Internal Legitimacy Crises

The Roles of the Regulatory Focus and Relational Social Capital of Headquarters and Subsidiaries

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Title paper

Internal legitimacy crises: The roles of the regulatory focus and relational social capital of headquarters and subsidiaries

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Internal legitimacy crises: The roles of the regulatory focus and relational social capital of headquarters and subsidiaries

Purpose: The purpose of this paper is to further the understanding of how the regulatory foci of the MNE headquarters and the subsidiary lead to internal legitimacy crises. We discuss how pragmatic and moral legitimacy crises affect relational social capital.

Design/Methodology/approach: The paper is conceptual.

Findings: This paper highlights the importance of internal legitimacy as well as the motivational orientations of headquarters and subsidiaries for the functioning of MNEs. Internal legitimacy management is crucial for building relational social capital. We propose that legitimacy crises are particularly likely to occur in cases of goal incongruence between headquarters and subsidiaries.

We postulate that organizations with a promotion-oriented institutional logic are concerned by the absence of pragmatic legitimacy processes. In contrast, given their aim of protecting the status quo, prevention-oriented institutional logic MNEs are concerned about the absence of moral legitimacy.

Originality/Value: The paper is the first to explore the relationship between regulatory focus, internal legitimacy, and relational social capital.

Keywords: Regulatory focus, headquarters-subsidiary relation, pragmatic legitimacy, moral legitimacy, relational social capital

Paper type: Conceptual

Internal legitimacy crises: The roles of the regulatory focus and relational social capital of headquarters and subsidiaries

Abstract

A multinational firm's headquarters and subsidiaries share an interdependent relationship. The actors have congruent, conflicting, and/or partially overlapping goals. We propose that the degree to which the relationship between a headquarters and a subsidiary is productive depends on the presence or absence of "internal legitimacy." Internal legitimacy is instrumental for developing relational social capital. The stronger this capital, the more effective organizational units will be in achieving their goals. Relational social capital helps bridge the differences among actors. Drawing upon legitimacy theory, we posit that internal legitimacy may be pragmatic, moral, or both. Our study demonstrates how the headquarters' and the subsidiaries' regulatory focus shapes the legitimacy dynamics among them. The regulatory focus may either be promotion or prevention oriented. In the absence of congruent goals, conflicting regulatory foci generate legitimacy crises. We discuss the theoretical and practical implications of our framework, and suggest further work in this area.

Internal legitimacy crises: The roles of the regulatory focus and relational social capital of headquarters and subsidiaries

1.0 Introduction

The relationship between multinational enterprises' (MNE) headquarters and their subsidiaries has been a topic of considerable interest among management and international business scholars (e.g., Dörrenbächer and Geppert, 2009). Although a subsidiary is an integral part of an MNE, its interests may not converge with those of the MNE's headquarters. Scholars note that the relationship between headquarters and subsidiaries is characterized by the simultaneous presence of cooperation and competition (e.g., Bouquet and Birkinshaw, 2008; Otterbeck, 1981; Tippman *et al.,* 2018). Subsidiaries depend on headquarters' resources to fulfill their mandates, but they also have their own goals, which may be distinct from those of headquarters. This potential for goal discrepancy between headquarters and subsidiaries leads to the emergence of a mixed-motive relationship between the two units and their managers as well as an increased likelihood of conflict (Komorita and Parks, 1995). While conflict is not necessarily detrimental to the relationship (Rahim and Bonoma, 1979), the emergence of a prolonged conflict and/or its ineffective management may create a dysfunctional relationship between the headquarters and the subsidiary. As this situation is counterproductive and, therefore, critical for the organization, a thorough understanding of the mechanisms that lead to either its escalation or resolution is of considerable theoretical and practical importance for the success of MNEs and continued research in the field.

Our key aim in this paper is to shed light on the roots of conflict in the management of MNEs. In this regard, we find the neglect of the internal legitimacy dimension in the international business literature critical. Furthermore, we contribute to the international business literature by adding a psychological perspective.

More specifically, in this paper, we investigate how the motivational orientations of headquarters and subsidiaries shape the development of relational social capital. The stronger the relational social capital, the more effectively the headquarters and subsidiaries can manage the goal differences between them. Relational social capital is defined as “those assets created and leveraged through relationships and concerns mutual respect and trust, relational closeness, expectations, and reputations” (Steinmo and Rasmussen, 2018, pp. 1965-1966). Relational social capital enables actors to conceive of situations in integrative terms (i.e., an outcome that is valued by both actors). This happens because relational capital allows the parties to show forbearance and enables the exchange of information in good faith. The link between internal legitimacy and relational social capital goes both ways—a high level of internal legitimacy creates social capital, while preexisting social capital facilitates internal legitimacy.

We fill a void in the international management literature by demonstrating the importance of subsidiaries’ and headquarters’ motivational orientations for determining whether relational social capital is strengthened, stays the same, or is weakened. As such, we argue that both subsidiaries and headquarters have a motivational orientation that can be either positive and forward looking (promotion focus) or inward looking and defensive (prevention focus). Our motivational approach (promotion versus prevention) to understanding these dynamics is based on the prevailing corporate ethos in the headquarters and the subsidiaries. While motivational orientation has been traditionally conceptualized at an individual level, we posit that different organizational entities may have different orientations that correspond to their dominant cultural orientation. Each organizational entity subscribes to a set of values and beliefs, which are a product of the organization's history, the dominant leadership style in the organization, and other external influences.

Differences in motivational styles may be problematic, as they may undermine the legitimacy of the other party's actions or behaviors. This could weaken the relationship and call its internal legitimacy into question (e.g., Balogun *et al.,* 2019; Conroy and Collings, 2016; Kumar and Das, 2007). Drori and Honig (2016, p. 347) define 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."

We argue that an understanding of internal legitimacy is key for understanding the degree to which headquarters and subsidiaries can build and maintain relational social capital over time (Kumar and Das, 2007). If internal legitimacy and, by definition, relational social capital are present, a subsidiary is less likely to question the headquarters' decisions and vice versa. As Balgoun *et al*. (2019, p. 50) note, "legitimacy is associated with attitudes and behaviors that largely determine people's responses to decisions or changes." Given that the headquarters and its subsidiaries may not have congruent goals, legitimization processes are key for cooperation among them (Kumar and Das, 2007).

If internal legitimacy is important for building relational social capital, then what factors determine whether headquarters and subsidiaries can build this type of legitimacy? Moreover, what types of internal legitimacy might be at play? What strategies do headquarters and subsidiaries adopt when seeking to repair their internal legitimacy? How does the presence or absence of internal legitimacy influence the interactional dynamics between headquarters and subsidiaries?

In this paper, we adopt a critical perspective on internal social processes within a multinational enterprise. The literature on MNE legitimacy tends to focus on the social acceptance of the MNE's external stakeholders, while it often neglects internal legitimacy. We propose the latter is critical to our understanding of organizations. Therefore, we follow Rygh's (2020) recommendation to study the "inner workings" of firms rather than focusing solely on financial performance. As such, this paper addresses the lack of extant research on internal legitimacy between the headquarters and subsidiaries. Sinkovic and Archie-acheampong's (2020) review of MNEs' social-value creation demonstrates that research interest has primarily been devoted to external legitimacy processes. Furthermore, Imasato (2010) shows that studies often focus on what is legitimate and seldom examine the more controversial actions that are viewed as illegitimate. Thus, we also respond to Bjerregaard, *et al.* (2016), who study practice transfers in MNEs and find that the focus is more on outcome than on how the process unfolds between the headquarters and the subsidiaries.

This paper makes three main contributions. First, we develop a process-based explanation of how the motivational orientations of headquarters and subsidiaries influence internal legitimacy dynamics and, in so doing, affect the development of relational social capital. In analyzing the motivational orientations of headquarters and subsidiaries, we draw upon regulatory focus theory (Higgins, 1997), which has gained increasing acceptance and popularity across a variety of management disciplines. Second, our paper links different motivational orientations to different types of internal legitimacies. By establishing these links, we highlight the fact that headquarters and subsidiaries may be motivated by different types of legitimacy concerns. Different orientations value different kinds of legitimacies, as their goals differ considerably. A promotion-focused orientation is concerned with accomplishment and pragmatic legitimacy speaks directly to this focus area. In contrast, a prevention-focused orientation is concerned with safety and stability. Moral legitimacy is associated with this orientation type, as actions or behaviors outside the accepted protocol may threaten the sense of safety. For example, headquarters' relational social capital may be built on attaining moral legitimacy, but the subsidiary's relational social capital may be based on pragmatic legitimacy. If the parties differ in their views of which type of legitimacy is the most important, they will struggle to build relational social capital. Third, informed by both psychological and sociological approaches, our paper sheds light on the micro-dynamics of intraorganizational interactions between headquarters and subsidiaries.

We proceed with a conceptual discussion of the key parameter of our analysis. We then address four types of motivation-related interactions between headquarters and subsidiaries, and exemplify each of them using a specific case. Finally, we offer our conclusions and put our findings into perspective.

2.0 Literature review

2.1 Types of legitimacy

Institutional theorists view legitimacy as crucial to an organization's survival (e.g., Bitekine and Haack, 2015; Colyvas and Powell, 2006). In fact, according to Diez-Martin*et al.* (2013, p. 1954), "organizations with greater legitimacy obtain better organizational results." Furthermore, Suchman (1995, p. 576) notes that legitimacy is critical 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 a foundation for understanding how an organization functions in practice. Various MNE stakeholders need to view the actions of headquarters and subsidiaries as “desirable, appropriate, or proper within some socially constructed system of norms, beliefs, and definitions” (Suchman, 1995, p. 574). Therefore, how stakeholders act towards MNEs and how they understand them are both important factors in MNEs’ success. More specifically, stakeholders must perceive the MNE not only as worthy but also as meaningful, predictable, and trustworthy (Suchman, 1995).

The extant literature has focused more on external legitimacy and how MNEs gain acceptance from external stakeholders, especially various actors in a subsidiary’s host country (Kostova and Zaheer, 1999), than on internal legitimacy. This is surprising, as internal legitimacy is an important determinant of relational social capital. In this paper, we focus on internal legitimization processes that are shaped by the motivational dynamics in the headquarters and subsidiaries. This is crucial, as the presence or absence of internal legitimization determines the relational social capital. An absence of relational social capital leads to various types of legitimacy crises, which we discuss below.

Institutional theory notes that the legitimacy construct is both powerful and consequential when consensus exists at the collective level in the organization. (Bitekine and Haack, 2015). Bitekine (2011) states that even though a headquarters’ policy can be legitimate at the collective level (i.e., have validity), it may not be viewed as appropriate (i.e., legitimate) by all subsidiaries or all subsidiary managers in the organization. Nevertheless, a subsidiary can decide to follow the wishes of other subsidiaries that are in favor of the policy. Thus, a conflict does not emerge and “unanimous agreement of all parties is not necessary for legitimacy to exist” (Kumar and Das, 2007, p. 1427).

Social psychological perspectives are important for understanding internal legitimacy judgments, and they have been used to investigate the role of legitimization strategies in shaping internal legitimacy judgments between headquarters and subsidiaries (Balogun *et al.* 2019; Piotti, 2012). Legitimacy judgments are "evaluations of organizational members that assess specific actions or decisions as desirable or appropriate within a specific context" (Balogun *et al.*, p. 224). Tost (2011, p. 694) finds that such decisions depend on judgements related to potential pragmatic and/or moral legitimacy crises. In cases where judgements are instrumental, they address the material interests of the organization. However, in cases regarding morals, judgements express an outcome of behavior and relationships (e.g., managers judge communications between headquarters and subsidiary to be respectful).[i] A reading of Suchman's (1995) work in parallel with Tost (2011) shows that Suchman's view on pragmatic legitimacy has a parallel in instrumental legitimacy, whereas moral legitimacy is a similar construct in both typologies.[ii]

We followed the legitimacy typology developed by Suchman (1995). This typology is widely accepted in institutional theory, and has been used to explain legitimization dynamics in alliances (Kumar and Anderson, 2000; Kumar and Das, 2007), emerging markets (Kumar, 2004), executive turnover (Haislip *et al.* 2016), and corporate responsibility (Lewis *et al.* 2016).

In line with Suchman (1995), we suggest that there are two types of internal legitimacy: pragmatic and moral. *Pragmatic legitimacy* depends on "the self-interested calculations of an organization's most immediate audiences" (Suchman, 1995, p. 578). Based on Suchman's (1995) framework, we can view the headquarters and the subsidiary as each other's constituencies. Pragmatic legitimacy occurs when the subsidiary views the headquarters' policies as facilitating positive outcomes for the subsidiary. The headquarters may infuse new resources into the subsidiary or give it a wider mandate in its global network. In the presence of pragmatic legitimacy, both the subsidiary and the headquarters view 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 their relationship as well as the interests of the MNE as a whole. Pragmatic legitimacy often facilitates the development of relational social capital for a number of reasons. It suggests that the actors are responsive to each other's concerns. This mutual responsiveness is helpful in creating bonding and developing trust. Moreover, the establishment of legitimacy may overcome any initial suspicion that the parties may have, which further develops relational social capital.

Moral legitimacy refers to a normative assessment of how an organization conducts itself (Suchman, 1995). This assessment may be either favorable or unfavorable, and departs from the dominant values of the organizational unit. Unlike pragmatic legitimacy, moral legitimacy is "sociotropic"—it does not depend on judgments regarding whether a given activity benefits the evaluator, but rather rests on judgments about whether the activity is the right thing to do. An organization can have high social acceptance because of its procedures and be greatly appreciated for its good-faith efforts to serve society rather than its actual performance. As an example of moral legitimacy, consider a constituent of headquarters (e.g., a subsidiary) that believes that the treatment it receives from headquarters is unfair. The headquarters might, for instance, restrict the resources that it provides to the subsidiary or it may impose additional reporting requirements. Furthermore, cases in which headquarters makes inaccurate estimations of a subsidiary's performance potential, or headquarters ignores contradictory evidence and warnings from subsidiary managers may lead to a moral legitimacy crisis

(Piotti, 2012). A favorable or unfavorable judgment depends on how the actors evaluate their counterparts' behaviors and activities. If the counterparts view each other as behaving appropriately, a positive evaluation of moral legitimacy emerges.

We suggest that both pragmatic and moral legitimacy are critical for building and sustaining relational social capital between headquarters and subsidiaries. The attainment and maintenance of legitimacy signify that the actors are making a conscious effort to produce positive outcomes (pragmatic legitimacy) and behave appropriately (moral legitimacy).

2.2 Legitimacy crises

Relationships between headquarters and subsidiaries are often rife with tension (e.g., Kostova, *et al.,* 2016). Headquarters may behave opportunistically by withholding information that is important for the organization or a subsidiary might behave opportunistically by engaging in rent seeking (e.g., Mudambi and Navarro, 2004; for an overview of opportunistic behavior in subsidiaries and agency problems, see Kostova *et al.,* 2018). We acknowledge that power relations between headquarters and subsidiaries vary significantly across and within MNEs (Nohria and Ghoshal, 1997). There are many instances of goal discrepancies between headquarters and subsidiaries. Alternatively, agency problems related to the subsidiary and its behavior may arise but the headquarters might choose not to pay attention, as the role or importance of the subsidiary is only peripheral relative to those of other subsidiaries.

A legitimacy crisis is a crisis of governance (e.g., Habermas 1975). It occurs when the headquarters is unable to enforce its will among its subsidiaries through either coercion or persuasion, and the subsidiaries successfully resist pressures imposed upon them. This results in a stalemate or impasse, which may keep the organization from effectively implementing its strategy. An inability to effectively implement a strategy is associated with pragmatic and moral legitimacy crises, which occur when a headquarters and a subsidiary have different perceptions of what is legitimate and what is not, and they are unable to resolve those differences. It is also indicative of a relational social capital problem. As a sustained crisis affects performance potential, and leads to a deterioration of the relationship between the headquarters and the subsidiary, addressing the situation is critical. Instead of acting as partners, headquarters and subsidiaries become antagonistic towards each other, and their decision making further reduces the quality of relational social capital. While a legitimacy crisis may begin as a crisis of governance, it may turn into a crisis of confidence in which trust, forbearance, and a conciliatory spirit become casualties.

We posit that the immediate precursors of legitimacy crises and the deterioration of relational capital result from differences in the motivational orientations of headquarters and subsidiaries. As we argued above, differences in motivational orientations influence the way in which the partners seek to accomplish their goals. Process differences between a promotion-focused and a prevention-focused orientation can create delays and misunderstandings among the actors. As delays and misunderstandings accumulate, they may create a momentum of their own, which leads to a legitimacy crisis. Therefore, in the next section, we define regulatory focus and examine how it influences motivational orientation.

3.0 Regulatory Focus as a Motivational Orientation

Regulatory focus theory is a theory of motivation that is increasingly attracting attention in organizational settings (e.g., Das and Kumar, 2011; Kark and Dijk, 2007; Lanaj *et al.,* 2012). This individual-level theory has been used to explain leadership behavior (Kark and Dijk, 2007), top manager-middle manager relationships (McMullen *et al.,* 2009), negotiations

(Appelt and Higgins, 2010), alliance failures (Das andeKumar, 2011), the nature of alliance contracts (Weber and Mayer, 2011), expatriate failures (Kumar *et al.,* 2019), internationalization behavior (Li and Gammelgaard, 2014), management experimentation (Ahmandi *et al*., 2017), transformational leadership (González-Cruza *et al.,*2019), CEO retirement (Bilgili *et al.,*2020), and customer behavior in e-commerce contexts (Wu *et al.,*, 2019).

Although the concept of regulatory focus is an individual-level construct, we maintain that headquarters and subsidiaries may develop their own motivational orientation consistent with their corporate ethos or culture. Organizational entities, such as headquarters and subsidiaries, may exhibit a promotion-focused or prevention-focused orientation. This orientation reflects the prevailing cultural ethos in the organization. We recognize that the cultural ethos may vary between the headquarters and the subsidiary as well as across subsidiaries. Moreover, regardless of the corporate ethos, there will be differences in motivational orientation across individuals, although the corporate culture may constrain individuals from deviating too much from the norm.

We begin by outlining the key elements of regulatory focus theory (Higgins, 1998). We then demonstrate the key features of the promotion and prevention regulatory foci. A central tenet of regulatory focus theory is that organizations can engage in self-regulation through either a promotion-oriented self-regulatory system or a prevention-oriented self-regulatory system. In a promotion-focused system, the emphasis is on satisfying nurturance needs, and on realizing goals and aspirations. In a prevention-focused system, the focus is on satisfying security needs in order to fulfill duties and obligations.

Insert Table 1 here

The promotion- and prevention-focused systems differ on multiple dimensions (see Table 1). A key point of differentiation is that promotion-focused systems are associated with eagerness, while prevention-focused systems are associated with vigilance (Higgins, 1997; 1998, 2000). Moreover, promotion-focused systems lead to entrepreneurial behavior (Ahmadi *et al.,* 2017). They also foster creativity (Friedman and Förster, 2001), are receptive to change (Lieberman *et al.,* 1999), and entertain more hypotheses (Lieberman *et al.,* 2001). In contrast, prevention-focused systems emphasize maintaining the status quo. These systems are associated with a need for stability (Liberman *et al.,* 1999), less creativity (Friedman and Förster, 2001), and a desire to avoid mistakes (Crowe and Higgins, 1997).

4.0 Promotion- and Prevention-focused Orientations

A promotion-focused orientation leads the organizational unit (e.g., the headquarters or the subsidiary) to focus on accomplishments and goal attainment. The emphasis on goal attainment allows the unit to experiment, take risks, and innovate (Ahmadi *et al.,* 2017). As these units focus on goal attainment, they are more likely to be sensitive to issues of pragmatic legitimacy and to do whatever it takes to maintain that legitimacy. Pragmatic legitimacy, as we argued above, is based on realizing desired outcomes. These outcomes depend not only on a unit's own actions but also on the actions of its partner. Promotion-focused actors are persistent, and they utilize both incentives and coercion to achieve their goals, which are typically performance related.[iii] For example, if a promotion-focused headquarters notices that a particular subsidiary is performing below expectations, it will take steps to encourage the subsidiary to pursue a different strategy or do things differently. If that does not work, the MNE may exit that particular market.

In contrast, a prevention-focused orientation is concerned with avoiding negative outcomes. Organizational units focus on heightened vigilance and risk aversion. No new actions are taken unless there is a preponderance of evidence that those actions will not harm the status quo. Stability is preferred to the uncertainty of change. There is also a reluctance to exchange information due to concerns that the information may later be used against the sharing unit. This orientation prioritizes moral legitimacy over pragmatic legitimacy. The organizational units (e.g., the headquarters or the subsidiary) assign greater importance to behavior that conforms with their values and norms, as conformity ensures the preservation of the status quo. Conflicts between organizational units are less well-accepted and less tolerated. If, for example, the headquarters finds that the subsidiary is behaving unethically, it may lay off the subsidiary manager.

In the following sections, we sketch out the dynamics that may unfold based on the institutional logics held by the headquarters and the subsidiary. There are four possible scenarios: (a) both the headquarters and the subsidiary are promotion oriented; (b) the headquarters is prevention oriented and the subsidiary is promotion oriented; (c) the headquarters is promotion oriented and the subsidiary is prevention oriented; and (d) both the headquarters and the subsidiary are prevention oriented.

5.0 Promotion-focused orientation in both units

In this scenario, the regulatory focus of both organizational units implies that they are proactive and eager, and that they use aggressive tactics to sell their position to their counterparts. Promotion-oriented organizational units seek gains and they will try a multitude of mechanisms to achieve their goals. Their success depends on whether they and their partner share the same goal. If both parties' goals are congruent and in alignment, and if a similar promotion orientation exists in the headquarters and the subsidiary, then they will be on the same page. Given the consensus on the goals and the means to attain them, the maintenance of pragmatic legitimacy should not prove troublesome. Success in attaining pragmatic legitimacy may strengthen the bond between the headquarters and the subsidiary, thereby increasing relational social capital.

A major problem arises in this scenario when the goals of headquarters and subsidiaries are not aligned (e.g., a highly proactive subsidiary seeks its own goals). This creates a crisis of pragmatic legitimacy. In this situation, both the headquarters and the subsidiary utilize aggressive influence tactics ranging from forceful persuasion to threats to get the other party to comply. Either party may act opportunistically, which may cause the headquarters and the subsidiary to view their counterparts as undermining moral legitimacy. This lowers trust, generates negative emotions, and undermines the consensus between the parties. Although moral legitimacy is not the preeminent focus here, the attempt to resolve the pragmatic legitimacy crisis creates a moral legitimacy crisis.

The dual crises of pragmatic and moral legitimacy will negatively affect relational social capital. For instance, the headquarters may force a change in the subsidiary's personnel if no other options are available. The subsidiary may seek to do the same, except its main avenue of influence will be persuasion. In any case, trust between the subsidiary and the headquarters will be hampered, which will also reduce relational social capital

This leads to the following propositions:

P1a: If a promotion-oriented headquarters and a promotion-oriented subsidiary lack goal alignment, then both units will face pragmatic and moral legitimacy crises.

P1b: If headquarters and subsidiaries simultaneously face dual pragmatic and moral crises, relational social capital will decrease.

Consider the case of new product development at Sugar Inc (Brown, 1997). The company had five subsidiaries and a holding board. The subsidiaries' senior executives had recently been appointed to their positions and felt a strong need to "prove themselves" to the holding board. The holding board was under pressure to demonstrate that the reorganized company would be effective, as the reorganization had altered the organization's strategic direction. From the outset, it was clear that both the representatives of the parent company (i.e., the holding board) and the representatives of the subsidiaries had a promotion-focused orientation. In 1987, a large UK-based confectionary company gave Sugar Inc the opportunity to market its US-made products in the UK and Ireland. Sugar Inc's CEO asked the development director (a member of the holding board) to investigate the feasibility of marketing these products. The development director assigned this task to Subsidiary 2, which was relatively inexperienced. The reasoning behind this move might have been that the development director had helped to establish the subsidiary.

The initial step was to investigate whether the project had potential. Subsidiary 2 commissioned a market-research firm to handle this step. Initial survey responses only showed limited potential for the focal products, a finding that contradicted initial expectations. However, instead of stopping the project, Subsidiary 2 hired another agency to carry out another round of market-based research. This decision was consistent with the unit's promotion-focused orientation, which revolved around the need for success. The second study confirmed the findings of the first, but noted that one product, Beta, might have potential in the UK market. Subsidiary 2 jumped on this finding, and presented a case to the board and the development director indicating that this project was worth pursuing. Information that did not fit this view was not presented to the board. Subsidiary 2 was so keen to carry out the project that it painted the potential in an overly positive light. Similarly, the development board did not critically assess the project, which was consistent with its need to demonstrate that the company had turned a corner.

This case demonstrates that when the partners have congruent goals and follow the same promotion-focused orientation, then the establishment of pragmatic legitimacy is relatively easy. Relational social capital is strengthened in the process.

6.0 Prevention-oriented headquarters and promotion-focused subsidiary

If the headquarters' orientation is prevention focused, then the unit's main objective is to maintain the status quo. Consequently, it will not introduce new initiatives or respond positively to initiatives from the subsidiary, and its strategic approach will be reactive rather than proactive. This is not problematic if the goals of headquarters and the subsidiary are aligned. However, problems emerge if alignment is lacking. The promotion-focused subsidiary faces obstacles in achieving its goals, and the two units ultimately find themselves in conflict. Along these lines, Piotti (2012) outlines a situation in which the subsidiary's proximity to the local context creates a situation of information asymmetry, and the eager subsidiary puts a prevention-focused headquarters in a vulnerable situation. Hag (2017) provides another example involving less powerful subsidiaries' inability to speak their mind in their relationships with headquarters. For example, a promotion-focused subsidiary might be located in a host country of peripheral importance to headquarters, but the subsidiary might have high ambitions and be eager to speak its mind. This generates a crisis of pragmatic legitimacy from the subsidiary's perspective, as it is unable to achieve its ambitions and its desires are thwarted by the headquarters. In terms of moral legitimacy, the subsidiary's aggressive initiative taking is viewed as a norm violation and generates negative sentiments in the headquarters. This creates a crisis of moral legitimacy from the headquarters' perspective.

In this situation, headquarters and subsidiaries face moral and pragmatic legitimacy crises, respectively. The moral crisis will have a negative effect on relational social capital. The clashes in regulatory focus orientation (i.e., promotion versus prevention) escalates conflicts and decreases relational social capital

This leads to the following propositions:

P2a: If a prevention-oriented headquarters and a promotion-oriented subsidiary lack goal alignment, then the conflicting orientations will generate a moral legitimacy crisis in the headquarters and a pragmatic-legitimacy crisis in the subsidiary.

P2b: If the headquarters faces a moral legitimacy crisis and the subsidiary faces a pragmatic legitimacy crisis, relational social capital will decrease

Consider the case of Caribbean Foods Limited (CFL) of Trinidad. CFL was a wholly owned subsidiary of Intasco, a US-based food and beverage company (Marks, 2000). It had operated in Trinidad since 1928, importing and selling Intasco's products. The company began manufacturing operations in Trinidad in 1978. Mark Davis joined CFL in 2000 as a marketing manager. He was a hands-on employee who was very aggressive and keen on expanding the company's growth. By all accounts, the subsidiary had a promotion-focused orientation , as performance was a top priority. Marks (2000, p. 2) refer to Davis: "If you don't keep them 'staff' on their toes now, when things get rough, you won't be able to get anything done." In contrast, the headquarters' culture was focused on maintaining control—an approach consistent with a prevention-focused orientation. The emphasis on control manifested itself in a multitude of ways, including a focus on procedures and the established ways of doing things. Davis wanted to change the process, but his attempts to do so were curtailed by headquarters. He felt that his creativity was being stifled. Moreover, he was advised not to give headquarters more information than necessary, as doing so would only invite more questions.

In this case, the evidence suggests a lack of goal alignment between the headquarters and the subsidiary. The headquarters was control oriented, while the subsidiary wanted autonomy. The lack of goal alignment coupled with conflicting orientations created pragmatic legitimacy and moral legitimacy crises. The subsidiary managers felt that they were too controlled by the headquarters, which stifled their creativity. This generated a moral legitimacy problem. Simultaneously, the excessive controls placed on the subsidiary failed to give it the leeway it needed to deal with situations in a productive way. Over time, these factors directly resulted in the weakening of relational social capital.

7.0 Promotion-focused headquarters and prevention-focused subsidiary

In this situation, the headquarters is at the forefront of initiative taking and wants the subsidiary to do the same. In contrast, the subsidiary is highly reactive and does not want to comply with headquarters' wishes. As outlined by Piotti (2012), headquarters' strategies may be based on wishful thinking, to which the prevention-based subsidiary will have reactive response. If there is goal alignment on strategic issues, problems should not arise. Conversely, if the goals differ, a legitimacy crisis could ensue. For the subsidiary, the maintenance of the status quo is of primary importance—it does not wish to jeopardize the status quo by embarking on new initiatives. At the same time, the headquarters feels unable to make any changes, as it assumes that the subsidiary would resist them. This compromises pragmatic legitimacy from the headquarters' perspective and moral legitimacy from the subsidiary's perspective. The subsidiary's failure to follow headquarters' dictates also threatens the moral legitimacy of the partnership, as the subsidiary is not viewed as behaving in the way that it should.

As this difference in orientation generates a moral legitimacy crisis, relational social capital will decrease. The prevention-oriented subsidiary will constantly feel pressure from the promotion-oriented headquarters, which causes uncertainty and anxiety in the subsidiary. This affects collaboration and trust between the units, and thereby decreases relational social capital.

This leads to the following propositions:

P3a: If a promotion-oriented headquarters and a prevention-oriented subsidiary lack goal alignment, then the conflicting orientations will generate a pragmatic legitimacy crisis in the headquarters and a moral legitimacy crisis in the subsidiary.

P3b: If the headquarters faces a pragmatic legitimacy crisis and the subsidiary faces a moral *legitimacy crisis, relational social capital will decrease.*

A good example of this is the conflict that developed between Königsbrau-TAK and its Ukrainian subsidiary (Gabarro, 2008). Königsbräu was a Munich-based German company that specialized in producing premium quality beers. It had established a subsidiary in Ukraine as part of its international expansion. The company initially entered Ukraine through a partnership, but it eventually took control of the Ukrainian company. The managing director of the Ukrainian subsidiary was Wolfgang Keller. When he accepted that role, the subsidiary was incurring losses of EUR 2.9 million per year. However, in the span of a few years, Keller managed to turn the situation around and the subsidiary became profitable, earning EUR 7 million on turnover of EUR 145 million annually. Keller's success was noticed in Germany, and it was rumored that he might become a member of the firm's executive board

The German company's orientation was promotion focused. Its emphasis was on expeditiously and aggressively addressing problems. The company willingly took risks and it was receptive to change. These company traits were also characteristics that Keller exemplified when he was put in charge of the Ukrainian subsidiary. Keller recognized that building relationships with distributors was essential for success and he left no stone unturned in seeking that success. He had an aggressive and flamboyant style, and he focused on developing relations within the organization and with distributors.

The subsidiary's orientation was prevention focused, as exemplified by the role played by Dimitri Brodsky—the subsidiary's commercial director. He joined Konigsbrau after leaving the Ukrainian subsidiary of a US-based toiletries company. His approach was notably different from that of the German company. Brodsky was extremely analytical and methodical, which led him to be highly conservative and slow in his decision making. His approach represented a prevention-focused orientation. He placed excessive emphasis on rules and procedures, but little focus on developing internal or external relationships. The overriding imperative was to avoid making mistakes. Contentious issues between headquarters and the subsidiary included conflict with a distributor and Brodsky's failure to collect on bad debts.

The conflicting approaches of the headquarters and the subsidiary created pragmatic and moral legitimacy crises. From the headquarters' perspective, the subsidiary was not proactive enough in dealing with the various problems with distributors, which generated a crisis of pragmatic legitimacy. This led Keller to actively engage with the distributors—an action that appeared to compromise the moral legitimacy from the subsidiary's perspective, as the headquarters was viewed as interfering in matters that were the subsidiary's responsibility.

8.0 Prevention-focused headquarters and prevention-focused subsidiary

This is the one instance in which the conflict between the headquarters and the subsidiary may be minimal, especially if there is goal alignment between the actors. Both actors are interested in maintaining the status quo and their strategic approaches may be congruent. Moreover, they are both likely to be reactive and to avoid actions that might threaten their counterparts. If, however, there is a lack of goal alignment, then a prevention-focused logic may prevent both actors from initiating actions that would help reconcile those goals. Although reactivity may ensure moral legitimacy, it may also call the pragmatic legitimacy of the partnership into question. In relation to the latter, if significant problems are neglected because both partners face difficulties in admitting bad performance, the problems are not solved, which will lead to poorer performance. However, as no moral legitimacy crisis occurs in this case, we assume that relational social capital will remain stable.

This leads to the following propositions:

P4a: If a prevention-oriented headquarters and a prevention oriented subsidiary lack goad alignment, the two units will avoid a moral legitimacy crisis, but they will face a pragmatic legitimacy crisis.

P4b: *In cases where a prevention-oriented headquarters and a prevention-oriented subsidiary only face a pragmatic legitimacy crisis, relational social capital will remain stable.*

Toyota’s accelerator crisis offers a good illustration of these dynamics (e.g., Gretto *et al.,* 2010). Toyota, a major player in the global automotive industry, began its US operations in 1957 when it established a sales subsidiary. Over the ensuing decades, the company grew rapidly. By 2008, with a market share of 12.8%, Toyota had become a dominant player in the automotive industry. The company’s preference has always been to maintain the status quo.

The accelerator crisis emerged in the US in 2009. The accelerator pedals were faulty, that they could stick, and that they posed a danger. Toyota faced a great deal of public criticism because it was slow to respond to the problem. The US Transportation Secretary, Ray LaHood, described Toyota as being a “little safety deaf.” Collectivistic cultures, such as the organizational culture at Toyota, are prevention-focused and the general desire is to avoid disturbing the status quo. This mentality was prevalent in both the headquarters and the subsidiary, which might explain the delayed response to the problem. This negatively affected Toyota’s reputation and its financial situation, as the company had to issue a recall. In trying to maintain moral legitimacy, the company sacrificed its pragmatic legitimacy.

9.0 Conclusion

This paper has highlighted the importance of internal legitimacy as well as the motivational orientations of headquarters and subsidiaries for the functioning of MNEs. The management of internal legitimacy is crucial for building relational social capital. This is particularly true in contexts where the relationship between the headquarters and the subsidiary is a mixed-motive one in which the actors' goals are only partially congruent. Legitimacy crises are particularly likely if goals are misaligned.

We postulate that if both headquarters and subsidiaries are promotion oriented, dual pragmatic and moral legitimacy crises will emerge, which will reduce relational social capital. If the headquarters is prevention oriented and the subsidiary is promotion oriented, the former will face a moral legitimacy crisis, while the latter will face a pragmatic legitimacy crisis, leading to reduced relational social capital. We expect the opposite pattern when the headquarters is promotion oriented and, therefore, faces a pragmatic legitimacy crisis, and the subsidiary is prevention oriented and, consequently, faces a moral legitimacy crisis. Again, this leads to decreased relational social capital. Only if both units are prevention oriented do we predict stable relational social capital, as both units should seek to avoid moral crises. However, this neglect of the challenges the organization faces will lead to a pragmatic legitimacy crisis. Figure 1 summarizes our findings.

--Figure 1 about here--

Our paper contributes to the international management literature in several ways. We highlight the importance of internal legitimacy in interactions between headquarters and subsidiaries. The extant work has focused on issues of external legitimacy, while internal legitimacy has received little attention even though internal legitimacy is crucial for building relational capital. The relational dimension is critical when MNEs formulate and implement global strategies. As Mudambi (2011) suggests, headquarters' ability to define and implement a "global strategy" is 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. Whether conflicts occur depends on the presence or absence of internal legitimacy.

Future research on MNEs and international management could focus on internal legitimacy processes, as most of the extant literature has examined external legitimacy processes. In-depth qualitative analyses of the ways in which internal legitimacy processes lead to either a promotion- or a prevention-focused orientation, and how those logics may differ within same organization are needed. One possible path forward is to depart from a micro-foundational perspective in terms of how research aggregate from the individual level (i.e., the managers of headquarters and subsidiaries), and investigate why this sometimes is institutionalized into a pragmatic focus and sometimes into a moral focus using another set of angles, such as culture on the one hand and power on the other.

In a conceptual paper, Rego and Steger (2019) highlight the importance of studying power in relation to social capital. Furthermore, according to Blazejewski (2012), subsidiary managers' ability to have a "dual identity" and shift between promotion- and prevention-based reactions to headquarters' initiatives depending on the situation can either decrease or intensify and redirect the lines of conflict. Consequently, future studies of conflict and legitimacy should focus on managers and employees, and their power in relation to the strategic development of the MNE (Köhler and Begega, 2018). In this regard, Higgins' (1998) theory on regulatory foci can be further investigated from a "hierarchical point of view"—that is, through the perspectives of the headquarters and the subsidiaries. Such analyses could involve a differential network (Nohria and Ghoshal, 1997) point of view, which would also consider the various roles played by subsidiaries. Furthermore, the bureaucracy of the MNE (e.g., its rules and regulations as well as its socialization processes revolving around its common values) could be integrated into such analyses. Finally, investigating the suggested framework from a principal-agency point of view (Mudambi, 2011) as well as the organization's ability to be innovative would be fruitful research avenues.

Differences in motivational orientations among subsidiaries imply that interactions with one group of subsidiaries might bring about certain types of legitimacy problems, while interactions with another group of subsidiaries might lead to other types of legitimacy problems. This subsidiary-duality problem affects both external and internal legitimacy pressures (Kostova and Zaheer, 1999), and is exaggerated by the institutionalized regulatory focus. As such, different types of legitimacy crises and repair strategies can come into play within the same organization. A key implication is that for an MNE with a high number of subsidiaries with different orientations, network management entails greater coordination costs. At the same time, the network might benefit from diversity.

Lastly, we acknowledge some of the limitations of the framework presented here. We assume that the regulatory focus orientation of the headquarters and the subsidiaries is stable. However, we acknowledge that different situations may evoke different orientations. For example, a subsidiary may favor a promotion focus but it might become prevention focused if the headquarters wishes to constrain the subsidiary in some way. Regulatory focus orientation is not static—it can shift over time. Finally, we present a conceptual framework that deserves careful empirical examination. These limitations notwithstanding, we believe our paper enriches our understanding of headquarters-subsidiary relations.

Another limitation is that we conclude our analysis with statements regarding whether moral or pragmatic legitimacy occur. However, we do not consider how to deal with such crises. Future analysis should address the issue of legitimacy crises, especially strategies to repair legitimacy. Managerial implications might be drawn from such analyses. In order to put our analysis into perspective, we suggest that a legitimacy crisis occurs when the headquarters or the subsidiary impede its counterpart in its attempts to achieve its goals. In other words, the headquarters and subsidiary have different priorities and different ways of achieving them. In such cases, a stalemate persists until the headquarters and the subsidiary begin the process of legitimacy repair to reestablish pragmatic and/or moral legitimacy.

Legitimacy repair can be an active or passive process (Suchman, 1995). The active process may unfold in many ways. The headquarters or the subsidiary may try to reshape its counterpart's expectations through communication or dialogue. Alternatively, it may adapt to the other party's expectations through restructuring. The process may also involve changes in personnel—particularly among top management—which may lead to a reordering of the institutionalized regulatory focus. The passive process may entail denial, justification, or the shifting of blame to the other party. Legitimacy repair is a dialectical process in which the headquarters and the subsidiaries may adopt either proactive or reactive strategies. A promotion-focused orientation leads the headquarters or the subsidiary to utilize an active legitimacy-repair process, while a prevention-focused institutional logic leads the headquarters or subsidiary to repair legitimacy through a passive process. Promotion-focused actors wish to quickly reverse negative outcomes and they are, therefore, proactive. Prevention-focused actors are concerned that an intervention might make the situation worse and, hence, they might delay in taking action. In a promotion-focused organizational system, the emphasis is on gains and actors eagerly undertake new initiatives to realize those gains. If those gains are thwarted, the immediate need is to reverse this momentum, which makes legitimacy repair important. In a prevention-focused organizational system, the emphasis is on avoiding losses by maintaining the status quo.

Lastly, this paper has several 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 minimizes the occurrence of such crises and 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. In this regard, we view the framework presented in this paper as generic. Analyses of the relationships between regulatory orientations, the type of legitimacy crises such relationships may bring about, and how those crises affect relational social capital can be used in other organizational settings. One suggestion could be an analysis that focuses on a subsidiary's TMT and its managers. Other research could examine the interactions between a corporate headquarters and a regional headquarters. Given its generic nature, the framework presented here can also be used in many settings, such as strategic alliance relationships.

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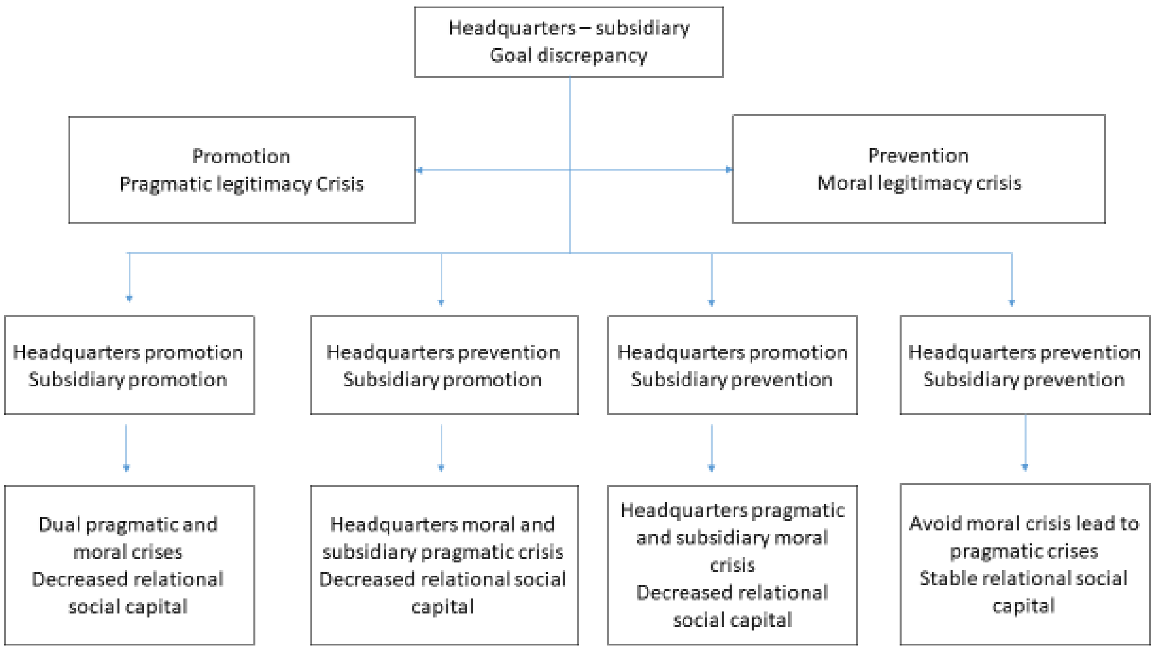
Table 1
Differences between promotion-focused and prevention-focused self-regulatory systems

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, changes resisted, work with few hypotheses, negative view of exchange relationships
Outcome of legitimacy crises	Redefined scope of power, no contextual change, higher effects on outcome	Avoid scope changes, emphasis on contextualization, low effects on outcome

Based on Das and Kumar, 2011; Weber and Mayer, 2011; Higgins, 1997, 1998, 2000; Liberman et al., 1999, 2001

Figure 1 Headquarters – subsidiary goal discrepancy, motivational orientation, legitimacy crisis and relational social capital framework



[i] The borders marking when legitimacy is either instrumental or relational are imprecise. The ways in which individuals relate to each other are often affected and, in many cases, taken over by the "case." Thus, the instrumental (case) becomes the issue affecting the moral-based relationship. According to Buber (1970), the "case" will be an "it," with its roots in institutions (e.g., a business exchange between a subsidiary and a headquarters), and it will dominate the moral-based relationship, which will be a "thou" (Buber, 1970).

[ii] Tost (2011, p. 687) excludes cognitive legitimacy on the grounds that it does not focus on the "substantive content of legitimacy judgments." This author introduces the notion of relational legitimacy, which refers to the degree to which the entity treats other individuals and groups with due respect (Tost, 2011). We suggest that relational legitimacy depends on the preexisting or dominant values that characterize that entity. To the extent that this is the case, it has strong parallels with moral legitimacy.

[iii] In so doing, they might engage in passive opportunism (Das & Kumar, 2001). Scholars distinguish between active and passive opportunism (Wathne & Heide, 2000; Seggie, Griffith, & Jap, 2013). Active opportunism implies undertaking forbidden actions, whereas passive opportunism implies not doing what should be done. Passive opportunism occurs when a firm, for its own benefit, either explicitly or implicitly evades obligations, or refuses to adapt to new circumstances. It includes such behaviors as hiding information, telling incomplete truths, and failing to provide notification (Seggie, Griffith, & Jap, 2013).