

---

# APPLICABILITY OF ORGANIZATION THEORIES IN THE STUDY OF TRANSNATIONAL CORPORATIONS

---

Review paper

UDK: 334.726

JEL classification: F23, L21, M16

DOI: 10.17818/DIEM/2025/1.9

Paper received: February 23, 2025

Paper accepted: June 9, 2025

## **Abstract**

*Transnational corporations are the most powerful and significant single economic entity of our time, whose role and strength are undeniable. Transnational corporations are not only economic but also extremely important political and social institutions of the modern world. We have witnessed numerous discussions about global competition and transnational corporations, but there are very few conceptual and theoretical discussions that would analyze transnational corporations and their management. However, there are a number of attempts to analyze certain aspects of transnational corporations from existing theoretical perspectives. Existing organizational theories are based on very simplistic assumptions that are not adequate for transnational corporations because they cannot illustrate the complexity and kind of abundance of transnational corporations. In addition, transnational corporations are rarely used as an object of research. This paper first defines the prerequisites for the applicability of organizational theories in the research of transnational corporations, and then analyzes the dominant organizational theories in order to determine their adequacy.*

**Keywords:** *transnational corporations, organization theory, management of transnational corporations*

## **1. INTRODUCTION**

The study of transnational corporations (TNCs) has become a critical area of research due to their complexity, scale, and global reach. This paper investigates the applicability of organization theories in understanding and managing the intricate dynamics of TNCs. TNCs operate in multiple markets and manage diverse product lines, which require multidimensional approaches to structure and management. Traditional organization theories often fall short in addressing the unique challenges posed by TNCs, such as the need for integrative optimization between integration and responsiveness. This paper examines how various organization theories, including transaction cost theory, agency theory, and contingency theory, offer insights into the management practices of TNCs while highlighting their limitations.

The key focus of this paper is to evaluate the relevance and limitations of these organization theories in the context of TNCs, specifically analyzing the structural and managerial challenges they face. While these theories offer valuable frameworks for understanding certain aspects of TNCs, they

often lack the flexibility needed to fully capture the dynamic, global, and heterogeneous nature of these organizations. Additionally, the paper explores the evolution of organization theories tailored to TNCs, highlighting a new paradigm that recognizes the importance of integrating competing demands and managing complex managerial tasks. By exploring these theories, this paper aims to provide a comprehensive understanding of how organization theories can inform the management and structure of transnational corporations.

## **2. THE IMPORTANCE OF ORGANIZATION THEORIES FOR TRANSNATIONAL CORPORATION MANAGEMENT RESEARCH**

This subchapter aims to analyze management processes within a transnational corporation. Therefore, it is necessary to determine the prerequisites for the applicability of organization theories in analyzing, conceptualizing and interpreting managerial tasks within the corporation.

A key differentiation between the transnational corporation and simpler organizational configurations stems from a combination of the consequences of multidimensionality and heterogeneity. Multidimensionality arises from multiple markets with multiple product lines in typical multifunctional activities such as sales, production, services, and research and development. Multidimensionality also means no simple, one-dimensional, hierarchical solutions for structuring a transnational corporation (Davis & Lawrence, 1977; Beer & Davis, 1976). Strategic, structural and political multidimensionality requires complex, multifocal approaches that constantly reach for compromises between different priorities embedded in different groups of managers (Doz, 1986). Taking into account multidimensionality, complexity, and heterogeneity for an optimal analysis of a transnational corporation, the organization theory should incorporate the following aspects (Doz & Prahalad, 2005):

1. Structural indeterminacy means that one-dimensional organizational structures and simple concepts such as centralization and decentralization are not useful for transnational corporations.
2. Internal differentiation indicates how management processes should be differentiated between countries, products and functions.
3. Integrative optimization means encouraging various compromises among multiple priorities.
4. Information intensity refers to the information transfer as a source of competitive advantage. It also refers to the implicit structure within a transnational corporation where information management becomes a key management task.
5. Lateral connections are also very important but cannot be defined in advance. Therefore, the emergence of lateral connections should be facilitated within the transnational corporation and by the needs.
6. Network organization and unclear boundaries.
7. Learning and continuity mean the tension between the need to repeat interactions at low costs and the need for innovation and change.

The described assumptions represent a framework for the analysis of existing theories in order to determine to what degree these theories can help in better comprehension of the transnational corporation.

Table 1. The importance of organization theories for transnational corporation management research

Relevance criteria for transnational corporation management research	Theory of transaction costs	Agency theory	Institutional theory	Contingency theory	Power relationships and adaption	Organizational learning
<i>Structural indeterminacy</i>	Yes	Implicit hierarchical	Yes	No, the structure is consistent with the environment, except for the matrix structure.	Yes, a self-adjusting web of power relationships	Yes
<i>Internal differentiation</i>	Yes	Simplified: Outcome versus behavioral control	Yes, it depends on the influences	Yes	Yes, it depends on external uncertainties	Yes
<i>Integrative optimization</i>	Narrowly defined self-interests are not compatible with expansion with relational contracts.	No, dominantly dyadic principal-agent relationships	Not explicitly defined	Yes, at least in part of the research (Lawrence & Lorsch, 1967)	Yes, the so-called power games incorporate multiple priorities	Yes, it is part of the learning process.
<i>The importance of information transfer</i>	Yes, but it is limited by uncertainties and asymmetry	Yes, but focused on observing behavior and measuring results	Yes	Yes	Yes, information is a key determinant of power	Yes
<i>Emergent, not prescribed lateral connections</i>	Transaction patterns are not defined a priori, but hierarchies are useful for inter-organizational analysis.	Yes, a series of contracts, but they do not include multiple connections	Yes	Possible, but not clearly defined (consistent with theory)	Yes	Yes, it is the result of a learning process
<i>Unclear boundaries</i>	Yes, it is tuned for boundary analysis, but it should incorporate relational contracting.	Yes	Yes, "isomorphic" pressures towards adaptation	They are not explicitly defined.	Yes	Not explicitly defined, but not excluded either
<i>Replication versus change</i>	-	-	Yes	No	Yes, it depends on the network structure	Yes, it is a central part of the theory

Source: adapted from Doz, Y. L. and Prahalad, C. K. (2005) Managing MNCs: A search for a new paradigm. In: Ghoshal, S. and Westney, D.E., eds. Organization Theory and the Multinational Corporation. Second Edition. Basingstoke, UK and New York, NY: Palgrave Macmillan, p. 26-27.

Transaction cost theory has offered an economic justification for the emergence and expansion of firm boundaries. Transaction costs, i.e., the costs of negotiating and concluding contracts, on the one hand, and the costs of monitoring, enforcing, and possibly adapting, on the other hand, influence the choice between free market transactions and the organization of transactions within a corporation (Coase, 1937; Williamson, 1975, 1985). When the relative transaction costs between the market and hierarchical organization of a given set of transactions change, it is economically rational to move the firm boundaries (Račić, 2000), as seen in Table 2.1. Transaction cost theory does not violate the defined criteria for its application in the study of transnational corporations; however, its usefulness is limited if reputational (Kreps, 1984) and relational (Dore, 1983) contracting dimensions are not included. The theory has proven useful in studying inter-organizational relations in North America, such as relations between US corporations and their suppliers and in studies of vertical integration (Stockey, 1983). However, it has not proven useful in studying relations between Japanese corporations and their suppliers because their relationship is based on trust and a long-term "win-win" approach (Dore, 1983). Finally, it is important to note that transaction cost theory, due to its assumptions about people and organizations, does not address managerial issues.

Agency theory contributes significantly to research on the management of transnational corporations. For example, it raises important questions, such as the question of control in terms of results and behavior (Eisenhardt, 1989). Control of results is confirmed as a model of control of international subsidiaries in situations where the parent corporation does not have enough information to control behavior, and the objectives of the subsidiary's management are not fully aligned with the objectives of the parent corporation (Doz & Prahalad, 2005). Behavioral control presents challenges for globally integrated subsidiaries because the relationship between specialized and interconnected subsidiaries often relies on the parent corporation's independent interpretation of the subsidiaries' roles. The simplistic binary approach, such as the control model choice suggested by agency theory, restricts the exploration of more nuanced combinations of control and management strategies employed within corporations (Lawrence & Dyer, 1983). Agency theory, just like the theory of transaction costs, is based on restrictive and culturally "colored" assumptions, which makes its application difficult. A much more detailed elaboration of agency theory in the context of intra-organizational analysis follows in the last subsection.

Institutional theory indicates that the environment strongly influences corporate behavior because institutional pressures, directly and indirectly, force the corporation to adapt to a given framework. Managers develop and implement socially acceptable forms of action, such as strategy, organizational structure, etc., consistent with institutional requirements and pressures to gain legitimacy from the environment (Tipurić, 2014). Institutional theory is most useful for analyzing the adaptation of subunits to different local environments and corporate management systems. It is also interesting for the second level of analysis, i.e., for analyzing adaptation within the Corporation instead of adaptation between institutions. Scott (1987) emphasizes the theory's applicability in formulating problems in parent corporation - international subsidiary relationship and organizational implications in respecting responsiveness and integration at different levels of aggregation, from the individual to the inter-organizational level. According to the above and according to Table 1 it can be concluded that institutional theory is consistent with the criteria for its application in the research of transnational corporations.

Contingency theory has significantly influenced research on transnational corporations. The first models of adaptation of a transnational corporation to geographical and production diversity (Fouraker & Stopford, 1968; Stopford & Wells, 1972) are examples of the application of contingency theory to the organizational structures of transnational corporations. Research into patterns and ways of controlling international subsidiaries by the parent corporation (Doz & Prahalad, 1984; Ghoshal & Nohria, 1990) are also part of the contingency model, although these studies also include the adaptation of international subsidiaries to the environment and culture of the parent

corporation, which is related to institutional isomorphism, i.e., to institutional theory. Contingency theory, as one of the theories of organization, with an emphasis on different responses to various environments and with an emphasis on the integration of activities among different environments, had the greatest direct impact on the research of transnational corporations (Doz & Prahalad, 2005). However, empirical research on contingency theory was mostly static and rarely included change processes. Exceptions are the research by Doz and Prahalad (1981, 1987). New challenges for contingency theory research are research on empowerment, decentralization and similar concepts. Criticisms of contingency theory are primarily related to its static nature and simple, dichotomous thinking (for example, the choice between the category of integration and responsiveness). But, despite that, according to table 2.1. contingency theory meets most criteria, at least to a certain extent, for application in studying transnational corporations. Unlike other more abstract organization theories, contingency theory provides a somewhat more solid but simpler framework for researching transnational corporations (Doz & Prahalad, 2005).

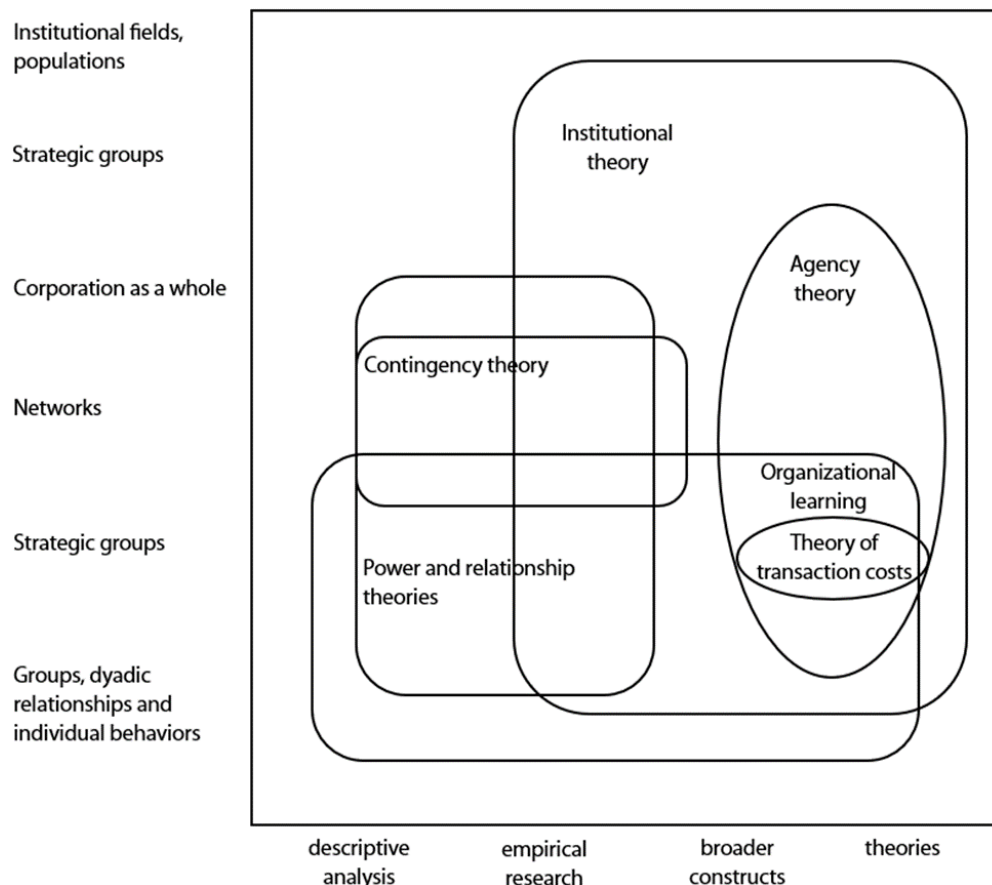
Crozier and Friedberg (1980) provided an insightful analysis of organizations as networks of relationships, where "players" pursue their interests and rational tactics in shared "games" governed by shared "rules." These rules act as intermediaries, and the collective games are influenced by the resources and constraints that individual "actors" face. A key resource in this context is the control of uncertainty, which directly impacts the performance of other members within the organization. The network of relations is neither fully integrated nor entirely fragmented; rather, organizations maintain a certain level of cohesion and consistency by managing internal conflicts (Astley & Van de Ven, 1983). The "game" within the network strikes a balance between integration and fragmentation. In this framework, adaption to environmental changes occurs through the evolution of the "game," illustrated by shifts in dependencies on the environment. This process increases the power of the "players" who effectively navigate these changes and dependencies. The adaptability of an organization depends on the density of its relational network. Organizations with strong hierarchical structures are less adaptive because their "games" offer only a limited set of strategies that cannot be easily modified. In contrast, organizations with diverse, lateral, and diagonal connections within their networks are far more adaptive, as they can reconfigure their relational networks in response to changes in environmental contingencies (Doz & Prahalad, 2005). According to Table 1, this theory meets, albeit often implicitly, the criteria for studying transnational corporations. Many assumptions of this theory are more realistic than those found in other organizational theories. For example, the assumption that individuals behave intentionally and rationally, pursuing self-interest, leads to differentiated personal goals within the organization, especially in situations of limited rationality (Podrug, 2010). Additionally, the notion that an organization is a network of relationships where information that reduces uncertainty serves as a resource and source of influence is a realistic and practical assumption. This theory is particularly compelling for researching transnational corporations both theoretically and practically. A key question worth exploring is how changes in the "rules" of the "game" within these active networks of relationships would affect the outcomes and behavior of the relational system (Doz & Prahalad, 2005).

Organizational learning, as a theory of organization, is primarily oriented towards change and development. Most scholars believe that learning and development should be observed at the individual level but in the context of an organization. However, Nelson and Winter (1982) emphasize that the institutionalization of learning occurs through organizational routines in which past positive and negative experiences are incorporated. Organizational routines then direct behavior. Levitt and March (1987) emphasize that organizational learning is fraught with problems. For example, learning "on the wrong track" leads to a "competence trap," and inductive learning from the experience of individuals is often wrong, etc. Ultimately, deepening organizational knowledge is often opposed to sharing knowledge (Chakravathy & Lorange, 1991). Several potential research questions are related to organizational learning in the context of transnational corporations. For example, Ghoshal and Nohria (1990) consider learning from multiple markets and environments very important for transnational corporations. However, it is important to note that the degree and process of learning in transnational corporations can vary significantly depending on the content itself. Learning

processes in transnational corporations can be different if they are related to geographical location when learning management systems and processes must simultaneously reflect the needs of integration and responsibility, etc. In conclusion, it is important to emphasize that there is a large space for research into organizational learning in general and transnational corporations (Doz & Prahalad, 2005).

### 3. CHALLENGES IN APPLYING ORGANIZATION THEORIES

The described organization theories differ in their assumptions and the levels of analysis, which is illustrated in Figure 1. However, before that, several key characteristics of the described organization theories limit their application in the research of transnational corporations. First, it is important to point out that the described organization theories (except contingency theory and the more recent development of institutional theory) fail to translate the theory into a model. The result is their weakness in connecting theory with empirical research (Doz & Prahalad, 2005). Simple statistical tests are feasible when the research subject is homogeneous groups or similar organizations. However, it is less feasible for heterogeneous groups or complex organizations, i.e., when they are oriented towards their management.



Source: Adapted from Doz, Y. L. and Prahalad, C. K. (2005) Managing MNCs: A search for a new paradigm. In: Ghoshal, S. and Westney, D. E., eds. Organization in general and Corporation. Second Edition. Basingstoke, UK and New York, NY: Palgrave Macmillan, p. 36.

Figure 1. Comparison of organization theories according to level of aggregation and theory development



The literature on transnational corporations abounds in descriptive analyses. Still, there is a lack of theory that would encompass different levels of aggregation from individuals and small groups within a corporation to clusters of transnational corporations that apply similar corporate strategies. Another limitation of the described organization theories is the high degree of abstraction, which results in the exclusion of key management processes such as resource allocation, conflict resolution, etc. Theories of organization, except organizational learning and power relationships and adaption, are mostly static and focused more on cross-sectoral analysis rather than longitudinal processes of change (Doz & Prahalad, 2005). As already pointed out in the transaction costs theory and agency theory, it is necessary to highlight the cultural limitations of organization theories. For example, self-interest and opportunism are extremely ingrained in the US traditions (Podrug, 2010) and the concept of organizational power reflects French culture (Delmestri & Brumana, 2017).

No organizational theory has fully succeeded in adapting its analysis to the level of transnational corporations. Although each research piece illuminates only an aspect of the managerial task in transnational corporations, taken together the work of Prahalad, Doz, Bartlett, Ghoshal, Hedlung, and Hamel provides us with a rich organizational theory that focuses specifically on transnational corporations and the managerial tasks within them. Below are the essential features of this new paradigm. First, the integration/responsiveness framework introduced by Prahalad and Doz (1987) captures the core processes within a transnational corporation. What sets this approach apart from traditional models is its clear recognition of the need to balance and optimize the competing demands of integration and local accountability. Second, it is crucial to highlight that the integration/responsibility framework is not only used to analyze industries, but also to understand how the evolving business environment shapes functional areas. A third important aspect of this paradigm is that the unit of analysis is the manager, rather than an abstract or higher organizational level. The organization, within this framework, consists of three main subprocesses: the cognitive orientation of managers, the dominant coalition of managers implementing a particular strategy (strategic consensus), and the structure of authority and power used for resource allocation.

The following general conclusions can be drawn from this framework (Doz & Prahalad, 2005):

1. The formal organizational structure includes subprocesses, and managers tend to prefer "pure" organizational forms, such as global geographic (or business) structures, because these clearly align with their cognitive orientations (Prahalad & Doz, 1987).
2. Managers often view matrix organizations as complex because their subprocesses are disconnected from the formal structure. In a matrix organization, subprocesses operate independently from the formal structure and require explicit management.
3. Strategic change necessitates a shift in the cognitive orientation of the managerial group, the formation of a new consensus around the strategy, and a realignment of power relationships among the involved groups.
4. Effective management of subprocesses requires the use of planning, budgeting, training, career management etc. (Doz & Prahalad, 1984). A major strategic shift can help realign the managerial group and its formal structure.
5. The nature and intensity of interactions and information exchange between international subsidiaries and the parent company, or among international subsidiaries themselves, reflect the strategic goals linked to each organizational unit (Ghoshal & Nohria, 1990). These patterns of information flow predict the cognitive orientations of managers, the strategic consensus process, and the power dynamics involved in resource allocation.

The fourth characteristic of the paradigm is that it does not pretend to be a universally applicable and comprehensive organization theory but is oriented to the analysis, understanding and normative assessment of the interaction process between managers of a transnational corporation.

## 4. CONCLUSION

In conclusion, the research presented in this paper underscores the challenges of applying traditional organization theories to the study of transnational corporations. While these theories offer useful insights into certain aspects of TNC management, they fall short in addressing the multidimensional and dynamic nature of these organizations. The limitations of these theories – ranging from their high level of abstraction to their static nature – highlight the need for more nuanced models that can capture the complexity of integration and responsiveness. Additionally, the cultural and contextual limitations of these theories further complicate their application to TNCs operating in diverse environments.

However, the evolution of organization paradigms, particularly the framework developed by Prahalad and Doz, offers a more suitable approach for understanding the intricate processes within transnational corporations. This framework emphasizes the importance of integrative optimization, managerial cognition, and power relationships in managing the tension between integration and responsiveness. By incorporating these factors, this new paradigm provides a more dynamic and applicable model for TNC management, offering valuable insights for researchers and practitioners alike. The findings suggest that future research should continue to refine these models, considering the rapidly changing global business environment and the increasing complexity of multinational organizations.

## REFERENCES

- Astley, W. G. and Van de Ven, A. H. (1983) Central perspectives and debates in organization theory, *Administrative Science Quarterly*, Vol. 28, pp. 265-273. <https://doi.org/10.2307/2392620>
- Beer, M. and Davis, S. M. (1976) Creating a global organization, failures along the way, *Columbia Journal of World Business*, Vol. 11, No. 2, pp. 72-84.
- Chakravarthy, B. S. and Lorange, P. (1991) *Managing the Strategy Process: A Framework for a Multibusiness Firm*. Englewood Cliffs, N.J.: Prentice-Hall.
- Coase, R. H. (1937) The Nature of Firm, *Economica*, Vol. 2, No. 16, pp. 386-405. <https://doi.org/10.1111/j.1468-0335.1937.tb00002.x>
- Crozier, M. and Friedberg, E. (1980) *Actors and Systems: The Politics of Collective Action*. Chicago, Ill.: University of Chicago Press.
- Davis, S. M. and Lawrence, P. R. (1977) *Matrix*. Reading, MA: Addison-Wesley.
- Delmestri, G. and Brumana, M. (2017) The multinational corporation as a playing field of power: A bourdieusian approach. In: Dörrenbächer, C. and Geppert, M., eds., *Multinational Corporations and Organization Theory: Post-Millennium Perspectives. Research in the Sociology of Organization*. Vol. 49, Bingley, UK: Emerald Publishing Limited. <https://doi.org/10.1108/S0733-558X20160000049011>
- Dore, R. P. (1983) Goodwill and the spirit of market capitalism, *British Journal of Sociology*, Vol. 34, No. 4, pp. 459-482.
- Doz, Y. L. (1986) *Strategic Management in Multinational Companies*. Oxford: Pergamon.
- Doz, Y. L. and Prahalad, C. K. (2005) Managing MNCs: A search for a new paradigm. In: Ghoshal, S. and Westney, D. E., eds. *Organization Theory and the Multinational Corporation*. Second Edition. Basingstoke, UK and New York, NY: Palgrave Macmillan, pp. 20-44.
- Doz, Y. L. and Prahalad, C. K. (1987) A process model of strategic redirection in large complex firms: The case of multinational corporations. In: Pettigrew, A., ed., *The Management of Strategic Change*. Oxford: Blackwell.
- Doz, Y. L. and Prahalad, C. K. (1984) Patterns of strategic control in multinational corporations, *Journal of International Business Studies*, Vol. 15, No. 2, pp. 55-72. <https://doi.org/10.1057/palgrave.jibs.8490482>
- Doz, Y. L. and Prahalad, C. K. (1981) Headquarters influence and strategic control in MNCs, *Sloan Management Review*, Vol. 23, No. 1, pp. 15-29.
- Eisenhardt, K. M. (1989) Agency theory: An assessment and review, *The Academy of Management Review*, Vol. 14, No. 1, pp. 57-74. <https://doi.org/10.2307/258191>



- Fouraker, L. E. and Stopford, J. M. (1968) Organization structure and multinational strategy, *Administrative Science Quarterly*, Vol. 13, pp. 57-70. <https://doi.org/10.2307/2391261>
- Ghoshal, S. and Nohria, N. (1990) Internal differentiation within multinational corporations, *Strategic Management Journal*, Vol. 10, No. 4, pp. 323-338. <https://doi.org/10.1002/smj.4250100403>
- Kreps, D. (1984) Corporate culture and economic theory, Working paper, Stanford Graduate School of Business, Stanford University.
- Lawrence, P. R. and Dyer, D. (1983) *Renewing American Industry: Organizing for Efficiency and Innovation*. New York, NY: Free Press.
- Levitt, B. and March, J. G. (1987) Organizational Learning, *Annual Review of Sociology*, Vol. 14, pp. 319-340. <https://doi.org/10.1146/annurev.soc.14.1.319>
- Nelson, R. and Winter, S. (1982) *An Evolutionary Theory of Economic Change*. Cambridge: Harvard University Press.
- Podrug, N. (2010) Odnosi uslužnosti između menadžerskih razina u velikim hrvatskim poduzećima. Doktorska disertacija. Zagreb: Sveučilište u Zagrebu, Ekonomski fakultet.
- Prahalad, C. K. and Doz, Y. L. (1987) *The Multinational Mission: Balancing Local Demands and Global Vision*. New York, NY: Free Press.
- Račić, D. (2000) Od teorije poduzeća prema teoriji strateškog upravljanja, *Ekonomski pregled*, Vol. 51, No. 1-2, pp. 118-144.
- Scott, W. R. (1987) *Organizations: Rational, Natural, and Open Systems*. Second Edition. Englewood Cliffs, N.J.: Prentice-Hall.
- Stockey, J. (1983) *Vertical Integration and Joint Ventures in the Aluminium Industry*. Cambridge, Mass.: Harvard University Press.
- Stopford, J. M. and Wells, L. T., Jr. (1972) *Managing the Multinational Enterprise: Organization of the Firm and Ownership of the Subsidiaries*. New York: Basic Books.
- Tipurić, D. (2014) *Iluzija strategije: Razotkrivanje socijalno konstruirane zbilje poduzeća*. Zagreb: Sinergija.
- Williamson, O. E. (1985) *The Economic Institutions of Capitalism*. New York: Free Press.
- Williamson, O. E. (1975) *Markets and Hierarchies: Analysis and Antitrust Implications*. New York: Free Press.