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# The Contribution of Local Environments to Competence Creation in Multinational Enterprises

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This paper examines the competence development of subsidiaries in multinational enterprises. We analyze how local subsidiary environments affect the development of technological and business competencies among other units in the multinational enterprise. We test our predictions using data from 2,107 foreign-owned subsidiaries located in seven European countries, by means of structural equation modeling — namely, LISREL. By bringing the local environment to the fore, we contribute to the literature on the emergence and determinants of firm-specific advantages. We link local subsidiary environments to the development of the competencies of other units in the multinational enterprise. The role of the multinational enterprise is characterized as integrative, as it may bridge local competencies and environments that are conducive to competence creation, and as it facilitates the use of resources residing locally throughout the organization. Thus, we contribute to an enhanced understanding of location as a determinant of the creation of units of competence and centers of excellence within multinational enterprises. In other words, we demonstrate that country-specific advantages are beneficial for competence creation in units other than the local subsidiary. We thereby link country-specific advantages to the creation of firm-specific advantages in the multinational enterprise — i.e., the multinational enterprise can build and augment firm-specific advantages by making the most of country-specific advantages.

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## Introduction

Knowledge and resources reside in the host locations of subsidiaries of multinational enterprises (MNEs). Such knowledge and resources can be conceptualized as country-specific advantages (CSAs) (Rugman and Verbeke, 2001). For the subsidiary located in the host-country environment, the presence of such knowledge and resources creates an opportunity to upgrade its own competencies, and to evolve (Birkinshaw and Hood, 1998). This evolution, in turn, can create subsidiary-specific advantages (SSAs) that if used by the entire MNE can become firm-specific advantages (FSAs) (Rugman and Verbeke, 2001). This echoes the argument that the local contexts of subsidiaries can be of critical importance for competence creation (Meyer et al., 2011; Rugman et al., 2011). Indeed, Bartlett and Ghoshal (1986) emphasized the strategic importance of the local environment of subsidiaries, which can benefit the entire MNE (Meyer et al., 2011).

The advantages stemming from a subsidiary's local environment may or may not be bound by location, meaning that such advantages may influence the entire MNE or only the focal subsidiary operating in the specific environment. However, the MNE has been described as an organization positioned to make better use of the resources dispersed in its units compared to individual firms' possibilities through the market. In fact, the abilities to make use of globally dispersed resources and to take advantage of the multiplicity of environments in which their subsidiaries operate constitute two of the distinctive advantages of the MNE (Cantwell, 1989; Kogut and Zander, 1993; Penrose, 1959). However, resources and competencies that reside locally in subsidiaries are often difficult to implement in other MNE units. Furthermore, benefiting from locally-situated competencies on a global scale is one of the greatest strategic challenges for MNEs (e.g., Gupta and Govindarajan, 2000; Szulanski, 1996).

Research has commonly investigated either competence creation at the subsidiary level or competitive advantages at the MNE level, but rarely studied their relation. This study identifies two distinct CSAs — market conditions for competence development and competitive dynamics in the local market — and how they affect the competencies of other MNE units in the

technology and business dimensions (FSAs). This allows for an investigation into drivers of MNE competence creation and factors underlying competitive advantage. We thereby empirically elucidate the issue of CSAs leading to FSAs for the entire MNE. This corresponds to an empirical investigation of selected parts of the framework developed by [Rugman and Verbeke \(2001\)](#).<sup>1</sup>

Research has identified local environments as sources of valuable knowledge and resources for subsidiaries ([Ghemawat, 2007](#); [McCann and Mudambi, 2005](#); [Rugman and Verbeke, 2001](#)). Such knowledge and resources may be locally bound and difficult to diffuse throughout the organization ([Gupta and Govindarajan, 2000](#)). In this regard, previous research has examined environmental factors as determinants of subsidiary roles ([Benito et al., 2003](#); [Birkinshaw and Hood, 2000](#)), while business network research (e.g., [Andersson et al., 2001](#); [Andersson et al., 2002](#); [Ciabuschi et al., 2011](#)) has focused on direct business relationships rather than on the local environment and market conditions for competence creation and innovative activity. Another stream of research has explored internal factors that drive competence development in subsidiaries ([Bartlett and Ghoshal, 1986](#)). However, less empirical attention has been paid to the link between the local environmental conditions of subsidiaries ([Birkinshaw and Hood, 1998](#)) and competence creation at the subsidiary and MNE levels, although [Birkinshaw \(1997\)](#) discussed what can be translated into patterns V, VI, and VII of [Rugman and Verbeke's \(2001\)](#) framework.<sup>2</sup>

In this paper, we address this gap in the extant research by focusing on the issue of whether competence development in the MNE is driven by subsidiary operations in dynamic locations and, more specifically, if local CSAs in these subsidiary environments are precursors to the development of technology and business competencies in other MNE units. For the MNE, this question is pivotal, as an MNE that can upgrade its competencies will be better able to stay competitive on a global scale. However, we know little about the link between local markets and competence development in other MNE units. A better understanding of this issue is important, as MNEs will have a better chance of survival if they can capitalize on strong FSAs by being located in countries with strong CSAs ([Hennart, 2009](#)). In other words, MNEs ought to bundle FSAs with complimentary CSAs. The quality and quantity of CSAs not only influence how the MNE operates in foreign markets ([Hennart, 2009](#)), but these factors also play an important role in MNE competence development.

In our analysis of local host environments' influence on the competence development of MNE units in the technology and business dimensions, we build on the business network tradition of unpacking different dimensions of activities that are of importance to MNE operations ([Andersson et al., 2002](#)).<sup>3</sup> This is also consistent with conceptualizing FSAs in terms of the production-related know-how and organizational capability dimensions discussed by [Rugman and Verbeke \(2001\)](#). This approach allows us to contribute to the understanding of how MNEs can benefit from the CSAs of its subsidiary locations on a global scale and offers an understanding that goes beyond the generic concept of competence, as we analyze business and technology competencies. We thereby connect the issue of location to the potential benefit for the overall organization in terms of the development of technological and business competencies — i.e., FSAs ([Meyer et al., 2011](#)). For the MNE, local pockets of resources can only contribute to the competitiveness of the organization in isolation. Only if local resources are used by other MNE units can the organization truly benefit from multinationality, and from its ownership, location, and internalization advantages ([Dunning, 1988](#)).

We develop a model anchored in the subsidiary and competitive dynamics literature streams, and we analyze four hypotheses by means of structural equation modeling using a LISREL analysis. For this analysis, we use a data set of 2,107 foreign-owned subsidiaries in seven European countries.

The paper is structured as follows. First, a literature review is presented, which is then followed by our hypotheses. Data and methods are presented in the subsequent section. This is followed by the results. We then move on to a discussion of the implications of our findings before we conclude the paper by elucidating theoretical and managerial implications, limitations, and suggestions for future research.

## Location and competence development

The locations of MNE subsidiaries and the local actors connected to those subsidiaries provide competencies, knowledge, ideas, and opportunities that are new to the MNE ([Andersson et al., 2002](#)). We define competence in accordance with [Dosi and Teece \(1998, p. 284\)](#) as: “a differentiated set of skills, complementary assets, and organization routines which together allow a firm to coordinate a particular set of activities in a way that provides the basis for competitive advantage in a particular market or markets.”

The subsidiary and the MNE may develop competencies in a range of dimensions. However, the concept of competence has often been used as an overarching framework for distinctive skills, resources and routines without differentiating between, or

<sup>1</sup> More specifically, we address patterns V, VI, and VII of the [Rugman and Verbeke \(2001\)](#) framework. Pattern V covers non-location-bound FSAs autonomously generated in host-country operations and subsequently diffused to other MNE units or embodied in products that are internationally marketed. Non-location-bound FSAs generated in host-country operations (that are connected to the organization's home base) and later diffused to other MNE units embodied in products that are internationally marketed are captured by pattern VI. Finally, pattern VII deals with location-bound FSAs created in host-country units and transformed by those units into non-location-bound FSAs. Unfortunately, our data do not allow us to deal with individual patterns. Instead, we contribute by investigating these patterns at an aggregated level.

<sup>2</sup> [Birkinshaw \(1997\)](#) focused on local market conditions for subsidiary initiatives. An abundance of literature uses [Porter's \(1990\)](#) work in industrial organization theory as a point of departure for analyzing processes taking place within subsidiaries and at the industry level in an attempt to explain the subsidiary's contributory role in the MNE ([Birkinshaw et al., 1998](#)), for analyzing the internal and external competitive environments of subsidiaries ([Birkinshaw et al., 2005](#)), and for analyzing subsidiary characteristics in industrial clusters ([Birkinshaw and Hood, 2000](#)).

<sup>3</sup> [Andersson et al. \(2002\)](#) made a distinction in terms of a subsidiary having embedded relationships in the business and technology dimension. We make a similar distinction, albeit with a focus on competencies.

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