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Innovative Projects Between MNE Subsidiaries and Local Partners in China: Exploring Locations and Inter-organizational Trust

Juana Du^a, Christopher Williams^{b,*}

^a School of Communication and Culture, Royal Roads University, 2005 Sooke Road, Victoria V9B 5Y2, BC, Canada

^b Durham University Business School, Mill Hill Lane, Durham DH1 3LB, United Kingdom

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ABSTRACT

We explore innovative projects carried out by MNE subsidiaries with local partners in China, focusing on the roles played by different components of inter-organizational trust with the local partners as well as features of the business environment in the specific location of the subsidiary. From a sample of 44 managers in MNE subsidiaries that we interviewed in three locations: Beijing, Shanghai and Guangzhou, we identify 33 cases of innovative projects with prominent local partner involvement. Using a qualitative, thematic analysis of the data, we gain new insights that explain innovative outcomes for the subsidiaries. Firstly, we find a tendency towards a sociological component of trust with local partners in Beijing in contrast to higher levels of an economic component of trust in Shanghai and Guangzhou. Secondly, we find that a successful outcome was noted by informants where the sociological component of trust was utilized in Beijing and the economic component of trust in Shanghai and Guangzhou. The findings highlight the interaction between business context and the nature of trust with local partners in determining innovative outcomes in an emerging economy. We discuss implications for managers and policy makers.

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1. Introduction

External interaction of subsidiaries in local markets is important to the performance of the subsidiary and the wider multinational enterprise (MNE) (Andersson et al., 2002). It is also important for innovative projects¹ aimed at change and rejuvenation in the MNE. Foreign subsidiaries interact with actors in the local external environment in the host country, allowing both the subsidiary and the MNE to gain access to the dispersed sources of knowledge required for innovative projects (Andersson et al., 2005; Kuemmerle, 1999; Mudambi and Swift, 2011). Such projects can lead to change in the subsidiary and throughout the MNE (Birkinshaw and Hood, 1998; Cantwell and Mudambi, 2005).

While most studies on subsidiary innovation and interaction with local partners have been conducted in developed economies, scholars have started to examine this in emerging economies – and China in particular (Zhang et al., 2009a, 2009b). While China has reduced its reliance on imported technology and equipment (Guan et al., 2009), it is seen as a catch-up economy (Li and

* Corresponding author.

E-mail addresses: juana.1du@royalroads.ca (J. Du), chris.williams@durham.ac.uk (C. Williams).

¹ An innovative project is a defined project for developing and/or applying of new ideas or behaviors to a new product, service, market, operational and administrative structure, process, or system (Damanpour et al., 2009); in this study we define innovative outcome as the result, or consequence, of undertaking an innovative project.

Kozhikode, 2008) where firms have a narrower and shallower knowledge base compared to those from developed economies (Awate et al., 2012). China is a unique context – somewhat different from other emerging markets – for examining subsidiary innovative projects. Firstly, China is the only one out of the world's top 5 largest economies that is still considered as a catch-up economy. Secondly, China is the only catch-up economy in the top 10 countries ranked by inward FDI (CIA World Factbook, 2016). Thirdly, increasing amounts of FDI have flowed into the country to allow MNEs to access human capital. The Chinese government has formulated policies to encourage inward FDI aimed at innovative sectors and has established numerous national technology development zones across the country (Zhang et al., 2009a, 2009b).

Despite these interesting features, China has also been described as a volatile business environment (Li and Atuahene-Gima, 2001; Zhang and Li, 2010). A high turnover rate of skilled employees has also been reported – this attributable to intense competition for good quality managers and skills (Leininger, 2007; Newman et al., 2011). At the same time, China has faced lingering intellectual property (IP) and knowledge protection issues (Hu and Jefferson, 2009; Yang and Clarke, 2005).

Trust has emerged as an important construct that can help MNEs understand and manage these types of hazards in China. Inter-organizational trust helps investing MNEs to establish smooth exchange relationships and manage innovative projects that have the potential to spearhead future growth. Indeed, scholars have argued that this is a critical part of collaborative strategy in transition economies (Peng and Heath, 1996; Steensma and Lyles, 2000). Inter-organizational trust allows for knowledge sharing through informal contacts and mutual understanding (Dahl and Pedersen, 2004) and is therefore especially important for innovation in risky situations where outcomes are unpredictable and difficult to govern through contracts (Wang et al., 2011). Disclosing proprietary or confidential information to a local partner is a signal that one trusts the other party, and exposes one's vulnerability. Inter-organizational trust, however, is an elusive concept that both managers and scholars have grappled with (Welter and Smallbone, 2006). It has been studied from many different angles, including both sociological and economic perspectives (Seppänen et al., 2007; Zaheer and Venkatraman, 1995).

While much of the empirical fieldwork relevant to trust in exchange relationships has been conducted in developed economy settings (e.g., Garcia et al., 2008; Sako and Helper, 1998), there is a growing body of MNE research that has begun to look at trust in subsidiaries in China (e.g., Lai et al., 2014). However, much of this has not taken an external perspective. Further, scholars have called for more research on the determinants of innovation performance in China (Guan et al., 2009), including the role that trust plays within the *context* in which relationships occur (Wang et al., 2011). This context consists of both the social setting in which personal relationships form and the institutional setting that enforces legal regulations (Welter and Smallbone, 2006). In essence, context refers to the business environment in which the organization interacts with other actors and is defined by features such as whether it is considered a knowledge-intensive economy. While scholars in trust research have argued that context matters when exploring the consequences of trust (e.g., Welter and Smallbone, 2006; Wicks and Berman, 2004), to our knowledge there is no research that looks at this in terms of MNE subsidiaries working on innovative projects with local partners in *different* locations within China. Exploring MNE innovative projects across diverse contexts within China potentially can enhance our understanding of the consequences of MNE strategy in catch-up countries that are only recently opening up for investment.

Our study examines this gap both theoretically and empirically. We use theory on inter-organizational trust (Arrow, 1974; McAllister, 1995; Seppänen et al., 2007; Zaheer and Venkatraman, 1995) as a starting point, which suggests a direct relationship between trust and innovative outcomes, and highlights the potential for the different components of trust to play a role in explaining innovative performance. We augment this with insights from the literature on industrial clusters and economic agglomeration (Jacobs, 1969; Porter, 1990; Romer, 1986), which highlights that contextual differences across sub-national locations in a country like China may influence how trust determines outcomes of projects with local partners. Our central research question is stated as: *how does the context for trust in inter-organizational relationships between an MNE subsidiary and local partners in China affect the relationship between trust and outcomes of innovative projects in the subsidiary?* Our empirical fieldwork is explorative and uses a qualitative, thematic coding approach. We conducted in-depth interviews with managers in 44 foreign MNE subsidiaries located in three tier-1 cities (Beijing, Shanghai and Guangzhou) and identified a sample of 33 cases of innovative projects across these locations.

The analysis shows how MNE innovative projects in China are influenced by an interaction between (1) location type (knowledge-intensive tertiary environment vs. primary/secondary industry), and (2) the most prominent component of trust (i.e., sociological vs. economic) used between the subsidiary and the local partners. The sociological component of trust emphasizes honesty, confidence, benevolence, and reliability - Zaheer and Venkatraman (1995) referred to this as “noneconomic trust” - while the economic component of trust emphasizes credibility, responsibility, predictability. We find a tendency towards the sociological component of trust with local partners in innovative projects in Beijing in contrast to higher levels of the economic component of trust in Shanghai and Guangzhou. Furthermore, a successful outcome was noted by informants where the sociological component of trust was used in Beijing and the economic component was used in Shanghai and Guangzhou.

Our study contributes to the literature on MNE subsidiary innovation in China by providing important qualitative insight into how the context in which inter-organizational trust occurs influences the relationship between different components of trust and outcomes of innovative projects involving the subsidiary and local actors. We find support for those who argue that context matters when exploring the consequences of trust in organizational dynamics (e.g., Welter and Smallbone, 2006; Wicks and Berman, 2004), this being related to the industrial and institutional nature of locations in the emerging economy where business transactions occur. We contribute to the MNE literature by providing insight into how relationships with external actors in emerging economies contribute to the innovative performance and competitiveness of subsidiaries and MNEs located in these types of countries.

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