Legitimacy Dynamics in Headquarters-Subsidiary Relationships

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Introduction

The relationship between multinational enterprises' (MNE) headquarters and their subsidiaries has been of considerable interest to international business scholars (e.g., Dörrenbächer and Geppert, 2009). Although a subsidiary is an integral part of an MNE, its interests do not necessarily converge with those of headquarters. Many scholars note that relationships between headquarters and subsidiaries are characterized by the simultaneous presence of cooperation and competition (e.g., Bouquet and Birkinshaw, 2008; Otterbeck, 1981). On the one hand, the subsidiary and its managers are dependent on headquarters' resources to fulfill its mandate. On the other hand, the subsidiary and its managers have their own particular goals, which may or may not coincide with the goals of headquarters and its managers. Subsidiary managers may also seek to develop the unit's own sense of identity, which may be at variance with that of the MNE (e.g., Mudambi and Navarra, 2004). The potential for goal and identity conflict between headquarters and subsidiaries leads to the emergence of a mixed-motive relationship between the two units and their managers. A mixed-motive relationship generates conflict, but the mere existence of conflict is not necessarily detrimental to the relationship (Rahim and Bonoma, 1979). However, the emergence of a prolonged conflict and/or its ineffective management may create a dysfunctional relationship between the headquarters and the subsidiary.

The traditional assumption in the literature on headquarters-subsidiary relationships is that the management of conflict is critically shaped by the distribution of power between headquarters and subsidiaries, with headquarters traditionally assumed to hold more power. Nevertheless, recent scholarship suggests that subsidiaries can become influential and play powerful roles in the organization (Bouquet and Birkinshaw, 2008). Although the construct of power is useful and indispensable in explaining how conflict is managed in intra-organizational interactions, it has its own set of shortcomings if analyzed solely from a structural point of view. For example, the headquarters might possess power but have no interest in exercising it, or it may use it selectively based on the personal preferences of the top-level decision makers.

An alternative approach to understanding the dynamics of conflict between headquarters and subsidiaries is to look at the interactions between the two units from a micro-behavioral level (Das and Kumar, 2011). The micro-behavioral perspective places top-level decision makers at the center of the analysis. This approach recognizes the importance of the individual level of analysis by incorporating the wishes and aspirations of the manager. Relationships between headquarters and subsidiaries are managed by individuals operating in a given organizational context. While the organizational context is undoubtedly important, but so are the psychological predispositions of headquarters and subsidiary managers. In this regard, we contribute to the international business literature by emphasizing the role of individuals and, in particular, their psychological predispositions in shaping how conflicts evolve and are managed by headquarters and subsidiary managers (e.g., Hodgkinson and Healey, 2011; Jarzabkowski and Spee, 2009; Powell, Lovallo, and Fox, 2011).

We integrate this perspective with the legitimacy literature (e.g., Kostova and Roth, 2002; Suchman, 1995), with an emphasis on internal legitimacy. The aim is to describe the process of legitimization and how conflicts escalate into legitimacy crises. In line with Drori and Honig (2013), we examine the processes through which internal legitimacy originates, develops, and is maintained at different organizational levels. This area remains underdeveloped in the international business literature (e.g., Kumar, 2016; Kumar and Das, 2007). Legitimacy is important for understanding the relations between MNE headquarters and their subsidiaries because it determines the degree to which the actors are inclined to cooperate with each other (Kumar and Das, 2007). Given that an MNE and its subsidiary may not have congruent goals, the ability to cooperate is key. This ability is dependent on the inter-partner legitimacy between them (Kumar and Das, 2007).

We integrate the legitimacy perspective with the regulatory focus orientation of headquarters and subsidiary managers. This is important because headquarters and subsidiary managers may differ in their psychological predispositions and in how they construe different situations. These factors may affect their perceptions and behavior, and determine whether legitimacy crises will arise. We draw upon regulatory focus theory in suggesting that managers are either promotion oriented and focused on maximizing positive outcomes, or prevention-oriented and focused on minimizing losses. Differences in the regulatory foci of headquarters and subsidiary managers produce conflicts that lead to legitimacy crises. Whether these crises escalate or are resolved depends on the types of power utilized by the respective managers.

FIGURE 1 HERE

The contribution of this paper is threefold. First, we integrate the micro level of analysis with the macro level by bringing back the individual. The psychological predispositions of managers in headquarters and subsidiaries are crucial, as is the organizational context within which those managers make decisions. Second, we develop a process-based explanation of how interactions might develop between headquarters and subsidiary managers, and the kinds of legitimacy crises that these relationships might encounter. This frame that has rarely, if ever, been utilized in explaining the relational dynamics between headquarters and subsidiaries. Third, in analyzing the micro dynamics of intra-organizational actions within an organizational context, the paper sheds light on the crucial issue of the management of the relationships between headquarters and subsidiaries in practice.

We begin by reviewing the nature of legitimacy, especially the intra-organizational and internal legitimacy dynamics. We then review the notions of regulatory focus (Higgins, 1998, 2000) and organizational power (Lukes, 2005). Thereafter, we demonstrate how strategic interactions proceed between the MNE and the subsidiary. We develop propositions before we conclude by discussing the theoretical and managerial implications of the framework advanced here.

Literature Review

The nature of legitimacy

Suchman (1995: 576) notes that legitimacy is significant for understanding 'how the organization is built, how it is run, and simultaneously how it is understood and evaluated.' A key corollary is that legitimacy provides the underpinnings for understanding how organizations function in practice. Suchman (1995: 574) defines legitimacy as a 'generalized perception or assumption that the actions of an entity are desirable, appropriate, or proper within some socially constructed system of norms, beliefs, and definition.' Scholars note that legitimacy exists on a continuum (Kumar and Das, 2007) and that 'a unanimous agreement of all parties is not necessary for legitimacy to exist' (Kumar and Das, 2007: 1427). Much of the existing research on MNE legitimacy focuses on external legitimacy and how an enterprise gains acceptance from external stakeholders, especially the various actors in the host country in which the subsidiary is operating (Kostova and Zaheer, 1999). However, internal legitimacy may be just as important for an MNE as external legitimacy. If the MNE is to function well, the headquarters and its subsidiaries must cooperate well with each other.

Scholars note that relationships between headquarters and subsidiaries are often rife with tension (e.g., Kostova, Marano, and Tallman, 2016), as there is always the possibility that the headquarters or the subsidiary might behave opportunistically (e.g., Mudambi and Navarro, 2004). Attainment of internal legitimacy obviates this problem. We follow Drori and Honig (2016: 347) in defining internal legitimacy 'as the acceptance or normative validation of an organizational strategy through the consensus of its participants, which acts as a tool that reinforces organizational practices and mobilizes organizational members around a common ethical, strategic, or ideological vision.' These authors also argue that internal legitimacy provides the much needed motivation for the actors to engage in cooperative behavior. Furthermore, as outlined by Kumar and Nti (1998), internal legitimacy may enhance cooperative behavior by strengthening psychological attachments among actors. A third argument, provided by Kale, Singh, and Perlmutter (2000), is that internal legitimacy induces actors to resolve conflicts in an integrative, rather than a distributive, way. Finally, internal legitimacy is likely to strengthen the reputation of the subsidiary as a desirable partner (Kumar and Das, 2007).

Suchman (1995) notes that there are two types of internal legitimacy: pragmatic and moral legitimacy. *Pragmatic legitimacy* is dependent on 'the self-interested calculations of an organization's most immediate audiences' (Suchman, 1995: 578). On the basis of Suchman's framework, we can view the headquarters and the subsidiary as each other's constituencies. In this regard, we can analyze whether, for example, the subsidiary views the policies of the headquarters as facilitating direct or indirect benefits for the subsidiary, such that the policies are viewed as responsive to the subsidiary's larger interests. We can also investigate whether the subsidiary believes that the headquarters unit has some good attributes (e.g., trustworthy, decent, or wise; Heidhues and Patel, 2012; Suchman, 1995). As such, pragmatic legitimacy crises are associated with obstacles in reaching a desired level of performance. In the presence of pragmatic legitimacy, both the subsidiary and the headquarters see the maintenance of a cooperative, cordial relationship as advantageous. In other words, both the headquarters and the subsidiary recognize that their involvement with each other serves not only their own interests but also the interests of the relationship between the headquarters and the subsidiary.

Moral legitimacy is indicative of how favorably or unfavorably the organization is viewed by its counterpart (Suchman, 1995). Here, the headquarters' constituency, (i.e., the subsidiary) might believe that the headquarters breaks 'the rules of the game' for immoral reasons, and vice versa. A favorable or unfavorable judgment is dependent on how the actors evaluate their counterpart's *behaviors*, and does not focus on performance-related issues. If the counterpart is viewed as behaving appropriately, then a positive evaluation of moral legitimacy emerges.

We suggest that both pragmatic and moral legitimacy are critical for the relationship between the parent company and the subsidiary. Pragmatic legitimacy speaks to the fact that the interests of both the actors are being fulfilled, while moral legitimacy is indicative of the fact that each actor evaluates the other as behaving appropriately. The latter is critical because it provides the critical foundation for a thriving relationship.

Regulatory Focus

Regulatory focus theory is a theory of motivation that is attracting an increasing amount of attention in organizational settings (e.g., Das and Kumar, 2011; Kark and Dijk, 2007; Lanaj, Chang, and Johnson, 2012). The theory has been used to explain leadership behavior (Kark and Dijk, 2007), negotiations (Appelt and Higgins, 2010), alliance failure (Das and Kumar, 2011), the nature of alliance contracts (Weber and Mayer, 2011), expatriate failure (Kumar, Budhwar, and Patel, 2014), and internationalization behavior (Li and Gammelgaard, 2014). Central to this theory is the recognition that people can engage in self-regulation through either a promotion-oriented self-regulatory system or a prevention-oriented self-regulatory system. Regulatory focus theory refers to a situation in which a manager[i] pursues a goal that maintains personal values and beliefs, which can be termed *regulatory orientation*. In this context, 'regulatory' relates to the fact that managers self-regulate the methods and processes involved in regulating affect, cognition, and behavior during their goal pursuit (Gamache *et al*., 2015). In a promotion-oriented self-regulatory system, the emphasis is on satisfying nurturance needs. This is best accomplished by seeking to achieve one's goals and aspirations. In a prevention-oriented self-regulatory system, the focus is on satisfying security needs, which are best met by fulfilling duties and obligations.

Insert Table 1 here

The promotion- and prevention-oriented self-regulatory systems differ on a number of dimensions (see Table 1). A key point of differentiation is that promotion-oriented managers are likely to adopt an eager approach, whereas prevention-oriented managers focus on a strategy of vigilance (Higgins, 1997, 1998, 2000). Moreover, promotion-oriented managers are more entrepreneurial and experimental, and are more willing to experiment with alternative options for achieving their goals. In contrast, prevention-oriented managers prefer to safeguard the status quo and are, therefore, less likely to pursue actions that could lead to failure. Bingham and Eisenhardt (2008) note the difference between managers who seek to secure the competitive position of the firm by strengthening the linkages between the company's existing resources and its activities, and managers who are more inclined to engage in experimentation.

Scholars also draw a distinction between a *chronic* and a *situational* regulatory focus (Kart and Van Dijk, 2007). The chronic regulatory focus has biological origins and is based on preferences formed in early childhood (Gamache *et al*., 2015). The situational regulatory focus is derived from the immediate environment, which can be dynamic and uncertain. In such markets, managers are likely to be promotion oriented. Other markets can be stable and predictable, and organizations can be bureaucratic and routine-based. In such markets, managers can choose to be prevention oriented (Shamir and Howell, 1999). A manager can, in fact, be promotion focused but work in an environment that encourages a prevention focus. However, the distinction between chronic and situational regulatory focus does not have a direct impact on our analysis of interactions between headquarters and subsidiary managers. This follows from the fact that the impact of regulatory focus is likely to be the same regardless of whether it is a product of chronic or situational factors. Nevertheless, the more important factor to consider is whether there is congruence between the chronic focus and the situational focus. In the presence of congruence, the impact will be similar and may, indeed, be amplified (Shah, Higgins, and Friedman, 1998). In the absence of congruence, much depends on whether the chronic or the situational focus is stronger.

Promotion-oriented managers are most likely to accomplish goals and are highly persistent (Higgins and Spiegel, 2004). They adopt a transformational, charismatic leadership style (Kark and Van Dijk, 2007) with a focus on tasks and performance, and they are concerned about the presence or absence of pragmatic legitimacy (Lanaj *et al*., 2012). In contrast, prevention-oriented managers stress the importance of attaining a minimum level of performance and, therefore, adopt a transactional leadership style (Kark and Van Dijk, 2007). Their emphasis is on work perceptions and attitudes, and they focus on reducing conflicts revolving around moral legitimacy (Lanaj *et al*., 2012).

This leads to the following propositions:

P1: The chronic regulatory foci of headquarters and subsidiary managers influence their leadership behaviors and strategic decision making. Their situational regulatory focus may amplify or dampen the chronic tendencies. Headquarters' and subsidiary managers' regulatory foci may create a crisis of pragmatic and/or moral legitimacy.

P2: A lack of congruence between headquarters and the subsidiary managers' chronic and situational regulatory foci escalates legitimacy crises.

P3: Promotion-oriented managers at headquarters and subsidiaries employ a transformational and entrepreneurial leadership style. They are eager to resolve problems of pragmatic legitimacy, but this eagerness might create problems of moral legitimacy.

P4: Prevention-oriented managers in the headquarters and the subsidiary follow a monitoring, safe-guarding leadership style. This vigilant management style resolves moral legitimacy problems but may create problems of pragmatic legitimacy.

Organizational Power

We might assume that if the regulatory foci of the headquarters and the subsidiary manager are similar, there might be less conflict. This is not necessarily true given that power in an MNE is asymmetrically distributed. The concept of organizational power remains central to our analysis.

In the international business literature, the concept of power is associated with Dahl's (1957) seminal contribution, which focuses on actor A's ability to get actor B to do something that he or she would otherwise not do. An MNE is, by definition, a hierarchy, and the headquarters formally owns the subsidiaries. *Headquarters power* refers to the fact that the headquarters has 'intra-organizational supremacy,' and can therefore command and control the subsidiary. Thereby, power becomes explicitly relational and asymmetrical (Lukes, 2005). Furthermore, power relates to the headquarters' ability to constrain subsidiaries in their strategic decision making. Headquarters is 'dominating' in this regard, as it can affect the subsidiary in ways contrary to the subsidiary's interests (Lukes, 2005). Headquarters has the mandate to both reward and sanction (French and Raven, 1959). In many instances, subsidiaries comply more because of a threat of sanctions than because of an actual sanction (Whittle *et al*., forthcoming). Consequently, even powerful subsidiaries face the threat of sanctions, as the headquarters can decide to solve legitimacy crises through disposal (Clark and Geppert, 2011) or by laying off the subsidiary manager (Hardy, 1996). The headquarters may also withdraw decision making rights from the subsidiary (Ambos, Asakawa, and Ambos, 2011; Baker, Gibbons, and Murphy, 1999). Given these factors, Diefenbach and Sillince (2011) find that hierarchical power seems to be persistent, and that most social systems are based on stable hierarchical relationships of superiors and subordinates. We describe this type of headquarters power as *persistent hierarchical power*.

The notion of a hierarchy is central to the description of how power manifests in headquarters-subsidiary relationships. However, Weber (1947) argues that in order to establish an enduring and permanent situation of domination, power has to be equated with authority. The notion of authority suggests that compliance is achieved when a subsidiary accepts the headquarters' dominance as legitimate because either the content of commands is reasonable or the process explaining the content is seen as legitimate (Bachrach and Baratz, 1963). Subsidiaries can therefore disagree with the goals defined by headquarters but still comply with the headquarters' wishes because the process is viewed as legitimate (Higgins, 2009). As such, An MNE is an example of a structure of dominance emphasizing compliance with certain rules. However, this structure of dominance can be transformed into a structure of authority when rules are accepted as a legally rational basis for constraining actions (Clegg, Courpasson, and Phillips, 2006). We refer to this power as 'headquarters' legitimate authority.'

The powers of headquarters, in whatever form, needs to be counterbalanced with the powers of subsidiaries. In some cases, headquarters will benefit from delegating power to subsidiaries, such as in cases of asymmetric information flows in favor of the subsidiary where performance depends on specialized and often tacit knowledge of host-country contingencies rather than on insights into global operations (Mudambi, 2011). However, utilization of legitimate authority power might lead subsidiaries to acquiesce to headquarters' decisions that may not be productive. On the other hand, the use of persistent hierarchical power might cause rent-seeking behavior among subsidiary managers (Mudambi and Navarra, 2004). These types of tensions have been referred to as a 'tug of war' between the 'ownership right' of headquarters and the 'control right' of subsidiaries over strategically important resources (Ambos *et al*., 2011; Foss and Foss, 2005; Mudambi, 2011). In any case, even subsidiaries, with delegated forms of power can still find their actions constrained by the fact that they need to avoid a future retraction of authority by headquarters (Baker *et al.*, 1999). Therefore, the distribution of power between headquarters and subsidiaries is an outcome of continuous negotiations (Ambos *et al.*, 2011; Mudambi and Navarra, 2004).

The international business literature has investigated a range of situations in which certain subsidiary characteristics provide the subsidiary with power. A subsidiary obtains power when it possesses certain resources, network positions, or resources needed to capitalize on institutional and market conditions (Ferner *et al*., 2004). In order to be powerful, the subsidiary must possess scarce resources upon which the headquarters or the MNE as a whole are dependent (Bouquet and Birkinshaw, 2008; Pfeffer and Salancic, 1978). Alternatively, it must control relationships that provide access to resources (Astley and Sachdeva, 1984) that are discrete and unique (Medcoff, 2011), and not obtainable through a third party (Ambos *et al*., 2011; Harpaz and Meshoulam, 1997). Furthermore, the ability to reduce critical uncertainties related to the environment as well as organizational centrality (e.g., being a divisional headquarters; Astley and Sachdeva, 1984) are parts of structural contingency power (Harpaz and Meshoulam, 1997).

All of these types of power can place the headquarters in a vulnerable situation if they are utilized by the subsidiary. Consequently, these types of power are typically used to challenge the organization's status quo (Bouquet and Birkinshaw, 2008), which leads us to refer to them as 'subsidiary rebellion power.' The term highlights situations in which resource-dependency power is only associated with the right of control, while the ownership right is still the prominent source of power (Ambos *et al.*, 2011; Anand, 2011). Therefore, in the aforementioned 'tug of war,' headquarters will recentralize strategic mandates when the benefits of doing so outweigh the disadvantages of vulnerability. Headquarters might also have an interest in restricting the most powerful subsidiaries if the risk of opportunistic rent seeking is assumed to be too high (Mudambi, 2011) and headquarters managers might find themselves in a situation in which they cannot exercise top-down decisions (Anand, 2011; Mudambi and Navarra, 2004). Such situations arise when subsidiary managers develop into 'autonomous barons' and headquarters managers only can initiate changes supported by the subsidiary manager (Prahalad and Doz, 1987).

However, subsidiaries might wish to maintain the status quo when headquarters wishes to use its powers. In that situation, the issue is the degree to which the subsidiary can resist (Bouquet and Birkinshaw, 2008; Erkama and Vaara, 2010), defy (Sandvik, 2010), operate autonomously outside the range of headquarters' orders (Fritz and Karlsson, 2006), or use politics to transform headquarters' strategic intentions into strategic inaction (Whittle *et al.*, forthcoming). Resistance is associated with power—the latter can be defined as the ability to implement one's will despite the resistance of others (Lukes, 2005). Therefore, resistance is not a direct expression of power but rather an obstacle for other actors wishing to realize their will. Consequently, in the power literature, resistance is associated with low-power actors, as they can only resist (i.e., minimize the effects of 'punishment') but not change a situation.[ii] Schotter and Beamish (2011) recognize subsidiary resistance as a common phenomenon that is not necessarily dysfunctional. The literature outlines reasons for the use of this type of power, such as the ability to bargain (e.g., using issue-selling techniques; Erkama and Vaara, 2010). In this paper, we refer to this type of power as 'subsidiary resistance power.'

Regulatory focus and its link to organizational power

Headquarters managers who are promotion-oriented will induce the organization to enter new domains and thereby accelerate its rate of growth. They will work towards achieving their aspirations and they will be eager to initiate changes. According to Kark and Van Dijk (2007), promotion-oriented managers use emotion as a mechanism for leadership behaviors. In this manner of motivation, managers lead because they like to lead others and they aim to achieve power. We propose that such managers will make use of all available ‘strategic instruments,’ such as rewards and sanctions, to achieve their ambitions, and that they will have a tendency to use persistent hierarchical power.

Prevention-oriented headquarters managers, in contrast, will avoid any negative outcomes, as they are concerned about organizational survival. They will work to avoid any type of conflict and they will be willing to negotiate with subsidiaries to arrive at a mutually acceptable agreement. Kark and Van Dijk (2007) suggest that these managers have a social normative motivation to lead, and that they lead out of a sense of duty and social responsibility. They are affected by social pressures, and they like to get subordinates’ acceptance rather than forcing them to comply. To achieve this acceptance, they are likely to use legitimized authority power.

This discussion leads to the following proposition:

P5: Promotion-oriented managers at headquarters make use of persistent hierarchical power, while headquarters’ prevention-oriented managers make use of legitimized authority power.

Promotion-oriented subsidiary managers will have an entrepreneurial mindset and they will strive to expand the subsidiary's influence by suggesting a number of initiatives to headquarters’ management. In addition, they will establish coalitions and make use of political power in order to achieve their ambitions. They are likely to utilize any kind of resource-dependency situation to achieve their ambitions, and are therefore likely to utilize rebellion power to challenge headquarters in their domain (Bouquet and Birkinshaw, 2008).

Prevention-oriented subsidiary managers will work to ensure the subsidiary's status quo. They await headquarters' orders and only react to avoid negative outcomes (e.g., a threat of a charter removal). When forced to react, they mobilize local labor unions to resist headquarters' orders (Erkama and Vaara, 2010) or they initiate issue-selling strategies. We therefore associate a prevention orientation with resistance power. This argumentation leads to the following proposition.

P6: The subsidiary's promotion-oriented managers achieve their entrepreneurial ambitions by utilizing rebellion power based on resource-dependency situations, while the subsidiary's prevention-oriented managers ensure the status quo by delaying headquarters orders based on the use of resistance power.

Regulatory focus, organizational power, and the impact on legitimacy crises

In the following sections, we outline the interactional dynamics evident when headquarters and subsidiary managers possess similar or different regulatory foci. There are four possible scenarios: (a) the headquarters manager and the subsidiary manager are both promotion oriented; (b) the headquarters manager is prevention oriented and the subsidiary manager is promotion oriented (c) the headquarters manager is promotion oriented and the subsidiary manager is prevention oriented; and (d) both managers are prevention oriented. Table 2 outlines the relationships between regulatory focus and types of organizational power, as outlined in propositions 5 and 6. Figure 1 outlines how interactions between managers can create tension and legitimacy crises, and shows how the use of powers can escalate or resolve legitimacy crises.

Insert Table 2 here

Promotion-oriented headquarters manager and promotion-oriented subsidiary manager

In this scenario, the regulatory focus of both managers means that they will be proactive and eager. They will use aggressive influence tactics to sell their position to their counterparts. The use of persistent hierarchical power clashes with the use of rebellion power and is likely to lead to conflict escalation. Pragmatic legitimacy crises can occur, especially in cases with different opinions of which goals to pursue (Suchman, 1995). This situation will be further escalated by a lack of congruence between chronic and situational focus. Furthermore, a clash between persistent hierarchical power and rebellion power may call the moral legitimacy of the partnership into question, which can be exacerbated by the fact that managers may engage in acts of passive opportunism (Das and Kumar, 2011). Whether this occurs depends on how carefully and/or skillfully the partners are able to deploy hierarchical and rebellion power.

An example of this scenario is in found Fritz and Karlsson's (2006) description of the Swedish multinational SKF. SKF was a world leader in the ball-bearings industry. Throughout the twentieth century, its subsidiaries were highly autonomous and powerful. The subsidiary managers acted as 'little kings' with no manifest desire to coordinate with headquarters (Fritz and Karlsson, 2006: 196-199). When Japanese companies moved to enter the west European markets, SKF's Swedish headquarters called for a group meeting with the four most-important subsidiaries. The objective was to rationalize programs and centralize decision-making power. However, headquarters could not enforce its will. The subsidiary managers engaged in rent seeking, thereby creating a moral legitimacy crisis. The situation did not improve until the subsidiary managers were replaced.

Based on the above line of argumentation, we postulate:

Proposition 7(a): If both headquarters and subsidiary managers are promotion oriented, they are equally motivated to attain and/or reestablish pragmatic legitimacy. However, this requires them to reach consensus on goals.

Proposition 7(b): If both headquarters and subsidiary managers are promotion oriented, they are likely to utilize aggressive influence tactics, which may threaten the moral legitimacy of the partnership.

Promotion 7(c): In both legitimacy-crisis cases, skillful management of power is needed to overcome the legitimacy crisis.

Prevention-oriented headquarters manager and promotion-oriented subsidiary manager

If the headquarters managers are prevention oriented, their main objective is to maintain the status quo. They will not initiate new initiatives or respond to initiatives from the subsidiary in a positive way, and their strategic approach will be reactive rather than proactive. The promotion-oriented subsidiary manager will be frustrated, and the headquarters and the subsidiary will find themselves in conflict. Different approaches to dealing with the problem will create a crisis of both pragmatic and moral legitimacy. In terms of pragmatic legitimacy, the subsidiary managers will feel constrained from realizing their ambitions. This will create a problem of pragmatic legitimacy at the subsidiary level, but not from the headquarters' point of view, as rejection of subsidiary initiatives will not affects the status quo. In terms of moral legitimacy, the aggressive initiative-taking approach of the subsidiary, which tries to use its resource-dependency power, will be viewed as an instance of norm violation and generate negative sentiments among headquarters managers. The subsidiary's rebellion power will clash with headquarters' legitimized authority. As it does so, a vicious, aggressive, defensive cycle may emerge. This may generate new problems, as it worsens the relationship between the actors.

Sargent and Matthews (2006) investigate cases of Mexican *maquiladoras*—subsidiary plants located along the U.S.-Mexican border. Their role is to import duty-free components, which are assembled or manufactured, and then exported to other units of the MNE. Generally, these subsidiaries are viewed as possessing low power, but entrepreneurial-oriented subsidiary managers can make convincing arguments and get initiatives approved. However, in one of the cases, the subsidiary was too proactive, which was not viewed positively by the headquarters. This proactive stance generated a moral legitimacy crisis from the standpoint of the headquarters.

This leads to the following propositions.

Proposition 8(a): If the headquarters manager is prevention oriented and the subsidiary manager is promotion oriented, they differ in terms of their views on which type of legitimacy is the most salient. The promotion-oriented subsidiary manager focuses on pragmatic legitimacy, whereas the prevention-oriented headquarters manager focuses on moral legitimacy.

Proposition 8(b): The prevention-oriented headquarters manager is reactive, whereas the promotion-oriented manager is proactive, giving rise to crises of both pragmatic and moral legitimacy.

Proposition 8(c): The legitimized authority of the headquarters clashes with the subsidiary's rebellion power, which may worsen the relationship between the partners.

Promotion-oriented headquarters manager and prevention-oriented subsidiary manager

In this situation, the headquarters manager will be at the forefront of taking new initiatives and will want the subsidiary manager to follow suit. In contrast, the subsidiary manager will be very reactive and will not want to comply with the wishes of the headquarters manager. For the subsidiary manager, the maintenance of the existing status quo is of primary importance, and he or she will not wish to jeopardize that status quo by embarking on new initiatives. This is likely to compromise both the pragmatic legitimacy and the moral legitimacy of the partnership. The headquarters manager will feel unable to make any advancements, as the subsidiary manager will resist proposed changes. This compromises the pragmatic legitimacy. The failure of the subsidiary manager to follow the dictates of the headquarters will also threaten the moral legitimacy of the partnership, as the subsidiary is not seen as behaving in the way that it should. The persistent hierarchical power of the headquarters will clash with the resistant power of the subsidiary. The use of both persistent hierarchal power and subsidiary resistant power is likely to escalate the conflict.

Whittle *et al*. (forthcoming: 2) refer to a case in which a subsidiary uses power to resist actions by headquarters and turn them into ‘strategic *in*actions.’ Their findings are based on an anonymous case of a British subsidiary of an US MNE. The subsidiary managers see headquarters managers as 'bad guys' whom the subsidiary needs to 'fight against,' and they stress the need to work 'under the radar' (Whittle *et al*., forthcoming: 10). The threat of sanctions is real, as subsidiary managers have been sacked because of 'political battles.' This resulted in vigilant behavior of 'doing nothing.' This case illustrates the biggest gap in the power asymmetry between headquarters and the subsidiary, as persistent headquarters power is opposed by resistant power.

This leads to the following propositions.

Proposition 9(a): If the headquarters manager is promotion oriented and the subsidiary manager is prevention oriented, they differ in their view of which type of legitimacy is the most salient. The promotion-focused manager at the headquarters level focuses on pragmatic legitimacy, whereas the prevention-focused manager at the subsidiary level focuses on moral legitimacy.

Proposition 9(b): The promotion-focused manager at the headquarters level is proactive, whereas the prevention focused manager at the subsidiary level is reactive, giving rise to a crisis of both pragmatic and moral legitimacy.

Proposition 9(c): Hierarchical power held by the headquarters clashes with the subsidiary's resistant power, which may worsen the relationship between the partners.

Prevention-oriented headquarters manager and prevention-oriented subsidiary manager

This is the one instance in which the conflict between the headquarters and the subsidiaries may be minimal. Both actors are interested in maintaining the status quo, and their strategic approach may be congruent. Both actors are likely to be reactive and to avoid actions that might threaten their counterpart. Although reactivity rules, which may secure moral legitimacy, it may also call the pragmatic legitimacy of the partnership into question. This occurs because the actors are either not inclined or not able to undertake actions that may enhance performance in response to changes in market competition. The subsidiary's resistant power will dovetail with headquarters' legitimized authority, producing a status quo.

The case of the Toyota accelerator crises serves as a good example of this situation. Toyota's headquarters were heavily criticized for their slow response to the problem and the delay in the recall of vehicles for safety reasons. In fact, the problem was well known in both the subsidiaries and the headquarters. However, a vigilant approach to problems and the conflict-avoidance culture common in Japan escalated the issue (Greto, Schotter, and Teagarden, 2013). Toyota managers have been described as 'conservative' with a principle of 'safety first.' They also strongly believe in legitimized authority (Greto *et al.* (2010: 3). This is a case of prevention-oriented managers working in a promotion-oriented environment, with tight competition in a declining automobile market. According to Greto *et al*. (2010: 7), market analysts pointed to 'Toyota's unique subsidiary structure as a contribution factor in the recall crises,' and they states that 'Toyota's leadership appeared to be in no hurry to address the problem.' In seeking to avoid problems of moral legitimacy, Toyota created a crisis of pragmatic legitimacy.

This leads to the following propositions:

Proposition 10(a): If the headquarters manager is prevention oriented and the subsidiary manager is prevention oriented, their views of which type of legitimacy is most important will concur. Both managers focus on moral legitimacy.

Proposition 10(b): Both headquarters and subsidiary managers will be reactive. This will avoid the problem of moral legitimacy but create one of pragmatic legitimacy.

Proposition 10(c): Headquarters' legitimized authority may be in sync with the subsidiary's resistant power.

Conclusion

We demonstrate the presence of interdependent linkages among internal legitimacy, regulatory focus, and MNE organizational power. MNEs need to deal with external legitimacy, but internal legitimacy crises of a pragmatic or moral character can occur as well, and need to be avoided or resolved. This paper suggests that the regulatory foci of headquarters and subsidiary managers are likely to lead to different kinds of legitimacy crises when these actors interact. Different constellations of regulatory focus give rise to different types of legitimacy crises—sometimes pragmatic, sometimes moral, and sometimes both. Different types of crises also occur at various organizational levels, such that the type of crisis at the headquarters level can be different from the type of crisis at the subsidiary level. Furthermore, we propose that different types of organizational power are associated with specific regulatory foci. Persistent hierarchical power and subsidiary rebellion power are associated with promotion-oriented managers, and legitimized authority and resistant power are linked with prevention-oriented managers.

The paper contributes to the international business literature in several ways. We integrate the micro level with the macro level, which is an uncommon approach in the extant literature. The incorporation of managers' regulatory foci is also novel to this stream of literature.

We also show that different kinds of power are uniquely associated with different regulatory foci. This becomes highly relevant when the MNE has to formulate and implement global strategies. The headquarters' ability to define and implement a 'global strategy' is, as Mudambi (2011) states, affected by the tug of war between ownership and control rights, and by the degree to which the subsidiary plays along with, obstructs, or tries to delay such decisions.

A theme highly relevant for a global strategy brings us to the second implication of the framework presented. Headquarters managers face a variety of psychological profiles among subsidiary managers, so interactions with one group of subsidiaries might bring about certain types of legitimacy problems, while interactions with another group of subsidiary managers might lead to other types of legitimacy problems. This subsidiary-duality problem, which is affected by both external and internal legitimacy pressures (Kostova and Zaheer, 1999), is exaggerated by these managers' regulatory foci. Some managers will deal with situations in a manner consistent with their regulatory focus, while others encounter tension between the situational demands and their regulatory focus. This speaks in favor of a high degree of differentiation, which Nohria and Ghoshal (1997) suggest will affect decisions regarding centralization, formalization, and socialization.

The framework has some limitations. As we ignore the role of emotions, one suggestion could be to integrate emotions into the framework (Rozin *et al.*, 1999). External legitimacy pressures could be added as well (Kostova and Zaheer, 1999). We also neglect the issue of group behavior and the impact of headquarters having a management team (in which members may have different types of foci). Moreover, we do not consider subsidiary-subsidiary interactions. In this regard, researchers might wish to investigate the clashes between rebellion and resistant power, and between promotion-oriented and prevention-oriented subsidiary managers. Furthermore, we suggest turning Table 2 around, and elaborating on cases in which promotion-oriented managers make use of legitimized authority and vice versa for our four scenarios. Finally, we suggest empirically testing the framework through interviews and/or experimental simulations.

The paper has important managerial implications. Headquarters and subsidiary managers must be sensitive to the internal legitimacy challenges that await them, and they must act in a manner that either minimizes the occurrence of these crises and/or respond appropriately when they emerge. Headquarters and subsidiaries are in an interdependent relationship, and managing internal legitimacy is one of their most important strategic tasks.

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Table 1
Differences between promotion-focused and prevention-focused self-regulatory systems

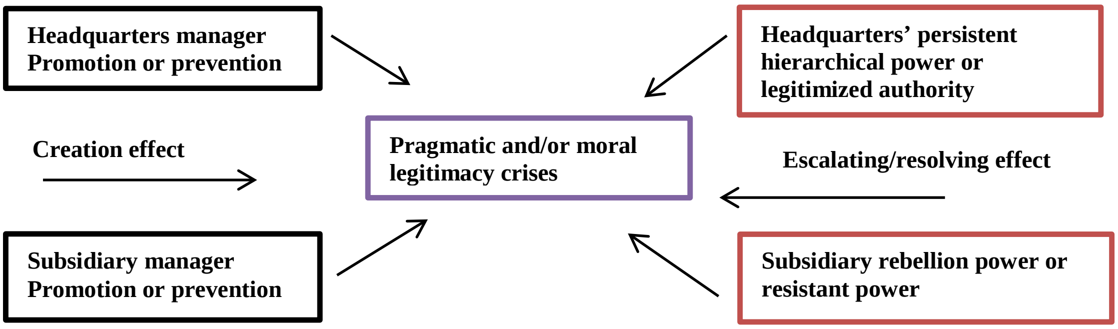
Motivational Elements	Promotion	Prevention
Individual needs	Advancements and accomplishments	Security and safety
Goal focus	Reaching positive outcome; +1 better than 0	Avoiding negative outcome; 0 better than -1
Motivational factors	Eagerness, desires, aspirations	Vigilance, duties, responsibilities
Approach	Entrepreneurial, errors acceptable, positive towards changes, work with many hypotheses, positive view of exchange relationships	Compliance, errors unacceptable, resist changes, work with few hypotheses, negative view of exchange relationships
Outcome of legitimacy crises	Redefined scope of power, no contextual change, higher effects in outcome	Avoid scope changes, emphasis on contextualization, low effects in outcome

Based on Das & Kumar, 2011; Webber & Mayer, 2011; Webber *et al.*, 2011. Higgins, 1997, 1998, 2000; Liberman *et al.*,, 1999, 2001

Table 2 Relationship between power and regulatory focus

Type of Power	**Management of Power**	**Managerial Regulatory Focus**
Persistent hierarchical power	Through the threat/promise of sanctions/rewards or the use of regulation	Promotion oriented
Headquarters' legitimized authority	Through bargaining and persuasion to secure subsidiary compliance	Prevention oriented
Subsidiary rebellion power	Through utilization of resource-dependency situations to secure subsidiary mandate development of individual rent seeking	Promotion oriented
Subsidiary resistant power	Through issue selling, or politicking and coalition making to avoid or delay subsidiary mandate losses	Prevention oriented

Figure 1


Headquarters manager
Promotion or prevention
Creation effect
Subsidiary manager
Promotion or prevention
Pragmatic and/or moral legitimacy crises
Headquarters' persistent hierarchical power or legitimized authority
Escalating/resolving effect
Subsidiary rebellion power or resistant power

[i] The psychology literature typical refers to ‘individuals,’ but for the sake of consistency, we use the term ‘managers.’

[ii] According to Lukes (2005), resistance has been analyzed by such scholars such as James Scott and Friedrich Nietsche in relation to slavery, where the slaves could not be liberated from slavery but sometimes had the ability (power) to resist the will of and punishment from their masters.