

**Overlapping Relationships of Headquarters and Subsidiaries to Local
Networks – A Conceptual Model of Antecedents and Performance
Consequences**

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Overlapping Relationships of Headquarters and Subsidiaries to Local Networks – A Conceptual Model of Antecedents and Performance Consequences

Abstract:

We develop a model of antecedents and consequences of embeddedness overlap – a situation in which subsidiaries as well as HQs of MNCs are both strongly embedded to the same external actors in local networks. This phenomenon is commonly seen in large MNCs and has started to attract scholarly attention. Yet, the literature provides little insight into the conditions under which it is beneficial or harmful to the MNC. Embeddedness overlap might be beneficial as it could help the differentiated MNC to profit from subsidiary embeddedness while it helps the HQ to gather knowledge of their subsidiary network. In turn, this would make life easier for HQs and their task of aligning the whole organization, finding appropriate coordination mechanisms, and managing knowledge transfer. On the other hand, embeddedness overlap runs counter the traditional logic of efficiency and creates duplication of activities. In the body of the paper we develop the concept of embeddedness overlap and link it to environmental as well as organizational context variables by formulating a number of propositions.

Keywords: MNC, embeddedness, HQ roles, Subsidiary roles, HQ-subsidiary relationship, overlap

Introduction

The conceptualization of the MNC as a differentiated network is widely accepted. It is suggested that the subsidiaries' level of embeddedness in their local environment is crucial as it is the basis for subsidiary-specific advantages and subsidiary entrepreneurship. In addition to possessing important resources, the subsidiaries of a differentiated MNC are conceptualized as being relatively autonomous and powerful, striving at least in part for their own goals which might even contradict the goals of the whole organization (Hedlund 1986; Birkinshaw 1997; Nohria & Ghoshal 1997; Rugman & Verbeke 2001).

In this network view it is assumed that it is primarily the subsidiaries' task to enhance the resource base of the MNC through its exposure to and contact with the local environments (Frost 2001; Andersson et al. 2002). In contrast to the subsidiaries, the HQ's role is to design the differentiated coordination and control mechanisms, to ensure that the MNC does not break apart, that it acts as a differentiated but integrated network of units, and that knowledge is transferred from subsidiaries to the rest of the MNC. However, this HQ role is very difficult to fulfill if not contradictory. Critical is especially the underlying assumption that HQs have knowledge about a large variety of subsidiary contexts, and that they are able to and possess the power to orchestrate and manage the differentiated network (Holm et al. 1995; Björkman & Forsgren 2000; Forsgren et al. 2005). One key argument is that subsidiaries which are embedded tend to be relatively isolated from the rest of the MNC and their embedded relationships are an effective barrier to HQ control and power (Andersson & Forsgren 1996; Ambos & Schlegelmilch 2007; Andersson et al. 2007).

In that respect, recent research has reported the interesting phenomenon that HQs, too, can build direct relationships to their subsidiaries' local networks. We call this "embeddedness overlap", i.e. a situation in which both the subsidiaries as well as the corresponding HQs are strongly embedded into the local, external network, i.e. to the same external network actors. Embeddedness overlap is a common phenomenon, for example, Forsgren et al. (2005) report that for approximately 10% of all subsidiaries in

their sample, the corresponding HQs have as well strongly embedded themselves into the local subsidiary network; and for 40% of all subsidiaries, HQs have at least some degree of embeddedness.

However, while there is initial research on this issue, it is unclear why and under which circumstances embeddedness overlap develops. First, the existence of such embeddedness overlap seems to contradict the assumption of divided labor of the bureaucratic organization and the traditional logic of resource allocation in organizations (Williamson 1975) developing and maintaining embedded relationships to the environment is costly and consumes managerial resources (Mizruchi & Galaskiewicz 1994; Luo 2003; Narula & Zanfei 2004; Boehe 2007)). Furthermore, from a network perspective, HQ relationships to the subsidiary network seem to break the rule of efficiency and effectiveness (Burt 1992). The efficiency and effectiveness rule says that investment in a new relationship should not be done if the contact can be reached through existing relationships and that resources should rather be committed to existing relationships.

Yet, some scholars have claimed that redundancy and duplication of activities is a necessary feature of modern network organizations that operate in turbulent environments (Hedlund 1980; Birkinshaw & Lingblad 2005). Initial empirical work has shown that MNCs operating with overlapping local relationships profit from subsidiary embeddedness while maintaining the HQ's capacity to fulfill its role in the differentiated MNC. For example, HQ local embeddedness helps reducing strategic influence of embedded subsidiaries, and transferring knowledge created by embedded subsidiaries (Holm et al. 1995; Yamin & Forsgren 2006; Andersson et al. 2007). Hence, given that embeddedness overlap seems to offer advantages while being very costly, our research question is: *Under which conditions are high levels of embeddedness overlap appropriate?*

We address our research question by investigating embeddedness overlap on the firm level and in the context of the MNC. The contribution of our paper is two-fold. First, it advances a firm-level theoretical framework that explains the phenomenon of embeddedness overlap in MNCs which we claim is an

important pillar to understanding the MNC as a differentiated network organization. Second, we substantially add to the network and embeddedness literature by integrating a more complex and hence realistic picture of MNC embeddedness. Thereby we enrich the theory of inter-organizational networks.

The remainder of this paper is structured as follows. First, we briefly review the relevant literature regarding the differentiated MNC and embeddedness. Second, we develop our model and specify five propositions. Finally, we discuss performance implications of embeddedness overlap and describe future research avenues and managerial implications.

1 Literature Review

Modern conceptualizations of the MNCs have frequently been linked to changes in the environment. It is common knowledge that environmental characteristics and dynamics have an impact on virtually “all aspects of the management of organizations” (Boyd et al. 1993, p. 205). Environmental dynamics include many different but related constructs such as turbulence, velocity, complexity, and uncertainty. In the last decades, it has been suggested that MNCs were increasingly forced to develop flexible organizational forms due to the trend of globalization, technological advancements and a general increase of uncertainty and instability. The resulting difficulties for management made MNCs adopt less hierarchical structures and develop network-like organizations characterized by a web of semi-independent units which cooperate and compete with each other (Hedlund 1986; Prahalad & Doz 1987; Ghoshal & Nohria 1989).

Probably triggered by the importance of the environmental conditions, over time, researchers have begun to analyze the environment in greater detail and have overcome the view of an impersonal marketplace (Gulati et al. 2000). One important claim is that sources of competitive advantage cannot be understood without analyzing the relationships of a firm to the external environment in depth (Forsgren et al. 1999). For the differentiated MNC, subsidiaries are suggested to be embedded in differing local environments holding different resources and capabilities, which makes it necessary for the MNC to differentiate its

management style (Ghoshal & Nohria 1989). The relationships to the environment are a basis for such differentiation (Pearce & Papanastassiou 1997) and a very important source of knowledge (Foss & Pedersen 2002). It is assumed that relationships to external network partners gradually develop from arm's-length to closer and more interdependent relationships and that this emerging network defines the opportunities available to the firm (Björkman & Forsgren 2000). The external network is seen as an important strategic resource of the MNC (Gulati 1998; Gulati 1999) and it is claimed that the "performance of firms can be more fully understood by examining the network of relationships in which they are embedded" (Gulati et al. 2000, p. 203). In sum, modern conceptualizations see the MNC as an organizational network which itself is embedded in an environmental network (Hedlund 1986).

Extant Embeddedness Research

Research on the embeddedness of organizations in its networks has taken place on many levels (Moran 2005). Analysis has ranged from studying embeddedness on the individual level (Krackhardt 1990; Brass et al. 1998) the organizational unit level (Andersson & Forsgren 1996; Hansen 1999; Andersson et al. 2002), and the firm level (Uzzi 1996; Tsai 2000). Therefore, the definition of the network or the organization to which individuals, units, or firms can develop relationships has varied with the level of analysis (Dacin et al. 1999). For example, the network has been defined as a "business network" with business relationships between the actors that involve buying and selling processes (Tsai & Ghoshal 1998; Forsgren et al. 2005). This is based on the idea that "all firms work in cooperation with others in offering their products and services to the market" (Chen et al. 2004 p. 321). Others have emphasized the importance of social relationships and hence social networks in contrast to the business network approach (Tsai 2000). However, the definition of business relationships seem to include information and social relationships as well since Forsgren and colleagues (2005 p. 17) note that an "important aspect of the exchange is the exchange of information. In a business relationship, managers in the two firms develop and maintain extensive contacts with each other". In the following, our focus will be set on the organizational unit level and we will refer mainly to business relationships (buying and selling exchange

relationships), information relationships and, occasionally, social ties on the individual level on which business relationships are based (Hansen 1999; Chen et al. 2004).

A further distinction has to be made between relational and structural embeddedness. Relational embeddedness refers to a dyadic perspective and hence to specific relationships between two actors as opposed to structural embeddedness which includes the whole network (Granovetter 1985; Gulati 1998). The relationship is defined as being strongly embedded when it is very close and intense – the highest level of embeddedness being a situation of strong mutual interdependence and adaptation (Frost 2001; Andersson et al. 2002). A unit or firm is defined as being strongly embedded when it has established many strongly embedded relationships to environmental partners. In the non-international context, embeddedness into the environmental network has been frequently analyzed to detect its effect on the organization and its behavior. For example, scholars have found evidence that firms which are strong in relational embeddedness profit from high levels of information exchange, trust, joint problem solving and mutual adaptation (Uzzi 1997; McEvily & Zaheer 1999). The embedded relationships are advantageous for the exchange of more fine-grained information (Uzzi 1996). The underlying logic is that strong relationships are more capable of exchanging tacit knowledge which is the basis for learning and innovative behavior (Lane & Lubatkin 1998). Firms invest strongly in such relationships and over time, they develop collaborative capabilities (Dyer & Singh 1998) and the network relations become a significant asset (Hakansson 1982). Studies have empirically supported this logic, and have shown that highly embedded firms are high performers (Uzzi & Gillespie 2002; Fischer & Pollock 2004) with a higher chance of survival (Uzzi 1996, 1997) and which develop critical capabilities (McEvily & Zaheer 1999).

In contrast, *structural* embeddedness refers to the fact that firms are embedded in sets of *connected* relationships (Cook & Emerson 1978). Here the perspective moves from the dyadic relationship (e.g. firm to customer) towards the integral network including, for example, customers' customers or customers'

suppliers. In this structural perspective, emphasis is put on the overall network and its characteristics, such as the overall network density or the number of existing structural holes (Brass & Burkhardt 1993; Brass et al. 1998).

Subsidiary embeddedness and organizational knowledge

The existing work on *MNC embeddedness* is based on the above-mentioned assumptions and mechanisms. Yet, instead of investigating the firm-level it has primarily focused on the subsidiary level and its direct relationships to the local subsidiary network (Asakawa 1996; Andersson et al. 2002; Schmid & Schurig 2003; Holm et al. 2005; Boehe 2007; Mu et al. 2007). Hence, MNC work has mostly integrated the construct “subsidiary relational embeddedness” into the research (e.g. Andersson 1996). The subsidiary is seen as a local “quasi-firm” (Forsgren 2004) in a unique embeddedness situation which is seen as the “local market interface” (Mu et al. 2007). It is assumed that subsidiaries develop and foster their external relationships in order to respond to environmental challenges (Peng & Luo 2000; Luo 2002; Luo 2003; Holm et al. 2005). In addition, a necessary condition seems to be that they have enough resources and liberty to do so (Andersson et al. 2005). In fact, it is frequently assumed that the MNC uses certain methods of coordinating and controlling the international activities to influence the behavior of the subsidiaries (Baliga & Jaeger 1984; Martinez & Jarillo 1989) and some of these mechanisms have been shown to hinder the development of subsidiary embeddedness (Andersson et al. 2005).

Yet, suppressing the development of subsidiary embeddedness is increasingly considered to have important disadvantages. A great number of scholars report that embedded subsidiaries are able to create new knowledge and be innovative since their idiosyncratic patterns of relationships expose subsidiaries to diverse knowledge, opportunities and ideas upon which the subsidiary can build and develop critical capabilities. Subsidiary embeddedness is conducive to knowledge and capability development, and innovative behavior (Nobel & Birkinshaw 1998). As a consequence, highly embedded subsidiaries are more important for other units’ competence development (Andersson & Forsgren 2000; Holm et al.

2005), they are more involved in the MNC innovation network (Johnston & Paladino 2007) and it is more likely that they become Centers of Excellence (Frost et al. 2002; Ambos & Reitsperger 2004). To this end, subsidiary embeddedness is a necessary feature of the differentiated MNC to take advantage of its multinationality and to profit from different knowledge sources in their various host markets.

Subsidiary Embeddedness and coordination & control

Besides the knowledge effects, subsidiary embeddedness has been linked to coordination and control issues. It is claimed that embedded subsidiaries can exploit substantial influence on their own status and their responsibilities within the MNC which is partly due to their specific knowledge and competencies (Forsgren et al. 2005; Forsgren 2004). In the non-international context, scholars described the embedding process of firms as a development which moves their attention towards the external network (Gulati & Sytch 2007). This increased relational orientation accompanied by mutual dependencies heightens the firm's evaluation of smooth relationships with and solidarity to external partners (Heide & Miner 1992; Gulati & Gargiulo 1999). Opportunistic behavior towards the external partners is reduced (Subramani & Venkatraman 2003). If subsidiaries in the MNC context are very embedded, this can mean that very intensive interaction of the subsidiary with its external network might come at the expense of the subsidiary's interaction with the own MNC or own HQ. This can in turn reduce HQ knowledge and understanding (Holm et al. 1995). In addition, it might lead to a situation in which the subsidiary is less opportunistic regarding its network partners again to the detriment of the relationship with the MNC. This is in congruence with findings that strongly embedded subsidiaries are knowledge creators but that the subsidiary's knowledge gained through embedded relationships does not automatically lead to reverse knowledge flows back to the MNC (Hakanson & Nobel 2001; Mu et al. 2007; Holmström forthcoming 2008) which signifies that MNCs have difficulties in integrating embedded subsidiaries back into the organization. Furthermore, it has been assumed that relation specificity (complex social and economic interdependencies develop in the embedding process (Forsgren 2004), stickiness of relation-specific knowledge and bounded rationality make it difficult for outsiders to understand the complexity of a focal

relationship (Ghoshal & Bartlett 1990; Forsgren et al. 2005). As HQs are considered to be outsiders to the subsidiary-specific relationships to the environment, it is claimed that HQs only have a vague idea about the characteristics and the importance of the external relationships their subsidiaries maintain (Holm et al. 1995). This leads to a control and coordination problem for the HQ (Holm et al. 1995) and it gives rise to a situation in which subsidiaries are very powerful (Andersson et al. 2007) and autonomous (Andersson & Forsgren 1996).

By conclusion, subsidiary embeddedness seems to develop under conditions in which subsidiaries are exposed to environmental pressure for developing and maintaining such relationships while having the necessary freedom (autonomy) and ability to do so. This is in line with related, yet more general research on inter-organizational relations in which it has been argued that these relations are endogenous depending on firm-specific and environmental factors. Furthermore, the degree of subsidiary embeddedness is an important driver of subsidiary knowledge creation while it also creates a coordination and control problem for the HQ.

Embeddedness overlap – Conceptual development and distinction from overall HQ embeddedness

As mentioned above, probably due to the immense complexity of the MNC, researchers have applied a very confined conceptualization of MNC embeddedness, i.e. subsidiary embeddedness. However, researchers claim that the conceptualization of the MNC as a multi-center organization also includes that relationships to the external network exist on many different levels of the organization (Halinen & Törnroos 1998; Dacin et al. 1999; Nell & Raab 2007). Hence, research is warranted which included not only external relationships of subsidiaries but also of HQs.

We are distinguishing two stylized types of networks to which HQ units can develop relationships:

First, HQs can develop their own set of direct relationships independent of the subsidiary network, i.e. networks to which subsidiaries do not have direct linkages. Dacin et al. (1999) suggest that the

opportunity for relationships on higher levels of the organization (such as HQs) has increased with the trend towards globalization as the latter can be interpreted “as a disembedding process that strips individuals and firms from their local structures and allows for restructuring at a more global level” (Dacin et al 1999; p: 341). For example, regional headquarters (RHQ) are sometimes taking over the complete strategic and operational responsibility for some external relationships from the subsidiary level. In Europe, some international sports goods manufacturers build their prime external relationships with region-wide operating customers, such as Footlocker, on the regional level, while the embeddedness of the region’s subsidiaries to local Footlocker affiliates reduces. Here, (R)HQ’s external relationships could be characterized as fully-developed business relationships in the sense that they involve buying-selling exchange. Embeddedness overlap is rather low in such a situation. Another example is a HQ’s own communication and social relationships with specific actors such as parent units of their partners. HQ managers (e.g. Corporate HQ of P&G) might develop strong relationships with HQ counterparts of important multinational customers (e.g. HQ of Carrefour) in order to discuss the general relationship quality, agree on joint strategic moves, or even to discuss some particular business in a specific country. These counterparts might also be governments or other political players for example on the European level.

Second, beyond the HQ’s own direct network relations, researchers have also begun to investigate the role of HQ external relationships to local network actors (Birkinshaw et al. 2001; Frost 2001; Forsgren et al. 2005; Andersson et al. 2007) in the following called *HQ local embeddedness*. For instance, Andersson et al. (2002, p. 992) note that “the HQ must take part and develop its own relationships with important customers and suppliers in the subsidiary’s network”. And Yamin & Forsgren (2006) argue that HQs need to develop their own relationships to the subsidiary. Furthermore, they argue that the need for HQ local relationships increases with the level of subsidiary embeddedness. In other words, embeddedness overlap develops. For example, The RHQ staff of a German pharmaceutical MNC situated in Austria, frequently visits local customer organizations (agents of local health care systems) and governments –

together with subsidiaries and on their own – to discuss business issues and to exchange important information. They build extensive social relationships and partly assist the local subsidiaries in their buying/selling exchange relationships. Note that our concept of HQ local embeddedness does not mean that the HQ only develops relationships to actors at the HQ location (i.e. the country where the HQ unit is located) but to several local networks of their geographically dispersed subsidiaries.

In this paper, we are focusing on this second type of HQ external relationships – those which connect the HQ unit to the subsidiary network and which we call HQ local embeddedness. The degree of embeddedness overlap to local networks is illustrated in the simplified model shown in figure 1. It conceptualizes the degree of overlap by modelling the embeddedness situation of one subsidiary and its corresponding HQ. According to the concept of the differentiated MNC, most of the embeddedness situations will be located in the lower right corner of the framework. In this situation the subsidiaries are relatively strongly embedded with a number of interdependent and mutually adapted business relationships to local actors¹ – this includes strong social relationships (Chen et al. 2004). The HQ only maintains a few and rather weak relationships to these actors and hence embeddedness overlap is low.

Embedded overlap is given when the subsidiary is strongly embedded locally and the HQ has developed strong relationships to these local subsidiary partners as well. Note that the subsidiary relationships can reach very high levels of embeddedness by developing highly interdependent business relationships while the HQ's local relationships are probably mainly communication and social relationships without a direct buying/selling exchange activity involved.

¹ Of course, the degree of local embeddedness still varies between the subsidiaries with some subsidiaries being less and some being more adapted to and dependent on their local partners (Andersson et al. 2002).

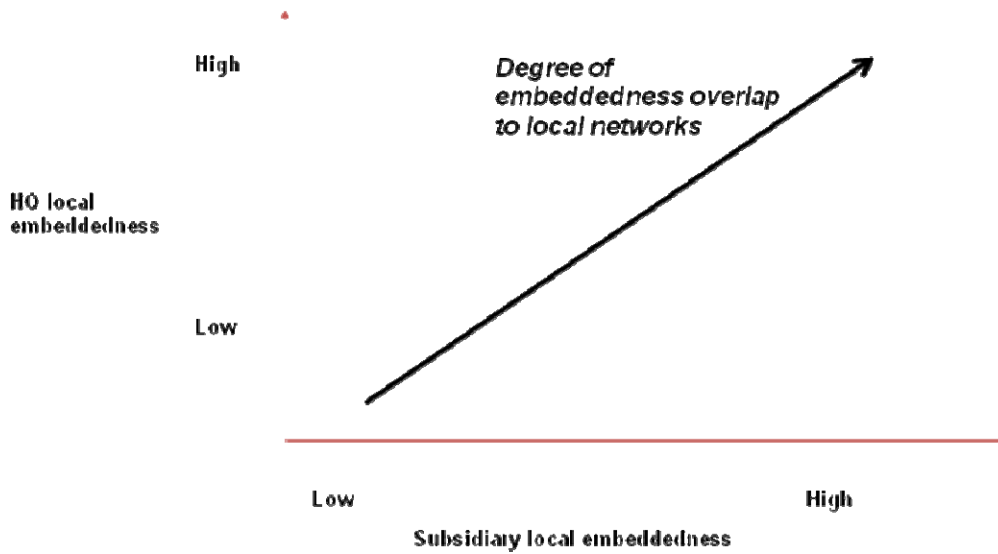


Figure 1: Model of embeddedness overlap to local networks

In sum, figure 1 illustrates embeddedness overlap to one particular local subsidiary network. Embeddedness overlap to local networks depends on subsidiary local embeddedness and HQ local embeddedness. As our unit of analysis is the MNC, we conceptualize the degree of embeddedness overlap to local networks as an aggregated construct comprising all MNC subsidiaries and their corresponding HQs which shall be defined as the HQ unit to which the subsidiaries have their primary direct reporting relationship.

2 Theoretical Framework and Development of Propositions

Based on the findings of the literature review and our concept of embeddedness overlap we propose a model to explain the degree of embeddedness overlap (see Figure 2). We develop a model which predicts the overall degree of embeddedness overlap on the level of the corporation (and not embeddedness overlap of a particular HQ-subsidiary dyad). Our model consists of some elements of the environmental context as well as the MNC internal situation named the organizational context. It is limited to factors that influence both subsidiary and HQ local embeddedness as only the combination leads to high degrees of embeddedness overlap. Hence HQ local embeddedness and subsidiary local embeddedness are

contingent upon the same factors. This is obvious in the case of the organizational factors which cover for example coordination and control issues in the HQ-subsidary relationship, which, by definition, influences the HQ as well as the subsidiary. Regarding the environmental factors such as industry conditions we argue that they are as well not only relevant for the subsidiary but also for the corresponding HQ and the whole MNC. We are advancing several propositions for variables which we group into environmental context variables (figure 2) and organizational context variables. Finally, we develop a fit-proposition with regard to the relationship between embeddedness overlap and MNC performance (not shown in figure 2).

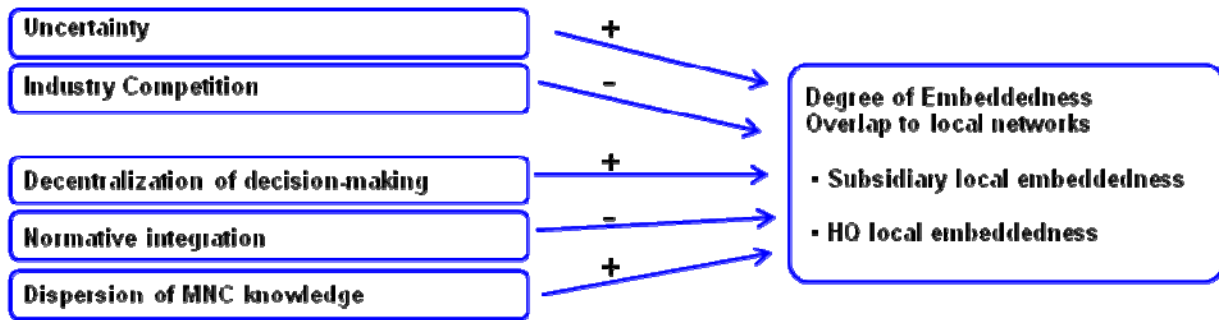


Figure 2: Development of propositions: Antecedents of the degree of embeddedness overlap to local networks

2.1 Environmental Context

The environmental context is a key driver to understand inter-organizational relationships. Regarding inter-organizational relations in general, it is well-accepted that firms enter relationships to external actors in response to challenges and opportunities posed by the environment. The firm is dependent upon the environment and strengthening inter-organizational relations can reduce uncertainty or help to procure resources needed that are at least partly under the control of another organization in the environment (Thompson 1967; Pfeffer & Salancik 1978). This has been shown empirically by a number of authors (Granovetter 1985; Beckman et al. 2004; Koka et al. 2006). Regarding subsidiary embeddedness it has been suggested that the structure of the market (e.g. uncertainty or competitive intensity) and the type of

industry partly explain subsidiary embeddedness along the lines of the research on the firm level (Park & Luo 2001). Others argue that subsidiary networking is an offensive reaction to the liability of foreignness the subsidiary faces in a new host country (Luo et al. 2002; London & Hart 2004).

In our model we have integrated environmental uncertainty which is a very important characteristic of the environment and very frequently used. In addition, we use the intensity of competition as a second variable. Both variables are relevant to the subsidiary as well as the HQ level of the MNC.

Environmental uncertainty

Environmental uncertainty can be viewed from a technological as well as market perspective and is frequently been captured by ‘turbulence’ in these dimensions. Technological turbulence is defined as the rate of change in technology associated with the development of products (Menon et al. 1997). It is reflective of the overall industry and not specifically the state of that industry in a particular market (Hewett et al. 2003). A rapid pace of technological change is said to create uncertainty (Weiss & Heide 1993). In such situations, there are many competing technologies and business models and a dominant technological standard has not evolved. Therefore, firms need to maximize chances to fully identify opportunities and risks (Birkinshaw & Lingblad 2005) which can be achieved through high-quality information gathering via strong relationships to other actors in the market. To this end, technological turbulence is a driver of subsidiary embeddedness.

The level of turbulence of the environment can also be related to market dynamics. Market turbulence can be defined as the rate of change in the composition of customers and their preferences (Jaworski & Kohli 1993). This construct captures the ever changing product needs and preferences of customers and consumers in a particular industry. It implies that more industry opportunities and challenges emerge simultaneously (Rawski 1994). Similar to the impact of technological turbulence, firms have to modify their products and services continually in order to respond to the environmental threat. Consequently, it has been claimed that in such an environment, the need for a strong market orientation is higher (Boyd &

Fulk 1996) and that increased customer and consumption uncertainty leads to increased inter-organizational relationships. The external relationships provide various types of exchanges and facilitate the acquisition and coordination of information. For example Lehrer & Asakawa (Lehrer & Asakawa 2002) show that MNCs are scaling back the integration of R&D subsidiaries in favor of the R&D unit's local embeddedness when facing turbulent environments.

Finally, in such environments, a single dominant source of information and logic of interpretation should be avoided (Prahalad & Bettis 1995; Birkinshaw & Lingblad 2005). Similarly, Hedlund (Hedlund 1980) has claimed that to respond appropriately to turbulent environments, firms need to be very creative and need to involve several hierarchical levels. Hence, environmental uncertainty is prone to drive a situation in which not only subsidiaries strive for deepened external relationships but that also HQs create their own relationships to the external actors to allow internal variation.

Proposition 1: The degree of environmental uncertainty is positively associated with the degree of MNC embeddedness overlap in a given MNC.

Industry competition

Intensity of competition is defined as a situation in which an industry's competitors are very prone to fighting and retaliation which creates a high level of market instability (Porter 1980). Customers may have many alternative options to satisfy their needs and wants (Jaworski & Kohli 1993). Yet, competitive pressures challenge the position of players in the market and make them more dependent on other firms (Caves & Porter 1978). Therefore, authors have argued that intense competition makes it necessary to neutralize this pressure through external relations (Luo 2003; Holm et al. 2005). In other words, subsidiaries in a competitive environment might not be able to develop a competitive advantage if run on their own (Luo 2003).

However, in contrast to the level of environmental uncertainty, the level of competition is also a sign of a mature industry in which there is substantial cost pressure (Birkinshaw & Lingblad 2005). Prices tend to decrease when competition is very intense and firms will therefore eliminate overlapping activities where

possible and strive for efficiency in their operations. Hence, while embeddedness is a very important countermeasure to increased competition, firms will still try to streamline their organizations and avoid the duplication of relationships to the external networks.

Proposition 2: The intensity of industry competition is negatively associated with the degree embeddedness overlap in a given MNC.

2.2 Organizational Context

Another important source of antecedents of subsidiary embeddedness is rooted in the HQ-subsidiary relationship as it defines the freedom of the subsidiaries to embed and the control and dependence problem of the MNC (the HQ) on the subsidiaries. In our model, we consider the level of decentralization of decision-making as well as normative integration as key indicators of the HQ-subsidiary relationship (Nohria & Ghoshal 1994).

Decentralization of decision-making

Decentralization of decision-making puts the locus of authority in the hands of the subsidiary managers (Pugh et al. 1968). If additional control mechanisms are lacking that might help to constrain subsidiary behavior, autonomous subsidiaries can be expected to act predominantly in the interests of their own organizational unit. If subsidiaries are highly autonomous their activities will be – to the detriment of the HQ – directed to the more immediate and important actors in their subsidiary environment, i.e. their local network partners. By definition, a high degree of embeddedness means that there are other specific actors than headquarters in the subsidiary's environment that the subsidiary considers as being important because if not, the subsidiary would have used its scarce resources to deepen the relationships to internal actors (Andersson et al. 2007). Therefore, a high level of subsidiary embeddedness has been empirically linked to high levels of autonomy (Andersson & Forsgren 1996; Asakawa 2001). Yet, the relatively

strong emphasis of autonomous subsidiaries on the local optimum creates a control gap for the HQ. This is similar to Ghoshal and Bartlett's conclusion that remote control loses efficacy when localness, by itself, is the key requirement for maintaining relationships in the subsidiary network (Ghoshal and Bartlett, 1990, 1993). In such a situation, HQ relations to local networks are becoming more necessary since they improve the HQ's first-hand knowledge of the local context and break subsidiary influence (Andersson 2007). The additional relationships by the HQ to the network partners seem to be an additional information channel for the MNC and the HQ in particular. In their work on account management, Birkinshaw et al (2001) argue that multiple relationships on several levels of the MNC to the same customers enhance internal information processing capacity of the MNC.

Thus, it has been argued that especially in case of highly embedded subsidiaries, HQ local embeddedness can serve as a mechanism to maintain control and power over the subsidiary without affecting the level of subsidiary embeddedness (Yamin and Forsgren 2006). This supports earlier claims by Holm and colleagues (1995) who suggest that HQ control over the development of the MNC requires knowledge about the network embeddedness of the subsidiaries. The scarce empirical literature has also produced the result that HQ local embeddedness is positively associated to a lower use of centralization in decision-making (Forsgren et al. 2005) which seems to signify that HQ embeddedness functions as a control mechanism.

Proposition 3: The degree of decentralization of decision-making is positively associated with the degree of embeddedness overlap in a given MNC.

Normative Integration

Subsidiaries are normatively integrated if the parent company manages to establish shared values (Ouchi & Maguire 1975; Edström & Galbraith 1977). Normative integration is achieved through extensive usage of job rotations, international teams and task forces, international training and development programs and a strong focus on the corporate culture. For the HQ, normative integration is an alternative control mode (Ghoshal & Nohria 1989; Hedlund 1986) as MNCs which achieve normative integration achieve that

their dispersed units show greater commitment to the organization, identify more with the firm, and are more loyal and willing to cooperate. In other words, their subsidiaries are more likely to behave in the interest of the whole corporation. Thus, the pressure for HQs to build relationships to the subsidiary network is reduced as the control gap is less severe.

In addition, it has been argued, that the development of embeddedness requires a lot of investments from the subsidiary. Subsidiaries need to understand the counterparts' capabilities and importance and the relational linkages must be nurtured and deepened which consumes managers' time and attention (Andersson et al. 2005). Hence, the subsidiaries' relationships with its environment run the risk of being limited by HQs that use too much control. In fact, normative integration requires from subsidiary managers to travel extensively to HQs or corporate meetings, participate in trainings, work in international teams, task forces, and project groups. This would mean that subsidiary managers commit more time to MNC internal issues and less to the local environment. Hence, as HQs might not face severe control problem and subsidiaries might not be inclined to develop external embeddedness, we propose that overlap will not occur.

Proposition 4: The degree of normative integration is negatively associated with the degree of embeddedness overlap in a given MNC.

Dispersion of MNC knowledge

The next organizational context variable is the degree of dispersion of the MNC knowledge base. A MNC's knowledge base is strongly dispersed if the knowledge reservoirs are to a large extent located in geographically dispersed subsidiaries. On the contrary, a MNC which is operating with strong, central knowledge pools has a less dispersed knowledge base. Scholars who featured the differentiated network organizations have frequently claimed that "a geographically diffused pattern of expertise is built up, corresponding to unique abilities in each node of the network" (Hedlund 1986, p. 21). This is thought to

be necessary in order to exploit the advantages of multinationality – a fundamental idea of the differentiated MNC. But what happens if the MNC's knowledge base is very dispersed?

On the one hand, in the context of inter-organizational relations, the competencies of a firm or a unit are a driver of its attractiveness as perceived by potential external partners. For example, Powell and colleagues (Powell et al. 1996) suggest that the more a firm is attractive to potential partners, the more likely it becomes that this firm establishes new interfirm relations. This has been empirically verified for R&D subsidiaries of MNCs: R&D subsidiaries which are evaluated as being very knowledgeable are more embedded into their environment (Hakansson & Nobel 2001). As the level of embeddedness is itself conducive to creating new knowledge, it becomes a self-enforcing process in which a competent subsidiary is able to strongly embed to competent partner firms which in turn enables the subsidiary to develop new knowledge. To this end, dispersion of MNC knowledge means that subsidiaries are very knowledgeable which in turn increases the likelihood that they are embedded.

For instance, Andersson et al. (2002, p. 992) note that “the HQ must take part and develop its own relationships with important customers and suppliers in the subsidiary's network” in order to recognize and understand differences in subsidiary external embeddedness. And Yamin & Forsgren (2006) argue that HQs need to develop their own relationships to the subsidiary network if they want to overcome their lack of knowledge of the local context.

Regarding the HQ-level, it is obvious that the degree of dispersion of MNC knowledge is a challenge to the integration and transfer of the knowledge within the MNC. First, valuable knowledge developed in external relationships is arguably tacit in nature (cf. Lane & Lubatkin 1998) which means that no single unit within the MNC including the HQ has exact and full knowledge of where important competencies are located (Forsgren et al. 2005). HQ's own relationships to the external partners help them to be aware of where and to what extent valuable knowledge is available in specific subsidiaries (Forsgren et al. 2005; Andersson et al. 2007b). Second, the control problem is more severe when the subsidiary is very knowledgeable and strongly embedded as this translates into a situation in which the subsidiaries are powerful (Mudambi & Navarra 2004). In case these subsidiaries are unwilling to transfer knowledge to

other units of the MNCs, the HQ's ability to force subsidiaries to share their knowledge is crucial (Forsgren et al. 2005). HQ's own relationships to the subsidiary network can break subsidiary power (Andersson et al. 2007) and drive reverse knowledge transfers from the subsidiary to the rest of the MNC (Forsgren et al. 2005). It seems that through HQ embeddedness the integration of the subsidiary into the knowledge network of the MNC is facilitated as the HQ improves its knowledge on where in the organization valuable competencies are located. This is in line with the finding that HQs build embeddedness especially to the networks of those subsidiaries which have a strong competence and knowledge base (Andersson et al. 2007b).

Thus, dispersed knowledge seems to be linked to subsidiary embeddedness which creates both a control problem and an incentive to the HQ to engage in knowledge detection and transfer activities. Therefore, we propose that the degree of dispersion of MNC knowledge is positively associated with embeddedness overlap.

Proposition 5: The degree of dispersion of MNC knowledge is positively associated with the degree of embeddedness overlap in a given MNC.

Embeddedness overlap and MNC performance

One important issue that we did not develop further in the above text is the effect of embeddedness overlap on MNC performance. We have focused on the conditions under which embeddedness overlap is likely to occur but that does not mean that embeddedness overlap is per se a driver of performance when it occurs.

However, in the tradition of headquarters–subsidiary research the investigation of effects on performance is very important and the ability of MNCs to effectively manage their dispersed subsidiary network has been suggested to be a source of competitive advantage such that performance benefits would be expected (Ghoshal & Nohria 1989; Nohria & Ghoshal 1997). As we have shown, embeddedness overlap is one particular and relevant aspect of the MNC's organizational design. Therefore, we suggest that the performance benefits of embeddedness overlap are contingent on environmental and organizational

context. We suggest a configurational approach to model the effect of embeddedness overlap (if it occurs at all) on performance. That means that embeddedness overlap is one element among many that collectively make up a structural archetype. In reality, the conditions we hypothesize are arguably not fully independent, nor are MNCs always able to address each of them individually. This suggests that a collective pattern exists. A systems-based approach for examining contingency effects can be found in Drazin & Van de Ven (Drazin & Van de Ven 1985) and Doty et al. (Doty et al. 1993). Following Drazin & Van de Ven (1985) we propose that the deviation from an ideal profile for either too much or not enough embeddedness overlap will result in lower performance. In this view, embeddedness overlap of the MNC is a contributor to high performance when it occurs alongside certain organizational and environmental factors. However HQ embeddedness can also negatively impact on performance if it is used in the wrong set of circumstances. In sum, we propose a fit-hypothesis which considers the organizational and environmental drivers as well as the embeddedness configuration: **The greater the level of fit between the organization's actual profile of environmental and organizational factors and its level of embeddedness overlap, the higher its performance.** However, especially the performance effect of the fit-hypotheses needs some more development since by using a configurational approach it is necessary to pre-specify a set of archetypes, ideally on the basis of theory (Doty et al. 1993). In that respect, our paper is just the first step into the investigation of fit and performance and future research is needed.

3 Discussion and Conclusion

Our paper has advanced the understanding of the phenomenon of embeddedness overlap in MNCs by showing how it is shaped by a set of environmental and organizational variables. Our contribution is an extension of the embeddedness literature and the work on the differentiated MNC. The subject's importance for theoretical and managerial issues has clearly been shown since embeddedness overlap offers important benefits (in terms of offering a way for HQs to be able to fill its role as an orchestrator of

the differentiated MNC) as well as substantial costs (in terms of duplication of activities and redundancies).

Future research

There are several other interesting research avenues. *First* of all, our framework is conceptual only and therefore needs empirical investigation. *Second*, future research should also investigate more in detail the actual or perceived costs of embeddedness overlap from a HQ perspective but probably also from a subsidiary perspective. In our model, we take into consideration that embeddedness overlap can have positive as well as negative performance effects but we do not develop the discussion of the costs in case of negative performance effects. For example, in addition to obvious costs that occur on the HQ level such as additional staff needed for the resource-consuming relationships to various local contexts, costs could occur on the subsidiary level e.g. through transfer prices. *Third*, while in our view it has some important advantages to propose a model on the firm level, research on embeddedness overlap in particular markets could be very helpful to understand the phenomenon more holistically. Some of the hypotheses might be transferable to the market-level but there might be additional variables that play an important role. For example, the general importance of a subsidiary and its market could play a decisive role in attracting HQs to develop their own relationships to the local environment (Bouquet & Birkinshaw Forthcoming 2008). Similarly, the specific subsidiary's knowledge base would be very important (Andersson et al. 2007). *Fourth*, our model is based on the simplifying assumption that the MNC exists of two levels – the subsidiary and the HQ level. This is a common simplification in many of the conceptualizations of the MNC and open to criticism which emphasizes that there are mid-range units such as regional HQs or divisional HQs or subsidiary units which possess world-wide mandates. In this respect, further research could investigate the issue more in detail to overcome this simplification.

Implications for MNC managers

Based on our theoretical model, managers should treat the phenomenon of embeddedness overlap as a particular and important aspect of organizational design. It is crucial for managers on the subsidiary as well as the HQ level to be aware of advantages and disadvantages of embeddedness overlap and to understand the conditions under which it develops. Moreover, excessive, undifferentiated across-the-board cost-cutting by eliminating duplicating activities and by creating a very lean HQ unit should probably be avoided in today's turbulent markets.

Furthermore, our model implies that MNC managers need to change behavior. Managers of embedded subsidiaries must accept HQ embeddedness and potential involvement and understand this as a valuable source of input for decision-making. HQ managers need to increase or decrease the level of embeddedness overlap depending on changes in the environmental and organizational sphere. Especially typical developments regarding for example M&A, diversification, and internationalization activities alter the overall environmental and organizational situation of the corporation as a whole. Hence, embeddedness overlap is an important element of MNC managers' dash board if the differentiated network MNC is to be managed effectively.

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