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Embeddedness, Ownership Mode and Dynamics, and the Performance of MNE Subsidiaries

Jana Oehmichen [a], Jonas Puck [b,*]

[a] Georg-August, University of Göttingen, Platz der Göttinger Sieben 3, 37073 Göttingen, Germany
[b] WU Vienna University of Economics and Business, Welthandelsplatz 1, 1020, Vienna, Austria

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ABSTRACT

Whereas researchers have provided profound empirical evidence for the direct relationship between subsidiary embeddedness and subsidiary performance, we intend to investigate the dependence of this relationship on firm-specific contingency factors. Specifically, we propose that the effects of internal and external embeddedness on performance are contingent on ownership mode and the past change of such mode. We find a positive moderating effect of changes in ownership mode on the relationship between external and internal embeddedness and subsidiary performance. The empirical results support our reasoning that dynamic learning routines realized in situations of organizational change positively affect the efficacy for external and internal resource access for subsidiaries. The contingency perspective of our study provides further support for IB research to avoid one-size-fits all statements but rather to consider the volatile internal and external parameters that determine MNEs' business.

1. Introduction

Over the last decades several scholars highlighted the relevance of MNE subsidiaries' resource access through both external and internal embeddedness (Almeida and Phene, 2004; Nell and Ambos, 2013; Phene and Almeida, 2008). We build on Granovetter's (1985) understanding of embeddedness "as the contextualization of economic activity in on-going patterns of social relations" (Dacin et al., 1999, p. 319). In the context of MNEs, embeddedness research concentrates on the role of subsidiary relationships with other business and institutional actors (Yamin and Andersson, 2011). Our study follows previous IB research that considers subsidiary embeddedness as a strategic resource that is able to influence MNEs' future capabilities and organizational success (Andersson et al., 2002). We also follow previous research by distinguishing between external and internal embeddedness (e.g. Hallin et al., 2011; Schmid and Schurig, 2003). Whereas external embeddedness covers relationships with local institutions (Mu et al., 2007) such as regulatory bodies, buyers, suppliers, competitors, and distributors (Luo, 2003), internal embeddedness represents a close, intense and frequent subsidiary-headquarters relationship (Schmid and Schurig, 2003) that supplies subsidiaries with resources and support from other subsidiaries and the headquarters themselves (Ciabuschi et al., 2011). We agree with previous research that both types of embeddedness are critical for the success of subsidiaries (Ciabuschi et al., 2014; Gammelgaard et al., 2012). However, we extend research by asking the following research question: Do contingency factors of subsidiary governance moderate the embeddedness — performance relationship in MNE subsidiaries? More specifically, we ask how modes of ownership by themselves (we distinguish between international joint ventures and wholly owned foreign subsidiaries) as well as post-entry changes of such modes affect the ability to deploy the resources that can be derived from external and internal embeddedness.

* Corresponding author.
E-mail addresses: jana.oehmichen@wiwi.uni-goettingen.de (J. Oehmichen), jonas.puck@wu.ac.at (J. Puck).

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Previous research about embeddedness in MNEs provided evidence on the relevance of internal and external embeddedness for innovative performance (Ciabuschi et al., 2014; Figueiredo, 2011; Hallin et al., 2011), learning and innovation potential (Mu et al., 2007), innovation transfer (Dellestrand, 2011), subsidiary performance (Gammelgaard et al., 2012), and the survival of the subsidiary (Delios and Beamish, 2001). Conceptually, most of these studies modeled the relationship between embeddedness and outcomes as non-context-bound. Recent findings, however, question this assumption as latest studies found that under specific circumstances (such as the stability of host-countries' institutions) embeddedness may even have a negative value effect as it might lock firms in wrong networks and thus restrict their abilities (Sun et al., 2010; Uzzi, 1997). Our study picks up these partly controversial results and challenges the non-context-boundedness of performance effects of embeddedness. Our empirical analysis supports the existence of governance contingency factors in the dual-embeddedness-performance relationship since we find that effects of external and internal embeddedness increase in situations of changes in ownership modes.

Our study makes at least three relevant contributions to the existing literature. First, we contribute to embeddedness theory. As outlined above, existing research largely (either explicitly or implicitly) conceptualizes the embeddedness-performance relationship as non-context-bound. The only exception we are aware of focusses exceptionally on contingency factors external to the firm (Sun et al., 2010). We challenge the established idea of uniform relations between subsidiary embeddedness and firm outcomes such as performance and expand the contingency view using a firm-internal perspective. We do so by adding internal contingency factors of subsidiary governance and changes in this governance structure.

Second, we contribute to research on effects of organizational changes in the MNC. We consider organizational change as initiator of the realization of learning routines. So far, such research about effects of these dynamic routines in MNCs is limited to contributions in the field of power in international business relationships (Griffith and Harvey, 2001), competitive advantage in international joint ventures (Fang and Zou, 2009), and the idiosyncratic development of individual MNEs (Lee and Slater, 2007). We argue that this perspective also holds when assessing the impact of ownership dynamics in the context of subsidiary embeddedness, and therefore expand the application of the concept of dynamic learning routines to a new context.

Third, we contribute to research on post entry effects of ownership mode choices and governance choice in the MNC and extend existing research by adding a dynamic perspective (mode changes). We argue that next to established control arguments a theoretical perspective that explicitly acknowledges the dynamism of organizations and their ability to handle challenges of this dynamism should be included. Research on ownership dynamics so far has largely focused on determinants (Johanson and Vahlne, 1977; Puck et al., 2009) or direct financial consequences (Chung and Beamish, 2010) of mode changes. We propose that these situations of change have a strong impact on the relationship between internal and external embeddedness and subsidiary performance. This adds a new conceptual perspective on consequences of mode changes.

The remaining part of the paper is structured as follows. Based on the existing perspectives on embeddedness of MNC subsidiaries we develop two baseline hypotheses about potential performance effects of (1) subsidiaries external embeddedness and (2) internal embeddedness within the parent organization. We continue by integrating a contingency perspective and add hypotheses about the moderating role of the mode of ownership and changes in ownership to our conceptual model. We then introduce our dataset and present our empirical results. Our conclusion provides relevant contributions to the literature and introduces a number of potential areas of interest for future research.

2. Theory and development of hypotheses

2.1. Dual embeddedness of subsidiaries

The concept of embeddedness goes back to the work of sociologist Granovetter (1985) who argued that economic behavior is embedded in social relations. From his point of view, the role of social relations is to build trust and to discourage malfeasance (Granovetter, 1985). Since then several researchers described embeddedness as a source for social (Adler and Kwon, 2002) and human capital (Haynes and Hillman, 2010). Being such a source of social capital, embeddedness ensures a continuous transfer of trust, reputation, and status (Payne et al., 2011). From a human capital perspective, embeddedness represents an important learning platform for companies and is thus an important channel for knowledge and information (Geletkanycz and Boyd, 2011). For these reasons, researchers largely agree on the general beneficial role of embeddedness for organizations. Researchers could for instance show that embedded individuals cause better work group performance (Sparrowe et al., 2001), that embedded companies have access to more lucrative loans due to social ties to their lenders (Uzzi, 1999), and that embeddedness with host-country partners is an important determinant of competitive advantage that reduces IJV failures (Meschi and Wassmer, 2013).

In the international business context, two streams of literature picked up the concepts of embeddedness. On the one hand, researchers investigating subsidiaries' local networks developed the concept of *external embeddedness* (e.g. Nell et al., 2011). External embeddedness is an important source for subsidiary knowledge (Mu et al., 2007). Subsidiaries learn from network partners (Andersson et al., 2007) in interactive learning processes (Hallin et al., 2011) and assimilate new capabilities (Schmid and Schurig, 2003). On the other hand, studies about the relationship and resource exchange between subsidiaries and parent firms argue based on *internal embeddedness* (Ciabuschi et al., 2011). Internal embeddedness represents the closeness, intensity, and frequency of subsidiaries relationships to their headquarters (Schmid and Schurig, 2003) and thus provides subsidiaries with resources and support from other subsidiaries as well as directly from the parent firm (Ciabuschi et al., 2011). Originally, these two streams of literature have been developed separately. However, recent studies chose a more integrated perspective on subsidiary embeddedness (Hallin et al., 2011; Nell and Ambos, 2013; Schmid and Schurig, 2003). First ideas about the simultaneous effect of external and internal embeddedness were that external embeddedness of subsidiaries is not always in the best interest of