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Subsidiary importance in the MNC: What role does internal embeddedness play?

Mo Yamin [a,*], Ulf Andersson [b,1]

[a] Manchester Business School, University of Manchester, Manchester M60 1QD, United Kingdom
[b] Copenhagen Business School, Denmark

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ABSTRACT

This paper addresses the issue of how a subsidiary's internal and external embeddedness interact in generating the importance of the subsidiary vis-à-vis the MNC as a whole. We take previous findings of the positive impact of external embeddedness on a subsidiary's importance as our starting point and consider two questions: (a) how does the internal embeddedness of a subsidiary affect its organisational importance, and (b) how do a subsidiary's internal and external embeddedness interact in generating organisational importance? We test hypotheses reflecting these questions on data from 97 foreign subsidiaries belonging to Swedish multinationals. We find that internal embeddedness is negatively related to a subsidiary's importance to product development but unrelated to its importance to production development. We also find that internal embeddedness dilutes the positive impact of external embeddedness on a subsidiary's importance to production development. We discuss the findings in the light of the extant literature and consider implications for future research and MNC managers.

1. Introduction

A significant development in the multinational corporation (MNC) subsidiary literature is the detailed investigation of the role of business networks in subsidiary development and impact in MNCs (Andersson & Forsgren, 2000; Andersson, Forsgren & Holm, 2002; Andersson, Forsgren & Holm, 2007; Forsgren, Holm, & Johanson, 2005; Ghauri, 1992; Holm & Pedersen, 2000). One issue that these studies have investigated relates to the 'organisational performance' of the subsidiary within the MNC of which it is a member. By 'organisational performance' of a subsidiary, we mean, following Andersson, Forsgren, and Pederson (2001), the impact of the subsidiary on the rest of the MNC through its knowledge development and knowledge sharing activities. One particular manifestation of the 'impact' of the subsidiary within the MNC is the *importance* that other units in the organisation, and particularly the headquarters (HQ), attach to the subsidiary insomuch as it is of use to them as a source of knowledge or capability. Business network studies have shown that subsidiary importance is a robust construct and reflects the subsidiary's potential to contribute to technological and market development in the MNC (Andersson et al., 2002) and is a key source of its bargaining strength (see, in particular, Andersson et al., 2007). Thus, for example, the basis of a subsidiary's status as a 'centre of excellence' within the MNC is the recognition by HQ that the subsidiary has gained expertise or capability in a particular function or activity of potential value to other units in the organisation (Andersson & Forsgren, 2000).

* Corresponding author. Tel.: +44 161 3063462.
E-mail addresses: Mo.yamin@mbs.ac.uk, mo.yamin@manchester.ac.uk (M. Yamin), ua.smg@cbs.dk (U. Andersson).
1 Tel.: +45 3815 3043.

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A subsidiary's importance to production or product development has been shown to be strongly linked to its 'embeddedness' in networks of business relationships between the subsidiary and a (small) number of customers and suppliers. While a subsidiary's business partners could be either sister affiliates in the MNC or external business organisations, most of the attention has been paid to subsidiaries' business relations with external business organisations and to the impact of such relationships on the MNCs. With rare exceptions (Garcia-Pont, Canales, & Noboa, 2009; Schmid & Schuring, 2003) internal subsidiary embeddedness has not been the focus of empirical investigation. Most empirical studies have only included measures/indicators of external business embeddedness in their analyses.

However, subsidiaries are clearly simultaneously embedded in both external and internal networks (Forsgren et al., 2005). Even though the degree or 'depth' of internal embeddedness may be less than that of the external embeddedness, it is unlikely to be zero (Holm & Pedersen, 2000; Yamin, 2005). An important question in this context is, given that a subsidiary's external network embeddedness enhances its importance to the MNC's competence development, does the subsidiary's internal embeddedness reinforce or dilute this effect?

This paper addresses the issue of how a subsidiary's internal and external embeddedness interact in generating the technological importance of the subsidiary vis-à-vis the MNC as a whole. We take previous studies' findings relating to the positive impact of external embeddedness on a subsidiary's organisational importance as our starting point and ask two research questions: (a) how does the internal embeddedness of a subsidiary affect its organisational importance, and (b) how do a subsidiary's internal and external embeddedness interact in generating organisational importance? In Section 2 we consider the distinctive features of the internal and external embeddedness of subsidiaries. In Section 3 we develop hypotheses relating to the impact of internal embeddedness on subsidiary importance and also with regard to the interaction between internal and external embeddedness in terms of a subsidiary's importance. Section 4 explains the methodology and data source utilised in this study and in Section 5 we discuss our findings.

2. Subsidiary embeddedness: features of internal and external exchange relationships

2.1. Subsidiaries' external and internal embeddedness

Several business and management scholars have employed the concept of embeddedness to stress the crucial role of relationships with other business and institutional actors as a driver of organisational success (Gulati, 1998; McEvily & Zaheer, 1999; Park & Luo, 2001; Peng & Luo, 2000; Uzzi, 1997). The concept has also been employed to analyse the power basis of the subsidiary for gaining importance in the MNC (Andersson et al., 2002, 2007; Forsgren et al., 2005; Garcia-Pont et al., 2009). In the business network literature (e.g. Andersson et al., 2007; Forsgren et al., 2005) subsidiary embeddedness is defined specifically in terms of mutual adaptations in developing production processes and products between a focal subsidiary and a small number of counterparts (mostly customers or suppliers) with whom the subsidiary has developed lasting business relationships. Through the cumulative adaptation process with counterparts, subsidiaries develop technological and organisational competencies which, when transferred to other units, help to improve the overall level and range of competencies within the MNC (Andersson, Forsgren & Holm, 2001).

Although the focus of most researchers has been on subsidiaries' external embeddedness, there is a good basis in the extant literature for the existence of internal business relationships and hence a degree of internal embeddedness within MNCs (for a detailed discussion of this literature, see Yamin, 2005). From a firm-theoretic perspective, the possibility of market or business relationships within hierarchies has been noted in the transaction cost/internalisation literature (Buckley & Casson, 1998; Coase, 1937). The MNC management literature indicates a significant degree of subsidiary leverage for independent initiative and mandate building and while much of this is developed through business relationships with external partners, the potential for internally focused business relationships is also acknowledged (Birkinshaw, 1996; Birkinshaw & Ridderstråle, 1999). In particular, there has been much emphasis in the literature on the value of intra-organisational cooperation amongst MNC managerial strata across national and sub-unit boundaries (Bartlett & Ghoshal, 1993; Gnyawali, Singal, & Mu, 2009; Kostova & Roth, 2003; Monteiro, Arvidsson, & Birkinshaw, 2008; Tsai & Ghoshal, 1998; Tsai, 2000). The existence of collaborative ties and relationships between sub-units are shown to drive the process of resource (information, products, personnel and support) exchange and combinations between units (Tsai & Ghoshal, 1998) which can lead to ongoing business exchanges between them. For example, the exchange of personnel between sub-units may help the sub-units to identify mutually profitable business opportunities.

2.2. Distinctive features of internal and external subsidiary embeddedness

Even when inter-subsidiary business relationships are established they may be somewhat different from business relationships with external partners. From the perspective of this paper, a crucial issue is whether internal business relationships have similar consequences for technical and production adaptations as external business relationships and, more generally, whether they have similar competence development effects on the subsidiary. In this section we consider four factors affecting the 'productivity' of a business network for the subsidiary. Table 1 lists the factors and their consequences for internal and external networks.