertainty into the headquarters-subsidiary relationship and subsidiary strategies in China.

Because the business is based on guanxi. It's based on personal relationships. And you need to have a common understanding of what you want to achieve, to have the same targets, the same strategy. And then you have to leave it to the Chinese way of doing things. You cannot implement the Norwegian way of doing things in China. That doesn't work. (JON, Group CEO)

There is a huge cultural difference between Singapore and China. So I think it's more important to play the real culture part in China than in Singapore. (THM, Dir. Prod.)

You need to build your networks. You need to build your connections. And then you can have success in China. So open market first and then culture, of course, is an important thing. (THM, Dir. Prod.)

Well, it's the special market. It definitely has to do with the specific culture and history. So when you are dealing with the market then there is a difference where things have developed so quickly.... like the guanxi, the networking. I think it's very important to China. They are more important than in other markets. (CEF, Sales Mgr.)

Comments by a manager of a Chinese subsidiary indicate the holding of a similar viewpoint:

For a foreigner to deal with Chinese clients, and going through us, getting contacts with shipyards through us, can definitely not be as convenient as to have a Chinese to deal directly with a Chinese. In China we have various approaches to build relationships. However, for Norwegians, as their cultural background is different, it is hard for both sides to get a closer relationship with each other. (LEW, Mgr. PM)

Another institutional uncertainty derives mainly from governmental rules and changes to them, which can affect MNE operations in China. Because foreign companies and MNEs are often not familiar with the applicable Chinese laws and rules, local staff will need to explain them to headquarters people, who must comply with them. Both sides can then consider how to construct the company's internal policies to satisfy both the legal requirements and the wishes of clients in the field.

To control overtime work on commissioning, there needs to be some balance here. For example, our field commissioning engineers originally worked in the field for four weeks, then rested for four weeks. This was hard for headquarters to accept, because they thought that it meant higher costs. So now we propose to work for four long days, then rest for three days. This will benefit our field engineers without affecting field work requests. Such an arrangement was actually proposed by local site engineers. (LEW, Mgr. PM)

A headquarters manager commented on the related issue of Chinese government policy:

Over recent years, the government policy has been an important thing. When we saw Chinese investment banks starting to invest, they can offer payments, trying to be a key driver behind the success. They build the market in China, so, of course, that's something we will reconsider in the future. If they change that policy, I mean, they are making decisions about their investment. Now, they invest in projects abroad. That's of course a change of strategy for China. (THM, Dir. Prod.)

5.1.4.3 Market competition uncertainties

In China, the fierce market competition also poses challenges for MNEs' headquarters-subsidiary relationships and subsidiary strategies. To deal with the level of competition, it is important to react efficiently and effectively in the fast changing environment. Firms will need specially defined rules and strategies and must be prepared to make changes very often. The interview excerpts below show that UST headquarters managers realized that there would be competitive uncertainties in China and that they would need to take measures to deal with these.

We have to do some thinking about how to do things in China. You have to remember when we came to China back in 1998, we were latecomers, because all the competitors of UST were already there. So, I think, okay, we want to go to China, because the market has been growing. But to be successful, we have to be, to do things differently.... So that's why we took another approach. (JON, Group CEO)

I guess it goes back to the competition, because I think China is such a new market that has a kind of need for technology from the outside, for example from Norway or places where technologies have been developed for a while. But definitely, competition will come from China. It is an immature market, you [China] need to get some experience and some knowledge, the knowledge of technology. (CEF, Sales Mgr.)

Since nearly all global players had entered the Chinese market, the competition environment was highly uncertain. (CEF, Sales Mgr.)

Market competition uncertainties thus influenced the MNE's headquarters-subsidary relationship and headquarters control very strongly. It has also influenced UST's subsidiary strategy in China. In a highly uncertain competitive environment, it will need to empower local management and the authorities to react to fast changing conditions. To do this, it will need to adopt output control measures and maintain a degree of flexibility in the control that headquarters exercises.

5.2 Subsidiary strategy

This section reports the results regarding UST's subsidiary strategy in China. UST had strong strategic motives to enter China, to gain access not only to a market with great growth prospects, but also to an abundant supply of low-cost manpower, allowing decreased operational costs. Having recognized its status as a latecomer to the Chinese market, UST adopted an accelerated internationalization strategy in an attempt to capture optimal potential benefits. Specifically, rather than seeking greenfield

investment opportunities, it adopted an acquisition approach to setting up its first Chinese subsidiary company. Since company resources were very limited in the beginning, UST began by acquiring only 50% of the company's shares. Partial ownership of subsidiaries would also give local partners a stronger incentive to contribute their local resources and become actively involved in the operations of the company. At the corporate level, the subsidiaries adopted a growth strategy to increase their market share in China. At the operational level, UST used localization to satisfy the needs of local customers as well as to cut operating costs. The following subsections detail successively the company's strategic motives, its entry strategies and its subsidiary strategy.

5.2.1 Strategic motives in China

5.2.1.1 Market-seeking

UST's entry into China was mainly driven by the market-seeking motive, since it recognized China's huge market potential and rapid growth. In 2010, China became the world's second largest economy. The industries in which UST operates have also grown dramatically in China during the last decade. IHS Fairplay data reveal that in 2009, Chinese shipyards delivered 37 million DWT of vessels, which is about ten times the tonnage delivered in 1998. Since China was gradually becoming one of the most important markets for the world shipbuilding industry, various UST functional segments had strong incentives to seek markets in China, in order to sustain growth.

The crane division has prepared for new challenges over the past three years.

UST has undergone a radical restructuring of its operations in the market for

marine cranes, primarily through the transfer of operations from Norway to China. This adjustment has been essential to enable UST to once again aggressively target the huge offshore cranes market in China. (UST Annual Report, 2006)

To me, the most important thing with subsidiaries in China is related to the fact that the Chinese market for our products, in general and for all our products, is growing. And China is taking market share from traditional countries. It's an obvious example, but it is also a long trend that more and more of the advanced segments are going to be manufactured in China. (TOF, President, Division)

The initial wish for starting up the UST energy office in Shanghai was to get close to the market and to increase our sales in China. (ARL, VP S&M)

Since the Chinese market was huge and UST's resources were limited, it focused on the high-end market, which was more profitable than other market segments, whereas the numerous domestic suppliers in the low-end market made it unprofitable for UST to compete in selling low-end products.

Our subsidiaries in China will increasingly promote high-end products and turn from pure volume to more specialized new buildings like gas carriers and offshore vessels. Some other Asian countries with lower labour costs, like Vietnam or India, or an African country, are likely to overtake us sooner or later in terms of number of orders, but within advanced segments, I think we'll be a major player for a long time. (JON, Group CEO)

The above quote indicates that UST focused on the high-end market not only to avoid the intense competition of domestic companies, but also to defend itself against competition from countries with much lower labour costs than China. To sum up, the major strategic motive of UST was to seek the high-end market in China.

5.2.1.2 Cost-saving

A secondary strategic motive was to reduce operating costs and to make UST more competitive. Since China has the biggest population in the world, the supply of labour is abundant, making labour costs relatively low in China. Therefore, transferring part of the production and service function from Norway to China would help to control operating costs and make UST products more competitive than those of other Western suppliers.

According to data provided by Nordic Industrial Park (Table 5-2), the total operating expenses for a firm in Ningbo, China was only about 16% of that in Norway. Cost savings were more significant for front-line workers (94%) than for managers (82%). Since the labour costs were much low in China, setting up subsidiaries there could significantly reduce operating costs, thus contributing to a greater profit margin.

Table 5-2 Costs saving when operations move from Norway to China

Annual operating expenses: Typical company in NIP*, Ningbo (US\$)				
		China	Norway	Savings
Rental cost		75,000	200,000	56%
Employees	Operators	145,000	2,357,000	94%
	Supervisors	34,000	200,000	83%
	Engineers	55,000	372,000	85%
	Management	83,000	465,000	82%
	Expatriates	143,000	125,000	-12%
Sales, general & admin.		79,000	200,000	60%
Total operating expenses		614,000	3,919,000	84%

Source: Nordic Industrial Park (*NIP).

The following quote provides additional evidence of such considerations:

We want to keep sourcing and manufacturing in China. And we would like to have local guys involved in the work to reduce costs. (JON, Group CEO)

The above data also indicate that an additional benefit of transferring from Norway to China is sourcing in China. Since China was the location of a cluster of low-price manufacturers, purchasing components and parts in China helped to save sourcing costs further. This was a typical cost-saving consideration.

5.2.2 Entry strategies in China

5.2.2.1 *Entry mode*

The takeover in 2001 of the Dry Cargo Handling division of Hamworthy KSE opened the door to the Chinese market for UST. The acquisition entailed a 50% ownership interest in the joint venture company, now known as UST HH Ships Equipment, based in Shanghai. The partner of UST in this joint venture was the state-owned shipbuilding conglomerate CSSC, whose strategy was to gain access to technology that could help China to grow as a world leader within shipbuilding.

In collaboration with CSSC, UST has grown UST HH continuously over the years. Its activities are focused on the engineering and sale to shipyards in China of access equipment such as hatch covers; within this niche market, the company has won a market share of close to 70%. Turnover for 2009 was 873 million NOK and the company's operating profit before depreciation was 47 million NOK, while the order backlog at the start of 2010 was 2 363 million NOK.

In 2004, a marine crane supply company now bearing the name of UST Marine Shanghai was established. This company is a wholly owned subsidiary of the UST Group. At that time, according to CEO JON, Group CEO, "these companies in Shanghai were small and insignificant, but they gave us a route into a market which we believed would develop fast". Until 2005, the company focused on sales and on establishing itself in the market for ship crane services and components in China.

In early 2005, the positive experiences of the UST HH collaboration led UST to enter another joint venture agreement with a Chinese shipbuilding group, the Dalian Shipbuilding Industry Corporation (DSIC). The venture, named UST BH Machinery Ltd., was based in Dalian and had a different product scope, the engineering, manufacture and sale of ships' cranes, mainly for the shipbuilding market in China.

Following these developments, UST's wholly owned subsidiary in Shanghai shifted its focus from China to other export markets in Asia. This involved a major structural adjustment, including the recruitment and training of engineers and of procurement and project management personnel, in order to deal with the company's entire value chain. This principle also applies to joint ventures.

Since then, UST has successfully established for itself a leading position in the growing Chinese marine equipment market. It operates two companies as 50/50 joint ventures with the two major Chinese shipyard groups, CSSC and DSIC, while its wholly owned Shanghai subsidiary has China as its base for the export of marine equipment to other countries in Asia. The three companies together employ a total of 130 people. At the end of 2005, the companies' combined order backlog was 450 million NOK.

In 2007, UST set up a division for the production of winches and deck machinery in Dalian, which it restructured in 2008 as a fully owned subsidiary, UST Marine Equipment Dalian. In 2009, the company had a turnover of 48 million NOK.

In 2008, UST acquired 50% of the shares in a fabrication company, UST Keyon Marine Equipment, based in the city of Zhangjiagang, to the north-east of Shanghai. Chinese

private investors owned the other half of the shares. The motivation for this venture was the need for greater control of the delivery of steel structures to other operations.

Sharing the value chain between Europe and China is a major strategic decision of UST headquarters.

The development of engineering and production operations in China is helping to strengthen the foundations of UST in Europe. In Norway, Sweden and Germany, we have a special focus on the first and last links in the value chain, i.e. sales, product development and after-sales. Value creation in Europe is based on customer contact with ship owners, a high level of development activity relating to our products and the provision of good service to our customers after the delivery of equipment. The initiatives in China will contribute strongly to this. (JON, Group CEO)

It is worth mentioning that UST intentionally targeted as its two major joint venture partners the SOEs which dominate the industry, CSSC and DSIC. UST undertook two joint ventures with CSSC: UST HH in Shanghai and Jiangnan UST Marine Equipment Co. in Nantong. With DSIC, itself a subsidiary of the China Shipbuilding Industry Corporation, UST founded UST BH in Dalian. The 50/50 share arrangement adopted for these two main joint ventures was a carefully chosen structure which ensured direct access to the Chinese market for UST with the support of two major SOEs. By selecting them as joint venture partners, UST benefited not only from the degree of market penetration, but also from winning a strong market share quickly and being awarded contracts by these partners' subsidiaries.

Based on 15 years of successful cooperation with leading Chinese SOEs, including its 50/50 joint venture operations with CSSC and DSIC, UST has structurally consolidated a unique position in the Chinese shipbuilding market. Having entered the Chinese market as a pioneer, UST Group now sees China as a second home country, where it has contributed a strong, globally well accepted brand name and state-of-the-art technology, while the Chinese partners have provided valuable market access.

5.2.2.2 Ownership structure

As exemplified by the cases discussed above, the typical ownership structure of UST's subsidiaries in China has been a 50/50 joint venture with share ownership divided equally between UST and its local partners. Table 5-3 lists the ownership structure of UST's subsidiaries in China at the end of 2014.

Table 5-3 Ownership structure of UST subsidiaries in China (2014)

Subsidiary	Registered in	Founded/ acquired	Ownership
UST Shanghai Co Ltd	Shanghai, China	2002	100%
UST HH Ships Equipment Co Ltd	Shanghai, China	2002	50%
UST BH Machinery Co., Ltd	Dalian, China	2005	50%
Jiangsu UST HH Ships Equipment co. Ltd	Jiangsu, China	2007	20%
UST Marine Equipment Ltd.	Dalian, China	2008	100%
Shanghai UST HH International Trade Co. Ltd	Shanghai, China	2012	50%
UST BH Trading (Dalian) Co., Ltd	Dalian, China	2014	50%
UST SCM Marine and Offshore Machinery Co. Ltd	Shenzhen, China	2014	50%

Source: UST annual reports (publicly available)

The two wholly owned companies were not established to serve the Chinese market, but only for manufacturing and export, as cost-driven investments. All of UST's other business in China was done through joint venture companies to gain access to the local market. These 50/50 ownership structures were the results of negotiations between UST and its joint venture partners. UST owned advanced technologies, while its SOEs partners controlled market access to China. Since both technologies and market access were essential to success in China, neither party could convince the other to accept less than 50% ownership. Thus, both parties played equal important roles in each subsidiary. This structure is the subject of positive comments both representatives of both UST and its partners:

Many people may think that a 50/50 shared ownership equals never being able to agree on anything, and that nothing gets done. In China, however, this ownership model has proven to be a key to success. It ensures that both parties work hard to find good solutions. Our joint success stems from mutual trust.

(WUQ, President of CSSC)

Our joint venture operations are based on 50/50 ownership with the leading state-owned corporations CSSC and DSIC. UST contributes with a strong brand and state-of-the-art technology, while the Chinese partners provide valuable market access. (JON, Group CEO)

It was the best solution for both parties. The ownership model ensures that both sides have to do their best to understand their partner, and see things from the other's perspective. As a result, we have always been able to support each other

in a good way, and have developed bilateral respect and mutual trust. (HEP, former general manager of UST HH, representing CSSC)

5.2.3 Subsidiary operating strategy

5.2.3.1 Horizontal diversification

The UST Group's strategic focus is on internal efficiency and market share growth. The group pursues some short-term and long-term strategic initiatives to consolidate its position among the top three players in all target markets. The four main elements of its strategy are: (1) a focus on cost control, price competitiveness, efficient workflow and a unified quality management system; (2) company-level procurement and product innovation, with the vigorous development of standardized building blocks and complete material handling solutions for end users; (3) building a solid corporate structure around the client's needs and account management at a group level; (4) continuing to strengthen and build on UST's long-term relationships in China and the Far East.

For its subsidiaries in China, UST headquarters adopted a horizontal diversification strategy. Specifically, it sought to capitalize existing resources and capabilities in developing a greater variety of products and services in order to capture market opportunities in China and other Asian countries. The strategies of each division were consistent with this corporate-level strategy.

For the Marine Division, UST aimed to deliver a wider range of cargo access and deck equipment to the marine industries. The primary focus was on developing the

production and marketing of winches and hatch covers. In the case of the Heavy & Offshore Lift Division, UST focused on all types of cranes for various offshore vessels and on heavy lift equipment for other maritime clients. It also aimed to expand into the rig and drilling ship market and to be a top-three player in all of its segments. Special emphasis was placed on product development for the offshore service vessel fleet and advanced solutions for specialized vessels operating subsea and in harsh climates, e.g. ice-class rigs and drill ships. As to the Services Division, UST aimed to establish the group's service networks in China. Service competence has always been deemed one of the main reasons for marine and offshore clients to choose UST equipment.

UST followed two strategic lines in order to achieve these objectives. First, it sought to leverage the group's strong market and cost position in China, including further development of strategic partnerships with the major state-owned shipbuilders and increased cooperation with Chinese partners within manufacturing. Second, UST switched from a product focus to a ship-type focus, such as by expanding the product portfolio per asset type and providing complete solutions and services for important vessel types within targeted segments.

5.2.3.2 Localization

At the operational level, in order to increase local responses and reduce operating costs, UST relied on the localization of partners, of staff, of operations and of production and purchasing. These important elements of the localization strategy are now considered in turn.

The localization of partners meant that UST looked for cooperation with local firms, especially leading SOEs, to gain access to the huge market in China. Local partners could provide valuable local network resources and deep understanding of the unique features of Chinese culture, which were essential for UST's further expansion in remote regions, as the CEO explained:

Because of this structure in the Chinese market—it's based on a few government-owned companies, not other players—we saw if we really wanted to become to a big player, we needed to play with the big ones. So, the whole strategy of UST in China was to play with CSSC. And that's why we do that. We talked with the big ones. We played with those guys. And we have made success very quickly actually. (JON, Group CEO)

We need to make UST as a local Chinese entity. In China, we need a partner. Even in Korea, we did not do this. Finding reliable and trustable persons is key to our success. We need to trust the partner and rely on the partner. (JON, Group CEO)

UST localized its staff by employing local managers and employees, because they had a deeper understanding of local customers' needs and could communicate with them more efficiently than expatriates from Norway. In addition, the costs were much lower for local managers and employees than that for expatriates. Again, the CEO's words support this explanation:

I mean, it was very stressful when it looked not possible from Norwegians to do this ... because it was business developing. We want to do new products and we want to hire Chinese people to go into the new market. It's not possible for Norwegians to do this. We needed local, we need the local people to use the local relationships to do it. Both to create confidence, but also to be able to talk to the right people. (JON, Group CEO)

UST localized its operations because culture, as an important informal institution, shapes human interactions and thus the ways of doing business. Since culture differs markedly between China and Norway, UST decided to adjust its Chinese subsidiaries' operations to the local context. The decision-making process was local to China, depending more on personal discussions than formal strategy meetings. UST did not transfer its standard procedures from headquarters to the subsidiaries. Instead, it allowed them to develop procedures that would accommodate the local contexts and the needs of local employees. In addition, although hard control was widely used in UST, it was less widely used in the Chinese subsidiaries.

Sure, I mean, if the headquarters believes that ... all the knowledge and all the strategy inside is based on the headquarters, that means you've started on the wrong foot. That will never succeed. You need to understand what's going on in the local market. You need to have the input from the local market. And then you have a process where you combine the interests and ambitions of the headquarters with interests and knowledge, and the ambitions of the subsidiary. And then you find a good combination. And then you start to implement it. And of course implementation is all the subsidiary's job. (JON, Group CEO)

As to the localization of production and purchasing, UST utilized the position and network of joint ventures and wholly owned companies to source components in China. It also built up its services business in cooperation with UST BH, UST HH and UST (Shanghai) to provide services locally. The localization of purchasing reduced the costs of UST.

The main consideration was, in the beginning I would say, let's start producing, so let's keep production in China. I think that totally turns out to be questions about you have to be in China, because of the market. ... It is totally dependent on being in China, because of the market in China. For building ways, not necessarily for producing but for actually getting contacts in the new world.

(TOO, VP of Operation)

Its localization strategy has helped UST to achieve considerable success over the years, in terms of both business scale and profits. It also helped UST to better understand how the company should develop in the Chinese market, as reported by the group CEO:

This was in 2010. We had developed a small business in Norway to become a big business in China, using the partnerships we had. We had partners back in in 1998, so we knew the rules, we knew the courses and we knew how to do this. And we had already had the Chinese people to do business for us in China. We knew that Norwegians could do it in Norway. We needed local people to do the local business. (JON, Group CEO)

In a presentation, JON, Group CEO summarized UST's strategic approach to entering the Chinese market, first by setting up joint venture companies with Chinese partners, making use of local networks to serve the local market, and secondly by basing production companies in China to serve the export market.

This section has explored UST's subsidiary strategy in China; the next turns to the headquarters-subsidiary relationship and subsidiary control.

5.3 Headquarters-subsidiary relationship and subsidiary control

UST headquarters has typically relied on five interrelated mechanisms to control its Chinese subsidiaries: the composition of the top management team, subsidiary staffing, control flexibility, communication, and rules and policy. In summary, UST headquarters has designed different management structures for its wholly owned subsidiaries and joint ventures. It has relied on local managers and workers in the Chinese subsidiaries to ensure that their operations fit with the local environment. To ensure control flexibility in dealing with that rapidly changing environment, the parent company has relied more on soft control than hard control, more on informal than formal control to monitor the subsidiaries and more on output control than process control. It has adopted various modes of communication to control the subsidiaries, including formal meetings, telephone meetings and personal contacts, and has encouraged personal relationships between Chinese staff and headquarters staff so that the former can more fully understand headquarters' objectives and intentions. Finally, it has ensured that the Chinese subsidiaries are aware of the need to follow the rules and corporate policies laid down at headquarters.

5.3.1 Top management team composition

The data show that the governance structure of each subsidiary in China included a board and a top management team. Typically, the board would take care of strategic issues and business direction, while the operational management team dealt mainly with daily business. The governance structure of the wholly owned subsidiaries was different from that of the joint ventures. Both the board members and the top management team of the wholly owned subsidiaries were designated by UST headquarters, while the functional departments were staffed by locally recruited Chinese employees and managers. This means that local Chinese managers actually played an important role in daily operations, an approach which allowed these subsidiaries to take advantage of the local managers' familiarity with the Chinese environment and business networks.

The governance structure of joint ventures was quite different. Because of the need for investment partners to play a decisive role, the overall structure and composition of boards and management teams were more balanced, being designed jointly by the two parties. Typically, UST would nominate a dedicated chairman of the board, a position usually assigned to an expatriate. The two investment parties would designate equal numbers of board members, with all directors having the same voting rights. If any decision was hindered by an equally split vote, the issue would be resolved by the chairman exercising his casting vote. Therefore, the board of each Chinese joint venture subsidiary was actually dominated by the UST side, although local partners had substantial influence. Beside its normal role in making strategic decisions, the board also assumed the very important function of coordinating the two parent companies to protect the interests of the joint venture. As to the operational management team, the

CEO or general manager would typically be nominated by the Chinese partner. This indicates that the top management team was usually controlled by the Chinese partner, although on some major issues they would need to seek the support of the board chairman to coordinate with UST headquarters.

This governance structure for joint ventures was carefully designed to take account of four diverse strategic considerations. First, the ownership structure of almost all the joint ventures was 50/50, which made it legitimate for each of the two cooperating parties to play an equally important role in the venture. Such a shareholding structure ensured that both investors had equal rights and would thus be willing to invest significant efforts in making it a success. Second, as both investors designated the same number of directors, it was necessary, in order for the board to function, for there to be someone who had the authority to make final decisions. Both investors agreed that the chairman of the board would have this power, although he would have to take into consideration the opinions of all directors. As the board would also have a coordinating function, UST would be able, through its designated chairman, to ensure proper control of the subsidiary. Appointing an expatriate to this position would also facilitate smooth communication between the chairman and headquarters. Third, recognizing that Chinese managers would have more local connections, a deeper understanding of Chinese culture and a sharper appreciation of the needs of Chinese customers, UST agreed that each joint venture company should have a Chinese CEO who would play a central role in its operational management. In addition, recruiting local managers would reduce staffing costs substantially. Finally, UST was justified in taking a dominant role in directing the subsidiaries because it had more global information, resources, product

expertise and technology, as well as wider experience of global operations, making its people particularly well qualified to take strategic decisions.

5.3.2 Subsidiary staffing

A key aspect of subsidiary control is staffing. While predominantly staffing both its partially and wholly owned subsidiaries locally, UST adopted somewhat different staffing strategies for the two kinds of subsidiaries in China.

The CEO of each wholly owned subsidiary was from Norway, but otherwise all of its managers and employees were local people recruited from the Chinese labour market. For example, when in 2005 UST acquired all of the shares in the joint venture crane company UST Hydralift, based in Shanghai, the subsidiary changed its name to UST Marine (Shanghai) and was managed by a Norwegian CEO, while the rest of the workforce was recruited locally in China.

As to UST's joint ventures, all of their managers and employees were Chinese, for the reasons given below by two interviewees:

We need Chinese people in the Chinese context to do this business. So, I mean, that business decision for me was quite easy. It was not a question of if we should do it. It was just a question of getting the right people to do it for us. (JON, Group CEO)

And for us with our team here, we can really choose the Chinese service engineers and just as you can use the foreign service engineers.... the service

engineers in Shanghai, they are growing and really taking care of the tough tasks. (TOO, VP, Operation)

The following considerations lie behind UST's adoption of this staffing strategy. First, since most of its customers in China were Chinese shipyards, local employees would share both language and cultural background with these customers, giving the firm natural advantages in communicating and developing relationships with them. More importantly, it was critical for UST to have on the payroll local employees who had relationships with managers of SOEs, which UST targeted as their most valued customers in China. Local employees would also have more experience than foreign employees of dealing with central and local government bodies, thus helping UST to build sound relationships with such governmental bodies. A simpler and more quantitative consideration was that UST could reduce its operating costs significantly by adopting a local staffing strategy for its subsidiaries, since labour costs were much lower in China than in Norway. The strategy thus helped to make UST more competitive in the market.

For all the above reasons, a local staffing strategy was widely adopted at various levels of subsidiaries management and in different functions and departments, from management to functional sales and technical staff. The UST management counted developing local staff among its achievements.

We want to do new product, and we want to hire Chinese people to go into the new market. It's not possible for Norwegians to do this. We needed ... local

people to use their local relationships to do it. Both to create confidence, but also to be able to talk to the right people. (JON, Group CEO)

I think it was definitely right to set up branch companies in China as it helps to cut our costs. As projects were happening in China, it was necessary to set up a company in China and support coordination among parties. In the end you need to deal with Chinese clients. (LEW, Mgr. PM)

5.3.3 Control flexibility

Control flexibility refers to the extent that subsidiaries are permitted to follow the rules and regulations set by headquarters. This parameter varied considerably among the different aspects of UST's control of its subsidiaries in China. On one hand, all subsidiaries followed the same rules concerning product quality and contracts, because high quality and the accuracy of contracts were of the same importance around the world. On the other hand, in most other respects, control flexibility was found to be higher in China than in other countries.

UST considered it desirable for its subsidiary control to be highly flexible for two important reasons, concerning the local environment and culture. First, the external environment in China was undergoing rapid change and subject to considerable uncertainty. The market competition landscape was changing dramatically due to strong market growth, fierce competition with both global and domestic players, and the swift institutional transition that the country was experiencing. Subsidiaries needed to respond to this dynamic external environment efficiently and therefore quickly and

flexibly, in order to seize opportunities and avoid threats, as the following interview extracts show:

Each subsidiary in China has a flexible strategy and no hard control. With that kind of board control and board strategy, with a lot of flexibility, we find opportunities and come up with local ways. We need to be very quick. Opportunities come up and disappear very fast in China. (JON, Group CEO)

I think it would be like if there is flexibility on the other side, and I think also we are willing to show flexibility on our side. So that will be a kind of give and take situation in many areas. (TOO, VP, Op.)

First of all, I think we need to have a control that should take into account the actual situation on the ground. So when things are changing in areas where we operate, we have to adjust both our goals and measures accordingly. So I think this needs to be dynamic. And that goes in all directions, not only things are getting more difficult, but any change should be reflected so that we can update and quickly change. (TOF, President, Division)

It needs to have certain flexibility. From a finance point of view, compared with financial management in Western countries, there are lots of different rules in China. (REL, Mgr. Finance)

It seems that in Singapore they are stricter and instruct staff in more detail. However, in China we very much depend on each employee. (LEW, Mgr. PM)

The second motivation for flexibility of control is that Chinese culture prefers more informal and flexible control methods. Specifically, Chinese culture views all rules and regulations as situation dependent, which means that the explanation and enforcement of the same rules or regulation will vary among different situations. Therefore, the standard rules and regulations that applied to UST's Western subsidiaries could not be applied and enforced in the same way for the Chinese subsidiaries, according to the CEO:

I know that German philosophy, the German way of doing things, is to follow standards. So if my management in Germany is just to follow standards, there is nothing wrong about that way of doing things. But if the Chinese management doesn't follow standards, [if] they do it differently, it's because they want to achieve results and following standards would not achieve results. You have to accept this. (JON, Group CEO)

So you need to be more flexible in your implementation. And that's why I'm saying you are taking the headquarters decisions. If you only take decisions within your office, it will not be successful. I spent a lot of time, as you know, in China. I spent a lot of time here. So you need to understand, to think what's going on. And then you can be part of the decision-making. So you have a centralized or decentralized model, either the former or the latter. (JON, Group CEO)

To ensure the exercise of highly flexible control, UST adopted soft-oriented and output-oriented control tactics in its Chinese subsidiaries, as explained below.

5.3.3.1 Soft-oriented and informal control

MNE headquarters can control its subsidiaries in a number of ways, including strategic plans, action plans, procedures, rules, formal reports, meetings, personal relationships and communication. Among these control methods, procedures and rules, for example, are ‘harder’ than e.g. personal relationships. Some aspects of control measures, such as ownership, organizational structure, company rules and procedures, are quite formal, whereas normal working communications, friendships and relationships among staff, mutual trust and so on are less formal. The policy of UST towards the management of its subsidiaries was to encourage headquarters managers to adopt soft and informal control measures in China. Managers were given cultural training to encourage mutual understanding and allowing time for discussion and communication before taking decisions. However, this culturally sensitive stance did not affect the company’s adherence to very stringent criteria on the quality of its products. The UST group made no distinction in product quality control among its subsidiaries around the world, since product quality was the key to UST’s reputation and success.

In other respects, UST tended to use soft control for the Chinese subsidiaries and rarely implemented the hard control measures at its disposal, such as strategic plans, action plans, procedures, monthly reporting or formal meetings. Instead, it relied more on soft control measures, such as personal communication and relationships, as the following excerpts from interviews indicate:

If you work in the Chinese context, you have to work in an informal way. I find that Chinese culture is very pragmatically flexible. And it’s more or less

impossible to control a Chinese company [by applying] your strict rules, because the business is based on guanxi. It's based on personal relationships.

(JON, Group CEO)

Then so, it is private and it is relationships, it is friendship which helps us go in two years. And that's the only way we have been carried forward.

(ARL, VP S&M)

A flexible strategy and no hard control. So I think with that kind of board control and board strategy, with a lot of flexibility, where I mean you find opportunities and suggest solutions and come up with local ways of focusing on strategy. It was giving high flexibility to the subsidiary to create the environment – a kind of considering on the sales side.

(DAS, VP Finance)

I think in general terms, I would say during the UST stage, what we had in the implementation is a type of soft control. There was no hard control in terms of policy. The UST way of controlling is softer, including board meetings, day-to-day discussions and reporting structures on financial figures. So the flexibility is high.

(DAS, VP Finance)

When we were UST, we were a subsidiary of UST, they used more soft control and output control. I think it worked very well. Why? Because hard control should be based on the targets to be managed, and it's a matter of scale. For small numbers of staff, you may adopt hard control, process control, and I think the costs of this kind of control tend to be high.

(TUM, Mgr. Tech.)

5.3.3.2 *Output-oriented control*

UST headquarters used process and/or output control to ensure that its subsidiaries' operations would follow headquarters-defined directions. It depended very much on output-oriented control, rather than process control, to monitor its Chinese subsidiaries.

First, the costs of process control will usually be much higher than those of output control, since process control requires more information and interactions between headquarters and the subsidiary, which tend to consume not only time, but also opportunities. Process control may lead to misunderstandings and contradictions due to linguistic and cultural differences, and although it costs a lot of resources, it may not ensure better outcomes.

In China what we are familiar with is trying to motivate people. On the other hand, if you adopt hard controls, it may damage staff motivation. Process control and output control should be balanced. For UST, if headquarters or the parent company gets directly involved in details, it is quite expensive. I'm more in favour of soft control and output control. (TUM, Mgr. Tech.)

Secondly and more importantly, process control is more difficult in China, mainly due to the highly uncertain external environment. The essence of control for UST was to make the subsidiaries operate in the right direction. The Chinese subsidiaries had to adjust their strategies frequently to maintain alignment with their external environment. Therefore, they needed to be able to respond quickly to external forces in order to ensure survival and success, which would not have been feasible if headquarters had imposed

strict process control. In contrast, output control could be used to ensure that the subsidiaries were moving in the right direction, while allowing them a high degree of operational flexibility; or, as the CEO put it:

We need to control the overall direction, but not all the details. To make sure they have the same target as I have. But how they do it may be different from other countries. I cannot tell them what to do. (JON, Group CEO)

5.3.4 Communication

UST was well aware that communication, trust and sharing of information were extremely important for the management of its subsidiaries in China, especially as related to the understanding of headquarters' objectives, intentions and strategies. The existence of a culture gap between home and host countries generated a need for effective communication between headquarters and the subsidiaries, to ensure that the corporate strategies were properly implemented in China.

If the headquarters believes that all the knowledge and all the strategy inside is based on the headquarters, then you're starting on the wrong foot. That will never succeed. You need to understand what's going on in the local market. You need to have the input from the local market. And then you have a process where you combine the interests and ambitions of the headquarters with the interests and knowledge and the ambitions of the subsidiary. And then you find a good combination. And then you start to implement it. And of course implementation is all the subsidiary's job. (JON, Group CEO)

Yeah, the communication factor is the most important factor in running a subsidiary in my view. Because by communicating correctly....., if any problems you bring up to be fixed, ... that's the most important factor in my view on how to run a subsidiary. (ARL, VP S&M)

Face-to-face communication, and the main objective of such communication is to make headquarters people come to see the Chinese market, and realize the unique characteristics of the Chinese market, what the macro-environment looks like, and what real life looks like. not just depend on reports, but more care about in-field investigations and feedback. (TUM, Mgr. Tech.)

One of the most important functions of face-to-face communication is to share information between headquarters and the subsidiary, thus supporting the decision-making process, as discussed by these managers:

It is important to share information. You have local knowledge, and we have a lot of technology information. So we have communication open and it will work both ways.....how we would like you to proceed, and you give us feedback, discuss how is the best way to proceed. It is communication which is very important. (CEF, Sale Mgr.)

Trust is so important, especially in China, where the networking is also important. It's important to have long-term relationships without too many changes that are going on. (CEF, Sale Mgr.)

Then so, it is private and it is relationships, it is friendship which helps us go in two years. And that's the only way we have been carried forward. (ARL, VP S&M)

First of all you should have trust. We are a large-scale MNE and the clients we have contact with are local, and local clients feel more at ease and willing to dialogue directly with local people. We will then pass the client's expectations to headquarters and then try to get consensus. (REL, Mgr. Finance)

5.3.5 Rules and policy

Although UST headquarters tended to apply soft, informal control and to pay special attention to flexibility in the management and daily operation of its Chinese subsidiaries, there must still be rules and policies which the headquarters would push the subsidiaries to follow. Once such rules and policies had been discussed and formulated, each subsidiary would be required to stick to them and ensure that discipline was respected. This was seen as necessary so that UST's subsidiaries in China could operate effectively and efficiently.

But of course, we cannot be too reluctant as to our requirements, so once in a while we need to be strict or to follow the requirements, we do. But I think in general, I would say that, from my point of view, it is kind of at least if the ship is flexible, I think it can also act flexible to an extent to get good cooperation. At least my intention, or I predict to my people working in China. (TOO, VP, Op.)

I would say that establishing and setting up rules for how we operate in China, this is how we do it. Cooperate, give a deadline, that's how we do business. And in this it's up to us to do it. They need to monitor and control, because they are the owner and let us go about our business in our own way. (ARL, VP S&M)

5.4 Subsidiary performance

There are numerous performance measures available to firms, including indicators of growth (e.g. sales growth, profit growth, market share growth), financial performance (e.g. ROA and ROE), stock market performance and more. The use of these indicators, which capture various aspects of a firm's performance, depends on the headquarters' strategic stance towards a given subsidiary. Our data show that UST headquarters has relied mainly on growth indicators to measure the performance of its Chinese subsidiaries. Specifically, it has used growth in sales, market share and profit to assess performance, which indicates that what UST valued most in its subsidiaries in China was their growth.

UST HH can be taken as an example of the use of these performance indicators. This subsidiary focused on RO-RO shipping equipment, hatch covers, winches etc. It had 28 employees in 1998, almost tripling to 79 in 2012. During the same period, sales revenue increased dramatically from 2.21 million NOK to 1.29 billion NOK. The market share of UST HH also increased consistently during this period. For example, it had around 5% of the Chinese market in hatch covers in 2000, rising steadily to about 65% in 2010. Its recent strategic initiatives have enabled the company to gain share in the market for another type of products, i.e. winches.

The second indicator of performance was growth in profit. UST typically used earnings before interest, taxes, depreciation and amortization (EBITDA) to measure the profit of a subsidiary. Profit was highly valued by UST headquarters because it not only reflects the revenue of the subsidiary, but also captures its cost control capacity of the, making it a better performance measure. Figure 5.6 shows that the EBITDA of UST HH increased from about 16 million RMB to about 90 million RMB during the period 2005 to 2010. Other indicators of the excellent recent performance of the UST Group, its subsidiaries in China and HH in particular are given in Figures 5-2 to 5-5 and Table 5-4.

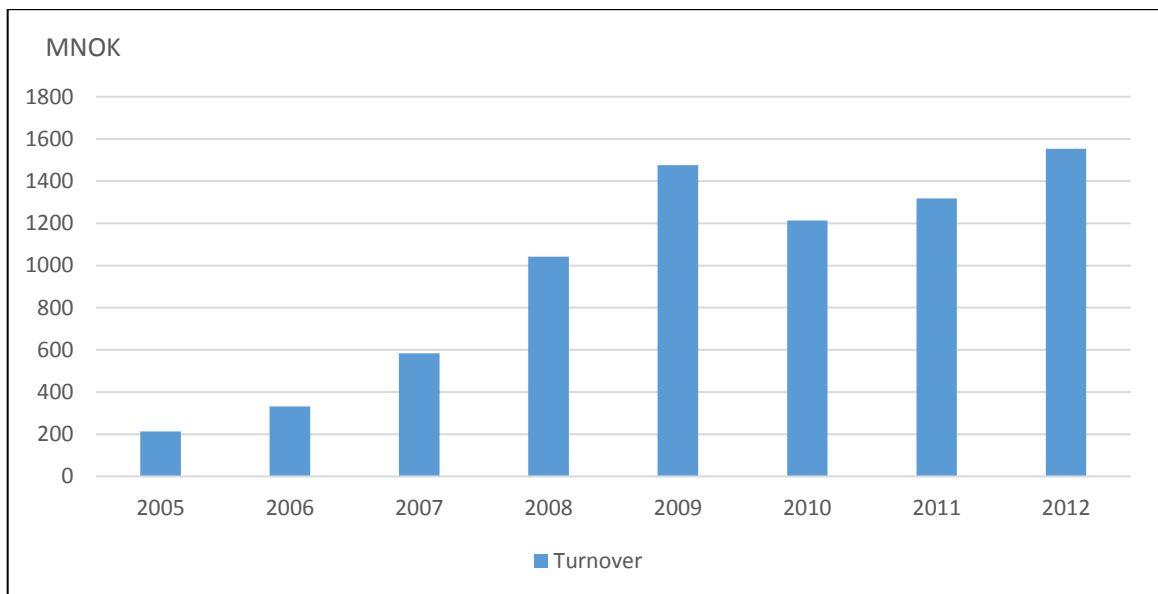


Figure 5-2 Turnover of UST' activities in China, 2005-2012

Source: Annual report of UST

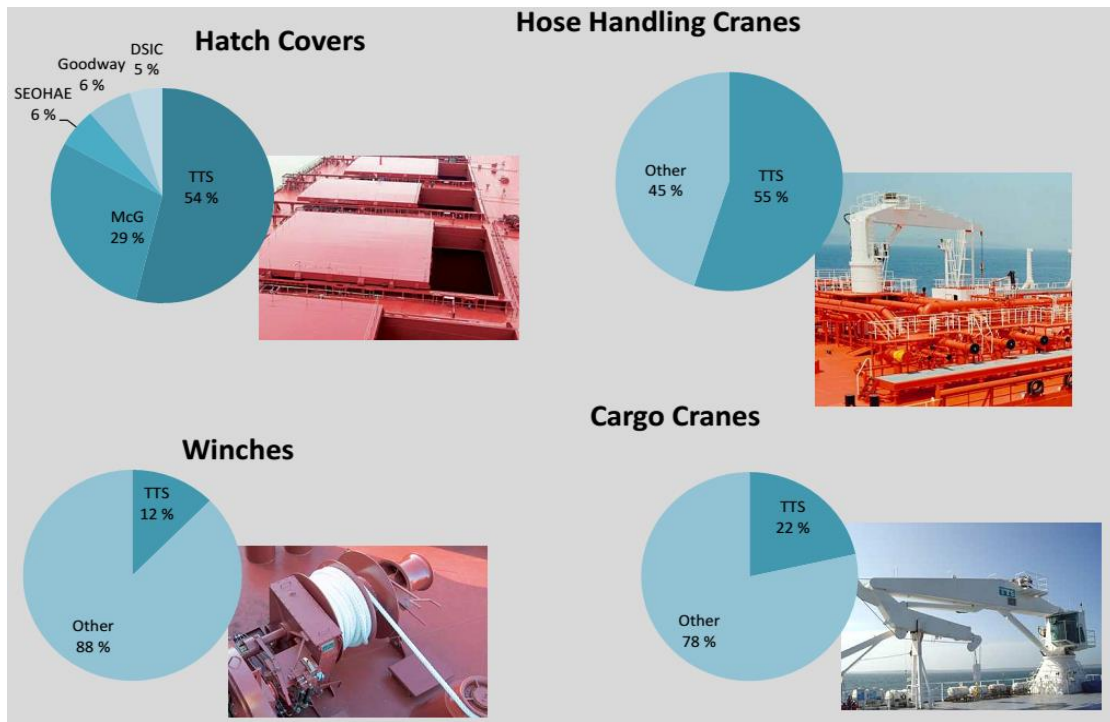


Figure 5-3 UST's market share in China, 2013

Source: UST annual report

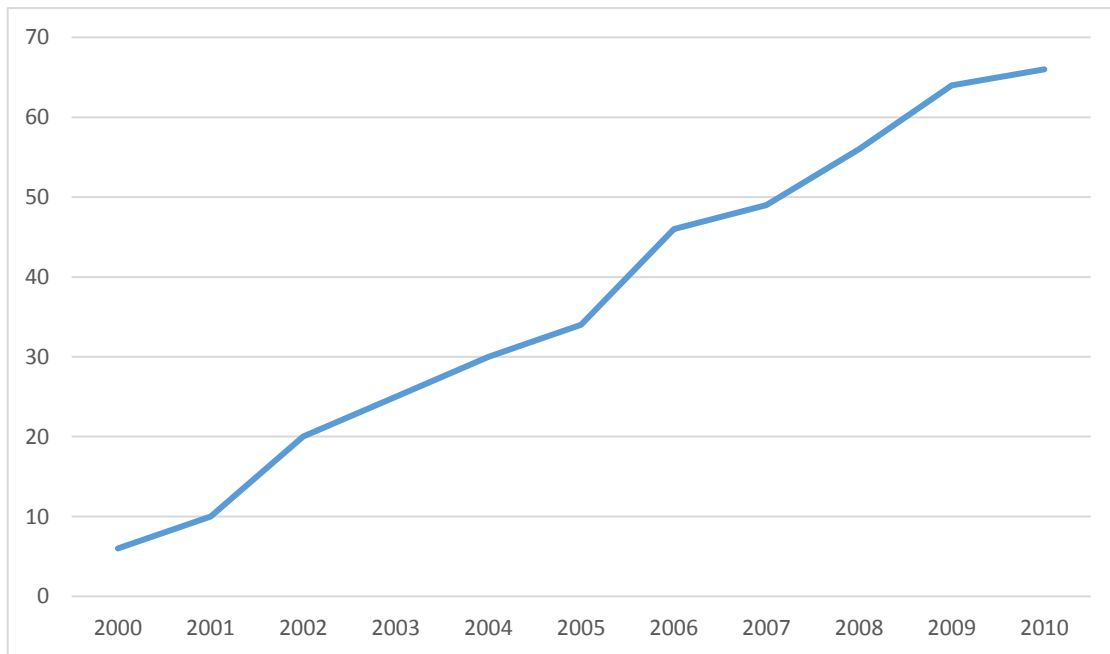


Figure 5-4 Significant increase in market share (UST HH)

Source: Annual report of UST.

Table 5-4 UST Group sales revenue

	2012	2013	2014
Europe	814,859	1,152,248	1,018,863
Asia	1,378,747	1,312,215	1,296,333
USA/Canada	99,704	51,111	116,137
Rest of the world	76,596	177,593	22,325
Total sales revenue	2,369,906	2,693,167	2,453,658

Source: UST annual report

<i>Sales revenues</i>	2009	2008
Scandinavia	592 671	917 143
Rest of Europe	925 056	1 131 496
Asia	1 917 247	1 782 568
USA/Canada	361 357	328 679
Rest of World	28 988	36 596
	3 825 319	4 196 478

Sales are allocated based on the customer's home country.

<i>Segment assets</i>	2009	2008
Scandinavia	2 339 353	2 893 013
Rest of Europe	860 793	1 038 591
Asia	331 690	275 883
USA/Canada	157 639	173 237
Rest of World	0	0
	3 689 474	4 380 721

Assets are based on where the assets are located.

<i>Investment expenses</i>	2009	2008
Scandinavia	100 919	199 756
Rest of Europe	252 810	197 991
Asia	19 828	28 006
USA/Canada	5 001	9 331
Rest of World	0	4 189
	378 558	439 273

Investment expenses are based on where the assets are located.

Figure 5-5 UST sales and investment, 2009

Source: UST annual report 2009.

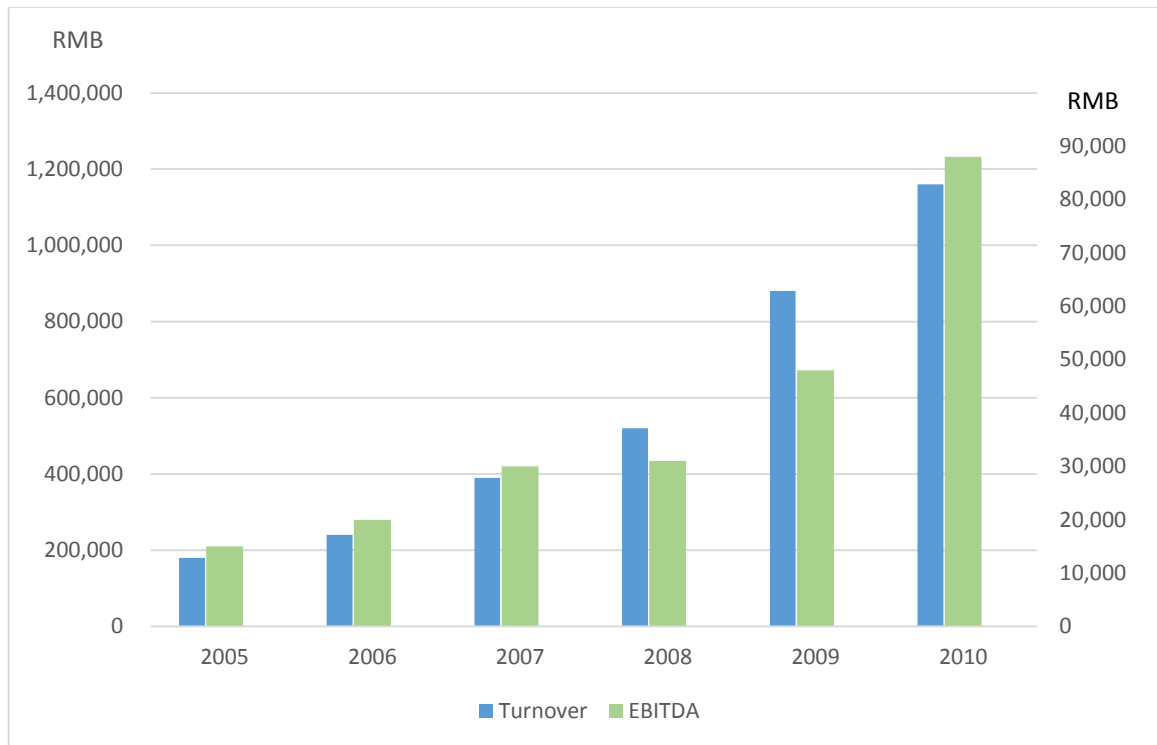


Figure 5-6 Strong development of UST HH

Source: UST annual report 2009

5.5 Summary

This chapter has discussed the factors featured in the research framework, using the results of qualitative analysis and some information made publicly available by UST.

It began by characterizing the internal and external environment of UST when it entered China to broaden its business range, by analysing the interview data provided by UST management employees. UST's main concerns about China were found to be the condition of the market and of the various institutions. Headquarters focused on these specifically, because they were seen to represent some uncertainties for UST's business in China.

The relationship of UST headquarters with its subsidiaries in China and its operating strategy were discussed next. We analysed UST's strategic motives in China, identifying these as seeking low-cost resources and enlarged market opportunities. It was noted that because China's market is dominated by a number of SOEs, UST adopted a policy of M&A and collaboration to facilitate access to these major enterprises and through them to customers in China. This chapter also found that the relationship of UST headquarters with its subsidiaries was designed to support its strategy in China; that is, UST was discovered to apply relatively flexible mechanisms of control to ensure the success of its Chinese subsidiaries.

The chapter ended by summarizing the performance of UST's subsidiaries in China in recent years, showing that its business there had developed rapidly, providing excellent results in terms of both financial and non-financial performance.

Chapter 6 Findings and Discussion

This chapter summarizes the major findings of this research and draws conclusions from the qualitative analysis, then it answers the research questions and discusses the managerial implications. Section 6.1 summarizes the overall research findings and revisits the research framework. Section 6.2 discusses the influence of MNE environment on subsidiary strategy choice. Section 6.3 considers how subsidiaries are controlled by the MNE's environment and the headquarters-subsidiary relationship. Section 6.4 examines the effect of this relationship on the MNE's subsidiary strategy. In light of the above considerations, section 6.5 discusses the relationship between subsidiary strategy and performance.

6.1 Findings

This section outlines the findings regarding the factors which influence MNEs' headquarters-subsidiary relationships, subsidiary strategy and the performance of subsidiaries in China. Figure 6-1 summarizes these findings by placing the concepts identified in this thesis within the conceptual framework established in Chapter 2, Section 2.9. The first arrow (lower left) shows that internal and external factors within the MNE's environment will drive its subsidiary strategy, which in this case includes the strategic motives and entry strategies of UST in China. The strategic motives were identified as market-seeking and cost-saving, mainly because the Chinese market was growing quickly and labour costs were very low in China. Because of the vast size and rapid growth of the market, while its own resources were very limited, UST initially adopted a partial M&A entry strategy. The MNE environment will also influence the

design of the headquarters-subsidary relationship and the subsidiary control policy, as denoted by the upper left arrow in Figure 6-1. Given the low labour costs in China, UST relied heavily on local managers and employees, which in turn facilitated access to the local market and supported UST's strategic management. The third (central) arrow indicates that the MNE's headquarters-subsidary relationship and subsidiary control will drive its subsidiary management, which in the case of UST was reflected especially in its strategic motives and entry strategies determining its subsidiary strategy. Specifically, UST captured external market opportunities through diversification, while reducing costs through the localization of management. Finally, the lower right arrow in Figure 6-1 illustrates the critical influence of subsidiary strategy and subsidiary control over subsidiary performance. These four causal relationships are now addressed in turn, beginning with the effects of environment on subsidiary strategy.

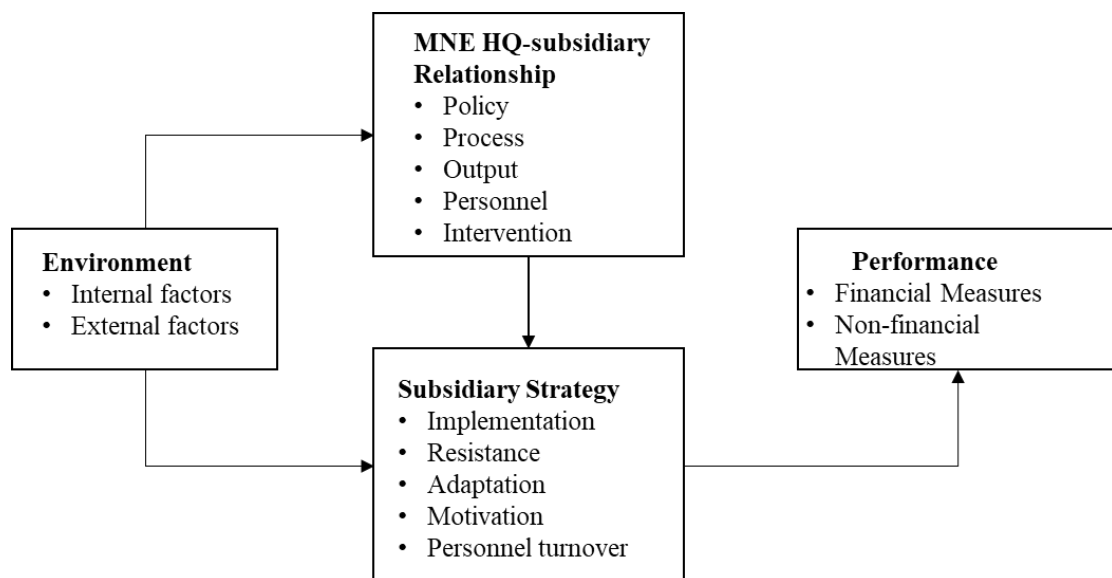


Figure 6-1 The effects of headquarters-subsidary relationships on strategy and performance

6.2 MNE environment and subsidiary strategies

The market environment is a critical determinant of subsidiary strategy. Specifically, it shapes the opportunities and threats that any subsidiary faces, thereby largely determining its strategy. This section discusses the influence of market environment on subsidiary strategy, including strategic motives, entry strategies and subsidiary strategy.

6.2.1 Environment and strategic motives

The three dimensions of the market environment which need to be considered here are conditions, competition and institutions. Corporate strategic motives are mainly shaped by market conditions.

First, the characteristics of the market in China led UST to adopt a market-seeking approach. For instance, some of UST's key customers were in the shipbuilding industry and IHS Fairplay data for 2009 indicate that 35% of global shipping was built in China, against only 1% in Europe. Therefore, China was recognized as the most important market for the shipbuilding industry. More importantly, this huge market was still growing quickly. According to IHS Fairplay, shipbuilding output in China was about 4 million DWT in 1998, growing steeply to around 37 million DWT in 2009. In addition, the limited home market in Norway constrained UST's further growth, which in turn strengthened its market-seeking motive in China.

Second, market competition and the low labour costs in China gave UST a cost-saving motivation to move into China. On one side of the equation, intense global competition

had driven down the group's profit margin, obliging it to cut costs. UST was in competition with National Oilwell Varco, Aker MH, TSC and others, all of which had entered low-cost countries and depended on their well-structured and efficiently planned supply chains in these countries to reduce costs. As a company originally based in Norway, UST faced great difficulties in planning its production base and supply chain to support a competitive position in the market. Therefore, as a strategic consideration, UST needed to transfer its production and product delivery functions to low-costs countries in order to give it a competitive advantage. On the other side, a move to China would allow UST to control its operating costs, especially labour costs, which were much lower in China than in Norway. Company data show that when UST first invested in China in 2001, the total operating costs of a subsidiary there were about 16% of those in Norway, including savings of 82% in labour costs in respect of management employees and as much as 94% for front-line workers. These much lower labour costs in China made cost-saving one of UST's strategic motives to enter China.

6.2.2 Market environment and entry strategies

The host-country market environment determines the costs and benefits associated with different entry strategies, thereby significantly influencing an MNE's choice of entry strategy. Thus, when UST management realized that the Chinese market had the potential to provide great growth opportunities, it took the strategic decision to enter China in order to benefit from the dramatic growth of industries in that market. However, the company faced some disadvantages from its relative lateness in doing so. UST could not build a strong competitive advantage solely on ordinary MNE internationalization processes, so it decided to accelerate its internationalization within the Chinese market.

The group therefore adopted an M&A strategy, buying shares in local companies in order to establish an initial presence in China. This choice was rational for two main reasons. First, M&A would allow UST to enter the Chinese market much more quickly than if it had adopted a greenfield investment strategy. Second, UST would gain network and relationship resources through M&A, since the acquired companies would already have developed these connections with key stakeholders in China. Networks and relationships were seen as key success factors in the UST internationalization strategy because of their major importance in facilitating business transactions in China.

Regarding ownership structure, UST typically acquired partial ownership of domestic firms to form joint ventures with leading Chinese SOEs. Table 6-1, which lists the ownership structure of the group's subsidiaries in different countries, shows that that this approach was peculiar to the Chinese market; in 2014, UST owned 50% of all but two of its subsidiaries in China, as against 100% of almost all of those in other countries.

Table 6-1 Ownership structure of subsidiaries (2014)

Subsidiary	Country	Founded in	Ownership
UST Brazil Services	Brazil	2014	99%
UST Marine Shanghai Co Ltd	China	2002	100%
UST HH Ships Equipment Co Ltd	China	2002	50%
UST BH Machinery Co., Ltd	China	2005	50%
Jiangsu UST HH Ships Equipment co. Ltd	China	2007	20%
UST Marine Equipment Ltd.	China	2008	100%
Shanghai UST HH International Trade Co., Ltd	China	2012	50%
UST BH Trading (Dalian) Co., Ltd	China	2014	50%
UST SCM Marine and Offshore Machinery Co. Ltd	China	2014	50%
UST Marine Ostrava s.r.o	Czech Republic	2005	100%
UST Liftec Oy	Finland	2004	100%
UST Marine GmbH	Germany	1997	100%
UST Neuenfelder Maschinenfabrik GmbH	Germany	2012	100%
UST Greece Ltd.	Greece	2009	100%
UST Marine S.r.l	Italy	2006	100%
UST Marine GmbH Korea Co. Ltd	Korea	2007	100%
UST Handling Systems AS	Norway	1994	100%
Norlift AS	Norway	1994	100%
UST Ships Equipment AS	Norway	1996	100%
Hydralift Marine AS	Norway	2003	100%
UST Cranes Norway AS	Norway	2007	100%
UST Marine AS	Norway	2009	100%
UST Offshore Handling Equipment AS	Norway	2012	100%
UST Polen SP.Z.O.O	Polen	2013	100%
UST Singapore Pte. Ltd.	Singapore	2009	100%
UST Marine AB	Sweden	2002	100%
UST HH AB	Sweden	2002	100%
UST Port Equipment AB	Sweden	2005	100%
UST Marine Holding AB	Sweden	2011	100%
UST Port & Logistics Holding AB	Sweden	2011	100%
UST Marine Inc.	USA	1994	100%
UST Vietnam Co. Ltd	Vietnam	2014	100%

Source: Publicly available UST annual reports

This M&A strategy was based on the following considerations. First, a special feature of the Chinese market is that it is dominated by SOEs. Collaborating with the strongest

of these afforded UST the most rapid possible access to this important market. Counterparties to the joint ventures had the strong incentive of a 50% share ownership to foster the success of each subsidiary. Specifically, the local Chinese partners could help the joint ventures to build relationships with key customers in China, whether these were their own sister companies or other industry players, which would typically also be SOEs, since there were strong and extensive networks of collaboration among these SOEs. Collaboration with SOEs secondly helped the joint ventures to gain legitimacy and key resources in China. Chinese parent companies were favoured by central and local governments, banks and other government agencies, with positive spillover effects for MNE subsidiaries. The third consideration was that UST hoped to take a strategic position in the market and to expand as quickly as possible to overcome the disadvantages of its latecomer status.

To summarize, adopting an M&A strategy and collaborating with local companies gave UST better access to the resources in China than it would have gained through greenfield investment. By means of its mainly 50/50 joint ownership with SOEs, UST opened the Chinese market and built relationships with local companies, especially those SOEs, in a short time, which strongly facilitated the success of its subsidiaries in China. This analysis of UST's subsidiary strategy in the context of the Chinese environment illustrates the significant role that an MNE's host-country environment plays in its subsidiary strategy. The next section considers the importance of environment for the headquarters-subsidiary relationship and for subsidiary control.

6.3 MNE environment, the headquarters-subsidiary relationship and subsidiary control

We suppose that an MNE's overall environment, comprising both internal and external factors in its home and host countries, determines the relationship between the headquarters and each subsidiary, especially the control mechanisms and methods used. The interview data collected during this research indicate that any differences of culture and language between host and home country will influence the cost and effectiveness of various control methods. The larger the cultural differences, the less effective these methods will be and the higher the failure rate of expatriates with home country nationality. This section discusses the influences of market environment on the composition of the top management team, subsidiary staffing and control flexibility.

In the case of UST, interviews with relevant people in the management layer provide evidence that not only the environment itself but also environmental uncertainty had crucial effects on the control mechanisms applied by the Norwegian headquarters to the Chinese subsidiaries. In response to the high environmental uncertainty in China, the headquarters team relied mainly on informal control mechanisms, including communication, soft control and personal relationships. More specifically, analysis of the data reveals an association between the uncertainty of the Chinese environment perceived by UST headquarters and its use of the following seven subsidiary control mechanisms: (1) It maintained a high level of communication to ensure that its decisions were based on adequate information about the host market and the subsidiaries; (2) it applied a high level of soft control to stimulate the use of initiative by subsidiary management; (3) it commonly used personal relationships to transfer high

quality information between headquarters and the subsidiaries and to build mutual trust; (4) it recruited a high proportion of local managers and employees in order to benefit from their abundant local knowledge and strong links with local resources and businesses; (5) it strongly favoured other forms of informal control, including personal contact, subsidiary culture and the use of awards and penalties, on the grounds that the implementation of informal control can support formal control methods and make a subsidiary more aware of headquarters' strategy and the MNE environment; (6) it exercised output control in preference to process control, because the latter would require more information and would be likely to introduce high transaction costs; (7) it kept rules and policy control to a minimum, while recognizing that both are necessary for subsidiary control.

The above relationships and influences were amplified by three background factors. First, headquarters lacked experience regarding the host country, depending heavily on the subsidiaries to explore opportunities and avoid potential threats. Secondly, the importance of the Chinese subsidiaries meant that they had to be granted a high degree of latitude in making their own decisions. Finally, the high cultural distance between host and home countries was a crucial impediment to headquarters acquiring sufficient reliable and timely information to make wise decisions in Norway on many matters, which led it to depend on the Chinese subsidiaries to make as many of their own decisions as practicable.

The following subsections consider in further detail two particularly important relationships of environment, with HR structures and with control flexibility.

6.3.1 Environment and HR structures

An MNE's policy on its headquarters-subsidary relationships and subsidiary control are implemented by managers, so it is valuable to consider their functioning from a human resource point of view.

The top management team's resources and capabilities are the key to a subsidiary's survival and success. In the case of UST's wholly owned subsidiaries in China, both the board members and the operational general manager (GM) were expected to be Norwegian people sent from headquarters, while local Chinese managers were mainly in charge of various functional departments. The senior management structure of the joint ventures was quite different, as it had to take the Chinese counterparty into consideration. Although the balance of investment was usually 50:50, the board was typically chaired by a non-Chinese assigned by UST headquarters. As to the operational team, the GM of the company and all other functional managers were typically Chinese. This combination ensured a balance between the understanding of headquarters objectives, culturally and in terms of business, while at the same time the company also understood the local environment of the host country.

The above top management team structure was designed with consideration of the following factors. First, the general manager of a subsidiary will need to interact frequently with his or her subordinates. Since most employees were native Chinese, the interaction cost would be much lower for a Chinese GM than for a Norwegian one. Second, since most customers were Chinese domestic firms, a Chinese general manager would be better able to understand the needs of local customers and thus to make correct

operational decisions more efficiently. Third, networks and relationships are highly valued by Chinese society. A Chinese GM could build networks and relationships with customers and key stakeholders such as government agencies much more easily than a foreign one, because of their commonality of language and cultural background.

Although the composition of top management teams differed considerably between UST's wholly owned subsidiaries and joint ventures in China, the staffing strategy was almost the same in both cases. Specifically, all employees excluding the GM were Chinese. Two critical dimensions of the market environment influenced UST's subsidiary staffing strategies in China.

First, the Chinese had natural advantages in dealing with domestic customers because of the distinct Chinese culture, where networking and interpersonal relationships commonly play core roles in the transmission of information and promotion of cooperation (Xin & Pearce, 1996; Peng et al., 2008). Local employees, especially those who had relationships with top managers of SOEs, were critical for UST's dealings with SOEs, which dominated its customer base in China. This was emphasised by the CEO and President of UST Group, cited earlier in Section 5.2.3.2 as referring to the need "to hire Chinese people to go into the new market". Not only did their linguistic and cultural background give local employees a natural advantage in communicating and developing relationships with Chinese firms, which constituted most of UST's direct customers in China, but they also had more experience of dealing with central and local government, enabling them to build better relationships between the firm and governmental bodies. As the local manager of one subsidiary put it, "Most customers

are local firms. Local customers want to talk to local people. Local employees can communicate with customers more easily.”

The second critical factor was the very low labour costs in China compared with Norway, allowing UST to save 82% on labour costs for managers and 94% for front-line workers. Hiring a high percentage of local employees would reduce the staffing costs of subsidiaries substantially, thereby helping to control operational costs and to improve EBITDA.

6.3.2 Environment and control flexibility

Control flexibility was very high for UST’s Chinese subsidiaries. Specifically, headquarters adopted soft-oriented and output-oriented control, granting these subsidiaries broad freedom in making decisions and setting procedures. According to our research, this control flexibility was largely shaped by the external institutional and market environment in China.

First, the fast-changing institutional environment in China made hard control highly risky. The institutional environment of China has changed fundamentally in recent decades as the country has transitioned from a planned to a market economy. Notably, when China acceded to the WTO at the end of 2001, all applicable laws and regulatory mechanisms were modified to meet WTO-related requirements. This helped the country to become more open to the rest of the world and allowed the shipping, shipbuilding and offshore-related industries to grow rapidly. Against this background, the market

potential has expanded very quickly over the last decade, obliging UST to react to the fast-changing environment and follow the local rules.

The second environmental factor is related to market competition. The market competition landscape has changed frequently in China due to strong market growth and intense competition with both global and domestic players. UST's subsidiaries in China needed to respond very quickly to these changes in order to seize opportunities and avoid threats. Hard control from the headquarters would have significantly restricted their speed of response and led to a higher failure rate. Therefore, UST favoured highly flexible control.

Finally, inflexible control would be associated with higher control cost, due to the great cultural differences between China and Norway. For example, Chinese people tend to place greater importance on personal relations than on contracts, while the opposite is true of Norwegians. Chinese people also prefer relatively informal and flexible control methods, while Norwegians are familiar with more formal and less flexible ones. These differences in culture are likely to lead to misunderstandings and even contradictions, thus undermining subsidiary performance. Since more rigid control can only be imposed by frequent interactions between headquarters and subsidiaries, it is associated with high control costs. UST's use of more flexible control methods to deal with its subsidiaries in China was thus a means of reducing costs.

6.4 The headquarters-subsidiary relationship and subsidiary strategy

This section discusses the relationship of UST headquarters with its subsidiaries and its subsidiary strategy. In particular, it reports the finding that the headquarters-subsidiary relationship and subsidiary control significantly influence the motivation of subsidiary strategy.

First, the headquarters-subsidiary relationship and especially headquarters control are found to have driven the motives underlying subsidiary strategy. Specifically, upon consideration of the Chinese market potential, UST adopted a market-seeking strategy and a local HR policy, relying on domestic managers and employees to take advantage of their better understanding of the local market. There was also a cost-saving motive in UST's local hiring policy. Second, the headquarters-subsidiary relationship and subsidiary control were found to have influenced UST's entry strategy, especially regarding the composition of top management teams and the adoption of flexible control policies.

6.4.1 The headquarters-subsidiary relationship and strategic motives

Since the industries in which it operated had grown dramatically in China during the past few years, UST's entry into the China market was mainly driven by a market-seeking motive, which critically influenced the design of its control mechanisms and the formalization of headquarters-subsidiary relationships and management schemes. Given the unique features of the Chinese market and the marked cultural differences between China and Norway, UST adopted a localization strategy and developed strong

teams of domestic managers and employees to capture the opportunities provided by the Chinese market. For example, networks and relationships are critical for conducting business in China. Compared with foreign expatriates, local operational managers and employees have more network connections and relationships with key stakeholders in China and are more adept at building networks and relationships in China. Therefore, almost all of UST's functional managers and employees in China were Chinese.

The cost-saving motive also essentially influenced the mechanisms by which UST headquarters exerted control over its subsidiaries in China. As an industrial firm, to operate in China UST needed to develop whole operational functions in the local market and their composition was driven by headquarters-subsidiary relationships. As they gained confidence in local managers and staff, functional heads in Norway became more willing to assign greater control of these functions to Chinese people, thus feeding the strategic motive to transfer activities to China. Since labour costs were relatively low in China, transferring more functions of local production, engineering, purchase and other supply chain activities allowed UST to cut operating costs, making it more competitive. Thus, a well-defined headquarters-subsidiary relationship positively supported the HR policy and encouraged human resource localization in China.

6.4.2 Headquarters-subsidiary relationship and market entry mode

As a first substantial step into the Chinese market, UST undertook partial mergers and acquisitions to found subsidiaries in China. In 2014, six of its eight existing subsidiaries were 50/50 joint ventures, while it was sole owner of the other two. This entry strategy

strongly influenced the realization of a unique headquarters-subsidary relationship and the design of the subsidiary control mechanisms.

First, the partial M&A policy gave the new subsidiaries a balanced power structure. Almost all of the joint ventures had 50/50 ownership, allowing each of the two cooperating parties legitimately to play an equally important role in the joint venture. In addition, the top managers of the acquired firms had typically worked in China for a long time and so had established local connections with key players in the industry, gaining a deep understanding of Chinese culture and the needs of Chinese customers. Therefore, these managers were the key assets of the acquired firms. They were more likely to be retained and to play important top management roles after M&A. This entry mode required the subsidiary control scheme and headquarters-subsidary relationship to be appropriately designed.

Second, upon becoming the (partial) owner of a new company, UST had to consider how to operate the business effectively and ensure a proper management style. It realized that employing a high proportion of local managers would benefit the operation and support the subsidiary strategy. In addition, local joint venture partners who had extensive relationships with local employees tended to retain them. As at the early stages of the joint ventures UST had only partial authority to make staffing decisions, these would be mainly shaped by the local joint venture partners.

Third, accepting that as concluded in Section 6.3.2 it should accept high control flexibility in China, UST was prepared to agree to the continuance of the existing procedures and routines for the daily management of the firms it had acquired. This

policy took advantage of well-defined relationships with subsidiary managers in the integration process. Since tight control might constrain or disrupt these particular routines and procedures, the control of these acquired subsidiaries was highly flexible. In addition, the managers and employees of these firms had their own philosophy of how to run them. UST's strategy was only gradually to change the overall strategic management of its subsidiaries in China. In the transition period, headquarters showed patience by giving local managers considerable authority to exercise their respective responsibilities, thus ensuring a smooth restructuring of corporate culture and management style.

6.4.3 Subsidiary control and subsidiary human resource strategies

Subsidiary control also influences corporate HR strategy towards each subsidiary. A localization policy and strategy will help to decrease operating costs. Being confident of ensuring that its operations in China would align with its overall corporate vision and objectives and with reliable control measures, UST adopted the localization of HR management policies in China.

By adopting an HRM localization strategy, UST ensured that its subsidiaries in China recruited a high proportion of Chinese functional managers, which helped to improve performance. HR localization typically offers two main benefits. First, Chinese culture views mutual trust, networks and relationships between firms as antecedents of successful transactions. Chinese managers would naturally be in a better position to build and maintain trust, networks and relationships with local customers, which would contribute to higher sales growth.

I guess trust is so important, especially in China, where the networking is so important. It's important to have long-term relationships. (CEF, Sale Mgr.)

The cost of Chinese managers is lower than foreigners. In China, managers need to build and maintain guanxi with top managers of the clients and government officials. In this respect, Chinese managers do a better job. (LEW, Mgr. PM)

Second, Chinese managers typically had more information regarding local firms and clients. They could communicate more effectively with clients and more easily understand their expectations because they shared a language and culture with them. Therefore, hiring more Chinese managers would tend to improve corporate revenue. The reliable headquarters-subsidary relationship and control ensured that such a strategy would be adopted.

6.4.4 Control flexibility and subsidiary strategy

Control flexibility influences subsidiary strategy through two mechanisms, involving local responsiveness and environmental uncertainty respectively. Considering that local staff confer advantages in making decisions and need to react efficiently, with local responsiveness, UST recognized the need to give proper authority to local managers for them to make decisions. As greater control flexibility would motivate local managers and employees in China to take advantage of their own knowledge and experience, it would have a positive effect on strategic management of the subsidiary. The following interview excerpts support this contention:

Soft control helps to improve the initiative of employees. Employees can make some decisions in operations. Hard control may hurt employees. They can do nothing but comply with orders. It is not a good thing. (JON, Group CEO)

There are several factors to take into account. I consider that three factors are very important, which are market, organizational structure and government policies. From a market perspective, the most important thing is that the market will decide whether you can make a profit... and this is the most important factor when we decide to operate in China.... From a company structural point of view, it authorizes managers to make decisions and in this way, operating in China becomes more effective. The more flexibility you authorize, you can make better contributions. And the third is governmental policies, which determine whether the government can create a friendly environment for foreign investors. (TUM, Mgr. Tech.)

The uncertainty of the Chinese business environment made hard control inappropriate and highly risky, because it would have been difficult to align remote decisions with local conditions. Furthermore, Chinese culture favours informal, more flexible control methods, whereas the more rigid the control, the greater would be the need for interactions between headquarters and subsidiaries. Since there were huge differences in culture between China and Norway, low control flexibility was associated with high control costs, with slow decision making and thus with poor subsidiary performance.

It needs to have a kind of flexibility. For financial management, accountancy rules in Western countries are quite different from those in China. (REL, Mgr. Finance)

The flexibility, from our point of view, is hoped to benefit the company's interests. Our main objective is to benefit the company. Take local tax policies as an example. Such practices will work, and we as local finance officers help to propose and analyse our practices so that they are both in line with Chinese policies and protect the company's interests. You need flexibility to take such measures. (REL, Mgr. Finance)

If the foreign parent company is involved in detailed management, costs will be very high. The decision making will be very slow and a lot of opportunities will be lost. (REL, Mgr. Finance)

6.5 Subsidiary strategies and performance

Corporate performance is collectively influenced by various functional divisions and subsidiary strategies, especially in an area or market with strategic significance such as China. An appropriate strategy allows the firm to take advantage of external opportunities and avoid external threats. Both entry strategies and subsidiary strategy (i.e. diversification and localization) were found to have a critical influence on the performance of UST's subsidiaries in China. This section discusses the mechanisms of these influences.

6.5.1 Entry strategy and subsidiary performance

UST's strategy of entering China mainly through joint ventures with domestic SOEs had positive effects on subsidiary performance, as the words of the CEO indicate:

Collaboration takes place on equal terms here. UST has brought its technology into the company. Meanwhile, support from CSSC has led to significant growth of the joint venture, which has become the largest provider of hatch covers in China, with a market share ... close to 70%. (JON, Group CEO)

The positive effects of the joint venture strategy can be attributed to three factors. The first is that since SOEs were the most important players in China and had strong support from the government, cooperation with them helped UST to be accepted quickly by the market. Each subsidiary company then gained orders directly from these leading SOEs and other local firms which had close relationships with them, without needing to go through the long process of joining a qualified supplier list. These extracts from the interview with the CEO provide further explanations:

Cooperation in China within the field of energy has two dimensions. With respect to DSIC, the agreements entail that UST is to be DSIC's preferred partner and supplier of drilling equipment whenever the shipbuilding group takes on assignments for customers in the rig market. With regard to UST BH Machinery, the cooperation means that the joint venture company establishes a separate offshore organization for production of drilling equipment and offshore cranes to sell these to Chinese yards. (JON, Group CEO)

Our joint venture operations are based on 50/50 ownership with the leading state-owned corporations CSSC and DSIC. UST contributes with a strong brand and state of the art technology, while the Chinese partners provide valuable market access. (JON, Group CEO)

The second factor is the 50/50 joint venture ownership structure, giving domestic partners a strong incentive to support the growth of the subsidiaries, in which they owned a significant share. Specifically, they would be incentivized to support the building of relationships between the joint ventures and key customers (typically SOEs).

Lastly, cooperation with SOEs helped the joint ventures to gain legitimacy and key resources in China, where the government plays a more important role than in many other countries. Chinese parent companies (SOEs) were favoured by central and local government, banks and other government agencies with preferred policies, which created a positive spill over effect for the subsidiaries. The following quote is consistent with this logic:

One particular advantage of the joint venture partnership is that all UST's activities appear to be in the Chinese market. A non-Chinese president of the joint venture company would create very different results. Being Chinese in China is as important here as in other markets. (JON, Group CEO)

6.5.2 Subsidiary strategy and subsidiary performance

At the corporate level, UST adopted a strategy of horizontal diversification in China, while at the operational level, it relied mainly on localization. These two strategic choices contributed to the strong performance of its subsidiaries in China.

First, horizontal diversification helped UST to capture the growth opportunities in China, thus contributing to high growth in sales. UST collaborated with two market-leading Chinese SOEs through joint ventures in different product portfolios. These SOEs had the critical resources such as government relationships that UST needed to enter various product areas. In addition, they strengthened the subsidiaries by helping to develop whole functions of production, purchasing, sales and services in the Chinese market. Having potential opportunities to enter these high growth segments, UST adopted horizontal diversification to further expand its product and service portfolios and its market coverage, to capture opportunities. Thus, horizontal diversification enabled a better utilization of resources, leading to strong growth in sales and market share in China. Evidence is provided by the words of JON, Group CEO cited in Chapter 5, section 5.2.3.2, noting that UST had “developed a small business in Norway to become a big business in China” by using local partnerships, adding that UST “needed local people to do the local business”.

Second, the localization strategy helped UST to reduce costs, thus contributing to a higher profit margin. Localization was applied to managers, employees and operations. Since it was much cheaper to employ local managers and workers than expatriates, localization would reduce staffing costs substantially. In addition, the localization of

operations such as purchasing enabled UST to benefit from the low costs of local products and services. Therefore, localization contributed to subsidiary profits by reducing overall costs, as this interviewee explained:

And then, of course, what could be the second important [strategy] would be related to ... sourcing and manufacturing in China. And it would be to support sales actively and also to reduce the costs, we would like to have local guys involved in the work that we have in China going from sales and sourcing to these activities. (TOO, VP, Op.)

More importantly, the localization strategy also enabled UST to benefit from the social capital owned by local partners, managers and employees, which helped it to gain contracts from key players in China, thus contributing to strong sales growth.

6.5.3 Subsidiary HR strategy and performance

In its subsidiaries in China, UST adopted a quite distinct HR strategy, recruiting almost all of its operational managers and technical employees directly from the local population. Adopting this strategy helped it to achieve better performance for two basic reasons, involving costs and local knowledge. Staffing costs were much lower for local employees than that for expatriates from Norway, so the greater the proportion of local people each subsidiary employed, the higher its profit. The CEO is again quoted in support of this analysis:

Cost control is important. I use more local employees, and then the cost is cut down. (JON, Group CEO)

In addition, local employees were more familiar than their expatriate counterparts with the business environment in China, because they had fewer barriers to communicating with domestic business partners and clients. The proportion of local employees thus had a direct and positive relation with subsidiary sales growth, as the CEO indicated by his reference in interview to needing “local people to do the local business”.

6.6 Summary

This chapter has discussed an analysis of the findings and used the research framework to summarize these findings. Figure 6-1 shows that an MNE’s internal and external environment will influence its headquarters-subsidary relationships and choice of subsidiary strategy, while the headquarters-subsidary relationship will also affect the subsidiary strategy. Finally, this analysis has established that the MNE’s subsidiary strategy will have a direct influence on the performance of each subsidiary.

The next chapter concludes this thesis.

Chapter 7 Conclusion and Future Research

The three sections of this final chapter draw conclusions from this research and summarize its findings (Section 7.1), identify its theoretical contributions and managerial implications for the enhancement of both headquarters-subsidary relationships and subsidiary performance (Section 7.2), recognize some limitations and indicate future research directions (Section 7.3).

7.1 Conclusions

7.1.1 The MNE environment is the first factor to consider on entering a host country

The environment of an MNE plays an important role in its subsidiary business strategy when entering a host country, affecting both its motives and the choice of entry mode. The firm should carefully analyse the internal and external environmental factors to determine the best entry strategy. This research has shown that the environment can directly affect an MNE's subsidiary strategy by determining its motives and entry mode, and that the environment can indirectly affect subsidiary strategy by influencing the headquarters-subsidary relationship.

In detail, when entering a host country, an MNE should consider four main environmental factors when determining its subsidiary strategy, the first of which is the market conditions in that country. These include the size, maturity and particular characteristics of the host market. Market size here means the MNE's potential for success in selling into that market. The enterprise should analyse the demand growth

rate of its main business in the host country and investigate whether the market structure is likely to change significantly in the future. This will help it to determine what resources it will need to invest in that country to meet the market demand. Host market maturity is another core characteristic that should be considered. The markets of most developing countries like China are usually not mature; in other words, the lack of expertise and experience in some fields makes local players eager to seek technical skills from abroad, so the host country will provide more support and customer services to attract MNEs into the market. However, the immaturity of the market also means that there is a high level of specificity in the MNE environment, so any incoming firm needs to pay close attention to the characteristics of the host country.

The second factor on which the MNE's subsidiary strategy depends and which it will need to analyse carefully is the competitive environment in the host market. This includes the number, size and activity of both domestic and international competitors which have already entered the market or are likely to do so in future. In developing countries like China, there are currently relatively few domestic competitors in the market, so any entrant MNE should focus on the existing international competitors and try to determine its comparative advantage when competing with them.

Thirdly, it should consider the host country's institutions. The institutional-based view is another important factor which can significantly influence the way the MNE controls its subsidiary. The institutional environment is an essential aspect of the host country's market environment and has two major components, consisting of its formal and informal institutions. In developing countries, formal institutions such as laws, regulations, policies, rules and contracts are not invariable, but will tend to change in

response to the constant development of the society itself. An additional characteristic of developing countries like China is that informal institutions including culture and customs tend to play a more important role than in developed ones. The culture of the MNE's home country is also likely to be very different from that of the host country, so that deciding how to deal with the informal institutional gap becomes one of the main factors that an MNE should consider when doing business in a developing host country.

The fourth factor which the MNE must take into account is environmental uncertainty. It needs to consider the overall extent of changes in the market and their trends when deciding in which field to invest. Any institutional gap and managers' personal social networks are also important when entering a developing market. Finally, market uncertainties regarding competition can influence the direction in which the MNE chooses to take its business and the field in which it invests its resources.

Consideration of these four factors illustrates the important role of the MNE's environment, comprising both internal and external factors, in its corporate strategy. It will determine its subsidiary strategy and give guidance on how to design the headquarters-subsidiary relationship and the subsidiary control scheme. This research has established that an MNE entering a developing country like China should focus mainly on market-seeking and cost-saving motives, using M&A and collaboration with local companies to gain better access to certain local resources.

In summary, when an MNE decides to enter a host country, it needs to consider in advance the internal and external market environment of that country. It should analyse these environmental factors comprehensively to make an informed choice of subsidiary

strategy and to design an appropriate relationship between the headquarters and each subsidiary to better support that strategy.

7.1.2 Subsidiary strategy is determined by the MNE environment and the headquarters-subsidiary relationship

This research examined the UST case and found that both the MNE environment and the headquarters-subsidiary relationship can influence subsidiary strategy. The environment, as noted above, broadly comprises the three dimensions of market conditions, market competition and host country institutions, while the salient aspects of the headquarters-subsidiary relationship are usually the composition of the subsidiary's top management team, its staffing, the flexibility of headquarters control and communication between the two. This relationship and the environment both influence subsidiary strategy, whose major components are strategic motive, entry strategy and operating strategy.

By analysing the UST case, this research has established that the motives behind its subsidiary strategy were mainly shaped by two aspects of market conditions: The huge and continually growing market in China gave UST a market-seeking motive, while market competition and the low labour costs in China provided a cost-saving motive. It can be concluded that the market environment shapes the opportunities and threats that an MNE's subsidiary faces, thus determining its strategy. The host country's market environment also determines the costs and benefits associated with different entry strategies and significantly influences the MNE's choice of entry strategy. Considering the specificity and unique characteristics of the Chinese market, MNEs usually choose

mergers and acquisitions as a route to collaboration with local companies. By doing this, UST gained better access to the resources in China.

It was also found that UST set up subsidiaries in China mainly in order to seek market resources and opportunities. This market-seeking motive will have influenced the design of its control mechanisms and the formalization of its headquarters-subsidiary relationships. The mechanism through which headquarters exerts control over its subsidiaries may also be influenced by the cost-saving motive in China. Thus, a well-defined headquarters-subsidiary relationship will positively support the human resource policy and encourage HR localization in the host country. Like UST in China, MNEs tend to choose partial M&As as the mode of entry into developing countries. This leads to a balanced power structure within the new subsidiaries. Almost all of the joint ventures involving MNEs in China have a 50/50 ownership structure, allowing the two cooperating parties legitimately to play an equally important role in the joint venture. MNEs also realize that a high proportion of local management employees can benefit their operation and support their subsidiary strategies, since MNE headquarters needs to think how to effectively operate the businesses and ensure a proper management mechanism. In addition, headquarters usually accepts highly flexible control, understanding that this will benefit the operation of a subsidiary in a host country like China. Top management of the MNE can then take advantage of its well-defined relationship with subsidiary managers in the integration process.

7.1.3 The MNE environment influences the subsidiary environment through the headquarters-subsidiary relationship

This research has found that the MNE's environment can influence its subsidiary strategy not only directly, but also indirectly, through the headquarters-subsidiary relationship. In other words, the headquarters-subsidiary relationship can mediate the relationship between MNE environment and subsidiary strategy.

This finding offers a different view of how an MNE can adjust its subsidiary strategy when entering a host country market. This research concludes that both internal and external environmental factors can influence the relationship between MNE headquarters and a subsidiary, especially the control mechanisms and control methods applied to the subsidiary in the host country.

When designing its human resource structure, the MNE needs to consider the costs and effects of localizing its subsidiary management. The social administrative systems in developing countries like China are not always highly developed compared with the MNE's home country, in which case managers' own resources and capabilities are likely to hold the key to a subsidiary's survival and success. When entering such a host country, the headquarters management team should consider that since the subsidiary's managers will need to interact frequently with their subordinates, most of whom will be locally recruited native people, localized management might work much better than globalized management. An additional important factor that any MNE based in a developed country and setting up a subsidiary in a developing country should consider, when designing the subsidiary's HR structure to optimize performance, is that it will

cost much less to hire local managers and employees than expatriates from the home country.

Where most of the subsidiary's customers are in the local market, as in the case of UST in China, a local management team will be better able to understand their needs and this will help the subsidiary to make the right operating decisions. Similarly, hiring local employees is the right choice for any MNE entering a developing country, because they will share the language and cultural background of the customers, which brings natural advantages in communicating and developing relationships with them.

In China, as in many developing countries, personal networks and relationships are highly valued in day-to-day business. Again, commonality of language and of cultural background means that a localized management structure will enable the MNE subsidiary to build stronger networks and relationships with customers and other key stakeholders, including government agencies.

This research has also shown that it is advisable for an MNE to exert flexible control over a subsidiary in a developing country, because local employees need full authority to decide on how best to conduct their business in the host country. By motivating local managers and employees to take advantage of their own knowledge and experience, greater control flexibility has a positive effect on the subsidiary's strategic management. Besides, the environmental uncertainty in some developing countries makes the imposition of formal control both difficult and ill advised, because decisions made far from the host country would be misaligned with local conditions and usually associated

with high risks. Considering these factors, MNEs usually apply flexible control as a subsidiary management mechanism.

An analysis of their internal and external environment leads MNEs such as UST to adopt localized management and flexible control mechanisms when entering developing markets like that of China. Therefore, their subsidiaries recruit a high proportion of local employees to achieve more effective management at lower cost, thus helping to improve their own performance and that of the parent MNE.

7.2 Contribution

The research reported in this thesis has used a qualitative methodology to analyse the MNE environment and the relationship between headquarters and subsidiary, identifying the constructs and factors that influence the MNE's subsidiary strategy and therefore determine the subsidiary's performance. By doing this, the thesis contributes to theoretical and managerial innovation in the following ways.

7.2.1 Theoretical contributions

7.2.1.1 Proposing a framework in which to analyse the effects of MNE environment and headquarters-subsidiary relationship on subsidiary strategy and performance

This research proposes a framework for the analysis of MNE subsidiaries in host countries, based on a literature review and the results of a qualitative case study of a Norwegian company, UST, and its subsidiaries in China. The research framework shows that the MNE's environment can influence its subsidiary strategy both directly

and indirectly through the headquarters-subsidary relationship, while the subsidiary strategy can in turn significantly influence its performance in the host country market.

In detail, the research framework guided the analysis of the MNE's subsidiary management practice in the host country. In this framework, the MNE environment, which can be divided into two aspects, internal and external, includes the host country market conditions, competition, institutions and environmental uncertainty. Subsidiary strategy includes strategic motives, entry mode and HRM. The MNE environment will drive subsidiary strategy in the host country market and can also influence subsidiary strategy indirectly, through the headquarters-subsidary relationship. The components of this relationship include the composition of the top management team, subsidiary staffing, control flexibility, communication, rules and policy. The headquarters-subsidary relationship is determined by the MNE environment and will influence subsidiary strategy. Finally, the subsidiary strategy has a significant influence on its performance.

Within this framework, when an MNE enters a host country market, it should first consider its internal and external environment. It must establish its motive for entering this market, decide on each subsidiary's entry mode and the most appropriate human resource structure to support the subsidiary strategy, by analysing the host market conditions, competition, institutions and uncertainty. The ultimate object of this research framework is to improve both financial and non-financial performance. It also offers a model for future researchers to use in their analysis of MNEs' corporate strategy in host countries.

7.2.1.2 Showing that the headquarters-subsidiary relationship works as a mediating variable

This research has shown that an MNE's environment can indirectly influence its subsidiary strategy through the mediation of the relationship between headquarters and subsidiary. Therefore, when the MNE enters a host country market, the headquarters should decide comprehensively on the various aspects of its relationship with each new subsidiary.

Researchers have usually treated the MNE environment as one of the determinants of subsidiary strategy (Benito, Grøgaard & Narula, 2003; Hillman & Wan, 2005; Birkinshaw & Pedersen, 2009; Tatoglu et al., 2014). And MNE headquarter-subsidiary relationship works as another determinant (Roth & Pahl, 1993; Ciabuschi, Forsgren & Martín, 2011; Conroy & Collings, 2012; Alharbi, 2014), but few have combined these two causal factors in their research.

The present research has used qualitative methods to establish that an MNE's environment can influence its headquarters-subsidiary relationship, which in turn influences its subsidiary strategy. Therefore, the headquarters-subsidiary relationship can mediate the relationship between MNE environment and subsidiary strategy. In this framework, the MNE's environment can influence its subsidiary strategy both directly and indirectly, which means that the environment plays an important role in subsidiary business strategy.

The theoretical findings of this research can provide some managerial suggestions for MNE headquarters. According to the research framework, headquarters can demonstrate and implement specific control over the subsidiary by analysing the MNE environment. On one hand, the research indicates that headquarters managers can more easily take a global perspective, reducing the likelihood of a one-sided analysis and limiting errors in decision making. On the other hand, MNE headquarters can address the key issues of the company's actual situation, identify the main contradictions and find solutions. Although the research framework provides a systematic means of designing comprehensive subsidiary control, limited resources make it impractical for headquarters to control the full range of operational mechanisms. In actual practice, therefore, it should attempt to control only certain key aspects of the subsidiary's operations, which means that headquarters needs to choose the most important areas in which to apply control mechanisms according to its own resources. At the same time, the research framework indicates that headquarters must consider both the internal and external environment of the MNE when deciding on suitable control mechanisms to achieve the best effect.

In addition, since the headquarters-subsidary relationship can mediate the relationship between MNE environment and subsidiary strategy, it is said to act as a mediating variable in this relationship. This provides a new theoretical viewpoint for MNE research. In this framework, the internal and external environment of the MNE can influence the composition of the subsidiary's top management team, the staffing of the subsidiary, the flexibility of headquarters' control, communication, rules and policy, thus influencing the subsidiary operating strategy. Future MNE research could therefore

focus on the headquarters-subsidary relationship in order to investigate the relationship between MNE environment and subsidiary strategy.

In detail, when addressing headquarters control over a subsidiary, not all possibilities and choices are covered by the simple dichotomy between equity control and non-equity control. Headquarters should consider the use of novel control strategies such as informal control mechanisms, in order to optimize results according to the changing situation. MNE headquarters can use its relationship with the subsidiary, combined with features of its internal and external environment, to strengthen its control of that subsidiary. Among the various control mechanisms available to it are resource sharing, technology-related control and business cooperation. Through the coordination and integration of the MNE's internal and external resources, headquarters can integrate the operation of the subsidiary to obtain optimal performance.

As to the subsidiary's reaction, depending on its own position and stage of development, it should respond to headquarters' demands in several ways in order to build its relationship with headquarters. First, it should react to headquarters when receiving technology, human resources, management skills and corporate culture. The subsidiary can analyse the characteristics of the host-country market, integrated with resources received from headquarters, to identify appropriate ways to do business. Second, where the subsidiary has business connections with other subsidiaries of the same parent group, it needs to consider the profit of whole group and make decisions in accordance with headquarters' suggestions. Third, when headquarters focuses on whether or not it is profitable, the subsidiary needs to contribute to the MNE group. In summary, when responding to headquarters, the subsidiary needs to consider various factors, including

the internal and external environment, to enhance its development in the host country market.

7.2.1.3 Identifying informal control as a significant factor in determining subsidiary strategy and performance

When discussing subsidiary control mechanisms, researchers have tended to focus on the relationship of control intensity with performance (Wu, et al., 2005; Schultz, et al., 2013). They have mainly considered regulations, policies, rules and contracts, which can be categorized as formal control mechanisms. However, in its qualitative analysis of the relationship between subsidiary strategy and performance, based on the UST case study, this research has found that for MNE subsidiaries in developing countries like China, formal control of this kind is not the main mechanism in use. Instead, headquarters commonly exerts control via informal mechanisms involving such factors as culture, communication and personal connections, which tend to be better incentives of subsidiary performance. The three main reasons for the use of these less formal methods can be summarized as follows: (1) Formal or inflexible control requires the subsidiary to interact with headquarters more intensively and more often. If the cultural distance between home and host countries is very large, formal control mechanisms tend to be associated with high control costs and slow decision making, thus weakening the subsidiary's performance. (2) If the environmental uncertainty in the host country is high and cannot be ignored, formal control is difficult to apply. A subsidiary in an uncertain environment needs more autonomy to make business decisions and adjust its business model to meet the demands of the host country market. Under formal control, it can do nothing but comply with orders, which will slow down this process and raise

management cost. Informal control can also help to encourage employees to exercise their initiative. (3) The MNE should consider the host country's cultural peculiarities. In the case of UST, it is relevant that power distance is greater in China than in Western countries, which means that exercising formal control would make operational management less efficient. In short, relatively informal and flexible control methods are favoured in Chinese culture.

Based on the above analysis, this research concludes that informal control mechanisms play an important role in MNE subsidiary management, especially in developing host countries like China. MNE research should pay more attention to informal control based on the institutional view.

7.2.2 Managerial implications

7.2.2.1 Focusing on the MNE environment when making management decisions

The analysis above shows that the environment is the factor to which an MNE needs to give priority when entering a host country market. Consideration of both the internal and external environment of the MNE will determine its subsidiary strategy and headquarters-subsidiary relationship.

In detail, when entering a host country, the MNE should first analyse the prevailing market conditions, establishing the size and potential of the local market, assessing whether its business will meet the market demands and how these may change in the future. The MNE should then identify its main existing competitors in the host market

and any potential competitors which might enter it in the near future, in order to evaluate its competitive advantage and clarify its motives for entering this market.

After analysing its own strengths and weaknesses as an entrant to the market, which are mainly internal environmental factors, it needs to consider the external environment. Since the institutions and culture of its home country may be quite different from those of the host country, it will be particularly important for it to deal with the market uncertainties that might harm or hinder the subsidiary's future business. To be well placed to do so, the MNE should localize the subsidiary's management in order to facilitate access to local resources and this will partly determine the headquarters-subsidiary relationship when doing business.

It is notable that the Chinese market has certain idiosyncratic features, as do markets in some other developing countries. For example, it is dominated by the activity of SOEs, so that any market entrant must consider carefully how to conduct its relationships with these key players. The case study found that UST pursued M&A and collaboration as its entry mode in China, in order to ensure that local partners were sufficiently incentivized to deal with the subsidiaries' relationships with local SOEs, so that the MNE headquarters did not have this burden. The M&A and collaboration strategy also helped to optimize the performance of the subsidiaries, since the local partners knew the local market better and had the knowledge needed to tackle the institutional uncertainties in the host country.

In order to support the M&A and collaboration entry mode and to ensure that the administration's commands are well executed, the MNE needs to hire a high proportion

of local managers and employees. This will reinforce the effect of management localization and reduce management cost at the same time.

7.2.2.2 Paying attention to informal control systems

When it comes to controlling subsidiaries in China, informal methods appear to be more efficient than formal ones. Due to cultural distance, MNEs from Europe or America might have some problems in understanding how Chinese employees act and why, which will degrade the quality of the headquarters-subsidiary relationship. Informal control mechanisms such as corporate culture, trust and interpersonal communication can be better ways of obtaining higher performance.

The ultimate objectives of subsidiary control are to achieve MNE headquarters' goals and maximize the performance of the subsidiary. Headquarters will employ a variety of both formal and informal control methods to coordinate its relationship with the subsidiary. In the UST case, because of cultural distance and market differences between home and host countries, and because the market was very promising in terms of both size and potential, the parent firm relied more on the informal control of its subsidiaries' activities, allowing them a considerable degree of autonomy in their conduct of business in the local market.

The subsidiary control mode adopted by an MNE will also vary with the stage of development. In the early phase of entry into a host country market, it will rely on technology, product design, market knowledge and capital to support its business. During this time, MNE headquarters will rely on relatively strong formal and direct

control over its subsidiary. Formal control involves the top-down imposition by the parent company on the subsidiary of extensive rules, procedures and regulatory measures. Controlling ownership by the MNE headquarters is the main premise of applying formal control. Headquarters will strongly influence the subsidiary's decisions on marketing, manufacturing, human resources and general management as means of formal control, which will result in better performance when the subsidiary is young. In some circumstances, however, formal control systems can easily be understood differently by different individuals. Such varied interpretations or misunderstandings can lead to inconsistency within the institution, and too many exceptions will increase the management burden and weaken the quality of management decisions.

As the complexity of a subsidiary's operating dimensions increases, the above considerations become more important for the MNE. As the subsidiary matures, it gradually commands strategic resources and demands increasing autonomy. Because of the specificities of the host country market, the subsidiary needs more autonomy to expand its business range. In the case of the increasingly powerful network structure of UST, the original formal control mechanisms had to be amended to meet the group's control needs in the new situation of its subsidiaries in China.

In this situation, the main direction of change is a greater dependence on more on flexible and informal control mechanisms, such as personal relationships and corporate culture. Informal control involves two-way communication between the parent and subsidiary companies and a relatively significant reliance on personal interaction. This includes the twin mechanisms of vertical integration between parent and subsidiary companies and horizontal integration among subsidiaries. Informal control, which

represents a new control concept, can reduce opportunism to a minimum and facilitate better performance. In addition, informal control can better support the subsidiary when there are very large differences of cultural and business environment between home and host countries, thus helping MNE headquarters to better implement global control.

This research has also found that informal control can benefit subsidiary performance under certain conditions. When the host country becomes the MNE's main market, informal control will give the subsidiary more autonomy to expand its business range. Informal control emphasizes the construction of enterprise-internal culture and management system flexibility, and it relies more on employee trust to realize the MNE's goals. Headquarters is more inclined to apply informal control to overseas subsidiaries in order to promote enthusiasm among the staff for their work, which will in turn enhance the subsidiary's performance. Therefore, in establishing its overseas business processes, the MNE needs to utilize informal control mechanisms to ensure that the subsidiary's business activities are aligned with the interests of headquarters.

7.2.2.3 Ensuring local partners' ownership incentive

Analysis of the UST case furnishes the conclusion that for MNEs doing business in developing countries, M&A and collaboration can be reasonable routes to better performance. UST usually adopted a 50/50 ownership structure for its subsidiaries in China, to incentivize its local partners. In this way, UST opened the Chinese market quickly and has enjoyed rapid development in the past few years. This shows that by M&A and collaboration, an MNE can succeed in a host country market in a short time, but it is important to note that it needs to ensure that local partners have a sufficient

share of ownership (50/50 in the case of UST in China) to incentivize their contribution to achieving strong performance in the host country market. Since developing country markets are often occupied by dominant business groups such as SOEs or consortiums, the local partners will probably have already built some connections with them. Ensuring that the local partners have adequate ownership can make them more willing to exploit and strengthen these relationships, which will in turn lead to better performance.

Besides, in some developing countries like China, the system of market institutions is not perfect and there exist many uncertainties in the market. Pursuing a strategy of M&A and collaboration with local partners will give the MNE more opportunity to be institutionally supported by the government or industrial associations. This will help it to avoid institutional risks and improve its access to local resources, thus further boosting its performance.

7.2.2.4 Utilizing HR localization as a subsidiary strategy

Many MNEs including UST have entered China with the motive of enjoying low HR costs, which requires the MNE to adopt HR localization, by hiring local employees from the local market. This means that it must hire local managers as well as front-line employees, because local managers can interact with local employees better, without cultural differences, and will be more familiar with how to manage and train the employees of the subsidiary. The MNE should also facilitate the promotion of front-line employees to management positions, thus cultivating their own management team who will better support the business in the future. In order to ensure this, the MNE

needs to train the local employees to promote their working skills and to better understand the parent company's strategy.

A policy of localization will probably also improve the MNE's social image in the host market, which will help it to obtain institutional support from the host government. This in turn will ensure that MNE has access to the resources it needs to carry out its business more smoothly.

7.2.2.5 Executing a performance-enhancing subsidiary strategy

The framework developed for this research takes the ultimate object of an MNE entering a host-country market to be the achievement of good financial and non-financial performance. Any MNE which, like UST in China, relies mainly on M&A and collaboration in subsidiary management may find that the shared ownership of a subsidiary poses a potential problem for future operational management practice.

In order to avoid this threat, the MNE needs to promote its execution capability to make sure that its subsidiary strategy is implemented as planned. In detail, it can train local managers and employees so as to absorb them into the corporate culture, which could be seen as a type of informal control. As already noted, MNEs need to pay special attention to informal control methods in developing countries like China. This requires headquarters to understand the host country's culture and social customs as well as possible.

Through training and the application of informal control mechanisms, the MNE can enhance its execution capability and ensure that its subsidiaries do business as planned.

7.3 Limitations and Future Research Directions

This study has several limitations that offer opportunities for future research.

First, the research framework was developed on the basis of a theoretical review and needs to be more specific when utilized in a real-life context. The framework was refined by analysing the case of UST and its subsidiaries in China. Based on this analysis, I have sought to identify the general factors which an MNE might meet in its management practice and to specify the relationships among these factors. Finally, I have sought to apply this research framework to similar contexts in all developing countries. I have done my best to make sure that the factors in the framework will represent the variables in other MNEs and I believe that it can be applied to the management practice of most MNEs in the world, but it is not possible to state whether it is valid for all MNEs, because there are likely to be some which do not seek to localize the management of their subsidiaries and some which have no regard for non-financial performance in host countries. Therefore, there is room for future research to improve the framework by broadening its scope of application.

Second, the analysis of only one MNE, UST, was used to test the propositions, which limits the generalizability of the conclusions. Because research objects are limited, this has always been one of the greatest problems in international business research; researchers cannot find enough objects to generalize their conclusions. I selected UST

for the case study because I have worked for the group for many years and it perfectly matched the aim of this research. I have used this connection to conduct the research and draw the conclusions that are summarized by the research framework. Although I have focused on the generality of each factor in the summary and have tried to place this research conceptually in a general context, it would have been impossible to include all of the situations in the real business world. Thus, future researchers could use the cases of other MNEs to test the generalizability of the present framework.

A third limitation is that this has been a purely qualitative study, offering no quantitative methods of validating the research framework. Limited by time and the researcher's capabilities, this research provides only a qualitative analysis of the UST case. Future research might therefore try to quantify the variables and use a quantitative methodology to study the framework, thus subjecting the present research to a robust test.

Finally, although China is the largest emerging economy and provides a suitable environment to test the theoretical framework, the results of this study may not be extended to other emerging economies. The environmental impact of MNEs' subsidiary strategy needs to be further examined in other emerging economies, which would not only help to test the generalizability of this study, but would also provide evidence of the causal associations among the headquarters-subsidary relationship, subsidiary strategy and subsidiary performance in emerging economies, thus drawing a more comprehensive picture in the context of international business research.

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Appendix

A-1 Interview Questions

HQ-Subsidiary Relationship, Subsidiary Strategy and Performance
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Influences on Subsidiary Strategies/Decision Making

1. What are the most important key factors that influence strategic decision making in MNE subsidiaries in China?
2. Can you explain why you think so?
3. How do these factors influence the subsidiary's decision-making?

HQ-subsidiary Relationship: Nature and Patterns

1. What are the main tools adopted by UST headquarters to control the subsidiary?
2. Why do you think headquarters made the decision to adopt these tools?
3. How do you assess the effectiveness and results of these control tools?
4. Are you more concerned about results, or did you also want to understand the processes?
5. Given the market in China, is it accepted as an emerging economy and the subsidiary company as the host country?
6. Do you see these controls as being flexible, for some reasons or to some of procedures?

HQ-subsidiary Relationship, Subsidiary Strategy and Performance

1. How do you think your corporate international business strategy has influenced the strategies of the subsidiary and its performance?
2. How do you perceive the subsidiary's response to headquarters strategies and headquarters control?
3. How do you think the subsidiary's strategies in China has exerted an influence on the overall corporate international business strategies?
4. How do you think the relationship between corporate level and the subsidiary should be developed?

A-2 Original Interview Record

The author has interviewed 11 persons for this research, all of them employed in the management layers of UST. Their basic information is listed in Table 3-1.

Due to the limitations of space, only the transcript of the interview with ARL is reproduced here as an example:

***ARL:** Hi*

***Researcher:** Hi, good morning.*

***ARL:** Can you hear me loud and clear?*

***Researcher:** Er, can you hear me?*

***ARL:** Yes, yes, very good.*

***Researcher:** Ok, ok. Er, er. Thank you for you help me with this. Er.*

***ARL:** Ok, ok, I don't know how to answer you, but I will be my best.*

***Researcher:** Ok, so, you see, can we start right now?*

***ARL:** Yes, of course.*

***Researcher:** Ok, you see, there are four questions in this interview. And it's about headquarter and subsidiary relationships. You know over past four years, we experienced the change between the UST Energy and now we are the Cameron, Cameron Sense, and so actually over the transition from the previous company to current company, actually the headquarter relationship has been changed to some extends.*

***ARL:** Yes, that's true.*

***Researcher:** But, let's come back to the very beginning that once UST Energy decided to set up a China operation as a company, at that time you were the director of China subsidiary also. So can you give me some your opinions from the very beginning, what are the most important things that*

make you make this decision to set up China and why, or explain a little bit, why you think it will be works like this?

ARL: *hmmm. You know, the reason, can you hear me loud and clear?*

Researcher: *Er, Yeah, the voice is not so big, but it's still ok.*

ARL: *Ok, ok, er, you know we became part of the UST, UST management had done a lot work in China. So we had a lot of things for free, but what we didn't, what we had never done anything in the Energy division, for the UST, so this was totally inform us that sells in China. And then, we hire you, and then we start opening the organization, of course, that has worked, has a lot of things that could have been done differently.*

Researcher: *Ok, so you mean at that time, because UST they already has the UST Marine, and for UST Energy, it is much, it's quite nature that to expand.*

ARL: *Correct. And because it is very easy to be heard in the UST organization, because they, so lately very good view over things and situation in China at that moment. And, as you know, you mostly the president, the CEO, whatever, and he had been working very closely in China for the last over ten years. So when we talk about China, he was at the top of the situation. So having discussed by the management, that we understood the Chinese market was very very good for us. We knew what we wanted out of China. But we have very little experience in China. I have been doing for many many years in running subsidiary in the West of the World, like I was in Abudin, in the Houston office, and in the Singapore office. In my previous positions, we check out for APES and that's a lot of huge considerate and we gain a lot of experience in how to run this company. Which thoughts and will think was very valuable to help understanding how is it to run a subsidiary and how is it to have a go to the company in this very remote regions, and get the feel for and understanding to how this should be run and what are the problems relates. That's I had a lot of experience there. And help talk to people talk to you know, and his knowledge about China, a very good combination.*

Researcher: *Ok, so, and once China subsidiary has been set up, you see from the very beginning, I am myself for business doing the marketing and sales, and then it coming an operating office and form an enterprise in China. And then once we get start operating in China, you see there's a lot of*

local marketing issues, local competition issues, and we need to follow with Chinese government policy, and there are also some cultural differences between China and Norway, and also organization structure and management issues, I know that you are familiar with, and all these, can you give me your opinion, what is the most important business environment factor; in considering your decision making, from example, when you make the decision, what kind of factor you think is the most important?

***ARL:** Em, I can talk a little bit around it, but one thing is for sure, except we make the decisions, the general manager is considering, he is not be sitting alone and waiting for the decisions, like you have now for the last two years. That is the worst thing that can ever happen. What after Cameron to go over, I think we had a better structure when we were own by UST. We had, this we had a board director, this we had meetings in China in all we met in Singapore, in Norway, and we have telephone meetings, and this we had a good communication only we met a little, which is good. The honest thing is that amount communication is very important, that all these managers in Norway had communication with you and the Chinese account department. That's one of the biggest problems in Norway, and I'm for sure in United States, they don't understand the importance of this communication. To one considerate in Shanghai or wherever in the world, the subsidiary that is, you feel so lonely, you feel so distracted, you are yourself, it is a big problem and it is also be ignored I think to be up there, no one is, do you get the prize from your main, seeing no one who cares. And the decisions we are taking over your head and now we have be emerged in China organization, it shall not be one Cameron Sense and I do not see any more, so it is happening and you don't have a saying. We don't have a say, in the United States, the American, this is way. And they don't understand the business, they don't even try to understand our business, the finance people just look at the figure, and say ok, we have to emerge that company, and they never face the consequence. Somebody else say that the consequence vary the decision, that is poor management.*

***Researcher:** Yes, yeah. So you see, that communication is an important factor that actually influences the decision making.*

***ARL:** Yeah, the communication factor is the most important factor in running a subsidiary in my, my view. Because by communicating correctly, if we have a board communicating with the young*

major, and all that say the prime manager is communicate with you purchase the I am the sea manager in Norway and communicate with you and people, and you have a part of communicating with each other and if any problems you bring up to be fix or something, forever you call it, that's the most important factor in my view on how to run a subsidiary.

Researcher: Yeah, and you see, in the academic research, communication is usually a kind of the way to, we say a kind of control to, how to say, approach of the control, it is kind of soft control. It's not through procedures or some criteria, or some orders. But actually it is a kind of way, to communicate each other, and make every party agree on how and what kind of actions we should follow. So then come to another question, that is for each of the multinational companies, either UST or the Cameron, I think the headquarter should adopt various approach, various ways to control the subsidiary and ensure the subsidiary is follow their rules and meet their expectations. And you are talking about that when we were in test UST, usually we by communication and join in the meeting, either in Norway or in Singapore and then you see, it's a kind of communication, and then we follow the same direction. And how do you asset the effectiveness and the results of the control tools, because you see, now in Cameron, we are not running like this, you see in Cameron, maybe they just as you said, just give us a notice or some information and this is what we have discussed and they have to follow. So we are not getting involved in the decision making process.

ARL: Correct. Taking somebody he doesn't know, that's the dangerous thing.

Researcher: Yeah, yeah. But do you think that Cameron way is more effective or UST way is more effective?

ARL: UST.

Researcher: Yes, ok.

ARL: But I must talk that the UST, but we also have faults. Because in UST, here in criteria one, we had management that who want to be in control, I think it is very important to start with what do we want to consider in Shanghai and why do we wanted? You see it's because we are going to purchase this things, or it is because we want project or it is because we want to sell more? And the initial wish for starting up the UST Energy office in Shanghai was to get close to the market and to increase

our sales in China. This fact is the case, sales is the case and then the sales style should be talked for that. If we are trying to purchase things in China, then the purchasing guy should talk about it. And that's how the decision should be made. And no doubt that the management had saying, but he should not be at the top. Because it is the case in UST. Single have the talk but he didn't have trying in meetings and at the top of the situation and very controlling the staff and that is be motivating for the rest of us. So he had just come back and said ok whoever like you, like the sales guys, he should be in charge of China or be Chairman of the Board or Chairman of the committee. That wasn't done and that was not a good thing. So also with UST model we have some faults. The good thing is that we have some interests, that is he want to be in charge. If he said it's ok, that's your in charge. I don't want to hear about this. That's also in normal, you also have some jobs. That he could be a member of the community but not in charge. That would be the best thing. If he comes to the Cameron model, that's like, OK we don't have a saying, they decided on everything, the finance people reducing and this is happens, and no one had the saying. I mean it doesn't work what so ever. So we have to find a new efficient model in order to get this working.

Researcher: *Yeah, yeah, I agree. I think that's the point. And, so when we were in the UST, you see we were not, actually not only concerned with the final results, they also would like to know how you achieve that result and how we can work together to get this result. We are not only concern about the destination; we are also concern the ways we get to the destination.*

ARL: *That's one first relationship convince, I mean that even though Cameron said that we don't going to have the board directly, we have going to have a committee meeting company will be emerged, our Chinese organization. What is left them, just personnel? And how is it go to be operated? How is the operated day? There is no formal organization, what's so ever, that's, that is working. So we have to manage ourselves. I mean probably have some way, but it is totally invisible in one year and have one circuit in China. No one Americans have any relevant what's so ever, I'm not in China anymore, we talk on the phone, we agree ourselves and it is willing down some day today business like we have any require from our yard. And we call the yard, and sometimes we lose, some time we even win. That is taking mini 5% towards the world. That is day to day business. Which is fortunately worked very well, but that is not because of the station, that is not because of*

the management. That is because of personnel working that we like each other, I mean that like we, we have sense we were together for quite years, so we know each other, we know what's going to happen and this is the only reason why it works.

Researcher: *Yeah, so you mean that actually it's a relationship between us, between the team in crescent and our team in China, it is mainly because of our relationship actually we keep it operating or running as normal as possible.*

ARL: *Yes, that's right. That's the only reason why it worked so well. The relationship between you and I, and in the States, in Sylvia and also and you had the this in Singapore, that you had in RC, and he is doing a very good, that is how in Singapore and but the worse Cameron cases, it's just the disturbs. They don't know what we are doing, but they are think in charge or something may not. Then so, it is private and it is relationship, it is friendship which helps us go in two years. And that's the only way we have been carry forward.*

Researcher: *Ok, so, and then it arrives another issue, because you see we have a certain good relationship with each other, but there are still a lot of company rules and procedures and we had to follow because that's company requirements. And for example, if you consider China is a, is a, China country as an emerging market, and so many things which is not 100% same as in the Europe or in the United States, because it is a developed market, developed country. And in China we have to encounter a lot of, how to say, emergency or urgent requirements from our customers, which is a, so do you think that activities for example, is you consider the control of the operation to ensure that China operation should follow the instructions or should follow the ways of the headquarter. But if it is mainly due to the exterior influence or exterior requirements, will you be consider some flexibility which is not 100% follow the company rules or procedures? Or you give some special consideration when you make some decisions on this?*

ARL: *It's a big complicated question. Let's start with the approval that we need. That's no questions that if we had an approval matrix which excel she is quite compliant, and that's has to be followed. We cannot send a quote to anyone, or that is approved according to the matrix. And that's one way of monitoring and controlling what you did and that is we have no choice but have to be followed 100% and we do that. The other ways how do we work, how do we server our customer. We have*

very much our sales in doing that, except from one somebody in Cameron organization she said that who this is my territory, if you are doing any business in China, you have to ask me because this is my territory and I am the account manager and area manager. Sometimes you can hear this words, and it is think correct when they say the statements, and we say that that we do answer them that ok, we keep you informed and we do, sort of, most in China, and sometimes we suggest and him get stop. But that is privacy I am not very much in favor, I don't like it what so ever. And it has to be, it has to aware the area sales, and the department, that's very very bad for the company. And that's nothing to do with China, it's just important in Brazil, in Singapore and in Korea. However, we have the customers in China, and what is the system in Cameron go, I mean we were there first, and we are about trying up the people in China, we are going to import to, and how's that sound, that bad. So the bad is they are trying to control what we are doing, and it will not be worked, that somebody to make the decision to gain the query, this is important to do. And you know we had our solution and solution this and talking to management to show those things, but it is not easy. That's also has to be with control.

Researcher: *Ok, er, and yeah, and from your point of view, you still think that China, China, for example, if China compare with Singapore, or compare with any other countries, in terms of control itself, it will be the same, more like the same, hm? But in terms of the policy or in terms of the strategy making, is there any consideration that China, for example, we can consider China as a special market, and then you see, and if in some occasions, is there some consideration in terms of the, I'm not saying the obscure matrix, But I'm saying that maybe is the price, or the payment terms or some other issues that China can be, or Chinese customers can be with some special treatment?*

ARL: *Hm, China is a special case in many many ways. First of all, it's very very big. Secondly, it's cheap and efficient and it's, as you say, it's an emerging market with it's growing and it's taking over big part to the Ocean market. The jek are almost taking all about the Chinese and there will be more. I also think the market it will be maybe in China, not so sure about the grow ships, but the big mark of the jek company setting construction we have done in China. And it definitely goes to be the no. 1 market. Another thing is that the Chinese also grow in financing, young and inspiring customers got a big world chest. That's also important. Once they are heading out in this big world, to achieve*

some business, you have the side, who is going to do what. You need to have two questions, who knows the technology and who knows the customers. And if you look at China, who knows the customers for our product. You see, Cameron, Singapore is a day far and treat, it's Cameron form and it's unique, and it's plane. We have the control on the customers, and next question is who controls the technology. It's the same of people. There's no doubt that in my word, we should be in China the way we haven't been in China for the last years. Any in the fairy, and anyone who doesn't know is just don't in the market. That's one of my main philosophies, that if you have control over the market and technology, you are the winner. In Cameron, someone is trying to change that game, to say that, ok, one face to the customer then you say, Ok, but what if you went to a shop and you want to buy something. let's say you are there, and you bought a car, and you find this yellow martin, we all know with our cars, next time you go there, you want to buy a house, and you get the same guy with next to the cars, he wants to sell you a house, and he haven't got a cool, this one face to the customer, you want to deal with the car sales man or you want to deal with the house people. You want to do with the house people, and you want to do with the whenever he is, and we are the experts, and the rest of the guys who come from Singapore wherever, and they are not the experts. They don't know the customers and they don't know the technology, so why you ahead in the driver seat.

Researcher: *Yeah, yeah, OK. Now let's trace back to the China subsidiary role, we are talking about the actually you see, usually, once a multinational company set up a subsidiary in some places, they have some purpose or they have some strategies to do this, and you see, for us, actually, either one strategy they will take, one is cost base, which is subsidiary will help the headquarter or the corporate to reduce the overall cost, and also another main purpose is value base, which is the subsidiary support to create value for the business, for example, the marketing, the extension of the sales, or the reaching to the new customers, and also another approach is that it will be the risk base, it means that in one area, maybe the company don't get the good results, but in China or in another place it can benefit, so then over all for the company they get the still good outcome of the business. So how do you describe the corporate control have influence on subsidiary strategies like this. You are talk about that China will be the actually the main interests to set up branch in China*

and in Singapore will be value base, which is interest in the most sales and in the marketing, and do you think it is can also contribute to support to the cutting of the cost, or support to break even, or to balance risk of the company?

***ARL:** Of course, I mean the if we look at the corporate, and what they do today, that is fine and they do the general marketing, they pick up the cost for they do exhibitions like xitu, last year they picked up in OPP, and Istanbul in Abudin, they also be the Internet stop for all these general, anticipate in general marketing, which is the only way to do it, no doubt. But we need comes to specialties and the marketing tools, special project should to us. Today, that need to divided into two, which is the corporate headquarter gone to do and what is our task to. It is very important to get correct, and once we want the corporate had stated that task, and then have to do it. We can't like even waiting to see the exam. For almost two years now, corporate in Cameron to make the policies, that we are frequently using and send to our customers. Because they want to Cameron units it and have a lawyer prove it that things should supposed to be correct. They finally approve it, you know they are and they need to start over again. And this is also a test by corporate with customer work. But if it done correctly, it divide the marketing in corporate and there is companies in correct market and both that are supposed to be doing, it's an ideal thing. No doubt, they can save cost are doing, for the companies are on the way, that's a good way of doing it, so.*

***Researcher:** Ok, so but now, you are talking about the Cameron, even traces back to the UST period, from the very beginning, you see, at that time, you think that, at that time, we have a much clearer picture that what we are doing, and also we have at that time we also have a plan to develop.*

***ARL:** Yeah, we had a strategy, we made a strategy, and we brought it up to the board meeting and say ok, good to go, and of course, we have finance people, who always try to get the cost down, and you help with questions and someone yes, but it waste a lot of battery in the UST manner, because somebody is getting throwing our rules, some Cameron who don't look at the consequence, they just look at the short money all the time, short money that is income. If they have to loan money, which is the weak by all finance people in my view, but my personal view. It's also very important that, I mean UST, they set up the rules, and Cameron, and they have set up of rules, circuit and matrix, set up rules to control the business, that's very important, of course it is.*

Researcher: *Ok, and now you see in China maybe the strategy, how do you think, you see, in China the strategy will influence the performance of subsidiary and operating resource? You see, previously, when we were in the UST, everyone working very closely, but now, it seems that in Cameron they are more, actually people are more rely on the structure, which is not relationship. And do you think that will have some influence on our performance results and our future possibility or something?*

ARL: *Yes, I definitely think it make influence on the way we do business. The fact part people make the decision for you without knowing what you are doing locally; I mean that's bad to anyone. It's bad for the motivation; it's bad for motivation, and bad for the project resource, no doubt. We are close to the management team in UST, we had a influence, when they make the decision we can argue, we can help in our way, that's in Cameron ways, no one to talk to, I mean, they just make the decision and this is what we do, and that's not good, not good at all to our motivation, so you get it, you get the attitude among the people are you and me are ok, ok, and you just let it go and see what will happens, you are not to contribute to this 100% as what we have used to be, because it's personally, now we get something set alone, set strategy, down to what will happen, that's the period, that's not good for motivation, not good for motivation, and not good for business.*

Researcher: *Yeah, so it means that now, even if we have a strategy, maybe it is really difficult to make it happen. Or you are hanging something. Because you see,*

ARL: *Yes, I also have a feeling, that's the bigger the companies are, the worse it gets. I mean if you look at GE, I don't know how many hundred and thousand people work in the company. It is very hard to get the things done. Cameron is like 20 thousands of people, and it's very big quantity. Very big quantity. When I started to hear that in where, hence, I studied up company course and you know, and Australia has the role how to people, how to, for half years, 25 and 28 people and we were set up entity. Those kind of small entities are worked well because the decision line was very short, when we had those a little entity, we have our separate rules introduced to these by the board. So even if we are a part of a big company, we still will be very very good to have small entity. Because we can, we are motivate, we share information with those going on, there's still separate rules into this by corporate. But test fewer rules and fewer monitoring things, and fewer controls, that it is like*

to get the work done philosophy with its totally reluctant in the company that you worked in, get the work done, that's not so important any more, to get the work done, the most important thing is to do the planning, to do all the prove staff, the ASV staff, the finance staff, anybody get this in doing a crucial staff. And there are so many finance people, they don't know what they want to do and waiting, but the small entities but always, always know the rules that belong to the corporate. I don't know if I answered your questions here, but anyway, I'm saying something.

Researcher: *Yeah, I think that's very interesting, and actually there are some opinions or comments on this issue, but I don't think that you gives the relationship but very important to, actually take a very important role, because you see, it is not very much depend on the formal, how to say, formal procedures or formal things. Actually in some of the occasions, relationship can have big influences on how the strategy should work out and how it should be influenced and how should be underlines, so I think, that's the key, and I'm study on this. So I think that actually compare between the UST structure and Cameron structure. You see, in terms of the subsidiary China and consequence relationship, there is a lot of differences, and the main set is also quite different. Because at that time, we contact each other more closely and standardly is suppose actually to encourage people to work hard and enhance the role. But now it is purely procedures and we just follow the procedures and waiting.*

ARL: *Yes, correct and for procedures, are just blurry not very clear and constant. Just look at the complaint we have to do every year, how many people are just read it.*

Researcher: *Yeah, I think that's also part of the reason because of the emerge and combination process during the emerge opposition, as you says, they don't have anyone understand the business in the decision making in Houston. They don't understand business and they don't have a clue our customers. That makes it difficult.*

ARL: *So.*

Researcher: *Yes, ok, so for headquarter and subsidiary relationships, and there influence on China strategy and performance, do you think you can give summarize your opinions and your comments on this or everything you think most important?*

ARL: Yes, first of all, the way it is done today is the worse I have ever seen. Secondly I would say that establish and set up rules for how we operate in China; this is how we do it. Cooperate deadline, that's how we do business. And in this up to us to do it, they need to monitor the control, because they are the owes and let's go around of our business on own ways. That's control it by a board or during the communicating and have meetings locally in China, because our people often need to go to China to experience the culture, that's in my view the only way can work. Communicate a lot, have regular meetings, keep the strategy and marketing plans, and customers' lists update, and talk the regular; that's how we should do it. And all these things we had in common, that's the cooperate should be involved in like sharing offices, of course. Sharing helping people that these things we should all in common, this is ok, but not introduce all the same shore area all around the world. Because business is stopping up. Everybody has shark because everybody is shark introduce in Cameron. That's everybody should have shark. I don't like the idea, because shark is ok. Because it is one company it is not ok every company. It's like a copy thing, the copycat buying, and he insists that he is a painter using the same tools. That's my recording work. The copycat has sent an Email to headquarters which is painter that I need, I need more nails, the answer is what colour.

Researcher: Yeah, that's the point.

ARL: If they don't understand business, they shouldn't control, they shouldn't be in charge of it. The should have a good governance for. This is how we do it. Of course, compliance thing as well. And this is how we sigh around our world. This is how office looks like. And this is how we are conducting our business. But they shouldn't have been involved in the business itself. Because It is very naughty and he need a nail and you should paint for it. They are saying to, they are going to uniform everything, so we get so awful, but we can get the work done in the end. So they need a small set of rules and then leave it up to the management to get the work done and if you stick out of lying company, you will be fired easily. It is a company run by people who are scaring the rest of us, like who is fired and use the language. But he is a part of the West guys they also scare, we can't do this, because if is say so we will all be fired and what is the soft managing by scaring. If the people not doing nothing, it should be motivate, and if you do stay then ok, tell the guy and don't do that again. Of course if you totally useless, fire him and somebody has hired somebody, it's like if I hire you,

I'm also responsible for what you do. And if you quite useless I will found out in one or two years and I will going to fire you, right? But I'm not going to be like the threat. You doing this is far from it, you can't do it like that. But this is done in Cameron. So we all be marketing related, because in American way of running business by scaring people.

Researcher: *Yeah, yeah, I agree. I think that's a, that's a key. Ok.*

ARL: *I need, yeah*

Researcher: *Yeah, you go ahead, go ahead.*

ARL: *So it has to do with the relationship between the owner with the corporate, and the subsidiary which is a very important thing. Which is this today, we all done the thing. But fortunately, we do have a lot of people which is good and we survive, and the business is how much better if corporate could leave some issue to be subsidiaries around the world. We bought like they bought for a reason. As one year they forgot what about it.*

Researcher: *Yeah, maybe.*

ARL: *it's like a marriage, there is a woman falling for Mr Motenful because he is the greatest she never met in love. One should get married and she needs another for a change, right? And change you to somebody who is more recognizable, and then she will throw you out. You have thought of the world in a woman when they start to give for the man in their life and what happens, that's what happens 100%, that's what happens to company, big company that we buy as more company, after all we choose is promising which is start to legal things and lose for nothing, and they lose the fascinate so we are not teach energy any more, with totally come up. We also have the bad things of Cameron, the things that we take too long and unsure inquiry and to pick up the phone when the customer calling, we are getting Cameron rise and slow with big process. Ok. I'm done, I'm done.*

Researcher: *Ok, thank you, ARL, thank you very much and you see, I will put our discussions in a transcript, and then to, I also interviewed other peoples and then I will put it together as analyze thesis, and once these things have been done, I will send it back to you then for you to get any opinions, comments or whatever. But, anyway thank you very much for accepting my interview on this topic.*

ARL: *You're welcome; you're welcome, thank you.*

Researcher: *Thank you. By the way, today tomorrow will be the May 1st, it is the Labour Day, so we will have several days of holiday in China.*

ARL: *In Norway as well. We have holiday after you, you know it is in Friday we begins the two holidays and most people will be away, we also have a holiday now.*

Researcher: *Ok, ok. Thank you.*

ARL: *Enjoy your holiday, thank you too.*

Researcher: *Thank you. Bye-bye.*

ARL: *Bye-bye.*

A-3 Reference Content

A-3.1 UST Group's target and strategy

The UST Group's main objectives is to design, develop and supply high-quality handling systems and services for the global maritime and offshore industries. UST aims to create value and increase efficiency for our customers through a dedicated focus on product quality, efficient project execution and customer-oriented services, combined with an innovative approach towards utilizing new technology.

Since 2014, UST has announced its long-term business target of building up a 6 billion NOK system as service provider within the global maritime and offshore industry by 2020. UST pursues opportunities, particularly within the heavy lift work boat market, to compensate for the sharp fall in the Offshore market since 2014, in order to be able to meet the 6 billion target within 2020-2022. The group mainly pursues an organic growth strategy based on increased value of sales per contract and capture of market share, but also on broadening its product portfolio through partnerships, co-operations and acquisition of peripheral products in the ship value chain.

Important objectives include:

- To always be considered a potential supplier in emerging and existing projects, and to achieve a market share above 30% in all our targeted markets.
- To have product technology among the top three in all segments where UST competes.
- To be a provider of complete, full life-cycle handling solutions and services for our targeted global markets.

- To establish a profitability level in line with the industry average.

In order to achieve these objectives, the UST Group focuses on the following main strategic lines:

- Leverage the group's strong market and cost position in China, including further development of the strategic partnerships with the major state-owned shipbuilders and increased co-operation with Chinese partners within manufacturing.
- Focus marketing on ship-type, including expanding the product portfolio per asset type and providing complete solutions and services for important vessel types within our targeted segments.
- Build a strong key account management structure around our key customers' needs and challenges.
- Enhanced services through rolling out strategic service hubs around major clusters of customer bases. Laying the foundation for long-term customer relationships through service interval and lifetime services agreements.
- Continued focus on cost reduction through the momentum program, by execution of internal efficiency tasks and structural changes in sourcing, workflow and integrated value chains

A-3.2 UST basis for consolidation

a) Subsidiaries

The consolidated financial statements comprise the financial statements of the Group and its subsidiaries as at 31 December 2015.

The Group's consolidated financial statements comprise UST Group ASA and subsidiaries. Subsidiaries are entities which UST Group ASA has the ability to control. Ability to control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. In assessing control, the Group takes into consideration potential voting rights that currently are exercisable. Control may also be achieved when the Group owns 50% of the shares or less, through voting rights from contractual agreements or when the Group is able to exercise actual control over the entity.

Non-controlling interests are included in the Group's equity. Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date when such control ceases. A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction.

In cases where UST achieves control over an entity, business combinations are accounted for using the acquisition method. The acquired identifiable tangible and intangible assets, liabilities and contingent liabilities are measured at their fair values at the date of the acquisition. Acquisition cost is expensed. Goodwill is measured at the acquisition date as:

- The fair value of the consideration transferred,
- The recognized amount of any non-controlling interests in the acquire,
- If the business combination is achieved in stages, the fair value of the pre-existing equity interest in the acquire, less

- The net recognized amount of the identifiable assets acquired and liabilities assumed.

Goodwill is tested at least annually for impairment. Goodwill is allocated to those cash-generating units or groups of cash-generating units that are expected to get benefits from the business acquisition.

If the excess value is negative, a bargain purchase (negative goodwill) is recognized immediately in profit or loss.

In cases where changes in the ownership interest of a subsidiary lead to loss of control, the consideration is measured at fair value. Assets and liabilities of the subsidiary and non-controlling interest at their carrying amounts are derecognized at the date when the control is lost. Differences between the consideration and the carrying amount of the asset are recognized as a gain or loss in profit or loss. Investments retained, if any, are recognized at fair value. Surplus or deficits, if any, are recognized in profit and loss as a part of gain/ loss on subsidiary disposal. Amounts included in other comprehensive income are recognized in profit or loss or is recognized directly in equity – depending on the character of the items.

All intra-group transactions, outstanding balances and unrealized internal gains between group companies are eliminated. Unrealized internal losses are eliminated, but considered an impairment indicator in relation to write-down of the asset transferred. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies.

b) Joint arrangements

Equity accounted investments are entities where the Group by agreement has joint control together with other parties, but not alone. Investments in these companies are recognized in the financial statements in accordance with the equity method. Investments in joint ventures are recognized in the financial statements at cost at the time of acquisition, and include goodwill (which is reduced by any subsequent write-downs) (ref. section 2.7).

The consolidated financial statements include the Group's share of the profit and loss and other comprehensive income of the companies. If the Group's share of losses exceeds its interest in an equity-accounted investee, the carrying amount of the investment, including any long-term interests that form part thereof, is reduced to zero, and the recognition of further losses is discontinued except to the extent that the Group has an obligation or has made payments on behalf of the investee.

As the activities of the joint arrangements are closely related to the operations of the Group, the Group's share of profit or loss of an associate and a joint venture is shown on the face of the statement of profit or loss as an adjustment of operating expenses, and represents profit or loss after tax and non-controlling interests in the subsidiaries of the joint venture.

The Group's share of unrealized gains on transactions between the Group and the joint ventures are eliminated against the investment to the extent of the Groups interest in the investee. The same applies to unrealized losses unless the transaction indicates a write-down of the asset transferred.

The financial statements of the associate are prepared for the same reporting period as the Group. When necessary, adjustments are made to bring the accounting policies in line with those of the Group.

A-3.3 UST's China strategy

UST strengthened its position in the important Chinese market in 2015. The new 50% owned subsidiary UST SCM commenced operation in China in 2015, and has taken orders for deliveries of heavy lift cranes to Chinese customers. Furthermore, UST has strengthened its lead on the 50% owned UST HH, which is consolidated as a subsidiary into the UST group accounts from the 2nd quarter of 2015. UST has also increased its focus on the 50% owned joint-venture company UST BH in 2015. This development of the activities in Asia is an important contributor to the execution of the UST long-term strategy.

UST has a strong position in the biggest global shipbuilding market

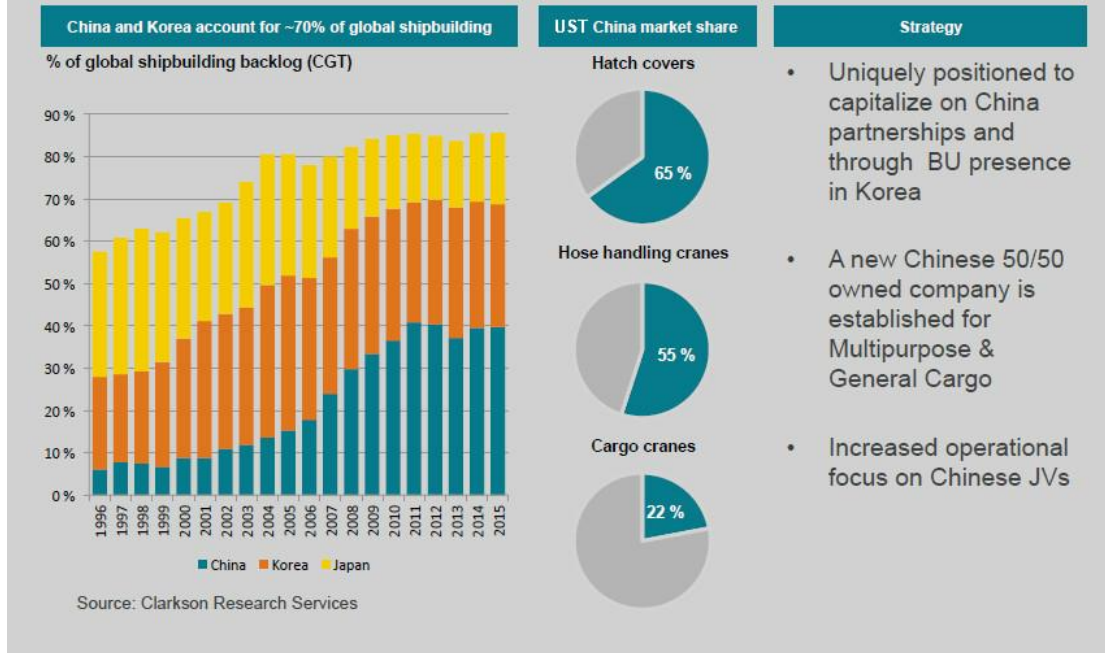


Figure A-1 The importance of the China market

Source: UST Group Interim Presentations Q1 2015

Figure A-1 illustrates the importance of the Chinese market. China contributes over 40% of global shipbuilding business. UST has realized this and set up subsidiaries in China making it uniquely positioned to capitalize on Chinese partnerships. In 2014, UST launched its new global strategy to show that it will continue to build on the solid position in China. UST aims to continue to leverage its strong market and cost position in China and increase the scope of manufacturing cooperation in China (see Figure A-2).

UST launched its new Global strategy in 2014 Roll out version for 2015-2017

<p>1 Continue to build on the solid position in China</p>	<ul style="list-style-type: none"> • The leading position in China provides shipping market access. China with ~40% of total shipping order book, Korea at ~30% • UST aims to continue to leverage its strong market and cost position in China and Far-East, and grow into Korea • Increase the scope of manufacturing co-operation in China
<p>2 Focus on ship type – more integrated package sales</p>	<ul style="list-style-type: none"> • Currently delivering single products to a high number of vessels • UST aims to move from product focus to ship type focus, and provide more value per sale, through bundling of products and systems. • Move closer to the end user -> Key Account ownership across UST
<p>3 Enhanced service offering through strategic hubs</p>	<ul style="list-style-type: none"> • Focus on major clusters of customer bases and create relationship for services on a ship's lifetime • Increase ability to serve the customer on the spot and in a timely manner • Develop service entities with technical and design knowledge for all UST products
<p>4 Focus on profitability</p>	<ul style="list-style-type: none"> • UST aims to reach operating income margins on par with industry average over a business cycle • Marine business units delivering decent margins. Further improvement expected in 2015 to reach average industry margins in 2017 • Offshore business unit currently underperforming. Work started in 2014 to turn this around and capture a fair share of the market

Figure A-2 UST Group China strategy

Source: UST Group Interim Presentations Q4 2014

UST first entered China in the form of wholly owned subsidiary, which gave UST 100% ownership and voting share (see Figure A-3). This mechanism was found not to be the most suitable for China's business environment. It brought a high turnover and backlog for its joint ventures in China. The management of UST found it better to give autonomy to these subsidiaries. At the same time, China's market became more and more important and this made the management of UST realize that the subsidiaries there had great potential to be a pillar of UST's business all over the world. After that, UST mainly adopted joint ventures as its entry mode when setting up subsidiaries in China. This made the subsidiaries improve operating conditions quickly and they eventually became major contributors to UST's performance (see Figure A-4).

UST Group ASA:

Subsidiary ¹⁾	Registered office	year	Ownership	share	currency	in local currency
TTS Syncrolift AS ²⁾	Drøbak, Norway	1994	100 %	100 %	NOK	950 000
Norlift AS	Bergen, Norway	1994	100 %	100 %	NOK	500 000
TTS Marine AB	Gothenburg, Sweden	2002	100 %	100 %	SEK	2 000 000
TTS Marine Shanghai Co Ltd	Shanghai, China	2002	100 %	100 %	CNY	8 185 303
Hyalift Marine AS	Kristiansand, Norway	2003	100 %	100 %	NOK	100 000
TTS Cranes Norway AS	Bergen, Norway	2007	100 %	100 %	NOK	500 000
TTS Marine AS	Bergen, Norway	2009	100 %	100 %	NOK	3 000 000
TTS Singapore Pte. Ltd.	Singapore	2009	100 %	100 %	SGD	1 141 813
TTS Greece Ltd.	Pireus, Greece	2009	100 %	100 %	EUR	200 000
TTS Offshore Solutions AS ³⁾	Bergen, Norway	2012	100 %	100 %	NOK	2 112 500
TTS Neuenfelder Maschinenfabrik GmbH	Hamburg, Germany	2012	100 %	100 %	EUR	3 000 000
TTS Polen SP.Z.O.O	Gdansk, Poland	2013	100 %	100 %	PLZ	250 000

¹⁾ TTS Marine Holding AB and TTS Port & Logistics Holding AB have been sold in 2015.

²⁾ TTS Handling Systems AS has changed names to TTS Syncrolift AS.

³⁾ TTS Ships Equipment AS has been merged into TTS Offshore Handling Equipment AS in 2015. TTS Offshore Handling Equipment AS has changed names to TTS Offshore Solutions AS.

Figure A-3 UST Group subsidiary all over the world

Source: UST Group Annual Report 2015

UST Joint Venture operations in China

- Joint Ventures are recognized in the financial statements according to the equity method. UST Group includes only its share (50%) of profit after tax in financial reports.
- The increased contracting, especially in the bulk and container segment, results in high order intake during the period both for cranes and hatch covers.
- Order intake in the joint ventures in 2nd quarter 2014 was MNOK 359 (100% basis).
- The joint ventures are seeing a strong market for its products. The market share is in a positive development.



Figure A-4: UST JVs in China

Source: UST Group Interim Presentations Q2 2014