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UNDERSTANDING AGENCY PROBLEMS IN HEADQUARTERS-SUBSIDIARY RELATIONSHIPS IN MULTINATIONAL CORPORATIONS: A CONTEXTUALIZED MODEL

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ABSTRACT

This paper proposes an agency model for headquarters-subsidiary relationships in multinational organizations with headquarters as the principal and the subsidiary as the agent. As a departure from classical agency theory, our model is developed for the unit level of analysis and considers two root causes of the agency problem – self-interest and bounded rationality. We argue that in the organizational setting, one cannot assume absolute self-interest and perfect rationality of agents (subsidiaries) but should allow them to vary. We explain subsidiary-level variation through a set of internal organizational and external social conditions in which the headquarters-subsidiary agency dyad is embedded. We then discuss several agency scenarios reflecting various levels of self-interest and rationality that lead to different manifestations of the agency problem. The proposed framework can inform more relevant applications of the agency perspective in organizational studies and motivate future research.

Keywords: agency theory, headquarters subsidiary relationships, bounded rationality, self-interest, opportunism, culture, institutions, multidomestic, global, transnational MNCs.

UNDERSTANDING AGENCY PROBLEMS IN HEADQUARTERS-SUBSIDIARY RELATIONSHIPS IN MULTINATIONAL CORPORATIONS: A CONTEXTUALIZED MODEL

INTRODUCTION

The relationship between an organization's headquarters (HQs) and its subsidiaries is often plagued by serious problems that can be detrimental to performance. Tensions between HQs and subsidiaries are particularly endemic to organizations characterized by significant decentralization and delegation of decision-making authority (Jensen & Meckling, 1995) like large diversified firms and multinational corporations (MNCs). Distribution of authority and responsibilities creates a level of uncertainty as to whether the subsidiaries will work towards the achievement of corporate goals or would use the delegated power to engage in undesirable behaviors for their own benefits. Mitigating such problematic behaviors requires a deep understanding of their root causes and manifestations.

Consistent with past research, we examine HQs-subsidiary relationships employing the agency theory perspective, which has been shown to be theoretically appropriate and insightful (e.g., Björkman, Barner-Rasmussen, & Li 2004; Chang & Taylor, 1999; Eisenhardt, 1989; Gong, 2003; O'Donnell, 2000; Roth & O'Donnell, 1996). Agency theory is concerned with designing optimal contracts between economic actors to curtail opportunistic behaviors due to rational self-interest (Jensen & Meckling, 1976). HQs-subsidiary relations are essentially of an agency nature as the two parties (HQs as principals and subsidiaries as agents) often have divergent interests, which may induce undesirable subsidiary behaviors while HQs have limited ability to verify subsidiaries' actions. This work has provided some valuable insights into HQ-subsidiary relations but has also produced mixed results. Some scholars have found no or only partial support for agency predictions and have consequently called for reassessment and further development of the perspective in this context (Gencturk & Aulakh, 1995; Kim, Prescott & Kim, 2005; Nilakant & Rao, 1994; O'Donnell, 2000; Shaw, Gupta, & Delery, 2000). Two particular shortcomings of current applications include the acontextual analysis of agency relations and the assumed universality of the assumptions of self-interest and economic rationality. Recently, scholars have suggested contextualizing agency theory but little has been done particularly for the HQs-subsidiary dyad (Lubatkin, Lane, Collin, & Very, 2007; Roth & O'Donnell, 1996; Wiseman, Cuevas-Rodríguez, & Gomez-Mejia, 2012). Similarly, the theory's foundational assumptions of self-interest and rationality have been challenged (Ghoshal, 2005; Ghoshal & Moran, 1996). Hendry (2002), for example, relaxed these assumptions and proposed that undesirable behaviors in organizations are not necessarily caused by agents' "self-interest with guile" but may result from their bounded rationality (which he calls "honest incompetence"). Here again, research has not provided clear theorizing on the implications for the HQs-subsidiary setting.

The main objective of this paper is to develop a novel agency model of HQs-subsidiary relations in MNCs that addresses past limitations and helps understand better the root causes and manifestations of agency problems. MNCs are organizations that conduct business through multiple subsidiaries in different countries. International management scholars have long recognized that MNCs are different from domestic firms, not only "in degree" but also "in kind" (Westney & Zaheer, 2001), and have begun to explore the theoretical implications of these differences (e.g., Kostova & Roth, 2003; Kostova, Roth, & Dacin, 2008; Kostova & Zaheer, 1999). At the heart of this distinction is the cross-border condition, which leads to two defining characteristics of MNCs – organizational complexity and contextual embeddedness. Accordingly, we propose a contextualized agency model reflecting the embeddedness of the HQs-subsidiary dyad in two environments – internal organizational and external social. Incorporating such embeddeness into the model enables us to address the above critique of acontextual model specifications based on “pure” assumptions.

The main building blocks of our model are the following. First, we conceptualize the agency problem at the unit level of analysis. While a few scholars have explored agency at the unit level (Chang & Taylor, 1999; Kim et al., 2005; Nilakant & Rao, 1994; Roth & O’Donnell, 1996; Shaw et al., 2000), this has been mostly done by reducing unit level discussion to the level of the individual managers and employing traditional individual-level theorizing afterwards. In contrast, we offer unit-level specific conceptualizations of key constructs and explanatory mechanisms. For example, we employ the concept of institutional logic (Thornton, Ocasio, & Lounsbury, 2012) to define the central assumption of self-interest as a collective property of the unit.

Second, to capture organizational reality more realistically, we bring together the two camps in agency theory – the classical, based on the assumptions of economically rational self-interested agents (Jensen & Meckling, 1976), and Hendry’s (2002) assuming possibly dutiful agents who might be bounded rational and incompetent. We propose that both of these assumptions co-exist and jointly shape the agency situation in HQs-subsidiary dyads. Isolating one and ignoring the other simplifies theorizing and is an effective analytical tool, but integrating both assumptions makes our model more relevant and applicable to organizations.

Third, recognizing the dynamics in an organizational setting, we do not treat self-interest and rationality as fixed and absolute (as in classical agency theory) but allow them to vary. We explain what determines such variation and its implications for the manifestations of the agency problem. Drawing on the MNC strategy literature (Bartlett & Ghoshal, 1989; Prahalad & Doz, 1987) and the literature on contextual embeddedness of organizations (Dacin, Ventreska & Beal, 1999; DiMaggio & Powell, 1983; Granovetter, 1985; Kostova & Zaheer, 1999), we propose that the levels of self-interest and bounded rationality are shaped by the MNC model (multinational, global, and transnational) and the social context in which a given subsidiary is embedded (national culture and institutions). Finally, we describe how different combinations of self-interest and bounded rationality of a subsidiary lead to different manifestations of agency – opportunistic, erroneous, unpredictable, and dutiful agent behaviors. To summarize, self-interest and bounded rationality serve as the foundation and main building block of our model, which links antecedents (organizational and social context) and consequences (manifestations) of agency. We believe our framework and model provide a more comprehensive account of complex agency problems in today's MNCs.

We would note that although developed for the MNC case, our model is applicable to any large and complex organization. While empirically the variation in self-interest and bounded rationality may not be as high in domestic organizations, theoretically the thrust of our propositions should be valid for all types of companies. In this sense, we followed Roth and Kostova's (2003) idea to leverage the distinctiveness of MNCs to challenge boundary conditions and assumptions of existing theories for the purposes of modifying and extending them.

The remainder of the paper is organized as follows. The next section presents a review of extant work on agency theory in organizational research. We then proceed with the development of our theoretical model which specifies the foundations of subsidiary-level agency, their organizational and social antecedents, and the manifestations of agency problems in the HQs-subsidiary context. We conclude with a discussion of the main contributions of our work, some ideas on empirical testing of the proposed model, and suggestions for future research.

AGENCY THEORY IN ORGANIZATIONAL RESEARCH

Scholars have been studying agency problems in organizations ever since Jensen and Meckling (1976) published their seminal paper. Agency theory has moved beyond financial economics (Jensen & Meckling, 1976; Ross, 1973) and is now recognized as one of the richest theoretical traditions in organizational research (Eisenhardt, 1989; Filatotchev & Wright, 2011; *Journal of Management Studies* Editorial, 2012; Wiseman et al., 2012). While mostly used in corporate governance work on shareholder-manager relationships (Hoskisson, Hitt, Wan, & Yiu, 1999; Jensen, 2001; Zajac &Westphal, 2004), agency theory has also been applied to study various organizational issues such as outsourcing strategies (Bahli & Rivard, 2003), supplier-distributor relationships (Lassar & Kerr, 1996), strategic alliances (Das & Bing-Sheng, 1998), and HQs-subsidiary relations (Björkman et al., 2004; Chang & Taylor, 1999; Hoenen & Kostova, 2014; O'Donnell, 2000; Roth & O'Donnell, 1996).

The agency relationship is defined as one in which the "principal" delegates decision-making authority to the "agent" to perform some service for the principal. Fundamental to agency is that the principal delegates authority and relinquishes control to the agent (Mitnick, 1992; Pratt & Zeckhauser, 1985; White, 1985), as is the original case of owners appointing professional managers to run their companies (Jensen & Meckling, 1976). The delegation of decision-making authority and the associated loss of control create potential goal incongruence and information asymmetry and result in an "agency problem" (Arrow, 1985; Fama & Jensen, 1983). Goal incongruence or partial goal conflict occurs because principals and agents have different preferences and diverging interests (Eisenhardt, 1989; Kiser, 1999). Information asymmetry occurs because agents usually have better information about themselves and their actions than principals do (Arrow, 1985; Eisenhardt, 1989; Kiser, 1999). The theory is based on the assumption of rational self-interest of principals and agents who are rational "utility maximizers" and pursue their own interests "with guile" (Alchian & Demsetz, 1972; Jensen & Meckling, 1976, 1995; Williamson, 1975).

The agency problem manifests itself in opportunistic behavior by the agent and adverse selection by the principal (Arrow, 1985). The former, also referred to as "moral hazard" or "hidden action", occurs because the principal cannot fully observe the actions of the agent (Arrow, 1985; Holmström, 1982). The latter refers to principals misjudging agents because the information about agents' skills and competences is "hidden" and agents may misrepresent their abilities and motivations (Eisenhardt, 1989). Two mechanisms - monitoring and incentives - can alleviate the agency problem (Jensen & Meckling, 1976). Monitoring reduces information asymmetry through observing the agent and ensuring compliance, and incentives reduce goal incongruence by aligning agents' rewards with desirable behaviors (Alchian & Demsetz, 1972; Jensen & Meckling, 1976). Based on the assumption that agents' behavior is malleable and can be shaped through such remedies, the goal is to design an optimal arrangement between principal and agent (Fama & Jensen, 1983; Jensen & Meckling, 1976). The most exemplary application of the classical agency model to organizational research is Eisenhardt's work (1989) on the effectiveness of behavior-based and outcome-based controls as monitoring and incentives mechanisms.

In an alternative strand of the agency perspective, Hendry (2002) argues that the self-interest assumption (opportunism) may be less relevant particularly for agency relationships embedded in cooperative settings such as organizations (see also Ghoshal & Moran, 1996; Perrow, 1986). What defines the agency relationship and creates an agency problem, in his view, is the delegation of decision authority and the inability of the principal to observe the agent; hence, self-interest is not a necessary condition for the agency problem to occur. Instead, he suggests, agency problems can arise even when agents are honest and dutiful, because of their and the principals' imperfect rationality. Bounded rationality may lead to principals' inability to specify objectives in a clear and transparent manner and/or agents' "limited competence to interpret objectives, judge situations, and take appropriate actions" (Hendry, 2002: 102). This logic leads him to suggest new manifestations and remedies for the agency problem, different from the classical agency model.

Another more recent development in agency research recognizes that the agency relation does not occur in a vacuum but is embedded in a social context (Aguilera & Jackson, 2003; Arrow, 1994; Cuevas-Rodriguez, Gomez-Mejia, & Wiseman, 2012; Doney, Cannon & Mullen, 1998; Hoenen & Kostova, 2014; Shapiro, 2005). For example, Wiseman et al. (2012) discuss how information asymetry, conflict of interest, and opportunistic agent behavior are shaped by the institutional environment, social cognition and networks, and power relationships. Similarly, Lubatkin et al. (2007) discuss how formal and background institutions and organizational context influence principals and agents through socialization and attitude formation.

THEORETICAL MODEL

Leveraging these diverse agency literatures and considering the specific context of HQs-subsidiary dyads in MNCs, we propose a theoretical model consisting of three main components: (a) foundations, or root causes of subsidiary-level agency in this setting, including subsidiary self-interest and bounded rationality; (b) contextual antecedents of the agency foundations including organizational and social factors which influence the levels of subsidiary's self-interest and bounded rationality; and (c) consequences or manifestations of subsidiary agency problems based on the simultaneous effects of self-interest and bounded rationality. Figure 1 below depicts our model.

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Insert Figure 1 about here

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Foundations of Subsidiary-Level Agency

Central to our view is the anchoring of the model in the unit level of analysis as opposed to the individual level typical for agency research. Respecifying the model at a different level requires a careful reexamination of the basic assumptions of self-interest and bounded rationality for that level. In its original formulation, agency theory does not consider the unit level and if the firm is discussed, it is conceptualized as a “nexus of contracts” among individuals (Alchian & Demsetz, 1972; Jensen & Meckling, 1976). Still, organizational scholars have applied the theory to the unit level viewing HQs as principals and subunits as agents (e.g., Chang & Taylor, 1999; Filatotchev & Wright, 2011; Fox & Hamilton, 1994; Nilakant & Rao, 1994; O’Donnell, 2000; Roth & O’Donnell, 1996). For the most part, these applications have equated the unit to its individual manager, thereby possibly committing cross-level fallacies (Rousseau, 1985) and losing opportunities to capture important unit-level properties and dynamics.

Agency theory views individual level self-interest as the universal motivation for human action and the primary cause of agency problems and dysfunctional behaviors such as lying, cheating, or shirking (Alchian & Demsetz, 1972; Jensen & Meckling, 1976; Rocha & Ghoshal, 2006; Williamson, 1975). Organizational units can also act in their self-interest, beyond the personal self-interest of its managers, prioritizing the interests of the subsidiaries over those of the whole organization (Mudambi & Navarra, 2004; Yu, Subramaniam, & Cannella, 2009). For example, subsidiaries can overstate performance results to HQs, misrepresent the unit’s capabilities to access resources, or violate the corporate code of conduct for unit level benefits even if such actions are detrimental to the whole organization.

Understanding agency behavior at the unit level requires understanding unit-level motivation. In our view, unit level motivation is not a simple aggregate of individuals’ self-interests but is instead a collective property of the entity. Based on recent organizational literature (Thornton & Ocasio, 2008; Thornton et al., 2012), we suggest using the concept of institutional logics to capture unit self-interest. Institutional logics represent priorities, preferences, values, beliefs, and practices that have been established and institutionalized over time in a particular organizational entity (Thornton & Ocasio, 2008). As such, they serve as important frames of reference that condition motivations and decision-making choices of individuals within these entities (Thornton et al., 2012). Applied to self-interest, this suggests that over time, units may develop a logic that puts units' priorities above those of the whole organization, and as a result, engage in behaviors benefiting first and foremost the unit.

Based on Hendry (2002), a second behavioral assumption of importance in agency theory is bounded rationality. Foss and Weber (2015) conceptualize bounded rationality as consisting of three dimensions: (a) limited information processing capacities (e.g. Simon, 1957), (b) cognitive economizing (i.e. reliance on mental shortcuts and heuristics) (e.g. Simon, 1990), and (c) cognitive biases and errors (e.g. Tversky & Kahneman, 1974). The three dimensions progressively build on each other, and collectively, limit or "bound" human rationality (Foss & Weber, 2016). We use this framework to discuss bounded rationality as a foundation of agency problems in HQ-subsidiary relationships.

Similar to self-interest, bounded rationality also exists at the unit level but should not be equated with a simple aggregation of the individual bounded rationality of all unit members. Instead, it is a property of the unit that emerges when unit-specific identities and frames are created. Unit bounded rationality can be defined through the same three dimensions as the individual level construct, but modified to capture the specificity of the collective entity. First, information-processing constraints due to physical ("computational") limitations and scarce attention (March and Simon, 1958) restrict the volume of information in decision-making (Foss & Weber, 2016). Such limitations also exist at the unit level. For example, prior research shows that organizational units vary with regard to their information processing capacities (i.e. amount and type of information processed) (Egelhoff, 1982; Galbraith, 1973) and attention focus (e.g. Bouquet & Birkinshaw, 2008b). Second, cognitive economizing means that individuals use mental shortcuts (heuristics) instead of systematically processing all of the available information. Heuristics include cognitive frames and stereotypes that help people make sense of their situation. While frames are held by individuals, organizations can act as frames (Foss & Weber, 2016) thus shaping their members' experiences and identification with specific frame elements and, in turn, leading to shared schema and shared cognitive frames at the unit level (Dacin et al., 1999). Third, cognitive biases refer to errors in judgment due to limited information processing and use of heuristics. Research on judgment and decision biases (e.g. Cannon-Bowers, Salas and Converse, 1993; Tversky & Kahnemann, 1974; Zajac & Bazerman, 1991) shows that many different biases also exist at the group and unit level, for example, groupthink (Janis, 1982) or premature jumping to solutions of complex problems (Baer, Dirks, & Nickerson, 2013). Therefore, bounded rationality exists and can be defined at the unit level.

Based on the above, we suggest that when the HQ assigns a specific role or task to a subsidiary, the subsidiary's response will be shaped by its bounded rationality. As per Hendry (2002), bounded rationality may lead to "incompetence" and failure of agents to perform as expected by the principal. Thus, poor or improper behavior of agents must not always be caused by self-interest, but might be the result of bounded rationality and associated incompetence of agents (Hendry, 2002). Due to bounded rationality, when acting on a particular task given by HQs, a subsidiary may fail to deliver the expected results because of information processing constraints, use of inadequate cognitive frames and heuristics, and "judgmental fallibility" due to biases (Foss & Weber, 2016; Hendry, 2002). In the rest of the paper, we use the term "high bounded rationality" to refer to high levels of incompetence problems resulting from bounded rationality.

To conclude, subsidiary agency is rooted in both self-interest and bounded rationality. Although emphasizing different aspects, these two root causes are not mutually exclusive and should be considered simultaneously for a more comprehensive examination of agency. Such an approach allows integrating classical agency theory with the model proposed by Hendry (2002) and better reflects the realities of organizational life where many actors are neither perfectly self-interested and rational, nor are they always fully honest and irrational.

Antecedents of Agency Foundations

In addition to considering both types of root causes, we allow self-interest and bounded rationality to vary and accordingly view them as continuous variables rather than as fixed and absolute[1]. This is important for explaining why and how different subsidiaries exhibit different levels of self-interest and bounded rationality causing different agency problems and behaviors across HQs-subsidiary dyads. Later on, for analytical purposes, we consider four stylized agency scenarios (whereby self-interest and bounded rationality are either low or high), to describe four different manifestations of the agency problem.

We propose that the variation in subsidiary self-interest and bounded rationality is due to the particular organizational and social contexts in which HQs-subsidiary agency dyads are embedded. Incorporating context is central to the case of MNC subsidiaries given their dual embeddedness in the intra-organizational and the external social environments (Kostova & Zaheer, 1999), which we argue shape the foundational behavioral conditions of self-interest and bounded rationality (Rocha & Ghoshal, 2006; Perrow, 1986). We develop propositions on these effects below.

Organizational Context. The internal organizational context includes strategies, structures, and practices employed by the MNC and its subsidiaries. The organizational context shapes individual and collective cognitions, norms, and values, through ongoing interactions, experiences, and sense-making processes (Dacin et al., 1999; DiMaggio & Powell, 1983; Granovetter, 1985; Lubatkin et al., 2007). Accordingly, we argue that different MNC strategies and structures will be associated with different agency situations because of their effects on the levels of subsidiary self-interest and bounded rationality.

The literature has identified a number of MNC archetypes based on their dominant strategy and way of organizing (Birkinshaw & Morrison, 1995). We employ the most widely used categorization – that of Bartlett and Ghoshal (1989) and Prahalad and Doz (1987) who describe four generic MNC models. Depending on the particular positioning of an organization on the global integration - local responsiveness grid, they are said to follow an international, multidomestic, global, or transnational model[2]. The models vary in key organizational characteristics such as levels of decentralization, configuration of assets and capabilities, subsidiary roles, patterns of knowledge development and diffusion, and degree and type of interdependencies (Bartlett & Ghoshal, 1989; Kostova & Roth, 2003). These characteristics influence a subsidiary's institutional logic of self-interest and its bounded rationality (e.g. activated frames).

The multidomestic model is associated with high degree of decentralization of decision making whereby HQs has limited input into the subsidiaries, which are not only allowed but expected to act autonomously to sense and exploit opportunities in their host countries. Subsidiaries resemble self-sufficient "miniature-replicas" of the whole MNC and operate with authority on a broad range of issues including business strategies, operations, product offerings, management systems, and others (White & Poynter, 1984). The multidomestic model is characterized by low and simple, that is, stable and codifiable interdependence between geographically separated units (Kostova & Roth, 2003). There is limited interaction, information-flows, and learning between the different subsidiaries as well as low interaction with HQs limited to only few select areas (e.g. finance). Subsidiaries compete for financial resources and the HQs closely monitor their financial performance[3]. Subsidiary employees are likely to be local nationals trained in the host country and seldom moving between subsidiaries or HQs. Thus, by design, the subsidiary of the multidomestic firm is an autonomous profit center that takes responsibility for its outcomes, competes with other subsidiaries for capital, and has very limited connections to the rest of the MNC (Hill, Hitt, & Hoskisson, 1992). Such emphasis on autonomy and self-sufficiency promotes a subsidiary- as opposed to MNC-focused identity, and a cognitive framing anchored primarily in the subsidiary and the host country (Nell & Andersson, 2012). Thus, subsidiaries of multidomestic firms are likely to develop a strong institutional logic of self-interest.

The global model is characterized by a centralized and standardized structure whereby subsidiaries are less autonomous and rarely involved in strategic decision making. They are given instead clear mandates for implementing corporate strategies. Such mandates can be function specific, for example, a subsidiary in a low-cost host country may have a manufacturing mandate for the whole MNC, while another subsidiary in a different location has a mandate to sell the products in the host market. This model implies significant synergies between vertically or horizontally related units (Hoskisson, Hill, & Kim, 1993) and is thus associated with higher interdependencies across subsidiaries and HQs (Kostova and Roth, 2003). Interdependent subsidiaries are inherently motivated to work together and cooperate with each other (Kostova & Roth, 2003; Tsai & Ghoshal, 1998; Zaheer, McEvily, & Perrone, 1998). They engage in “repeated games” (Mudambi, 2011) and are concerned with the “next round” when their “track record” will be evaluated (Birkinshaw & Hood, 1998). Furthermore, the global model employs elaborate centralized control systems whereby subsidiaries are evaluated and incentivized based on their contribution to MNC-level performance. HQs exercise “strategic control” which considers not only financial but also behavioral parameters that ensure synergies throughout the organization (Hoskisson et al., 1993). All these conditions activate an MNC- rather than subsidiary-focused identity and frame. Therefore, subsidiaries in global MNCs are less likely to develop an institutional logic of self-interest.

The transnational model is characterized by complex intra-organizational relationships that lead to multiple identities, institutional logics, and frames. The objective is to identify and exploit business opportunities in local markets through local responsiveness, to achieve synergies and efficiencies across units and locations through global integration, and to leverage distributed organizational capabilities and innovation globally through organization-wide learning (Bartlett & Ghoshal, 1989; Ghoshal & Nohria, 1989; Prahalad & Doz, 1987). For that, subsidiaries have both local and global responsibilities and are managed through complex control and coordination systems. On the one hand, they are given a lot of autonomy, are expected to develop local initiatives, and are held responsible for their own performance. Associated with this is a significant level of competition with other subsidiaries to enhance their resources and mandates (Birkinshaw & Hood, 1998). This naturally fosters a subsidiary-based identity and logic of self-interest. On the other hand, subsidies are expected to collaborate and coordinate their actions with the rest of the organization for global efficiency and learning. This implies extensive exchange of information and knowledge with other subsidiaries and the HQs, as well as substantial employee mobility, for example through temporary assignments abroad, relocation across units, and use of project teams or task forces across product and geographic areas. Associated with this is an emphasis on normative control through social capital and shared values throughout the organization (Bartlett & Ghoshal, 1989; Björkman et al., 2004; Kostova & Roth, 2003; Nohria & Ghoshal, 1994). As a result, subsidiaries in transnational organizations can develop a broader organizational identity anchored in the MNC as a whole rather than being focused only on their own subsidiary, which curtails self-interest logics.

Because of this duality, both subsidiary- and MNC-based identities and loci of interest co-exist and neither one of them can become dominant. This balance is further stressed by the dynamic nature of the transnational model which implies continuous adaptation to changing conditions through on-going redefinition of subsidiary roles and redistribution of decision rights. This leads to complex, dynamic, and difficult to codify interdependences (Hedlund, 1986; Kostova & Roth, 2003) that promote multiple identities and frames and an institutional logic of constrained self-interest. Finally, subsidiaries in transnational companies vary with regard to their role and interdependence (Birkinshaw & Morrison, 1995), with some resembling units in multidomestic companies, and others – units in global firms. This implies variation in their specific organizational conditions leading to different positions on the continuum between MNC versus subsidiary-focused identity and the associated frames and logics. Therefore:

Proposition 1. The MNC model affects a subsidiary’s institutional logic of self-interest. Specifically:

Proposition 1a: The typical subsidiary in multidomestic MNCs is likely to operate with an institutional logic of high self-interest.

Proposition 1b: The typical subsidiary in global MNCs is likely to operate with an institutional logic of low self-interest.

Proposition 1c: Subsidiaries of transnational MNCs are, on average, likely to operate with an institutional logic of medium or constrained self-interest, which however may vary across subsidiaries depending on their specific role.

The MNC model also influences subsidiary bounded rationality and the related incompetence relative to HQs’ tasks. HQs in such companies specify very simple and clear objectives, usually limited to codifiable financial performance targets, which are easily interpreted and understood by the subsidiaries. Reflective of their high autonomy and low interdependence with other units, subsidiaries are free to make decisions and resolve trade-offs within their local domains without involving or considering HQs or other units. Consequently, the subsidiary's information processing capacity is unlikely to be burdened by intra-firm information processing requirements which reduces the need for using cognitive shortcuts like heuristics and therefore the risks of biased decision-making. Subsidiaries' cognitive frames are anchored in the local context which keeps them informed about relevant issues in the host environment. Together with the subsidiary's autonomy, it enables subsidiaries to design locally appropriate strategies that match their knowledge and capabilities and gives them the opportunity to upgrade such capabilities if needed. We would note that although subsidiaries operate with nonoverlapping and distinct frames and heuristics, this is unlikely to trigger serious agency problems because this scenario does not require much cross-unit interactions and communication. Therefore, holding everything else constant, subsidiary's bounded rationality under the multidomestic MNC model is likely to be low.

The global model presents a mixed picture. On the one hand, due to the centralized nature of these companies, substantial decision making is located at the HQs. Subsidiaries in this model tend to be specialized and connected to other units through relatively stable and codifiable interdependences. The organization is rather formalized and standardized, whereby HQs set comprehensive goals to the subsidiaries and provide detailed instructions of how they should be achieved. If a subsidiary needs new capabilities, the learning is guided and facilitated primarily by HQs. On the other hand, the global model is more complex than the multidomestic due to the interdependency across units. Even though HQs specify the goals and tasks for all units throughout the organization, subsidiaries still need to coordinate their actions with other subunits.

This additional layer of communication and coordination facilitates learning, but it also challenges the information processing capacity of the unit and thus leads to use of heuristics and biases. With regard to frames and heuristics, the global model will, on the one hand, promote organization-level identities and frames shared among subsidiaries. On the other hand, since subsidiaries often focus on different parts of the value chain, they are likely to develop and employ their own nonoverlapping frames and heuristics in addition to the common ones. This increases the risk of role and task misinterpretation when interacting with other units (Foss & Weber, 2016). Overall, the global model is associated with medium levels of bounded rationality and possible but constrained subsidiary incompetence.

The transnational model comes with substantial bounded rationality as it is far more convoluted and ambiguous (Kostova & Roth, 2003). Most decisions are supposed to be made jointly between separate but interconnected units each with their evolving goals, priorities, and capabilities (Bartlett & Ghoshal, 1989; Kostova & Roth, 2002). Corporate goals are formulated rather broadly with little specificity (Hendry, 2002) and subsidiaries are left with substantial ambiguity as to their goals and mandates especially when less structured and standardized tasks such as innovation, political activities, or adaptation of business models are concerned (Filatotchev & Wright, 2011; Hendry, 2002). This requires a lot of sense making, interpretation, and communication with other subsidiaries to further clarify their tasks and appropriate actions. Such extensive exchanges, coupled with the possibility of “conflicting voices” from other units, severely challenge the information processing capacities of the subsidiary and push it towards extensive use of heuristics, making errors in judgment more probable. We recognize that the transnational model is ideally designed to facilitate cross-unit learning and maximize knowledge across the organization through extensive flows of information and people. In addition, it is aimed at building organization-wide shared values, identities, and frames that harmonize heuristics and reduce interpretive ambiguity. However, such integration is difficult to achieve due to the dynamic and complex organizational setup as well as the intense competition between the semi-autonomous subsidiaries, which might not be willing or able to engage in knowledge sharing and normative integration (Egelhoff, 1999; Gupta & Govindarajan, 1991; Monteiro, Arvidsson & Birkinshaw, 2008; Mudambi & Navara, 2004). Finally, similar to self-interest, unit-level bounded rationality will vary based on the subsidiary's role and standing in the organization. Therefore:

Proposition 2. The MNC model affects subsidiary's bounded rationality. Specifically:

Proposition 2a: The typical subsidiary in multidomestic MNCs is characterized by low unit level bounded rationality.

Proposition 2b: The typical subsidiary in global MNCs is characterized by medium levels of bounded rationality.

Proposition 2c: Subsidiaries of transnational MNCs, on average, are characterized by substantial bounded rationality, which may however vary depending on their specific role.

Social Context. Social context influences organizations through cultural and institutional forces (Dacin, et al., 1999; Kostova & Zaheer, 1999; Meyer, Mudambi, & Narula, 2011) which constrain undesirable behaviors and prescribe what is legitimate, expected, and valued, and thus shape organizational strategies, structures, and practices (Meyer & Rowan, 1977; Scott, 1995). By constraining and enabling certain actions and behaviors, national culture and institutions reduce uncertainty, and make economic activity more orderly and predictable (North, 1990). Accordingly, we propose that the agency situation in the HQs-subsidiary dyad is influenced by the social context in which the dyad is embedded, including its cultural and institutional makeup (Kostova, 1999; Scott, 1995).

In particular, we examine how the cultural value of individualism/collectivism (Hofstede, 1980) and the quality of formal institutions (North, 1990; Peng, Sun, Pinkham & Chen, 2009) in a country affect subsidiary self-interest and bounded rationality, and through this, the manifestations of the agency problem in MNCs. We chose these two aspects of the social context because of their centrality in international business research and also, their salience for HQs-subsidiary relationships (Berry, Guillen, & Zhou, 2010; Hofstede, 1980; Kostova & Roth, 2002; Triandis, 1995). We would note that given the proliferation of cultural and institutional frameworks in the literature, it is impossible to be exhaustive in examining all types of social effects on agency[4]. Within our choice of individualism/collectivism and institutional quality, we suggest two distinct types of effects on subsidiary self-interest and bounded rationality – direct and distance effects.

Direct effects. The direct effect refers to the influence of the national environment of the subsidiary (host country) on the likelihood of it developing a logic of self-interest and exhibiting bounded rationality induced problems. Different cultures have different views on authority, compliance, and relations between individuals and social groups, all of which are at the core of the agency relationship (Hofstede, 1980; Schwartz, 1992). In individualistic cultures, the self is viewed as autonomous and independent from the group, and, thus, the individual goals are not necessarily aligned with group-level goals. In contrast, collectivistic cultures emphasize the primacy of the group, and see personal interests as secondary to those of the collective. Collectivists tend to view the self as interdependent with others, and have a stronger preference for being part of a group and by reference, being involved in their company (e.g. Brewer & Venaik, 2011; Hofstede, 1980; Smith, Dugan & Trompenaar, 1996). Thus it can be expected that, on average, subsidiaries in collectivistic cultures are less likely to develop a strong logic of self-interest. However, cultural influences should not be trivialized by claiming, for instance, that units in collectivistic cultures do not present agency problems because they have a “collectivistic” mindset. As research shows, what is very important for collectivists is where they draw the line between in-group and out-group (Triandis & Trafimow, 2001). If the HQs are perceived as outsiders, “collectivistic” subsidiaries may develop a rather self-interested logic disregarding the interests of the corporation.

Culture is also likely to affect subsidiary’s bounded rationality as it shapes the way actors view and use information, evaluate situations, and make decisions (Fidrmuc & Jacob, 2010; Schwartz, 1999). Individualistic cultures tend to emphasize rationality and comprehensive data-driven analysis of different options in decision making, thus improving their information processing capabilities, reducing the reliance on simple heuristics, and limiting the risks of biases. In contrast, collectivistic cultures may forego data driven solutions because of heavy use of heuristics considering social factors such as group dynamics, social relations, the needs of others, and group interests (Kim, Triandis, Kâğitçibaşi, Choi & Yoon, 1994). This in turn will have an impact on the degree to which a given subsidiary is able to correctly interpret and understand HQs mandates, and develop efficient and effective plans for implementing them. A collectivist framing of a given task increases the risk that the subsidiary would overly consider the social aspects of the task which might lead to a different solution than what the HQ asked for. Furthermore, the need to consider all social factors might overload the subsidiary’s information processing capacities leading to a heavier use of heuristics and associated biases. Therefore, subsidiaries in collectivistic cultures are more likely to experience high levels of bounded rationality than those in individualistic cultures.

Subsidiary self-interest and bounded rationality will also be affected by the quality of the institutional environment in the host country. For example, more economically developed host countries with established and mature formal institutions and strong rule of law provide clear and transparent rules for business conduct and constrain extreme “self-interest with guile”. Deviation from rules and standards of ethical business conduct are less tolerated and often sanctioned. As a result, economic agents, be it individuals, organizations, or subsidiaries of MNCs, are more likely to act within the boundaries of the law and the rules set out by their organizations. In contrast, emerging and developing markets are characterized by “institutional voids” (Khanna & Palepu, 1997) reflected in underdeveloped and less mature institutional arrangements often plagued by corruption, poor rule of law, and substantial informality in coordinating business transactions. These countries are also undergoing significant institutional change that creates a sense of unpredictability, crisis, and risk. As a result, economic actors may switch to a “survival mode” and focus disproportionately on their own interests at the expense of others. Subsidiaries in emerging markets and developing economies are thus more likely to develop a logic of self-interest. Furthermore, the ambiguity and complexity in such environments are likely to consume a lot of subsidiaries’ information processing resources. In addition, they have less developed educational systems and technological knowledge, less standardized principles of work, and lower overall management skills (Bloom, Genakos, Sadun, & Van Reenen, 2012). This is likely to lead to use of simplistic heuristics or activation of inadequate cognitive frames. In sum, host countries with less developed formal institutions, such as emerging markets, highlight the condition of bounded rationality and its impact on subsidiary’s ability to understand and execute the tasks it is charged with by HQs. Therefore:

Proposition 3. Host-country social context directly affects subsidiary’s self-interest and bounded rationality. Specifically:

Proposition 3a. Subsidiaries in individualistic cultures are more likely to develop a logic of self-interest than subsidiaries in collectivistic cultures. In collectivistic cultures, subsidiary's perceptions about its group boundaries will moderate this relationship such that when HQs are viewed as outsiders, self-interest will be higher.

Proposition 3b. Subsidiaries in collectivistic cultures exhibit higher levels of bounded rationality than subsidiaries in individualistic cultures.

Proposition 3c. Subsidiaries in host countries with less developed formal institutions are more likely to develop a logic of self-interest and exhibit substantial bounded rationality.

Distance effects. In addition to the direct effects, we propose a distance effect of social context on HQs-subsidiary agency relationship. Distance results from the cross-border condition in MNCs (Ghemawat, 2001; Kostova & Zaheer, 1999) and is defined as the difference between two countries with regard to a particular aspect of social context, such as cultural, administrative, economic, linguistic, or institutional (Ghemawat, 2001; Kogut & Singh, 1988). Distance presents major challenges for MNCs in a variety of activities, for example transferring knowledge across borders, integrating foreign acquisitions, managing cross-border joint ventures, achieving legitimacy across locations, and designing effective agency remedies (e.g., Gong, 2003; Kogut & Singh, 1988; Kostova & Roth, 2002; Kostova & Zaheer, 1999; Roth & O'Donnell, 1996; Tihanyi, Griffith, & Russell, 2005; Xu & Shenkar, 2002).

We propose that the cultural and institutional distance between home and host countries impact the HQs-subsidiary agency problem. Distance increases the likelihood of subsidiaries' developing a logic of self-interest. When HQs and subsidiaries are located in culturally distant countries, they lack a common core of values, norms, and beliefs which in turn influences behaviors and, ultimately, creates perceptions of distinct identities and cultural boundaries. For example, compared to collectivistic cultures, individualistic cultures live a rather fast pace of life (Levine & Norenzayan, 1999), communicate very directly with less attention to the social status of counterparts (Holtgraves, 1997), and with less emphasis on cooperative team processes (House et al., 2004). Based on the literature on fault lines (e.g. Lau & Murnighan, 1998), when subsidiaries perceive such cultural differences, they are likely to develop “us” vs. “them” mentalities (in-group / out-group distinctions), animosity, less confidence towards the out-group, and a feeling that their cultural identity might be threatened. As a result, they are likely to develop a logic of self-interest as a protection and preservation mechanism.

Greater cultural distance is associated with higher levels of bounded rationality because it implies that HQs and subsidiaries possess different information and cognitive frames, rely on distinct heuristics, and suffer from different biases (Fidrmuc & Jacob, 2010; Schwartz, 1999). Institutional distance reflected in differences in economic models, legal frameworks, educational systems, level of development, role of the state, labor, and others (Berry et al., 2010; Ghemawat, 2001) will have a similar effect on bounded rationality. Subsidiaries from institutionally distant countries are likely to possess and use different information, operate out of different cognitive frames and heuristics and, as a result, have difficulties understanding and interpreting HQs priorities and requests. This challenges the subsidiary’s correct understanding and interpretation of HQs’ objectives and requests, that is, it increases the likelihood of bounded rationality based problems. Therefore:

Proposition 4.The distance between the social context in the HQs’ and subsidiary’s countries affects subsidiary self-interest and bounded rationality. Specifically:

Proposition 4a. Cultural distance increases the likelihood of subsidiaries developing a logic of self-interest.

Proposition 4b. Cultural and institutional distance are positively related to subsidiary’s bounded rationality problems.

Manifestations of Subsidiary Agency

The previous section proposed that the root causes of the agency problem in HQ-subsidiary relationships – self-interest and bounded rationality – vary across subsidiaries due to different organizational and social conditions in which subsidiaries are embedded. Building on these ideas, here we discuss how different combinations of self-interest and bounded rationality create different agency situations manifested in a variety of behaviors. We organize this discussion based on four stylized scenarios where self-interest and bounded rationality are high or low. Figure 2 presents four types of agency behaviors that are likely to occur under the different scenarios, which we refer to as opportunistic, erroneous, unpredictable, and dutiful.

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Insert Figure 2 about here

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Opportunistic Behavior. The first scenario implies high self-interest and rationality of subsidiaries, which is most consistent with mainstream agency theory. High self-interest in our conceptualization means an institutional logic that favors units' interests over those of the organization as a whole. Since they shape the way units interpret their discretion and use their delegated authority, such logic ultimately leads to self-serving opportunistic behaviors with little or no concern for corporate interests and possibly even detrimental to the corporation. Here, subsidiaries are not concerned with aligning interests with HQs, which feeds into the goal incongruence between the parties. Due to low bounded rationality in this scenario, subsidiaries have competence and capacity to make sense of the situation, understand all possibilities for action and their impact on desired outcomes, and if necessary, manipulate and disguise information for their own benefits. They may also deliberately increase the information asymmetry with the HQs, further constraining HQs' ability to observe and verify their decisions and actions. Thus, under this scenario of assumptions, subsidiaries are likely to be calculative, manipulative, and opportunistic optimizers of their own interests.

There is a wide range of possible opportunistic behaviors of MNC subsidiaries, for example, deliberate misrepresentation of information to the parent by providing deceptive, misleading, or selective facts, and by covering up or cheating. This may also manifest itself in pseudo compliance or the so called ”ceremonial adoption” of corporate initiatives and practices whereby the unit formally reports adoption to HQs, but in fact does not follow the practice (Kostova & Roth, 2002). Other manifestations include deliberate falsification of financial reports, shirking productive capability, or lying about unsuccessful project outcomes (Harrison & Harrell, 1993; Young, 1985). In addition, subsidiaries might sabotage HQs and abuse the discretion granted to them through intellectual property misappropriation, tunneling corporate resources and assets, transfer pricing, and other rent- or power-seeking actions at the expense of the corporation (e.g., Fama & Jensen, 1983; Jensen & Meckling, 1976; Mudambi & Navarra, 2004).

While this scenario generally maximizes subsidiary outcomes with no consideration for the corporation, it can also motivate subsidiary behaviors with potential positive effects for the MNC. As suggested in the global strategy literature, subsidiaries with strong capabilities coupled with autonomy and independence, may engage in strategic initiatives such as local innovation and market adaptation (Birkinshaw & Hood, 1998), which in the long run could benefit the company (Zahra, 2007). This can very well be part of the design of the organization, such as in the multidomestic MNC model. Even then however, the essential agency problem remains as described above. In summary, the combination of high self-interest institutional logic and low bounded rationality increases the risk of pervasive calculative, manipulative, and other self-serving opportunistic behaviors by the subsidiary. Based on the contextual antecedents of self-interest and bounded rationality discussed above, we could suggest that this manifestation (opportunistic behavior) occurs when for example, the MNC employs the multidomestic model, and the subsidiary is located in a developed, individualistic country.

Erroneous Behavior. The second scenario implies low self-interest coupled with high bounded rationality, which is more consistent with the perspective emphasizing cognitive limitations as root causes of agency problems (Hendry, 2002). In this scenario, subsidiaries are supportive and cooperative towards HQs and do not deliberately try to increase information asymmetry or behave opportunistically. However, an agency problem may still exist due to the subsidiary's limited rationality relative to the given authority and assigned tasks. Here subsidiaries do not know how to effectively use the delegated discretion and as a result may not act in the HQs' best interest. Although well-intentioned, they simply lack the necessary knowledge, capabilities, and foresight to correctly interpret and judge the situation, take appropriate actions, and understand their consequences. Although in this case there is no apparent goal incongruence between HQs and subsidiaries, due to the potential lack of adequate knowledge and erroneous interpretation by the subsidiary, there might be a misfit between corporate goals and subsidiary's "vision" of the right course of action (Marengo & Pasquali, 2012). As stated by Hendry (2002: 102), "There will be some degree of misunderstanding, misinterpretation, or misjudgment, and the principals will therefore bear some cost, corresponding to the difference in utility between achieving their objectives as they would (retrospectively) understand them and achieving their objectives as the agents (at the time) understand them". Overall, under this scenario, subsidiaries are agreeable, cooperative, and supportive, but they may not be able to deliver and are prone to engaging in erroneous behaviors. Examples of erroneous behaviors might include strategic errors, inadequate brand and product adaptation, misallocation and suboptimal use of resources, and unintentional violation of corporate code of conduct and ethical standards. In summary, the combination of a logic of low self-interest and high bounded rationality at a given subsidiary increases the risks of non-intentional strategic errors, inappropriate actions, and other erroneous behaviors by the subsidiary. Based on the above propositions, this outcome is likely for example for subsidiaries of MNCs employing the global model, which are located in less developed and collectivistic countries, especially when the ingroup-outgroup boundaries between the subsidiary and the parent company are negligible.

Unpredictable Behavior. The third scenario is a combination of subsidiary's high self-interest and high bounded rationality, that is, a self-centered institutional logic and a lack adequate competence to perform the task. This pushes the agency problem to the extreme, as it is very difficult, if not impossible, for the principal (HQs) to predict and assess subsidiary decisions and actions. The subsidiary's logic of self-interest is likely to result in some goal incongruence. However, while motivated to pursue their own agenda, subsidiaries may not be fully capable of doing so in a rational way. Due to their inadequate knowledge, limited information processing capabilities, heavy use of heuristics, and cognitive biases, they may take actions, which are not necessarily in their best interests and might, at times, even be beneficial to the MNC. Similarly, due to its high self-interest, the subsidiary will likely attempt to increase information asymmetry by hiding or deliberately manipulating information to HQs. Yet again, its partially irrational and uninformed strategies constrain the subsidiary's attempt at increasing the information gap to HQs, resulting in a limited ability to pursue hidden actions. Thus, deliberate opportunistic behavior of the subsidiary is likely to be constrained and very difficult to interpret and understand for the HQs because of its randomness and inconsistency.

All of this leads to serious dysfunctional behaviors manifested in a wide range of actions, such as reluctance to cooperate with HQs, or making random and seemingly illogical decisions, which are not necessarily well thought out and calculated. For example, such a subsidiary may employ child labor despite corporate guidelines against this practice, hoping that this will increase its profit margins. However, this can backfire as the possible loss of legitimacy and reputation for the whole MNC (Kostova & Zaheer, 1999) may lead HQs to punish or even close down the subsidiary. Subsidiaries may also hide problems and challenges they are facing from HQs in order to look good, which however might prevent asking for necessary help and support from HQs.

Finally, while the high levels of self-interest in this scenario mean that subsidiaries are not concerned with aligning interests with HQs, it is possible that some limited number of the subsidiary’s goals is actually aligned with the corporate goals. For those goals, it is unlikely that subsidiaries would be motivated to manipulate or hide information on their actions. However, an agency problem may still occur due to the subsidiary’s limited rationality and its inability to achieve this goal. As a result, the subsidiary might commit errors; that is, they might still not act in the HQs’ best interest as they lack the competence to make appropriate judgments of the situation and to take all necessary actions. In summary, the combination of a high self-interest institutional logic and high bounded rationality at a given subsidiary increases the risks of unpredictable behaviors by the subsidiary, such as constrained opportunistic behavior (“incompetent dishonesty”) and, to a lesser extent, erroneous behavior (“honest incompetence”). In any case, this scenario leaves the principal in the dark and represents a very difficult agency challenge. Based on the earlier propositions, we could expect this agency behavior when the MNC employs the transnational model and the subsidiary is placed in an emerging market at a high cultural and institutional distance from the home country.

Dutiful Behavior. The fourth scenario implies a logic of low self-interest coupled with low bounded rationality. This combination is different from the first three in that it reflects an ideal state of an agency relation and, strictly speaking, is not a manifestation of an agency "problem". Here subsidiaries are driven by a corporate-focused logic and are committed to protecting corporate interests and achieving corporate goals. They follow rational approaches to decision-making and possess the appropriate knowledge and capabilities to correctly interpret HQs' goals and interests, make the right strategic decisions in their realm of responsibilities, and execute the right actions fulfilling their delegated duties. Such relations are characterized by agent compliance and initiative, conscientiousness and reliability and are consistent with the notion of "stewardship" (Donaldson, 1990). This scenario is associated with the lowest levels of goal incongruence and information asymmetry. This is because of the willingness and ability of the subunit to about their own activities to HQs. Such an open and transparent exchange with HQs will further align the interests of both parties. Examples of dutiful behaviors include full compliance with corporate standards in daily activities, or reliable and effective implementation of HQs' initiatives. Dutiful behavior could be expected for example in global MNCs and a subsidiary located in a developed host country which is also culturally and institutionally similar to the home country.

DISCUSSION

The objective of this paper was to examine HQs-subsidiary relations in MNCs through an agency lens. Our framework was developed for the organizational setting and the unit level of analysis, which motivated a new view about the assumptions of agency theory and allowed us to specify a broader set of agency scenarios and manifestations for HQs-subsidiary dyads. In summary, we proposed that the organizational model employed by an MNC and the cultural and institutional characteristics of the host country shape the agency situation of the subsidiary, specifically, the level of its self-interest and bounded rationality. These root causes of the agency problem lead to different behavioral manifestations– opportunistic, erroneous, unpredictable, and dutiful. As depicted in Figure 1, the foundation of our model is the conceptualization of the root causes of agency, which is critical for linking contextual conditions to behavioral outcomes.

Theoretical Contributions

Our paper makes several contributions to the literature. Most importantly it proposes variation of the agency problem across MNC subsidiaries and explains the sources of this variation. This is a significant departure from past organizational research on agency that has followed the classical agency model assuming the same universal root causes of rational self-interest leading to the same behavioral manifestations of agent opportunism for all HQs-subsidiary dyads across MNCs. We believe our approach better captures the complexity of the phenomenon and has the potential to make the agency perspective more realistic and relevant for organizational research.

To develop our model, we proposed a number of extensions and modifications of agency theory, which we view as contributions in themselves. First, our model was developed for the unit-level as opposed to the typical individual level of analysis, which required respecification of main elements of the theory. Starting with the root causes of the agency problem, we offered novel conceptualizations of unit-level self-interest and bounded rationality, based respectively on institutional logics (Thornton & Ocasio, 2008; Thornton et al., 2012), and shared frames and cognitions (Dacin et al, 1999; Foss & Weber, 2015). This helped to avoid the potential fallacy of applying individual level constructs to the unit level without proper theorizing (Rousseau, 1985; Nyberg & Ployhart, 2013) and to develop a theoretically grounded alternative for examining unit level agency. It also generated a new set of ideas and arguments that can enrich the conversation on agency and take it into new directions beyond the classical model.

Second, in proposing a two-dimensional framework of root causes of agency – self-interest and bounded rationality – we integrated two previously disconnected literatures within the agency perspective – the classical model (Jensen & Meckling, 1976) and the alternative "less sinister" view (Hendry, 2002). As opposed to taking sides in this debate by choosing to focus on either self-interest or bounded rationality, we accommodate both and thus avoid being "concomitantly pessimistic" (Ghoshal, 2005; Ghoshal & Moran, 1996) or overly optimistic about the nature of agents (Donaldson, 1990). We argued that there is no reason to position these streams as mutually exclusive and antagonistic, as both dimensions co-exist and vary independently. Importantly, and again in contrast to previous applications, we argued that both self-interest and bounded rationality are likely to vary across agency dyads. "Sliding" the self-interest and bounded rationality scales allows the examination of a more realistic and comprehensive set of agency situations and manifestations.

Third, by leveraging the contextual embeddedness of the HQs-subsidiary agency relation in MNCs, we provided an explanation of the organizational and social determinants of subsidiary self-interest and bounded rationality. Our propositions on the MNC model suggest different likelihood and severity of the agency problem in MNCs depending on whether they follow the multidomestic, global, or transnational model. The propositions on social context, including the cultural and institutional characteristics of the countries in which the agency dyad is embedded, explain why different subsidiaries, even in the same MNC, might exhibit different agency issues. Furthermore, the distinction between direct and distance contextual effects presents a more sophisticated understanding of social embeddedness. Choosing the MNC as the theoretical setting for our model was critical in being able to highlight and theorize on organizational and social contextual effects. It also made our contribution distinct from previous attempts for contextualizing agency theory (Lubatkin et al., 2007; Wiseman et al., 2012).

Fourth, our integrated framework allowed us to derive an expanded set of agency manifestations. In addition to the classical opportunistic behavior, and again as a departure from the typical zero-sum view, we discussed erroneous and unpredictable, as well as dutiful behaviors of subsidiaries, which is a much more comprehensive account of agency problems in MNCs. Understanding the variety of agency behaviors of MNC subsidiaries and the organizational and social conditions that lead to each type of behavior is critical for designing proper remedies to reduce agency risks and costs. We recognizee that our model is a more complicated version of typical agency applications, often praised for their predictive accuracy and parsimony. However, we believe that our more comprehensive approach can increase the explanatory power of agency applications, as it addresses a variety of theoretically possible agency scenarios and manifestations. Therefore, in this case, we would argue, it is worthwhile "...complicating the models … by assuming motives other than self-interest" (Rocha & Ghoshal, 2006: 585).

Directions for Future Research

With this paper we intend to revitalize the conversation on agency theory in the organizational domain by providing a solid and novel foundation for additional theory building and empirical work. The most immediate possibility would be to build on our model for examining effective remedies of the HQs-subsidiary agency problems. For example, the traditional mechanisms of monitoring and incentives (Jensen & Meckling, 1976) might be effective in curtailing opportunistic behaviors, but they might not be useful in the other agency scenarios. They can do little when, for example, agents behave badly because of their bounded rationality. Here, future research could build on Hendry (2002) and further integrate the vast literature on organizational learning. While we have briefly outlined how learning takes place in the different MNC models, we did not cover some important aspects of organizational learning such as absorptive capacity (e.g. Chang, Gong, & Peng, 2012), power issues (Bouquet & Birkinshaw, 2008a), or role of experience (Argote & Miron-Spektor, 2011). In addition to learning, one could explore remedies of a more general nature that simultaneously address a wider set of agency situations, by tackling both self-interest and bounded rationality. For instance, remedies of more social and informal nature, such as normative integration, employee socialization, and mentoring can help alleviate a whole range of agency problems (Hendry, 2002; Lubatkin et al., 2007; Shapiro, 2005; Wiseman et al., 2012). Developing this issue might shed additional light on extant work that has shown the difficulty of designing effective monitoring and incentive solutions (Holmström & Milgrom, 1991; Nilakant & Rao, 1994; O'Donnell, 2000; Roth & O'Donnell, 1996; Tirole, 1986). It would also be valuable to explore some structural solutions that could remedy agency problems in MNCs such as regional HQs (Heenan, 1979). If designed properly, such units could close the distance between parent companies and subsidiaries, serve as a bridge between corporate and subsidiary frames and interpretations, and expand the scope of subsidiary' identity beyond the subsidiary and towards the whole MNC (Hoenen, Nell, & Ambos, 2014; Lehrer & Asakawa, 1999). Another interestingl question that must be addressed is the level of specificity of agency remedies that should be employed. Our theory would suggest that the remedies must be tailored to specific scenarios (Figure 2). As Mitnick states, "Ideally, we should aim for a theory of agency problem remediation in which particular coping strategies are linked to particular agency problems" (1992: 95). Too much customization however might create inefficiencies or even equity concerns amongst subsidiaries (Nickerson & Zenger, 2008). Therefore, it would be important to study the optimal level of customization of agency remedies and the effectiveness of more universal remedies.

More thought should also be put into understanding the trade-offs in dealing with agency problems in organizations. For example, as discussed above, subsidiary self-interest can be by design as it promotes subsidiary initiative and innovation (Birkinshaw & Hood, 1998) and thus can be beneficial for the organization (Zahra, 2007). Then, it becomes important to think about the "healthy" level of subsidiary self-interest and to study when, why, and at what point, self-interest might become dysfunctional, and design remedies accordingly. In sum, we see a number of important extensions of our model aimed at identifying a “toolkit” of remedies from which HQs can choose to efficiently and effectively manage the diverse agency situations.

Another general direction for future research is enriching our model by expanding the list of variables and examining more complex interactions between them. For example, beyond the MNC models that we explored, one could also be more precise in studying subsidiary-level organizational determinants of the agency situation. In our current model, we assumed that all subsidiaries of multidomestic and global MNCs are similar and acknowledged that subsidiaries in transnational companies may vary based on their roles. However, we did not provide a detailed explanation of the effects of distinct subsidiary roles. Incorporating the relevant literature (Birkinshaw & Morrison, 1995) would enrich our understanding of the wide variety of agency situations and their variance at the subsidiary level. Furthermore, one could theorize on the joint effects of organizational and social context in shaping agency manifestations. In fact, we have implicitly argued that a particular manifestation might occur in different configurations. Specifying more precisely which configurations lead to which manifestation is not trivial as it requires dealing with opposing effects. For example, institutional distance might increase bounded rationality of a subsidiary while, simultaneously, the subsidiary’s individualistic culture reduces the issue of bounded rationality. The ultimate effect of bounded rationality therefore might depend on additional contingencies that require further theorizing.

Extensions can also be suggested on the social context. Here, we limited our discussion to one cultural dimension (individualism/collectivism) and one institutional construct (institutional quality). However, there are many more cultural and institutional frameworks that might affect the agency situation and warranty attention. For example, Hofstede’s (1980) dimension of power distance can be conceptually linked to the hierarchical relationship between HQs and subsidiaries, and uncertainty avoidance – to the issue of differential risk preferences in classical agency theory. Other institutional frameworks can also be useful. For example, comparative institutionalism describes different “varieties of capitalism” (Hall & Soskice, 2001) across countries that differ with regard to role of state, economic freedom of business actors, degree of coordination and collaboration, and others, which can also influence the logic of self-interest and the bounded rationality of subsidiaries embedded in these environments. Finally, in addition to influencing self-interest and bounded rationality of a subsidiary, the social context might also lead to additional variation in agency manifestations. For example, opportunistic behavior may come in different shapes and forms depending on the context; in a less institutionally developed country, it may be manifested in behaviors such as stealing and corruption, while in developed countries, it may be reflected in sophisticated financial fraud and complex enrichment schemes.

Finally, a very important theoretical extension of our work would be to examine the principal side of the HQs-subsidiary agency dyad. Consistent with previous work on “principal opportunism” (Perrow, 1986; Wiseman et al., 2012; Yan, Guorong, & Hall, 2002) and principal bounded rationality (Hendry, 2002), it is reasonable to suggest that HQs also can engage in inappropriate conduct and dysfunctional behavior, for example cheating, manipulating, and even exploiting subsidiaries for their own rather than corporate interests (Foss, Foss, & Nell, 2012). Similar to the subsidiary-focused discussion above, we could theorize on different organizational and social effects on the principal’s (HQs) self-interest and bounded rationality, for example the culture and institutions of the HQs home country.

Conclusion

Agency theory has been employed for studying intra-organizational relationships in MNCs for a long time. Our paper provides a novel and enriched framework which has the potential to significantly elevate this research in the future. On the one hand, we incorporate ideas from more recent agency theory work that go beyond the mantra of the classical model, thus broadening the lens through which we view agency. On the other hand, we build on the specificity of the agency situation in MNCs for a more relevant and sharp application of agency ideas. We believe our analysis of the foundations of the agency problem in this context, the organizational and social determinants of its severity and nature, and the variety of its likely manifestations, will trigger a renewed interest in this extremely important area of organizational research and will produce many important practical recommendations for MNC managers.

FOOTNOTES

[1] While we recognize that variation is also likely on the HQs' side, for the purposes of this paper we concentrate on the subsidiary side and examine only subsidiary's levels of self-interest and bounded rationality.

[2] In this paper, we follow other scholars and do not explore the international model as it is less well-defined than the other archetypes and lacks empirical evidence (Harzing, 2000).

[3] The multidomestic model is similar to the classic M-form where the organization may seek financial economies while not necessarily pursuing more complex vertical and synergistic economies (Hill & Hoskisson, 1987).

[4] For example, just within the domain of culture, there are thousands of published papers which represent different theoretical perspectives; and only within the multi-dimensional value-based approach, there are multiple frameworks which suggest different sets of cultural value dimensions (e.g. Hofstede, 1980; House, Hanges, Javidan, Dorfman & Gupta, 2004; Trompenaars & Hampden-Turner, 1998; Kluckhohn & Strodtbeck, 1961).

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FIGURE 1

Subsidiary-Level Agency Model in MNCs

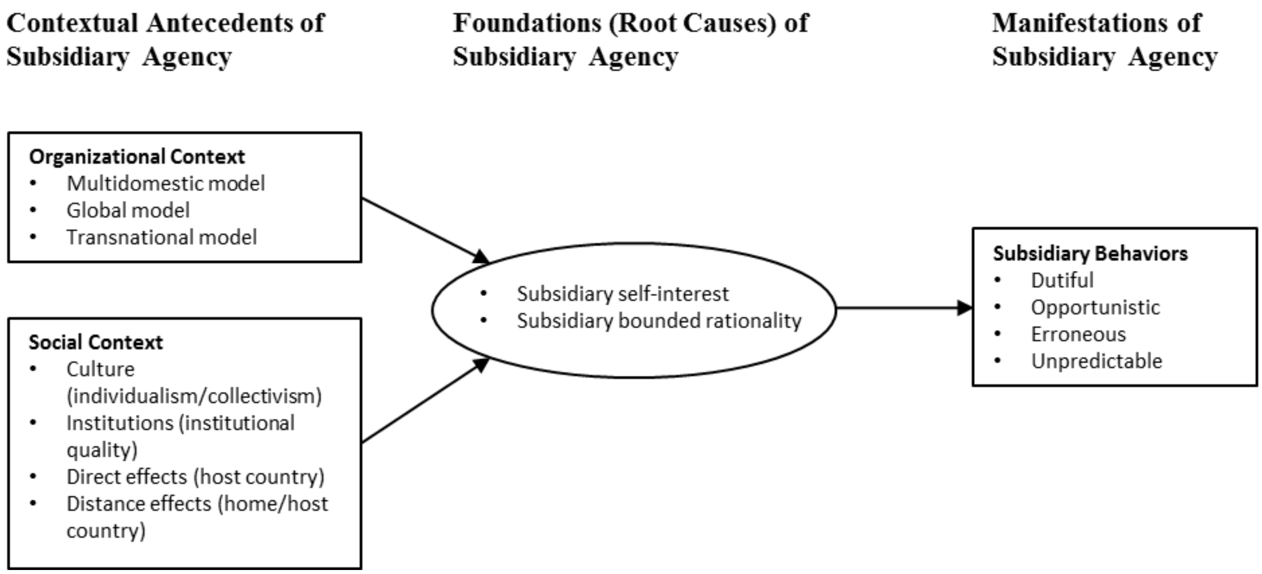

FIGURE 2

Manifestations of Subsidiary Agency

	High Self-Interest	**Low Self-Interest**
Low Bounded Rationality	**Opportunistic Behavior** Subsidiary as agent characterized by • Subsidiary-focused institutional logic • Sufficient knowledge and competence • Calculation with guile	**Dutiful Behavior** Subsidiary as agent characterized by • Corporate-focused institutional logic • Sufficient knowledge and competence • Compliance and contribution
High Bounded Rationality	**Unpredictable Behavior** Subsidiary as agent characterized by • Subsidiary-focused institutional logic • Limited knowledge and competence • Unpredictable and inconsistent behaviors including constrained opportunism and strategic errors	**Erroneous Behavior** Subsidiary as agent characterized by • Corporate-focused institutional logic • Limited knowledge and competence • Strategic errors