



## Subsidiary embeddedness as a determinant of divisional headquarters involvement in innovation transfer processes

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### ABSTRACT

This paper conceptualizes divisional headquarters as an important hub-firm within the MNE, orchestrating innovation transfer processes between subsidiaries. It is argued that the internal and external embeddedness of a subsidiary hosting an innovation development project subsequently influences divisional headquarters involvement in the transfer of that innovation. In this way, embeddedness, i.e., the relationships that firms have with each other in the innovation development phase, is brought to the fore as an important factor for MNE subsidiaries hosting innovation development projects for explaining the involvement of divisional headquarters in a subsequent transfer. This highlights divisional headquarters as an active orchestrator of innovation transfers within the MNE. Data from 169 innovation transfer projects as well as 146 internal and 121 external embedded relationships at subsidiary level support the argument of embeddedness as a driver of divisional headquarters involvement in subsidiary innovation transfer projects. From a business network perspective, the findings highlight the role of internal and external embeddedness during innovation development in the subsequent involvement of divisional headquarters in the transfer phase. Embeddedness is not only important for subsidiaries in the innovation development phase but also for divisional headquarters involvement in, and orchestration of, innovation transfer.

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### 1. Introduction

A prominent feature of the multinational enterprise (MNE) is its geographical dispersion of activities around the world with different activities of the value-chain taking place in separate locations (Buckley, 2009; Mudambi, 2008; Mudambi and Swift, 2011-this issue). Innovation development in MNEs does not only take place at headquarters. Instead, a lot of innovative activity occurs at subsidiary level (Birkinshaw and Hood, 1998, 2001; Ghoshal and Bartlett, 1990). The MNE can be conceptualized as a business network (Andersson et al., 2007b; Forsgren et al., 2005). In this business network, MNE subsidiaries are connected to sister units, but also to units external to the MNE. Put differently, business network embeddedness implies both an internal and an external perspective for the focal subsidiary (Forsgren et al., 2005).

MNE subsidiaries can provide the overall organization with new knowledge, ideas and opportunities by being embedded in business networks that span organizational and country borders (Andersson et al., 2002). Embeddedness refers to business relationships and functions that units have developed with each other through a history of interactions. Previous studies related to business networks have investigated its role in innovation development (Forsgren et al., 2005). However, the MNE's ability to take

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advantage of the positive aspects of subsidiary embeddedness in relation to innovation development is largely conditional on the fact that these innovations are transferred throughout the organization. Still, few studies have investigated the relationship between subsidiary internal and external embeddedness in the development phase and headquarters involvement in innovation transfer processes. Innovation development and innovation transfer can be perceived as two distinct processes, where what goes on during the development stage may influence what happens during the subsequent transfer stage. This study contributes to business network theory by investigating the relationship between subsidiary embeddedness at the innovation development stage and divisional headquarters involvement in innovation transfer processes. This issue has been left unexplored by research. Consequently, the current study contributes to business network theory by investigating drivers of innovation transfer orchestration.

In the MNE, headquarters can be conceptualized as the overall orchestrator of activities with a holistic responsibility for the operations of the multinational group ensuring that activities are integrated, coordinated and combined, although other hub-type firms can exist within the organization (Dhanaraj and Parkhe, 2006). If headquarters combine resources and activities, the individual parts may add up to a greater sum than the individual parts alone (Andersson et al., 2005). Innovation transfer is thus a key activity in MNEs. It can be conceptualized as a distinct event taking place between a sending and a receiving unit, and it can also be conceptually and empirically separated from the innovation development process. Innovation transfer enables the MNE to make use of existing resources in multiple locations (Cool et al., 1997; Schulz, 2001; Szulanski et al., 2004). However, research has indicated that headquarters is often ignorant of activities occurring at and resources located at subsidiary level (Holm et al., 1995). Given the importance of innovation development and transfer for MNEs (Grant, 1996; Kogut and Zander, 1993), this lack of knowledge implies that, from a headquarters perspective, the MNE runs the risk of missing out on supporting promising subsidiary innovations subject to transfer. Rugman and Verbeke (2001) argue that headquarters may have to assist subsidiaries in their promising projects by intervening and supporting activities at subsidiary level. In fact, innovation governance, in the form of promoting development and dissemination of innovations, is a key activity in MNEs (Argote and Ingram, 2000; Foss, 2007).

Research has shown that transfer activities can be arduous, costly and time-consuming (Gupta and Govindarajan, 2000; Szulanski, 1996; Teece, 1977; Zander and Kogut, 1995). In this context, it has been argued that headquarters can be very important in influencing MNE innovation flows (Birkinshaw, 2001; Ghoshal and Bartlett, 1990). However, if headquarters do not know which innovations to support, the task of orchestration becomes difficult. Thus, when orchestrating innovation transfer, a headquarters unit operating closer to its subsidiaries vis-à-vis corporate headquarters, such as divisional headquarters (Birkinshaw et al., 2000; Rugman and Verbeke, 2004, 2008), presents a potential organizational solution to the problem of the lack of subsidiary-specific knowledge for MNEs. In this paper divisional headquarters is understood as a distinct unit with a specific operational responsibility for specific units without the overall MNE responsibility, which is within the domain of corporate headquarters (Chandler, 1991). Divisional headquarters is also a separate unit compared with individual subsidiaries, i.e., value-adding entities operating in host countries (Birkinshaw and Hood, 1998).

By operating close to the subsidiaries and their respective business networks divisional headquarters may be better informed and can thus serve as a boundary-spanning hub-firm within the MNE network (Dhanaraj and Parkhe, 2006). However, the role of divisional headquarters has received limited attention in the international management literature, especially in relation to its innovation coordinating activities.

Embeddedness is an important aspect within the business network view, where relationships are assumed to influence the behavior of actors (Gulati et al., 2000) that to a large extent contribute to the competitive advantage of MNE subsidiaries, but also to the overall competitive advantage of the organization. Embeddedness and networks can be viewed as a strategic resource for firms in general and perhaps even more so in the MNE context (Andersson et al., 2002). For a subsidiary, being embedded in relationships means participating in activities that are more or less specific and difficult to observe for non-network participants (Forsgren et al., 2005). This presents a conundrum for the MNE and its headquarters since one of its roles is to make sure that knowledge and innovations are diffused throughout the organization (Hamel and Prahalad, 1985; Rugman and Verbeke, 2001). A corollary is that corporate headquarters may know little about the subsidiary's network context (Asakawa and Lehrer, 2003; Holm et al., 1995) and that divisional headquarters is likelier to know more about subsidiaries' business networks (Birkinshaw et al., 2000). Consequently, the roles of divisional headquarters and corporate headquarters may differ in terms of embeddedness as a determinant of involvement in innovation transfer projects.

This paper seeks to investigate whether the relational embeddedness of a subsidiary (Andersson et al., 2002) developing innovations drives the involvement of divisional headquarters when the innovation is transferred to other subsidiaries within the MNE. At the same time, models for corporate headquarters involvement are tested in order to empirically determine if corporate headquarters pay attention to subsidiaries' degree of embeddedness. This reasoning builds on literature finding that internal and external factors motivate different strategic actions made by divisional and corporate headquarters (Birkinshaw et al., 2006). The results suggest that divisional headquarters involvement in innovation transfer is positively influenced by both the internal and external embeddedness of the subsidiary. Moreover, no significant models were found for corporate headquarters involvement in innovation transfer based on internal and external embeddedness.

The findings contribute to an understanding of how MNEs can configure themselves in order to respond to the multifaceted and differentiated context facing their subsidiaries, and the paper adds to the literature on different forms of headquarters that exist within the MNE (e.g., Birkinshaw et al., 2000, 2006). Furthermore, it helps us better understand activities related to innovation transfer, and, consequently, MNE competitive advantage, by focusing on divisional headquarters as an important hub-firm and by identifying it as an active participant in MNE innovation transfer processes. This also increases our understanding of the orchestration of innovation transfer activities (Dhanaraj and Parkhe, 2006) and the role of different actors orchestrating

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