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THE INTER-COMPANY RELATIONSHIPS AND STRATEGIC AUTONOMY

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THE INTER-COMPANY RELATIONSHIPS AND STRATEGIC AUTONOMY**ABSTRACT**

The gains from closer interaction with foreign companies should be weighted against potential losses in autonomy of local companies. The case evidence points at the focal importance of company's capabilities and resources for its autonomy. Company's international experience and network position were also identified as main determinants of power distribution.

INTRODUCTION

In inter-company relationships there is often a trade-off between independence and inter-dependence. The power distribution among cooperating parties becomes a prominent issue. For example, foreign owners are used to exchange their financial and informational support for greater control over the strategy of subsidiary. Although common, this behavioural pattern should not always occur. This aspect is more complex. The strategic autonomy of agents within a network is influenced by a set of different factors. These intra-company, relational, and external factors are in many respects interrelated and have joint impact on this distribution of autonomies. The purpose of this research is to show that the autonomy of participants in inter-company relationship is highly dependent from several intra-company, relational, and external factors that determine the nature of power distribution. The research problem will be dealt on example of autonomy changes in foreign-owned Estonian companies.

The paper starts with a brief outline of inter-company relationships literature followed by the discussion of power distribution. The next section will introduce a way of linking these two subjects by highlighting the key determinants, which will thereafter be incorporated into a

theoretical framework. Following discussion offers subsequent empirical evidence about network autonomy. The paper concludes with managerial and research implications of the knowledge gathered. The limitations of research will be discussed as well.

The empirical analysis draws upon multiply case studies. These case studies describe the differing impact of international inter-company relationships on the autonomy of Estonian counterpart. In order to allow for the generalisation of results, the cases describe the companies from several sectors and size groups. The multiple case studies should provide sufficient evidence about the underlying management process.

THE NETWORKS AND SUBSIDIARY ROLES

We start the theoretical outline with discussion of networks as forms of inter-company relationships and subsequent subsidiary roles that represent different levels of autonomy. The entire theoretical framework will be formed in the next section and finally depicted in figure 1. There are many definitions of networks. Thorelli defines network 'as the one intermediary between the single firm and the market, i.e. two or more firms which, due to the intensity of their interaction, constitute a subset of one or several markets' (Thorelli 1986, p. 38). More broadly, 'inter-organizational network could be defined as clusters of business units held together, in network fashion, by market mechanisms'. (Zeffane 1995, p. 26). In a more theoretical view, the network approach has three main features: actor bonds, shared resources, and integrated actions (Johanson and Mattsson, 1988). Actor bonds determine also the actor's network position. Shared resources indicate that an actors' success in operating depends on other participants' choices. Inside the network, there could be competition for the use of common resources (Thorelli, 1986). Integrated actions imply that networks can be viewed as economic entities, although much more

complex than organizations. The role of network support in the international markets is the main subject in several contributions (Coviello and Munro, 1995; New and Mitropoulos, 1995; Zeffane, 1995).

Ghoshal and Bartlett differentiate between multinational network and external network (Ghoshal and Bartlett, 1990). Under multinational or network, they mean 'a group of geographically dispersed and goal-disparate organizations that include its headquarters and different national subsidiaries' (Ghoshal and Bartlett 1990, p. 603). It has also been argued that the network approach within corporate structure could lead towards more specialized, coordinated and integrated structure than for example decentralized organizations that use polycentric strategies (Malnight, 1996).

The international aspirations of the firm are in some instances considerably supported or inhibited by its inclusion into the larger network of intra-corporate business units. In these situations, a local firm can be assigned different kinds of management tasks. These tasks determine the role, and subsequently the strategic importance, of each unit or firm in the corporate structure.

Due to an increased need for integration between subsidiaries, brought on by globalization, these roles become increasingly specialized. Some units are assuming the coordinating functions of (regional) headquarters, while others constitute arms-length operations. Several authors discuss these changes in the strategic role of subsidiaries in the light of growth in lateral relations (White and Poynter, 1984; Bartlett and Ghoshal 1986; Martinez and Jarillo, 1991; Gupta and Govindarajan, 1991; Roth and Morrison, 1992; Birkinshaw and Morrison, 1995; Taggart, 1997).

One of the earliest approaches defined marketing satellite, 'miniature replica', rationalized manufacturer, product specialist, and strategic independent types of subsidiaries (White and

Poynter, 1984). ‘Miniature replica’ is a unit that replicates the layout of headquarters, while the strategically independent position is most beneficial to successful subsidiary’s internationalization.

Christopher Bartlett and Sumantra Ghoshal divide subsidiaries into four categories: implementer, contributor, strategic leader, and ‘black hole’ (Bartlett and Ghoshal 1986). In terms of international embeddedness subsidiaries in positions of strategic leader or at least contributor are in a favourable situation. Jon Martinez and Carlos Jarillo define units as autonomous, receptive, or active (Martinez and Jarillo, 1991). Following that classification an active subsidiary is most integrated into strategic decision making, while receptive unit is likely to perform only certain supporting tasks.

Kendall Roth, Allan Morrison, and Julian Birkinshaw discuss the idea of the subsidiary with global or world mandate (Roth and Morrison, 1992; Birkinshaw and Morrison, 1995). This subsidiary is comparable to former regional headquarters because it controls and coordinates several business functions in subordinated subsidiaries. These and some other classifications of subsidiary roles are summarized in table 1. Types given in bold are to be considered most important from inward-outward connections, or international role perspective.

*** Insert Table 1 here ***

In conclusion, the recipient companies are most likely to retain autonomy, when they have strategic capabilities, valuable to the investors by full incorporation of this unit into the framework of strategic coordination. Without that specialized knowledge, subsidiaries are more likely to assume the position of implementer or subordinated arms-length subsidiary. In following, the strategic capabilities and also other factors that influence this headquarter-subsidiary power distribution are investigated in greater detail.

THE DETERMINANTS OF STRATEGIC AUTONOMY

The strategic autonomy of a network actor depends on many factors. In last section valuable strategic capabilities were identified as one possible source of autonomy in decision making.

Other factors that have prominent influence are actor's resource base, its network position, and international position. The external factors like differences in business environment have to be discussed as well.

The aspect of company's capabilities and resources is in primary focus of the resource-based view. Developed during last two decades, with landmark writings by Birger Wernerfelt (1984) and Jay B. Barney (1991), this concept looks at a firm as a collection of inimitable resources and capabilities, whereas differences in a particular firms' competitiveness result from their unique abilities to accumulate, develop and deploy their resources and capabilities in order to formulate and implement their value-enhancing strategies. Resources are finite in supply; they depreciate over time and usually diminish in value when shared with other parties. Capabilities are invisible, knowledge-based phenomena that expand with use over time and appreciate when shared (Wernerfelt, 1984; Barney, 1991). According to Jay Barney, these valuable, rare, imperfectly imitable, and not substitutable resources and capabilities are sources for sustainable competitive advantage (Barney, 1991).

The discussion above indicates that company's capabilities and resources are important facilitators of its competitiveness. Thus, we would expect that network agent possessing valuable capacities and resources would have considerable bargaining power for gaining strategic autonomy from foreign partners.

The company's position in network could depend on the history of its development (first mover advantages) and on home market business environment. One precondition for gaining focal

network position could be the entrepreneurial orientation of the firm. Jeffrey Covin and Dennis Slevin (1991) offer the following list of important external variables that play a key role in determining entrepreneurial environment (Covin and Slevin, 1991).

The entrepreneurial orientation of a company supports its ability to form network around its core business rather than to be incorporated into network as peripheral agent. The closer to the core a network member is positioned the more autonomous it is likely to be. However, focal position in regional (sub)network might be viewed as peripheral in terms of larger inter-company network. Therefore, autonomy of foreign-owned company would be influenced by its position in relation to core operations of foreign owner. It is important to note, that closeness to the core has to be coupled with valuable capabilities and resources, otherwise the subsidiary company is more likely to be subordinated than autonomous.

The autonomy of a network actor in cross-boarder network depends also on its international experience. The importance of experiential knowledge increases with the sophistication of the product handled and with the complexities of the target market, allowing firms to perceive and formulate opportunities (Johanson and Vahlne, 1990).

In terms of power distribution between foreign headquarters and local unit, the internationalization knowledge accumulated locally prior to takeover by foreign company will support the units claim for higher autonomy in decisions.

The differences in business environment constitute yet another factor influencing power distribution. In the process of internationalization there are several variables in different levels of environment affecting the market entry. Luostarinen (1970) uses three layers of impact: Macro-environment or super-system, microenvironment or sub-system, and milli-micro environment or

sub-sub-system. The first is related to home and target country variables, the second with firm level variables, and the last with the variables affecting decision-making procedures.

So far we have discussed firm level variables and positions of companies in networks. The differences on macro level, between the locations of parent and foreign subsidiary, tend to make target market operations less comprehensible for foreign investor. This aspect offers a support for granting higher autonomy to locals at least in an early phase of market presence.

The figure 1 summarizes the concept of networked company's strategic autonomy in terms of the prominent influence factors. The dotted arrows indicate the possible interdependencies between the factors themselves.

*** Insert Figure 1 here ***

In following section, the empirical evidence based on multiple case studies will be provided. The case study method helps to obtain elaborate insights about the motivations, beliefs, and experiences of corporate level managers.

THE AUTONOMY ISSUES OF FOREIGN-OWNED ESTONIAN COMPANIES

The method of case study analysis has been scrutinized by Robert K. Yin. According to him (Yin, 1992) case study is an empirical inquiry that investigates a contemporary phenomenon within its real-life context; when the boundaries between phenomenon and context are not clearly evident; and in which multiple sources of evidence are used.

The selection of case companies was based on theoretical rather than statistical sampling. The main theoretical considerations were related to the field of activity, to company size, and to the level of foreign commitment. The analysis is based on information gathered during interviews with company managers and from public sources of information (reports, newspapers etc.).

Toftan Sawmill

Toftan, employing 103 people, is a manufacturer of sawnwood that started operations in 1995. Born as a foreign company, Toftan is co-owned by Swedish sawnwood manufacturer Hebeda Trä AB (60%) and Finnish wood procurement company Thomesto OY (40%) and produces annually about 107 000 m³ sawnwood. The important role in network is played by Thomesto's wood procurement subsidiary Mets & Puu, which supplies Toftan with roundwood. Toftan has also received long-term financing from both owners and cooperates in sales with Hebeda Trä AB. Company can use also Swedish sawmills as a base for training its employees.

In the start-up period, the management and key employees came from Swedish parent company, but during ten years of operation the strategic involvement of foreign owner has been reduced to joint discussions of development strategy in board meetings. During first five years of operation, Swedish owner provided Toftan also with expatriate sales personnel.

This example shows how the development of company's capabilities and resources along with its international experience has gradually increased its autonomy in the network. Although, Estonian and Swedish business environments have considerable differences, they did not play focal role in power distribution at the early stage of Toftan's development.

Krenholm

The Krenholm Manufacture was established in 1857 on the island in the Narva river by a German industrialist Baron Ludwig Knoop, and served later as an integral part of the Soviet industrial system. After Estonia had regained independence in 1991, Krenholm's re-orientation to the US and West-European markets made it possible to privatize the enterprise in 1994. Since 1999, the Swedish company Borås Wäfveri AB has owned all the shares of Krenholm Group.

After the privatization, the group has tried to focus more on developing its own brands and trademarks, while improving the quality and value added of the offered products. The company has now diversified its activities, including the production of working clothes and making inroads into the segment of leisure clothing. The Krenholm Group has following major sales subsidiaries – Krenholm Textile, Krenholm Scandinavia AB, Krenholm Germany GmbH. The present situation in the global textile markets has forced Krenholm's Swedish owner to close down its production units in Sweden and transfer the production to Krenholm. This has made the company the main production site of the entire group. At present, Krenholm employs around 4900 workers. About 59% of company's total sales go to the EU and 19% to the US market. Although, until recently company had local managing director, and relatively large freedom in developing its marketing channels, by now Swedish owners have reduced Krenholm's autonomy by using expatriate Swedish management. This change was partially related to the fact that local manager and foreign-owners had differing views about the projected need for downsizings. The management change has also influenced the structure of company's sales subsidiaries abroad. During former management, company had also sales affiliate in UK, but now the Swedish parent represents Krenholm on this market.

In this case, the reduced differences in business environment, along with a shift of foreign owners production focus to Estonia, have reduced the autonomy of Krenholm. Despite its increasingly focal position in corporate network, the company lacks very unique capabilities (technology is to the great extent transferred from foreign owner). Thus, the interest to control the operations in Narva has increased rather than decreased. The main reason for autonomy loss seems to be the growing interest of foreign owner in this production site. Therefore, Krenholm is a very interesting case of how reallocation aspect can adversely influence subsidiaries autonomy.

Hansabank Group

Hansabank was established in July 1991 as an affiliate of Tartu Commercial Bank in Tallinn. In 1992, the parent company got into economic difficulties and from 10 January, 1992 Hansabank continued its operations as an independent business unit. The 1996 was an important landmark in the bank's history, because it acquired Deutsche-Lettische Bank in Latvia and it was renamed as the Hansabank-Latvia. In 1998, Hansabank received a large foreign investment from Swedish Swedbank, who obtained by 1999 more than 50 per cent of the bank's shares. On 7 July, 1999, the Hansabankas- Hansabank affiliate in Lithuania opened its doors to customers. It was a Greenfield investment. In this year, Hansabanka (renamed from Hansabank-Latvia) announced the purchase of UBB Ventspils and therefore continued expansion via takeovers. In 2001, the bank successfully finalized a tender to privatize the Lithuanian Savings Bank- LTB, which was then merged with Hansabankas and the new name of the merged bank became Hansa-LTB. Because LTB was the second largest bank in Lithuania this privatization deal considerably increased the market share of the Hansabank Group in Lithuania. At the end of 2003, there were, in total, 5771 employees in Hansabank Group.

During the last decade, the Hansabank Group has become a Pan-Baltic organization that includes the entire Baltic region as its home market. The nature of the company has also changed from a domestically-owned bank to a foreign affiliate of a Swedish bank. Nevertheless, Hansabank Group retains a considerable autonomy in controlling its operations in Latvia and Lithuania. Hansabank Group has received from its foreign owner a regional mandate for governing the development in Baltic countries. The strategic autonomy has been retained mostly because of companies unique capabilities in increasing the efficiency in banking sector (elaborate introduction of Internet and phone-based services) and its experience in expansion to Baltics.

Mootorreisi Group

Mootorreisi Group was founded in 1993. Mootorreisi Group operates under the Eurolines trademark. From its inception, the company has been 60 percent owned by three Estonians and 40 percent by the German company Deutsche Touring GmbH, which is one of the biggest carriers in Europe.

In 1994, the firm began operating bus lines to Germany, other Baltic States and Russia. Soon after that, the first foreign affiliates were registered in Riga, the capital of Latvia. Sales and marketing company SIA Mootorreisi and passenger carriage company SIA Baltijas Autobusu Linjas (SIA BAL) started operations in 1995. In 1996, the sales and marketing operations were also transferred to SIA BAL. In 1995, the foreign affiliate for international bus transport UAB Tibus was registered in Vilnius- Lithuania and one year later also the sales and marketing affiliate UAB Eurolines Baltic International (UAB EBI). Both started functioning in 1997.

In 1997, the former cooperative partnership with the Russian bus company that began in 1995 was replaced by the creation of an 80 per cent owned foreign affiliate ZAO Evrolines in Saint Petersburg. Twenty per cent of affiliate's shares are owned by the Russian managing director. At present, the Russian company has an affiliate in Moscow and in Minsk- Byelorussia. The expansion to Minsk in Byelorussia was related to the need to create a logistics centre for the buses going from Moscow and Saint Petersburg to Western Europe.

Although, Mootorreisi Group has well-known German bus company as minority owner, this case is still an example of company that has built its autonomous network of subsidiaries. In addition to the ownership structure (majority is still owned by locals), the company has retained its autonomy because of differences in business environment (especially Russia is very different

from Western Europe) and because of its unique capabilities and experiences in managing these differences for the benefit of all parties involved.

DISCUSSION AND CONCLUSIONS

All four cases described above introduce different viewpoints on power distribution between Estonian foreign-owned company and its foreign parent. In Toftan's case cooperation with parent has gradually increased the autonomy of Estonian subsidiary, while company has close partnership with wood procurement subsidiary of its minority owner. Krenholm represents a situation where Estonian subsidiary has lost rather than gained autonomy. Krenholm started after privatization as relatively independent company (at least in terms of its foreign expansion), but as the production shifted from Sweden to Estonia, the Swedish parent started to exercise more and more control.

The service companies, Hansabank Group and Mootorreisi Group, are both examples of relatively autonomous foreign-owned companies. However, because these companies have somewhat unique market positions, this result should not be generalized to the entire service sector. Hansabank had already established several subsidiaries in Latvia and Lithuania prior to receiving foreign direct investment. Since the foreign owner did not have comparable international experience, the existing governance structure and subsequent autonomies were to the great extent preserved. In Mootorreisi case, the foreign-owned company itself forms the governing core of the international network. Although German minority owner is a valuable source for knowledge transfers, it does not dominate company's strategic management.

In terms of figure 1, company's capabilities and resources (especially in Hansabank and Toftan), along with its international experience, were the most dominant determinants of power

distribution between Estonian company and its foreign parent. For example, market-specific knowledge of Baltic business environment gave Hansabank important advantages over its Swedish owner company. These capabilities were successfully internalised by Swedbank via retaining the autonomy of Hansabank in governing Baltic operations. Toftan's case indicates how capabilities coupled with growing experience can increase the company's managerial role. The network position of case companies had twofold impact on their autonomy. In case of Krenholm movement towards core position reduced company's autonomy, because its resources were controlled by parent, while in case of Mootorreisi Group focal position in international network contributed to its strategic autonomy.

Thus, our analysis rendered a very interesting result, showing that core position in network is likely to give higher autonomy only in cases when focal position in operations coincides with focal position in terms of general management. In case of disparities between the two, the key position as a production site might even be detrimental. This conclusion indicates a need for further differentiation between functional and strategic roles of foreign subsidiaries.

Although, differences in business environment did not prove to be the main determinants of power distribution, in Mootorreisi case, and less so in case of Krenholm, the business environment was an important secondary factor in the inter-play of different determinants of unit's autonomy. Therefore, it might be the case that differences in business environment have often rather tacit impact on these role assignments, intermediated through other more focal influence factors. This aspect, however, needs additional research before to change the figure 1. From the reviewed cases Krenholm represents arms-length units, while Hansabank and Mootorreisi have strategic mandate. Toftan sawmill is between the two extremes with inclination towards higher autonomy. These results are summarised in table 2. This table offers also some

indication about the dynamics of case companies' autonomy over time. The changes towards an increased or reduced autonomy were clearly identifiable in cases of Toftan and Krenholm.

*** Insert Table 2 here ***

This research has several limitations. The case study analysis allows us to rigorously explain the particular characteristics of relationship, but, in several situations, it fails to illuminate the most archetypical features that could be generalized to all similar companies. Thus, one should exercise extreme caution when generalizing given results to all Estonian companies.

The other constraint concerns interpretation. In case of qualitative research, the danger of misinterpretation of facts or events is bigger than in case of quantitative research. The methodological variations make it more difficult to bring in cause and effect patterns.

The third limitations concerns terminological issues. In social sciences, there is a tendency to adopt different notions, even when the subject researched differs mostly in viewpoint rather than in essence. Therefore, the terminological problems might leave their mark on the results.

The most important implication of this research is the need to concentrate on the development of unique capabilities and resources. Without these intra-company features the autonomy of company could remain short-lived. These capabilities have also great influence on the relationship between network position and power distribution. The corporate history could potentially serve as a tool for predicting the power distribution after takeover by foreign investor.

The preconditions for remaining autonomous are often established before that event.

Future research on power distribution should investigate the autonomy issues in case of inter-company relational networks, where there is no ownership ties involved. There is also need to gather well-targeted survey evidence in order to reduce described limitations via data and methodological triangulation.

Table 1

Strategic roles of subsidiaries

AUTHORS:	STRATEGIC SUBSIDIARY TYPES:
White and Poynter (1984)	‘miniature replica’, rationalized manufacturer, product specialist, strategic independent
Bartlett and Ghoshal (1986)	implementer, contributor , strategic leader , ‘black hole’
Martinez and Jarillo (1991)	autonomous, receptive, active
Gupta and Govindarajan (1991)	local innovator, local implementer, global innovator, integrated player
Roth and Morrison (1992)	integrated, global subsidiary mandate
Birkinshaw and Morrison (1995)	local implementer, specialized contributor, world mandate
Taggart (1997)	partner , militant, collaborator, vassal
Taggart (1998)	autarchic subsidiary, confederate subsidiary, strategic auxiliary , detached subsidiary

Source: based on White and Poynter, 1984; Bartlett and Ghoshal 1986; Martinez and Jarillo, 1991; Gupta and Govindarajan, 1991; Roth and Morrison, 1992; Birkinshaw and Morrison, 1995; Taggart, 1997; Taggart, 1998

Figure 1

The main influences to the strategic autonomy of a networked company

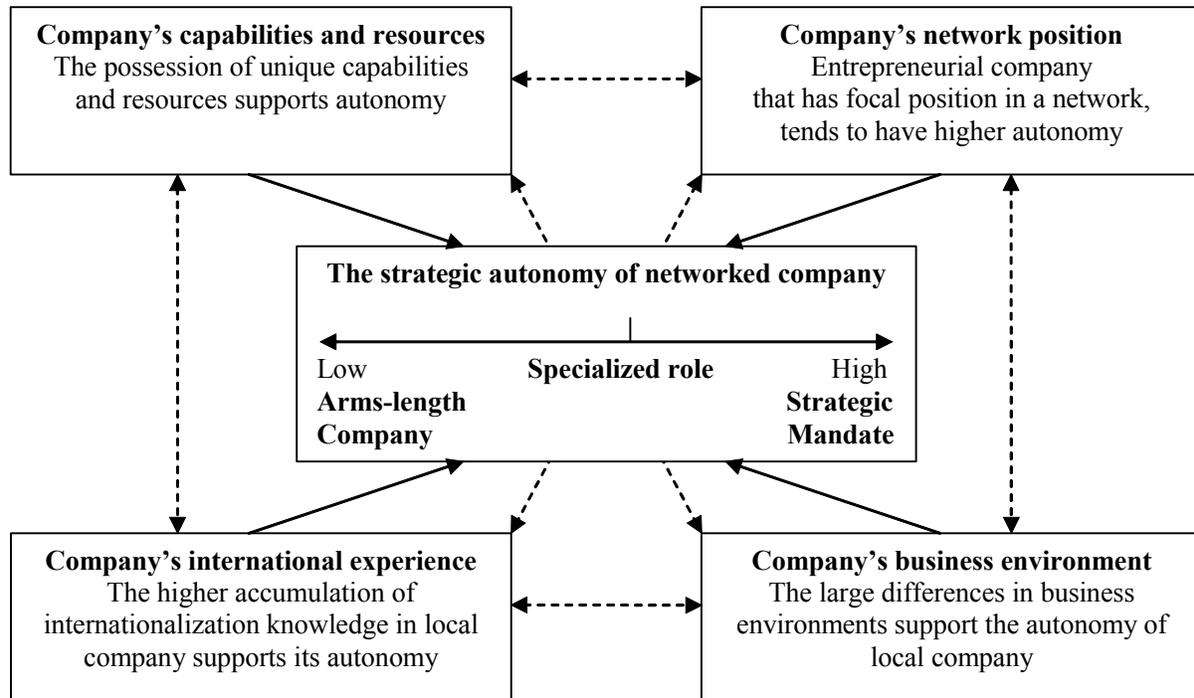


Table 2

The strategic autonomy and its determinants of the case companies

Case Company:*	Strategic position:	Dominant determinants of strategic autonomy:**
<i>Toftan</i> ↑	Specialized	capabilities and resources +; international experience +
<i>Krenholm</i> ↓	Arms-length	core position in network -; business environment -
<i>Hansabank</i> -	Strategic mandate	unique regional capabilities and resources +;
<i>Mootorreisi</i> -	Strategic mandate	core position in network +; business environment +

* arrow indicates the increase or decrease in autonomy

** + positive impact and - negative impact to the case company's autonomy

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