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Expatriates and corporate-level international strategy: governing with the knowledge contract

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Abstract

Purpose – This paper proposes a methodology for governing expatriate assignments in the context of corporate-level objectives.

Design/methodology/approach – The approach taken is to envisage expatriate managerial assignments within the theoretical framework of agency theory and the knowledge-based view of the firm. The paper begins with the view that knowledge acquisition and integration is a primary goal for most expatriate assignments. The relationship between expatriate managers and multinational corporation (MNC) headquarters from an agency perspective are considered and the notion of a "knowledge contract" as a means of governing that relationship is discussed. Four corporate-level international strategies available to MNCs (global, international, transnational, and multidomestic) are then examined and the extent of agency problems under each strategy is discussed.

Findings – The paper makes specific predictions about the type of knowledge contract that is most likely to address agency problems for each corporate strategy.

Originality/value – This research extends agency theory by introducing the knowledge contract as a means of managing agency concerns. This offers a broader range of contract alternatives, moving researchers beyond traditional agency theoretic prescriptions. The research also contributes to the literature on expatriate management by integrating assignment success with research on corporate-level international strategy. Few authors have recognized organizational strategy as an important unit of study in international human resource management. Doing so, however, has yielded a unique set of contingency relationships that would otherwise be obscured.

Keywords Expatriates, International business, Corporate strategy, Knowledge management

Paper type Conceptual paper

Introduction

Multinational corporations (MNCs) invest more in a single expatriate manager than perhaps any individual in the organization other than the chief executive officer (CEO) (Selmer, 2001). In spite of this, organizations rarely consider expatriate assignments from a strategic perspective. One indicator of this problem is the lack of consensus regarding how to gauge the success of these assignments. In fact, scholars have considered different measures of success at different levels of analysis, and these indicators are often inconsistent with one another (Edmond, 2002). For example, some scholars have considered success at the level of the subsidiary, and suggested that it is primarily a function of financial objectives such as growth and profitability (Fey and Bjorkman,

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2001). Others have considered success at the level of the individual employee (Tung, 1987), suggesting that successful assignments are those that do not end prematurely (Hogan and Goodson, 1990). These indices of success are inconsistent, increasing the difficulty of relating them to success considered at the level of the organization. A primary goal of this work is to consider how MNCs can govern expatriate managers in view of corporate-level objectives. We believe that our conceptualization of these processes offers a more comprehensive measure of expatriate success.

To accomplish our research objective, we first discuss how expatriate managers can contribute to the competitive advantage of MNCs through their role in the knowledge transfer process. We then present a framework for discussing corporate-level international strategy, consisting of four basic types. Drawing on agency theory (Jensen and Meckling, 1976), we consider the extent to which agency problems exist in the relationship between expatriate managers and MNC headquarters under each type. We describe the potential conflict of interest that exists between MNC headquarters and expatriate managers and examine how to align their interests using what we refer to as the "knowledge contract." Finally, we make specific predictions about the best kind of knowledge contract to use to successfully address agency problems under each strategy.

This work makes three contributions to the literature. First, it provides a new mechanism for gauging expatriate success. Whereas, previous analyses have focused mainly on individual and subsidiary levels, this paper explores organizational level concerns. We address individual and subsidiary level factors only to the extent that they are related to corporate-level strategy. Second, in regard to governing and managing expatriate assignments, this research moves the emphasis from traditional measures of compensation and promotion to that of knowledge management. This represents a significant shift from current practice and from the dominant prescriptions emerging from the expatriate literature. Finally, our analysis of expatriate managerial assignments by type of corporate-level international strategy provides a useful typology of expatriatism with the potential to facilitate future research efforts to explore more fully the concept of expatriate types.

Knowledge and the agency problem

The knowledge-based view of the firm is one of the most commonly used strategic lenses for evaluating organizational actions and outcomes (Grant, 1996). Knowledge-based logic suggests that the most important objective facing MNCs today is the transfer and exploitation of knowledge in a manner that is more effective and efficient compared to external market structures (Ghoshal, 1987; Grant, 1996; Jackson *et al.*, 2003; Teece, 1977). As external markets become more open and efficient, MNCs experience pressure to design increasingly efficient knowledge transfer strategies (Gupta and Govindarajan, 2000), and expatriate managers serve at a critical point in the knowledge management chain. Specifically, the MNC's capacity to transfer knowledge within its boundaries efficiently and effectively hinges on its global network of expatriates (Bender and Fish, 2000). Therefore, it is imperative that firms pay close attention to the mechanisms that govern expatriate managers in the knowledge management process.

Expatriate managers play a crucial role in the knowledge integration process and are important to efforts undertaken to effectively leverage knowledge resources (Downes and Thomas, 2000; Zahra *et al.*, 2000). This process involves both acquiring knowledge and diffusing that knowledge throughout the organization. In fact, Gupta and Govindarajan (1991, p. 473) suggested that "the primary reason why MNCs exist is because of their ability to transfer and exploit knowledge more effectively and efficiently in the intra-corporate context than through external market mechanisms". Although knowledge integration may be a major goal in expatriate assignments, there are some reasons why this integration may not occur. Expatriate managers have little incentive to share knowledge they have acquired because, to the extent that they harbor a monopoly of locally developed knowledge, they gain bargaining power in the MNC by controlling an important asset (Coff, 2003). Further, it is impossible for the organization to be aware of all the knowledge expatriates gain during their assignments or to monitor the extent to which expatriates share that information. This results in a basic agency problem.

Agency theory is commonly used to examine governance mechanisms in a relationship where one party delegates control to another party (Jensen and Meckling, 1976). A fundamental concept in agency theory is that of a contract that governs the principal-agent relationship in a situation where both parties act according to their economic self-interests (Fama, 1980; Jensen and Meckling, 1976). The "agency problem" refers to conflicts between the two parties that the contract is meant to address. The extent to which agency problems exist revolves around the dual issues of information asymmetry (i.e. the agent has information that is not available to the principal, and it is difficult for the principal to verify the agent's intentions or behavior) and opportunism (i.e. agents may act according to their own preferences, at the cost of other goals that are important to the principal) (Eisenhardt, 1989). Although these two concepts are related such that information asymmetries increase the potential for opportunistic behavior, the literature has historically viewed information asymmetry and the threat of opportunism as distinct variables (Conner and Prahalad, 1996). Thus, MNCs need mechanisms to ensure that the information for which they sent expatriates overseas to acquire will actually be shared and integrated into the rest of the firm, either within the host country or in the home country. The managerial expatriate assignment results in a classic principal-agent structure in which a principal (MNC headquarters) delegates control to an agent (the expatriate manager). Information asymmetries and a threat of opportunism are products of this structure.

A conflict of interest between principal and agent is a fundamental assumption of agency theory (Jensen and Meckling, 1976). Information asymmetries and the threat of opportunism are not problems unless such a conflict exists. In fact, solutions to the agency problem often try to avoid the conflict by aligning the interests of principal and agent. Scholars have established that a conflict of interest exists between MNC headquarters and their subsidiaries, owing to different goals, motivations, and roles (Bjorkman *et al.*, 2004; Nohria and Ghoshal, 1994). Roth and O'Donnell (1996) suggested that this conflict of interest existed between MNC headquarters and subsidiary managers. We agree, and further extended it to the relationship between MNC headquarters and expatriate managers. The primary interest of expatriate managers is likely to be advancement of their own career. In pursuit of such interests they may make themselves more valuable to the firm by harboring knowledge and skills rather than institutionalizing them. Thus, their own interests conflict with those of headquarters. Yan *et al.* (2002, p. 380) describe this in more detail:

> According to agency theory, because of the low verifiability of what the expatriate manager is actually performing in a foreign environment, it is likely that he or she will leverage this performance and engage in activities such as cultivating local networks that increase his or her marketability, jockeying between companies for better job offers, or withholding strategic information from the focal firm to increase individual bargaining power.

This conflict of interest between MNC headquarters and expatriate managers lies at the heart of differing perspectives about expatriate success. Under agent opportunism, the experience described above may be highly successful from the individual's perspective but not at all successful from the organization's perspective. To address these divergent perspectives, we suggest that firms align the success metrics of headquarters with those of the expatriate manager by settling in advance common objectives for knowledge integration.

The knowledge contract

We introduce a "knowledge contract" between expatriate managers and the MNC to describe explicit arrangements about integrating locally acquired and developed knowledge. Organizations may use the knowledge contract to resolve agency problems that exist between the two parties. We define the knowledge contract as the governance mechanisms, or rules of the game, by which organizations monitor and reward expatriate managers for how they acquire, synthesize, and share local knowledge with the subsidiary, other subsidiaries, or the firm's headquarters.

Although the knowledge contract will have both explicit (written) and implicit (psychological) forms, we focus here on the written component. Organizational knowledge goals drive the written knowledge contract, which Yan *et al.* (2002) characterize in three components: retention, transfer, and utilization of expatriate manager expertise. The focus of retention is on keeping the expatriate manager's knowledge by keeping the manager within the organization's boundaries (Bender and Fish, 2000). The written knowledge contract may seek to retain expatriate managers, for example, with guarantees of employment or promotion upon repatriation (Fey and Bjorkman, 2001). Knowledge transfer here refers to moving knowledge from the expatriate manager into another knowledge repository in the organization (Teece, 1977). In the written knowledge contract, this may take the form of expressly designated mentor or co-worker relationships with other expatriates or with host country nationals (Chiesa and Manzini, 1996). Alternatively, knowledge transfer may occur because of written mandates for the institutionalization of knowledge via requirements for documentation or reports. Organizations may address the utilization of knowledge from expatriate managers in two directions. First, they may guard against knowledge utilization toward opportunistic ends using the knowledge contract (Mudambi and Navarra, 2004). For example, expatriate managers may be prohibited from engaging in competing businesses in the local market for some period of time. Second, they may provide incentives for leveraging expatriate knowledge for strategic competitive advantage (Cantwell and Mudambi, 2005). For example, expatriate managers may be rewarded with additional compensation for innovations developed at their subsidiary (Bonache and Fernandez, 1997).

Researchers have also identified a psychological contract that specifies beliefs about reciprocal and promised obligations (Rousseau, 1989). Although it is implicit, unwritten, and informal, the psychological contract may include important expectations that, if left unmet, can adversely affect the employment relationship and its outcomes (Morrison and Robinson, 1997). For example, Feldman and Thomas (1992) argue that perceived violations of international managers' psychological contract can contribute to high turnover rates. For the expatriate manager, the focus of the psychological contract is on rewards such as continued development, attractive future assignments, and promotion (Yan *et al.*, 2002). For the organization, the psychological contract revolves around the significant financial investment that it has made in the individual (McNulty and Tharenou, 2004). We recognize the psychological contract and the written knowledge contract are not entirely independent. However, we are mainly concerned in this research with the governance mechanisms of the written knowledge contract rather than the unstated and implied expectations of the psychological contract.

The MNC can employ various governance mechanisms within the knowledge contract to either encourage or enforce knowledge integration (Chiesa and Manzini, 1996). Prior research has considered the means necessary to ensure knowledge transfer between MNC headquarters and subsidiaries (Bjorkman *et al.*, 2004). However, the knowledge contract is mainly concerned with mechanisms for integrating knowledge into the organization, or transferring knowledge from the expatriate manager to local managers or other expatriates. Mechanisms for knowledge integration may include incentives such as promotion guarantees, contingent financial rewards, or enlargement of responsibility. The knowledge contract may incorporate monitoring and control mechanisms, such as documentation and reporting requirements, or compartmentalizing routines such that complete knowledge does not rest in a single individual. It may also include structures designed to promote knowledge sharing, such as mentoring or co-worker relationships with a view toward knowledge transfer. Managing with the knowledge contract assumes an intentional approach toward understanding knowledge that emerges from expatriate assignments and incorporating mechanisms back into the individual's contract to ensure its retention, transfer, and utilization. The more mechanisms that firms employ, the more specific the knowledge contract becomes, aligning the interests of principal and agent and attenuating potential agency problems.

Although it might seem that MNCs should always move toward increased specificity of knowledge contracts to better align the interests of principal and agent, this specificity is not without cost (Jones, 2001). Transaction costs of the knowledge contract are the summed costs, direct and indirect, associated with the rules and routines designed to monitor and reward expatriate managers for knowledge integration behavior. As MNCs move from broad, nonspecific contracts to very specific, binding contracts they also increase the transaction costs involved in administering and monitoring that contract. Thus, when agency problems are severe, firms will likely employ specific knowledge contracts to mitigate the potentially high costs associated with their agency problems. However, when agency problems are not significant, firms are more likely to make use of nonspecific knowledge contracts to reduce overall transaction costs. Therefore, we posit the following (see Figure 1):

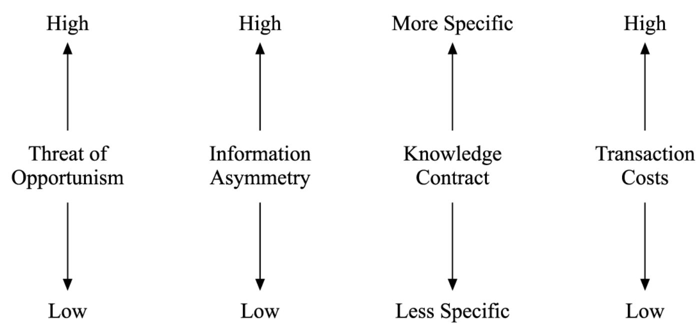

Figure 1.
Specificity of the knowledge contract

P1. The threat of opportunism by expatriate managers and the degree of information asymmetry between expatriates and MNC headquarters is negatively related to specificity of the knowledge contract.

The seriousness of the principal-agent problem, and the utility of different types of knowledge contracts, also depends on the specific international strategy the MNC is implementing. This is because different corporate-level international strategies leverage different kinds of knowledge and impose different knowledge-development concerns. These relationships are described next.

International corporate-level strategies

Corporate-level international strategy types, and how to choose a suitable one, have received much attention in the popular press (Mankin and Cohen, 2004), mainstream business literature (Hout *et al.*, 1982), and academic literature (Harzing, 2000). Firms that operate internationally typically face two types of competitive pressures: pressure to reduce costs and pressure to be locally responsive to the markets in which they operate (Bartlett and Ghoshal, 1991). These pressures place conflicting demands on subsidiaries. To minimize costs, firms may need to base their core businesses and productive resources at the most favorable low-cost location and offer standardized products to a global marketplace. To accommodate diverse demands arising from market differences, firms may also need to differentiate product offerings and marketing strategies from country to country, which raises costs. Carrying out a specific strategy to balance these competing demands allows firms to develop ownership advantages, or firm-specific advantages (FSAs), associated with internalization (Rugman and Verbeke, 2001). When an MNC reaches a certain level of product complexity across multiple industries and countries, it becomes increasingly burdensome to operate without an international strategy at the corporate level (Hitt *et al.*, 1994).

The academic literature features a wide variety of dimensions and prescriptions for corporate-level international strategy, resulting in some conceptual ambiguity about the substance of an "international strategy." One often used typology is that prescribed by Bartlett and Ghoshal (1998), who identified four main strategies for the MNC: global, international, transnational, and multidomestic. A global strategy is one that centralizes strategic and operating decisions in the home office, which is responsible for integrating interdependent strategic business units worldwide. Firms following this strategy try to standardize their product offering and marketing strategy so they can reap maximum benefits from economies of scale. This strategy is most suitable to situations in which there are strong pressures for cost reductions and demand for local responsiveness is low, such as that found in many industrial goods industries (Hitt *et al.*, 2007). Because of the need to coordinate strategies and operating decisions across country borders, these firms require a high degree of resource sharing and cooperation, leveraging innovations and core competencies developed at or with the home office.

A multidomestic strategy, on the other hand, seeks to achieve maximum local responsiveness (Hout *et al.*, 1982). Customization is at a premium, and firms design products and strategies to meet the specific needs and preferences of local customers. Consistent with customization is an accordingly high cost structure where firms develop a set of value creation activities for each major national market in which they do business, rather than leveraging resources and distinctive competencies from the home office. As the organization decentralizes strategic and operating decisions to business units, each national subsidiary operates in a largely autonomous manner.

The international strategy bears similarity to a global strategy in that it creates value by transferring core competencies and resources from MNC headquarters to foreign markets. However, the international strategy is distinct in that the firm decentralizes resources and capabilities outside the core to subsidiaries. Firms carrying out an international strategy will typically undertake some level of customization of product offering and marketing to leverage core competencies within local markets, but customization is usually limited in scope. This strategy is common among firms that control a valuable core competence at headquarters that is lacking or insufficient in the foreign market, and is only useful when pressures for local responsiveness exist but are fairly weak.

Finally, the transnational strategy involves a firm simultaneously seeking to lower its costs while being responsive to local demands. The difficulty in implementing a transnational strategy lies in reconciling conflicting goals:

- the demand for low cost, which requires global coordination; and
- the demand for local responsiveness, which requires flexibility and local control.

Firms seek to resolve this conflict by creating an integrated network of subsidiaries with shared vision and common commitment. The core distinction of a transnational firm is that competencies and resources do not reside solely in a single country, but instead may develop in any of the company's worldwide operations. Knowledge, therefore, is decentralized and knowledge transfer occurs between subsidiaries as much or more than between headquarters and subsidiaries.

Extent of the agency problem under each strategy

The agency problem differs across the four types of MNC strategies discussed above. Within the context of a global strategy, for example, expatriate managers are likely to take on an institutionalized role with little managerial discretion. Because coordination occurs mostly from the home office, the organization does not imbue expatriates with power to make independent decisions for the subsidiary. Instead, expatriate managerial decisions are interdependent with headquarters and with other subsidiaries (Roth and O'Donnell, 1996). Because the emphasis is on cost reduction and worldwide standardization, it is important to centralize strategic decision making at the home office. Expatriate managers therefore have fewer occasions to act opportunistically. As a result, we propose the following:

P2a. The threat of opportunistic behavior by expatriate managers is low in firms carrying out a global strategy.

Further, the specialized knowledge needed to manage a firm exercising a global strategy is based at headquarters. This requires visibility on the part of expatriate managers worldwide for the strategy to work effectively. Information that is available to expatriates is also available to the home office. In fact, under this strategy, most of the core knowledge needed for high-level expatriate managers to do their job originates from the home office. Because knowledge is centrally located and shared with subsidiaries throughout the world, it needs to be both codifiable and transferable (Kogut and Zander, 1993). The emphasis, then, is on explicit knowledge that headquarters disperses from a central repository and makes widely available throughout the firm. There is relatively little need to develop local knowledge because the primary objective of expatriate managers becomes one of implementing strategies established by the parent company (Bartlett and Ghoshal, 1998). Thus, we propose:

P2b. Information asymmetry between expatriate managers and MNC headquarters is low in firms implementing a global strategy.

Expatriate managers working under a multidomestic strategy typically control research and development, production, and marketing activities with a great deal of autonomy, often with host country nationals. These firms do not centralize decision making at headquarters, but instead delegate authority so that expatriate managers can customize products and services and add value. As a result, monitoring their work is increasingly difficult (Rajagopalan and Finkelstein, 1992). The goal of expatriate managers becomes a complex one of sensing and exploiting local opportunities (Bartlett and Ghoshal, 1998). This is a highly nonprogrammable task, and it is important for expatriate managers to gain the necessary knowledge to develop innovations locally. Expatriate managers in the multidomestic firm will acquire knowledge that is region-specific and is nontransferable. Thus, expatriate managers in multidomestic firms will incur risk as they gain information that, in large part, is not valuable in other settings. These expatriates are likely to reduce that risk by engaging in various forms of opportunistic behavior. Thus, we propose:

P3a. The threat of opportunistic behavior by expatriate managers is high in firms carrying out a multidomestic strategy.

Similarly, as the role of expatriate managers becomes more autonomous, they increasingly lose the ability to transfer skills and knowledge to the home office or to other subsidiaries (Hill and Jones, 2004). A significant portion of the expatriate manager's knowledge stock under a multidomestic strategy is highly localized, so there is little incentive to transfer that knowledge back to the home office because it may not be generalizable to other markets. Neither the incentive system nor the structure is in place to promote knowledge transfer. As expatriate managers in the multidomestic firm develop local knowledge through intricate social relationships with host country nationals (Toh and DeNisi, 2003), they are likely to build tacit knowledge that is not readily transferred to the MNC. Furthermore, expatriate managers may purposely inhibit knowledge transfer to leverage that knowledge in future bargaining with the MNC and make themselves more valuable to the firm. Because the success of expatriate managers in multidomestic firms is tied to local responsiveness, it is important that they both acquire local knowledge and leverage that knowledge for firm growth. There are, however, several factors inhibiting transfer of that knowledge to the home office. Expatriate managers in firms following this strategy create information asymmetries between themselves and MNC headquarters, so we propose that:

P3b. Information asymmetry between expatriate managers and MNC headquarters is high in firms carrying out a multidomestic strategy.

The goal of expatriate managers in firms carrying out an international strategy is one of adapting and leveraging headquarters' competencies (Bartlett and Ghoshal, 1998). Organizations necessarily provide expatriate managers with some degree of decision-making authority so they can adapt products and services locally; ultimately though, the head office retains tight control over strategic decisions (Hitt *et al.*, 2007). The knowledge base developed by expatriate managers leverages core competencies in the local market, and is therefore partially region-specific. However, skills developed in leveraging core competencies from headquarters are more readily transferable to other markets, in contrast with expatriate managers in multidomestic firms who deal primarily with locally developed core competencies. Therefore, personal asset specificity (and its associated risk) incurred by expatriate managers in international firms is less of a problem than it is for multidomestic firms, but more common than for global firms, where local knowledge and responsiveness are not highly valued. There is less need for expatriate managers in international firms to engage in opportunistic behaviors as ways of reducing risk, leading us to propose that:

P4a. The threat of opportunistic behavior by expatriate managers is low in firms carrying out an international strategy, but not as low as that found in global firms.

Firms carrying out an international strategy centralize core competencies at headquarters, so they generally develop knowledge at the home office and transfer it to expatriate managers (Bartlett and Ghoshal, 1998). Expatriates in these firms transfer valuable competencies and products to a market where indigenous competitors lack those competencies and products. As expatriate managers receive core competencies from headquarters, the emphasis is again on explicit knowledge that can be codified. However, because these firms are not innovating locally and local responsiveness is limited to rudimentary customization, there is less emphasis on acquiring local knowledge. The international strategy attends to language differences and basic cultural norms from a marketing standpoint, but does not attempt to adapt core competitive advantages to local needs. The international strategy may involve more tacit knowledge development than that found in the global strategy because expatriate managers must adapt and leverage core competencies locally. The tacitness and complexity of knowledge development does not approach that found in multidomestic firms that focus on local innovation and value creation. Therefore, information asymmetries in international firms are relatively low, such that:

P4b. Information asymmetry between expatriate managers and MNC headquarters is low in firms carrying out an international strategy, but not as low as that found in global firms.

The role of expatriate managers in a firm using a transnational strategy is unique because these firms differentiate contributions of subsidiaries (Bartlett and Ghoshal, 1998), and managers therefore take on specialized functions. Expatriate managers assume global responsibility for a set of value creating activities associated with a specific product or service, resulting in a laterally coordinated organizational structure (Roth and O'Donnell, 1996). The complex nature of such a role mandates a certain degree of managerial discretion, which in turn increases the number of decision options available to the expatriate (Hambrick and Finkelstein, 1987). This laterally coordinated form bears similarity to multidomestic organizations because the role of expatriate managers is multi-faceted, nonprogrammable, knowledge intensive, and concerned with local innovation. At the same time, the degree to which skills and knowledge developed by expatriate managers in transnational firms are region-specific is tempered by an emphasis on information sharing and resource interdependence.

The transnational strategy has at least two main effects on expatriates' motivation to share knowledge. First, expatriate managers have incentives to share locally developed innovations and knowledge with the home office and other subsidiaries, making that knowledge less region specific and more useful on a global scale. Second, expatriate managers in transnational firms have at their disposal a developing knowledge base from a broad variety of subsidiaries, making each manager's knowledge base inherently more global. Armed with a personal asset base that is less region specific than that found in multidomestic firms, expatriate managers in transnational firms incur less personal risk and are therefore less likely to seek risk aversion strategies. The significant degree of managerial discretion that organizations ascribe to them is counterbalanced by their risk tolerance. Therefore, the threat of opportunism by expatriate managers in transnational firms will be high, but not as high as that found in multidomestic firms. Specifically, we propose that:

P5a. The threat of opportunistic behavior by expatriate managers is high in firms carrying out a transnational strategy, but not as high as that found in multidomestic firms.

The nature of the transnational strategy requires expatriate managers to acquire, leverage, and transfer specialized knowledge, but the transferability of knowledge in transnational firms is limited by at least three issues. First, expatriate managers working under this corporate strategy face a vast array of information originating from diverse sources across multiple geographic boundaries with associated language, time zone, and cultural barriers. This information is far more complex and multidimensional than that found in firms following global or international strategies and expatriate managers are unlikely to be capable of processing and transferring all the information that is available to them. Second, knowledge transfer in the transnational firm is checked by the competing demand of local responsiveness. Local responsiveness raises costs, reduces the ability (and willingness) to share knowledge, and increases, to some degree, the personal asset specificity of expatriate managers as they seek to meet the customization needs of a particular market. Local responsiveness also results in a higher degree of tacitness because locally developed knowledge is wrapped up in culture, customs, and relationships. Third, lateral centralization of core competencies contributes to information asymmetries between expatriate managers and the MNC because the network of subsidiaries does not transfer all knowledge efficiently. Multiple subsidiaries generate core competencies and value-added activities. As such, either headquarters or expatriates may gain information that is salient to the expatriate's task without the other party being aware that such knowledge even exists. Unlike the other three strategies, where one of the two parties in the principal-agent relationship creates knowledge, the transnational firm introduces third-party innovation to which either the agent or the principal may not be privy. These three issues together create information asymmetries between the home office and expatriate managers in transnational firms. Because the transnational MNC focuses on shared knowledge, the effect of these asymmetries should not be as severe as that found in multidomestic firms. Thus, we propose:

P5b. Information asymmetry between expatriate managers and MNC headquarters is high in firms carrying out a transnational strategy, but not as high as that found in multidomestic firms.

We summarize our arguments about information asymmetries and the threat of opportunism for each of Bartlett and Ghoshal's (1998) four corporate-level international strategies in Table I. These two dimensions, information asymmetry and the threat of opportunism, will in turn determine the extent to which the potential for agency problems exist.

Agency problems and the knowledge contract

Given the preceding propositions, we may use the knowledge contract to develop agency theoretic prescriptions for situations involving specific corporate-level strategies. We argued earlier that a more specific knowledge contract will result in higher transaction costs as firms impose rules, routines, and procedures designed to bind expatriate knowledge to the MNC at large. These transaction costs include not only negotiating, but also monitoring and enforcing the knowledge contract (Hennart, 1988). Organizations have several means of enforcement at their disposal, including coercion, sanction, and withholding of rewards. The transaction costs of enforcement depend in large part on the form of enforcement, which is likely to be affected by the degree to which the organization has invested in the expatriate.

A countervailing force is the transaction cost associated with the threat of opportunistic behavior on the part of expatriate managers and with information asymmetries between expatriate managers and MNC headquarters. To avoid or resolve problems, organizations can design the most efficient knowledge contract by balancing these two broad, competing costs. It is also important to consider the utility of knowledge integration to the organization. Prior research has often examined bidirectional knowledge transfers between MNC headquarters and their subsidiaries (Foss and Pedersen, 2002; Gupta and Govindarajan, 2000). However, the knowledge contract is more concerned with unidirectional knowledge integration, alternatively described as knowledge transfer from the expatriate manager to organizational routines, local managers, or other expatriates. Therefore, the utility of the knowledge contract will be directly proportional to the amount of locally developed knowledge held by expatriate managers, because such knowledge is valuable to the firm (Bonache and Fernandez, 1997; Very *et al.*, 2004).

A multidomestic strategy is likely to bring about the most locally developed knowledge as firms decentralize value creation activities and expatriate managers take on complex roles. The same logic applies to the transnational strategy as expatriate managers seek to develop local knowledge that they may share with managers in other subsidiaries. Knowledge development in the transnational strategy may be tempered, however, because expatriate managers are less autonomous than in the multidomestic strategy and benefit from knowledge creation from various sources. A global strategy, on the other hand, will result in the lowest amount of knowledge creation. Products and strategies are standardized worldwide, making expatriate managers more likely to remain socialized into the parent company and less likely to engage in local knowledge development. An international strategy will also result in minimal local knowledge creation, although we may expect this strategy to yield some potentially important developments about local product offerings or marketing tactics. Thus, similar to the threat of opportunism and information asymmetry, utility of the knowledge contract will differ across the corporate strategies, with the lowest existing in the global strategy to highest in the multidomestic strategy.

Table I.
Threat of opportunism and information asymmetry in corporate-level strategies

	Threat of opportunism	Information asymmetry
Global	Lowest	Lowest
International	Low	Low
Transnational	High	High
Multidomestic	Highest	Highest

Consistent with Eisenhardt (1989), we believe it is helpful to conceptualize an agency-related contract as being on a continuum of specificity. Thus, we suggest the most efficient governance mechanism for the relationship between expatriate managers and MNC headquarters will be an increasingly specific knowledge contract as we move from centralized firms (global) to decentralized firms (multidomestic). As explained here, global strategy firms present the lowest amount of information asymmetries and a minimum potential for opportunistic behavior by expatriate managers. Therefore, the most efficient knowledge contract is one minimizing overall transaction costs. Strict governance mechanisms, and their associated costs, are likely to introduce inefficiencies in the globally managed firm. Therefore, firms exercising a global strategy should employ nonspecific knowledge contracts for maximum efficiency (Figure 1).

On the other end of the spectrum, firms exercising a multidomestic strategy are burdened with the highest degree of information asymmetry and the highest potential for opportunistic behavior. These firms need more strict governance and more specific agency contracts to mitigate the potentially severe costs of the agency problem. Although specific knowledge contracts have higher transaction costs for monitoring and enforcing the terms of the contract, these costs are offset by the potentially high costs of opportunism. Multidomestic firms, then, will find specific knowledge contracts to be the most efficient form of governance for the principal-agent relationship. Between these two extremes, international firms experience little in the way of opportunistic behavior from expatriate managers and generally do not have significant information asymmetries, but more so than global firms. Therefore, firms carrying out an international strategy will find maximum efficiency in nonspecific knowledge contracts with correspondingly low transaction costs, although they will require more specificity than that found in global firms. Firms exercising a transnational strategy, on the other hand, have a higher degree of information asymmetry and significant potential for opportunism by expatriate managers, but not as much as that found in multidomestic firms. Transnational firms therefore need a specific knowledge contract to address agency problems. However, the most efficient agency contract for transnational firms will not be as specific as that found in multidomestic firms because the agency problem is less severe for transnationals. Therefore, we propose that:

P6. The most efficient governance mechanism between MNC headquarters and expatriate managers takes the form of a specific knowledge contract in firms carrying out a multidomestic strategy and a nonspecific knowledge contract in firms carrying out a global strategy. Between these two extremes, the most efficient form of knowledge contract for the transnational strategy is more specific than that of the international strategy.

Discussion

One of the main contributions of this analysis is introducing the knowledge contract as a primary means to manage agency concerns. Grant (1996) envisaged that the knowledge-based theory of the firm had important implications for the distribution of decision-making authority in organizations. Distribution of decision making, in the forms of delegation and managerial discretion, are central to understanding opportunistic behavior. At the same time, agency theory researchers have also called for developing a broader range of agency contract alternatives to produce a greater variety of agency theoretic remedies (Eisenhardt, 1989; Wright *et al.*, 2001). Our application of the knowledge-based view to a knowledge contract between principal and agent represents such an extension and provides a unique understanding of how organizations might address agency concerns.

Another contribution of this work is to integrate corporate-level strategy and expatriate managers. Few authors have recognized organizational strategy as an important unit of study in international human resource management. Our multilevel analysis moves in this direction, yielding a unique set of contingency relationships that would otherwise be obscured. Specifically, the corporate-level international strategy employed has a significant effect on the degree to which information asymmetries and the threat of opportunism surface in expatriate assignments. These in turn affect the knowledge management roles that both expatriate managers and MNC headquarters may be expected to fulfill. This is a significant conclusion because firms are better able to evaluate the success of expatriate assignments when they evaluate them based on organizational level objectives, rather than individual or subsidiary level objectives. For example, an individual expatriate manager may believe that he/she had a successful assignment based on personal criteria such as factors of adjustment or compensation. Subsidiaries, on the other hand, may judge success based on business-level criteria such as growth, profits, or market share. Organizations have their own set of criteria for success that, according to the knowledge-based view of the firm, includes retaining, integrating, and utilizing knowledge for sustained competitive advantage (Gupta and Govindarajan, 1991).

Finally, the ideas advanced herein also contribute to research on repatriation. Much of the literature on expatriate assignments concerns itself with issues of selection, training, adjustment, the assignment itself and matters prior to departure. Repatriation literature, on the other hand, addresses adjustment back to the home country, career management, and retention (Baruch and Altman, 2002). The knowledge contract holds the potential to alleviate repatriation concerns, therefore making expatriate assignments more attractive to managers. Organizations may anticipate common problems associated with repatriation, such as career development and role uncertainty (Black *et al.*, 1992), and fold them back into the knowledge contract to reduce managerial uncertainty about repatriation. This, in turn, positively affects expatriate managers' willingness to accept overseas assignments and their ability to perform in those assignments (Feldman and Thompson, 1993).

Implications for managers

For the practitioner, there are at least two applications of our arguments. The first relates to compensation and risk. Research on expatriate assignments has focused much attention on the issue of compensation (Reynolds, 1997). Agency theory has often emphasized compensation as a means to influence behavior (Bonache and Fernandez, 1997). Roth and O'Donnell (1996) infer that expatriate managers in decentralized firms (corresponding to transnational and multidomestic firms in our analysis) receive high compensation packages and a high proportion of contingent pay. This is consistent with our analysis because expatriate managers in transnational and multidomestic firms take on a greater amount of risk due to personal asset specificity. However, instead of reducing the agency problem by seeking to align behavior with contingent pay and paying a premium to expatriates for personal risk, we propose that firms consider risk reduction strategies by using the knowledge contract.

There are several ways MNCs may use the knowledge contract to reduce expatriate risk. For example, the knowledge contract may contain employment or promotion guarantees. Thus, if expatriate managers develop knowledge that is specialized to a particular culture, they do not run the personal risk of not being employable outside that market. Instead, the knowledge contract effectively shifts risk back to the MNC, obviating the need for risk-oriented premiums. Another example works in the reverse direction, recognizing that expatriate managers assume the risk of assignment failure and therefore risk becoming personally less valuable to the organization and to the market. The knowledge contract may address this problem by explicitly defining mentoring, co-worker and knowledge transfer mechanisms that reduce the risk of assignment failure. Although there will be transaction costs associated with a more specific knowledge contract, it will also yield reduced risk for expatriate managers and, correspondingly, reduced premiums paid for assuming such risk.

Another area where this research informs management practice is that of expatriate effectiveness and success, as shown in Table II. When firms apply the appropriate knowledge contract given a particular corporate-level strategy (i.e. QI and QIV), it results in clear objectives for expatriate assignments from an organizational perspective. The knowledge contract aligns goals for expatriate managerial assignments with corporate objectives, so both the MNC and the expatriate have a clear understanding of what constitutes success. Expatriate managers are likely to be more comfortable and more successful in an environment where objectives are clearly defined and aligned with the MNC. For example, expatriate managers in a multidomestic firm will likely prefer a more specific knowledge contract because this will reduce information asymmetries. They can be confident that the MNC understands the need to acquire region-specific knowledge and capabilities and will not penalize them for that specificity in subsequent assignments or repatriation.

Limitations and future research

The arguments offered in this paper are subject to limitations. We recognize that our examination of the agency problem for the relationship between expatriate managers and MNC headquarters is limited in scope. We believe the influence of corporate-level international strategy will explain a sufficient amount of variance in expatriate assignments to warrant exclusive attention. An interesting area of future research would be to consider more in-depth typologies. How do business-level strategies affect the knowledge contract? How do industry trends affect the knowledge contract? As more and more companies strive to be transnational, how can they use the knowledge contract to ease their transition? How does the need to integrate business- and corporate-level strategies affect the knowledge contract?

Degree of agency problem	Specificity of knowledge contract: High	Low
High	QI. Success High threat of opportunistic behavior due to information asymmetries demands close monitoring of knowledge development and transfer	QII. Failure Risk is high for the MNC. Expatriate managers may capitalize on their position at the expense of the MNC
Low	QIII. Failure Transaction costs are unnecessarily high	QIV. Success Emphasis is on knowledge flow from the MNC to the subsidiary. Transaction costs may be kept to a minimum

Table II. Using the knowledge contract to gauge expatriate success

Further, we found that introducing the knowledge contract as a means to attenuate agency concerns forced us to consider moderating influences only insofar as they have a significant impact on the knowledge contract. However, moderators to the relationship between expatriate managers and MNC headquarters may affect our conclusions. For example, how does a firm's geographical portfolio and experience with expatriatism affect its use of the knowledge contract? How might the knowledge contract affect expatriate training and selection (Caligiuri *et al.*, 2001; Selmer, 2001)? Future research should incorporate such moderators and compare agency theory remedies with remedies from alternative strategic lenses, such as social network theory or resource dependence theory.

Entry mode and cultural distance are two important moderators that could influence specificity of the knowledge contract. Firms have various means available to them to expand internationally, ranging from licensing arrangements to joint ventures to wholly owned subsidiaries. Firms may employ expatriate managers under any of these arrangements. So, an important research question is: "how does the mode of entry into a country affect how the knowledge contract should be employed?" (Malhotra, 2003). Do more resource intensive forms of entry (e.g., subsidiary) result in more potential for agency problems and therefore more specific contracts? Also, the cultural distance between home and host countries is very important to expatriate assignments (Barkema *et al.*, 1996). Greater cultural distance requires expatriate managers to assume more risk, providing opportunity for firms to use the knowledge contract to transfer that risk to themselves.

Also, the literature would benefit from applying a more general agency theoretic approach to the relationship between expatriate managers and MNC headquarters that could potentially consider firm-level and environmental factors (Lubatkin *et al.*, 2001). For example, how do corporate governance and ownership structures influence the knowledge contract? How do national and professional institutions influence the knowledge contract?

Although our research suggests a new means of gauging expatriate effectiveness and success, we have not discussed specific metrics of implementing this approach. An important area for future research revolves around discovering how the organization measures knowledge development. How will firms decide when expatriate managers should share knowledge? Managing expatriates with the knowledge contract assumes an intentional approach toward understanding knowledge that emerges from expatriate assignments, so characterizing and measuring this knowledge is important to the process.

Finally, we developed our arguments from the perspective of western firms and western expatriates. The degree to which agency theory findings are generalizable to other cultures and countries warrants further study. To extend the arguments presented herein to expatriates originating from other countries, scholars will have to examine the underlying foundations of agency theory for generalizability. It is possible that different conclusions will surface based on different assumptions when the actors are changed.

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