MANAGING INTERNATIONAL NETWORKS
Presentation of a research project

by

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ABSTRACT

This is a presentation of a research project which focuses on influence in divisions of Swedish international firms. Our aim is to study how some intraorganizational relations, i.e. relations between divisional managements usually situated in Sweden and subsidiaries mainly located in Europe, can be influenced by interorganizational factors. The networks in which the subsidiaries are engaged are investigated, in order to see how the characteristics of the networks influence the conditions for the subsidiaries to manage their own development and influence the strategy of the whole division. We assume that the long-term strategic behavior of the divisions and the subsidiaries can be related to the business networks in which they are embedded.

A model, which in earlier versions has been presented at the EIBA-conference in Madrid 1990, at the Strategic Processes Research Conference in Oslo 1991 and at the IMP-conference in Uppsala 1991, is developed. This model is the base for an empirical study which was started during spring 1991 and will be finished at the end of 1992.

The project is partly financed by the FA-Institute - Institute for Research on Business and Work Life Issues. Project leaders are professors Jan Johanson and Mats Forsgren at the Department of Business Studies, Uppsala University, and assistants are Ulf Andersson, Ulf Holm, Cecilia Pahlberg and Peter Thilenius.

INTRODUCTION

Studies of international business traditionally take a hierarchical perspective, where the corporate executive committee controls the subsidiaries and makes the main strategic decisions. (Cf Fouraker and Stopford, 1968; Franko, 1976; Doz and Prahalad, 1981;
Porter, 1986; Egelhoff, 1988). The internationalization process is described as an increasing commitment to markets further and further away, where a firm-specific asset, controlled by the corporate executive committee, is exploited. The foreign subsidiaries act, according to this literature, as the extended arm of the mother-Company. (See e.g. Aharoni 1966, Johanson and Vahlne 1977, Nordström, 1991)

The underlying assumption in these studies is the ability of the headquarters to control and influence a number of subsidiaries in other countries. The main influence over development and investments is thus in the hands of the corporate executive committee at a strategic management level, and the subsidiaries are, in this perspective, active mostly at a local level. Empirical findings in recent years indicate, however, that a substantial proportion of foreign investments has been initiated and accomplished by subsidiaries abroad. These investments are related to activities and information in the subsidiaries rather than to strategic initiatives at the headquarters. (Bartlett and Goshal, 1989; Forsgren, 1989; Gupta and Govindarajan, 1991.)

There is, thus, some evidence suggesting that the hierarchical picture should be replaced by a more complex one, with a number of geographically dispersed, more or less mutually dependent power centres, which in addition to the corporate executive committee exert considerable influence over the development of the total firm. The former periphery of subsidiaries has developed into significant centres for investments, activities and influence, motivated by the economic power in the industrial structures to which the subsidiaries belong. This new multi-centre structure is most evident for firms which are highly internationalized and have a large share of their business and staff outside the parent Company. (Hedlund, 1986; Forsgren, 1989; Goshal and Bartlett, 1990; Kogut, 1990; Poynter and White, 1990).

Our basic assumption is, thus, that the fundamental conflict between the subsidiaries’ need for freedom of action and possibilities for local adaptation, and at the same time, the need for a joint direction and thereby central control from the corporate executive committee’s point of view, leads to difficulties in the strategic management and control of the firm. The traditional view, where the corporate executive committee designs the various control systems, is in our project replaced by a perspective where control is connected rather to power (influence) and position in a network of business relationships. Control has, in this perspective, a wider meaning and is more a question of social relations within the organisation (Astley and Sachdeva, 1984).
Centrality and Network Position

Our study is built on the assumption that the different units within an international firm are parts of a business network, and that the positions within this network affect the possibilities to influence the strategic long-term orientation of the firm. By business network we mean a set of connected exchange relationships between actors controlling business activities. Each activity is more or less dependent on the performance of a number of other activities which must precede or are expected to ensue. Thus, realized strategies in such internationalized firms are assumed to be a consequence of a unit’ relative influence. Business strategies can be seen as the consequence of a struggle between actors, on different organizational levels and with different functional roles, promoting the interests they consider essential. (Hägg and Johanson, 1982; Forsgren and Johanson, 1992).

However, the units do not have the same possibilities to act and to influence other units. They can have a more or less central position in the network, and the centrality will not necessarily coincide with the hierarchical level.

Figure 1: Centrality in a business network
In a business network, A may have a higher degree of centrality than B, although B hierarchically is above A. Connections to the environment give A a more central position. If a subsidiary occupies a central position in a business network which is important for other units in the internationalized firm, the subsidiary has a base for influence irrespective of its position in the hierarchy.

The concept of centrality has been treated within exchange theory and intraorganizational theory (Cook and Emerson, 1984; Astley and Sachdeva, 1984; Markovsky et al., 1988; Patton and Willer, 1989; Krackhardt, 1990; Astley and Zajac, 1990). Cook and Emerson (ibid) propose that a unit’s centrality has to do with the possibilities of exchange of specific resources with other units and to what extent the unit is the only source available for other units to get these resources. This spider-aspect of centrality highlights the relative position in a network of resource-flows. A unit can be in the centre or in the periphery of such a system, and a reasonable approximation of centrality is the number and intensity of the unit’s connections.

A somewhat different view on centrality in an exchange network is proposed by Willer and Patton (1989). According to these authors, the centrality is first of all dependent on a unit’s type of exchange alternatives, not the number and intensity of exchange. By introducing the concepts of exclusion and inclusion they show that even in a situation when a unit is more of a spider than any other unit in the system, it can be heavily dependent on a specific unit because exchange with the latter unit is a necessary prerequisite for exchange with all the other units. In such a situation the power is no longer centralized to the structurally more centralized unit.

Centrality can also be viewed as a collective phenomenon. Astley and Zajac (1990) stress the importance of functional centrality, i.e., to what extent a specific unit is important for the function of the whole system, not only for another focal unit. This means e.g. that centrality is related more to collective dependence, and less to dyadic and relative dependence between two units. Then centrality of a unit is based on the unit’s role and work-function in the system, and a reasonable approximation for a units centrality is the consequences for the system if the focal unit is taken away from the system compared to the consequences for the focal unit itself. This type of analysis is similar to Gouldner’s concept of functional reciprocity (Gouldner, 1967; Larsson, 1985; Forsgren, 1989) and to what Yamagishi call “Proportional Reduction of Flows” (Yamagishi, 1987).
To sum up, the centrality concept can be defined as by Holm (1991):

The functional centrality of a unit in an interdependent inter/intraorganizational network is determined by the loss of activity flows for the system if the unit was removed. In relation to other units, the unit is the most central which removal causes the most negative consequences for the overall activities in the network/organization.

Influence and Network Position

Influence is a central concept in our study, and we consider influence and authority as two distinct dimensions of the power concept (Bacharach and Lawler, 1981). Authority is based on the formal right to control, while influence consists of informal attempts to affect issues or behaviors indirectly. Authority is thus the formal aspect of power and it flows from a higher hierarchical level downwards, while influence can flow upwards, downwards or horizontally (Larsson 1985, Forsgren 1989).

Influence is based on the direct control over the own activities and the importarme of these activities to other actors, but also on indirect control over other actors' activities. An actor can lessen his dependence, and thereby increase his power, by cultivating alternative sources of resources. Increased cooperation between actors enhances these actors' capacities to influence their environments. Perrucci and Pilisuk (1970) suggest that a unit, in order to obtain scarce resources, can mobilize more power by expanding its interorganizational connections, and according to Benson (1975), increased cooperation between organizations enhances their capacity to dominate their environment. Thus, organizations with extensive linkages to the environment are most likely to be powerful. (Provan et al., 1980). The relative strength of a subsidiary is therefore due to its possibilities to raise resources and to influence the firm's activities through direct or connected relationships (Holm et al., 1991).

In our perspective, influence is relative in the sense that both the management and the subsidiaries can exercise influence in different situations. As we assume that a unit's influence is dependent on its network position, it is important to make a survey of this position, i.e. to study the actors, resources and activities involved. In our opinion, the more a subsidiary, from actors outside the firm, obtains resources of critical importance
to other units within the division, the stronger its position inside the division. This is most evident if the subsidiary is the only link to the critical, external counterparts, i.e. there are no alternatives for the other units to get the needed resources. Where the counterparts are located, inside or outside the division, is therefore of interest.

**Hierarchical Position versus Network Position**

Although we consider the network position essential, the possibility to exercise influence is also affected by the hierarchical structure of the firm. As the corporate executive committee has an hierarchical position above the subsidiary, it has a legitimated right to make decisions and to implement these on the operational levels. The hierarchical aspect of control deals mainly with questions about the formal ways of supervising a firm. Control through hierarchical means is ultimately based on the legitimate right to control, i.e. the traditional organizationally sanctioned right, not on the control over actual resources. (Bacharach and Lawler, 1981; Larsson, 1985).

It is usually assumed that the higher a unit’s position, and thereby formal authority, the greater its base for power, all other variables excluded. This derives from the assumption that a higher formal position in the hierarchy gives a better possibility to survey the environment and upcoming situations. Thus, handling a large amount of uncertainty gives a unit an important power base. (Hickson et al., 1971). The importance of control of information is stressed by many researchers (e.g. Pfeffer, 1978). Although this control often belongs to higher formal positions, other units can gain more influence by getting control over information and knowledge.

As discussed earlier, control through the hierarchy can be either countervailed or intensified by the other source of control, the network position. If the resource control is in the hands of the subsidiary, and the subsidiary has a central position in the network, the possibilities to control through the hierarchy are limited. The control can then be even more apparent in the opposite direction. Having a central position in the network can thus be a base for power and influence, irrespective of hierarchical position. The relation between hierarchy and network position is illustrated in Figure 2.
Hierarchical control is one-sided and, as discussed above, based on the legitimated right to make decisions and to implement these on lower levels. If the management does not control any critical resources important for the subsidiary, the possibility to execute this right is limited. Influence through network position, though, is reciprocal. The possibilities to influence is a question of having a central position with access to resources and extensive linkages to important actors in the networks.

**MANAGING INTERNATIONAL NETWORKS (MIN) PROJECT** - Research design

The objective of the MIN-project is to study how the characteristics of the network in which the units of an international firm are engaged, influence the conditions for the subsidiaries to manage their own development and to influence the strategy of the whole division. To what extent, for example, does a subsidiary influence strategic investments and acquisitions, and how are the possibilities to do this affected by the network as well as the hierarchical structure?

The focus is on the relation between a management (usually situated in Sweden) and subsidiaries mainly located abroad. We concentrate on units in Europe, but some additional studies are made outside Europe as well as within Sweden in order to cover the influence from geographical and psychic distance.

International firms usually have a number of divisions or business areas with a global responsibility for strategic and managerial issues, and we focus on the relations within such units. Therefore, the management is in this study not the corporate executive
committee, but the divisional or business area management. Within the division, the relations to a number of subsidiaries are studied. The focused levels are illustrated in Figure 3 below.

**Figure 3: Focused levels**

As we consider the network of vital importance for a unit’s possibilities to have an influence within a firm, it is necessary to determine who the actors in the network are. However, it is impossible to cover all relationships, and therefore we concentrate on the most important actors, within as well as outside the firm. If the subsidiary produces more than one type of product, we focus on the product that is considered the most critical. Our aim is to identify the overall most critical relationships which have an influence on the activities in the subsidiaries. In each subsidiary, thus, we focus on the three functions we consider to be most essential for the purpose of our study: sales, purchasing and the management. The persons in charge of these functions are asked to name the three most important customers, the three most important suppliers and the three most important other counterparts, inside as well as outside the division. The focused actors are illustrated in Figure 4.
The divisional management is obviously a very important counterpart, and in addition to the questions concerning the other counterparts (customers, suppliers etc), an extensive number of questions cover the relationships between the subsidiary and the divisional management. The respondents are asked to decide on a number of different attitude statements, mainly measuring influence, conflict, and distance. When the subsidiaries in a division have been visited, we go to the divisional managements and ask them the same kind of questions in order to cover their opinions about the subsidiaries. In addition to attitude statements, the divisional managements also answer questions about the importance of the different subsidiaries in a number of aspects as well as questions about visiting patterns, budget issues etc.

From the discussion in this paper, it is evident that the relationship between the subsidiary and the divisional management is the central part of our model (see Figure 5 below). Due to its complexity, this latent variable is however impossible to measure directly. Therefore, the model contains four secondary latent variables.

These four variables form a causal framework which can be said to be divided into two parts. On the left-hand side of the model we have the two variables “network position” and “hierarchical position” as discussed above, we mean that the network position of a unit reflects its possibilities to influence the strategic and managerial orientation of the
division/firm. However, this influence can be restricted by the hierarchical position of the divisional management. The right-hand side of the model contains the variables strategic and managerial orientation, where the latter is divided into the sub-variables formal and personal control. Our assumption is, as discussed above, that the relationships between the divisional management and its subsidiaries affect the strategic and managerial orientation of the whole firm, thus affecting other units within or outside the studied division or business group.

Figure 5: Model

The four latent variables, network position, hierarchical position, strategic orientation and managerial orientation, are measured by a number of different variables. Each variable contains a number of indicator groups. Considering all measurement variables, the model has several hundreds of indicators. These indicators can easily be adopted to the LISREL-program and the material can thus be subject to group- and factor as well as structural analysis. In the next section, the four latent variables will be further discussed.
Network Position

The network position can be measured by a number of variables and we will here present three variables which we consider to be of importance. The first concerns the relative importance of the units. In order to determine the importance, the most important actors surrounding the subsidiaries must be identified, as well as the resources controlled by the units. We study in what way the different counterparts are essential for the subsidiaries, for example their importance for product and production development, sales volume or information about market activities as well as the focused subsidiaries importance for the counterparts.

Whether the counterparts are within or outside the division is also essential to study, as we assume that subsidiaries with extensive connections to units inside the division are more likely to be under influence from the divisional management, i.e. the management has a possibility to control the subsidiary through other units within the division. If, though, the subsidiary has most of its connections to units outside the division, we assume that the possibilities for the divisional management to control the subsidiary are considerably smaller. The subsidiary and its important external counterparts are interdependent, and the subsidiary’s adaptation to for example the customers' demands will be more important than the relation to the divisional management in Sweden.

In order to be influential, though, a subsidiary must be of importance to other units within the division. We measure this importance by using the concept “Proportional Reduction of Flows” (Yamagishi 1987). The relative economic importance of the focal units is studied, and we determine the subsidiaries’ direct and indirect contributions to the firm’s profit and turnover. In order to determine how dependent a subsidiary is on the rest of the division, including the divisional management, we ask the respondents how they estimate the consequences for their subsidiary if the division "ceased to exist". This imaginary removal will indicate the hypothetical reduction in internal flows within the firm.

The above-mentioned relationships are all dyadic i.e the direct relationship between specific actors is studied. However, we are also interested in the influence from connected actors. Is, for example, the relationship between a subsidiary and an important supplier influenced by others, for instance competing suppliers, customers or
competitors, and if so, what is influenced (volume, technology etc). Of vital interest is if these connected actors are within or outside the division.

The second group for measuring the network position concerns the units’ knowledge about each others’ network. Knowledge is in our perspective a rather tangible subject, because it considers actual relationships between the actors in a business system. As knowledge cannot be absolute, the main question is to estimate the relative degree of knowledge. How much does the divisional management know about the subsidiary’s counterparts, and how much do the subsidiaries know about the divisional management’s relationships? According to Krackhardt (1990), power in a network does not only accrue to those who occupy central positions but also to those who have an accurate perception of the network. In our network perspective, knowledge about the actual structures, actors and relationships is thus a base for influence. In a sense this variable can counteract the other variables. The subsidiary’s possibilities to have an influence may be expected to diminish if the divisional management has a clear knowledge about the subsidiary’s most important counterparts. Conversely, the subsidiary’s possibilities will increase the less knowledge the divisional management has.

A vital aspect connected to the network position concerns social relationships. Our assumption is that a subsidiary with individuals having extensive personal contacts to important customers, suppliers and other counterparts has a more established network position than units without such contacts. Other significant counterparts might be representatives for governmental units, banks or financial institutes, trade associations, competitors, R&D-units etc. Through contacts with important counterparts, the subsidiary has an opportunity to get valuable information as well as a possibility to influence. As social contacts take time to establish and are built on mutual trust and adaptation, it is most likely difficult for the divisional management to take control over these relationships, even in cases when they are of importance for the whole division. When a counterpart is essential to the division, the subsidiary can thus strengthen its position by acting as a “beach-head” - the subsidiary is the division’s only contact to the counterpart.

If a subsidiary is important for the function of the whole division, if this subsidiary has extensive contacts with important actors in a the surrounding network, and if the divisional management has limited knowledge about the subsidiary and its network,
there are several indicators of a strong network position. The divisional management’s control through hierarchy can then be countervailed by the subsidiary’s influence obtained through this position. Thus, if resource control is in the hands of the subsidiary, and this subsidiary has a central position in the network, the possibilities for the divisional management to control through the hierarchy are limited. The control can then be even more apparent in the opposite direction. Having a central position in the network is thus a base for influence, irrespective of the hierarchy.

Hierarchical Position

In order to determine the hierarchical position, we first study the geographic as well as the psychic distance between the divisional management and the subsidiaries. Our assumption is that units far away from the divisional management are more difficult to manage than units in countries close to the management. The same assumption concerns psychic distance.

A second variable is the span of control, which reflects the number of units the divisional management potentially can control. We assume, that a wide span of control (= a large number of units) results in difficulties for the divisional management to supervise the subsidiaries as close as when the span is narrow. The number of formal hierarchical levels between the subsidiaries and the divisional management is also investigated, and our assumption is that supervision and control is facilitated when there are few levels between the units.

A third measure variable is the attitudes in the local divisions towards the hierarchy, a variable we call “hierarchical legitimacy”. An indicator of this is the local unit’s opinion about the formalization within the division. We study to what extent a local unit is constrained by formal rules and policies concerning such areas as technical design and manufacturing, accounting, marketing and organizational philosophy, and ask the respondents to what extent they rely on and follow these rules. Another indicator of the hierarchical legitimacy is connected to the global divisional management’s knowledge. According to a political perspective (Forsgren 1989), managers without knowledge about markets and technologies risk losing part of their legitimacy.
**Strategic Orientation**

The effect of network position and hierarchical position on the relationship between a subsidiary and divisional management can be studied through the strategic orientation of the firm. To what extent, for example, can a subsidiary influence strategic investments and acquisitions, and how is this affected by network position?

By strategic orientation we mean the division’s actions in terms of products, markets, investments and localization, including localization of development activities and management. It refers to actual activities which can be observed as facts rather than as intended strategies developed by the divisional management or the headquarters. In our view, the stronger the network position of the subsidiary, the more influence the unit can exert on the strategic orientation and therefore on, e.g., the actual investments of the division. A strong network position is reflected in investment behavior oriented towards the development of the subsidiary’s network. One example is efforts in developing products which are mainly of interest to the subsidiary or the acquisition of companies which are of importance in the subsidiary’s network. The divisions’ resources for strategic action are limited, and the stronger the position of the subsidiary, the larger the share of these resources will, ceteris paribus, be spent on investment which is in accordance with the subsidiary’s interests.

**Managerial Orientation**

The variable managerial orientation refers to the formal and personal management control systems. The traditional view of formal management control is unirational, indicative of a single rationality emanating from the senior management group, which is presumed to be implemented throughout the organization by use of formal control systems. This view has been challenged by several scholars arguing that political relationships between interest groups determine an organization’s actions and outcomes. Organizations are constructed out of conflicts, and management control systems are a means, as well as a result, of the political interaction between organizational interest groups. (Wildawsky, 1978; Dunbar, 1981; Markus and Pfeffer, 1983; Dermer and Lucas, 1986; Covaleski and Dirsmith, 1986). Relationships should be understood in terms of political negotiations and the balancing of forces between units, and not solely
in terms of unilateral regulations by a controller of a controller. The role of each organizational unit is regulated, but this regulation exists on the basis of negotiations between units. Actual control systems are, in fact, the emergent results of prior political negotiation between organizational units (Dermer and Lucas, 1986).

According to our view, the subsidiary’s network position as well as its hierarchical position influence the formal control system in terms of, e.g., measurement systems used and the budgeting process. In fact, though, this relation can materialize in different ways. Either the control system is incongruent with the distribution of power or it is not because the political negotiations between the parties involved have adapted the system to the different interests. But in international firms with several subsidiaries but under a common headquarters, the possibilities to adapt the control system to each one is limited and is also in conflict with management’s need for consistency in the whole system. A reasonable assumption would therefore be to expect the control system to be more adapted to the subsidiaries with the most powerful network position and/or powerful hierarchical position.

The formal management control system is supposed to be a tool for managers in their interaction with subordinates in order to inspire people to perform organizational activities that will further the organization’s goal rather than their individual goals. It consists of a structural dimension as well as a process dimension (Anthony, Dearden and Bedford, 1989).

The structural dimension usually focuses on various types of responsibility centers classified according to the degree the inputs and outputs, for which a center manager is responsible, are measured in monetary terms. This classification also mirrors the degree of independence of the unit. If, for instance, one subsidiary is defined as an expense center in the system while another subsidiary is an investment center, there is reason to assume that the latter subsidiary, ceteris paribus, in relation to the rest of the organization, has a higher degree of control over its input and output activities. We can therefore also expect a relationship between the type of responsibility center and the network and hierarchical position.

The management control process can be presented in terms of programming, budgeting, operating reporting and analyzing (Anthony, Dearden and Bedford, 1989). Programming has to do with selecting specific programs in terms of product or product
lines and the budgeting with transforming this into activities that correspond to responsibilities of the manager of each responsibility center for the time period. The budgeting process is essentially one of negotiation between the subsidiaries and the divisional headquarters to determine what the subsidiaries will do and in what manner, and the end product is an approved statement of the revenues and/or expenses expected during the budget year for each subsidiary and for the whole division. To the extent that the parties deem the process as important they also aim at influence the outcome of these negotiations in terms of activities and standards as much as possible. Therefore, the more powerful the subsidiary, the more influence it will exert on activities defined in the budget and budget goals, not only for its own programme but perhaps also for other subsidiaries’ programmes, thus influencing the whole division.

The analysis of outcome against budget may also reflect the position of the unit. First of all this is a question of who has got the “first option” in interpreting the deviations from budget. The more powerful the subunit, the more it itself controls the analysis of the causes of deviation from budget and the corrective actions.

But beside these relationships between different components in the formal management control system and a subunit’s position, the relationship can also be of a more general nature. Considering that the management control system is first of all a manager’s tool to control subunits, the power structure can also be expected to influence the managers’ possibilities to use the tool effectively. The efficiency is dependent on the extent to which the different phases in terms of programming, budgeting, operating, reporting and analysis, is carried out in an accurate way and collectively constitute a “closed loop”. If one or several of these phases are missing or performed in a bad way, the tool as such looses its control efficiency. If a subunit wants to evade the formal management control system, and also has a position which gives it possibilities to do so, it can be reflected in an incomplete process with only rudimentary phases or perhaps some phases totally missing.

The formal control is also reflected in rules on investment decisions and representation in the units’ executive boards. We investigate to what extent a subsidiary can decide on investments not only within its own unit but also influence investments in other units. When it concerns board-representation, we assume that subsidiaries which are represented in the divisional board or corporate executive committee are considered more important by the firm than subsidiaries without representation. Representation by
the divisional management or corporate executive committee in the subsidiary board can also be a measure for the importance of a subsidiary.

Personal management control concerns the visiting pattern and includes the divisional management’s visits to the subsidiary as well as the subsidiary’s visits to the divisional headquarters. The frequency of visits from the corporate executive committee is also studied. Our assumption is that many visits to a subsidiary indicates that this unit is of importance. We also mean, that it is an indication if the management from Sweden more often visit the subsidiary instead of the subsidiary management visiting Sweden. The divisional managements contacts with the subsidiary’s counterparts, in terms of time and intensity, are also studied, in order to see how important these counterparts are considered to be. As time seems to be a scarce resource, we assume that the divisional management only meet with those who they consider being of importance. Finally, the nationality of the management is considered important for the personal control. One way of overcoming the problem with psychic distance in the relationship between divisional and subsidiary managements is to use expatriates as subsidiary managers. But the result of this is dependent on the relative influence in the relationship.

The empirical phase

The model and research design presented above constitutes the theoretical framework of an ongoing study which includes ten divisions and about 60 divisional management - subsidiary relationships in Swedish international firms. Data collection is carried out through standardized interviews with managers of the subsidiaries as well as the divisional management. The empirical phase of the project will be completed at the end of 1992.

Statistical analysis of the material will give insights into the overall relationships between network position, the hierarchical position and the influence on strategic and managerial orientation in different divisions and different subsidiaries within one and the same division. It will also be possible to make different kinds of partial analyses of the relationship between certain indicators which are used to measure underlying variables.
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