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# MNC Subsidiary Embeddedness in the Host Country An Integrated Conceptual Framework

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**Abstract**

It is widely acknowledged in international business (IB) studies that a host country can play a critical role in the strategic development of MNC subsidiaries. This study departs from the traditional embeddedness concept, which expresses the relationships between MNCs and the national context of host countries, and develops an integrative framework based on four different approaches: the transaction cost and internationalization approach; the resource-based view and micro-political approach; the network paradigm; and the approach of economic geographers. This integrative framework may be used in future research to provide a deeper analysis of the relationship between the multinationals and the local host milieu.

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## 1. Introduction

The management of multinational subsidiaries has emerged as a mainstream of IB studies over the last fifty years, given that they have been proven to be the locus of many strategic activities that create and contribute to the parent firms' resources and capabilities [1]. It has been shown that embeddedness in the host country can be a driving factor and strategic source for subsidiary development [2]. An extensive review on the existing body of work reveals that this terminology has been conceptualized in many different ways. No singular approach, however, can adequately capture its intricacies due to the complex nature of this concept. This requires a more comprehensive framework to be fully comprehensible. Furthermore, given that a subsidiary is a displaced activity [3] which specialises in an activity or a limited range of activities in the firm value chain [4], it does not necessarily embed into a specific market.

This paper develops the ideas around the above issues and focuses on understanding the different dimensions of embeddedness of a MNC subsidiary in a host country. In order to answer the question "How can the embeddedness of a MNC subsidiary in a host country be characterised?", this paper provides a review on the terminology of embeddedness of a MNC subsidiary in different academic approaches to frame a comprehensive conceptual framework.

## 2. Literature review

### *2.1. Approaches to understanding the strategic roles of a MNC subsidiary*

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Recently, there has been widespread consensus that a MNC is no longer defined as a condensed, rationally homogeneous organization with a consistent goal whose subsidiaries all play identical roles [5]. Instead, the framework around a MNC as an inter-organisational network developed by Ghoshal and Bartlett (1990) has been popularized and become the intellectual foundation for the network perspective of firms [6]. A MNC is conceptualized as a differentiated network with loosely or densely tied internationally dispersed units [7, 6]. Expressed differently, a modern MNC is conceptualized as an organisation that is embedded in heterogeneous and distinctive national contexts [8, 9, 10]. Therefore, the analysis of the multinationals is incomplete without understanding each subsidiary's eccentric resource base, strategies and particular roles within the MNC, and linkages with other sister units [1]. Additionally, the headquarter-subsidiary relationships within the MNC cannot be understood without conducting an explicit analysis of the distinctive and idiosyncratic arrangement of the networks of each subunit, consisting of various relationships held with major customers, suppliers, government authorities, and other partners in the market where the specific subsidiaries locate [11].

Traditionally, parent-subsidiary relationships are considered from a hierarchical standpoint [12], in which headquarters are presumed to be the sole source of capability development. Knowledge then, will be created at the parent firms and transferred vertically to foreign subunits [13]. However, during the last two decades, as a result of theoretical and empirical research into the internationalization behaviour of firms, the traditional view of the subsidiaries' influences has evolved. The MNC head offices have increasingly realised the emergence of their internationally distributed subsidiaries as a source for acquiring knowledge to improve subsidiary-specific advantages and to shape their own destiny [1]. More attention is devoted today to the strategic role of subsidiaries as the locus of many strategic activities that enrich and renew MNCs' knowledge stock and then lead to competence development of the MNC [14]. According to Birkinshaw and Hood (1998) local environment determinism is one of three key drivers of the subsidiary evolution [15].

The influence of the local environment on the evolutionary path of the MNC subsidiaries as presented by Birkinshaw and Hood's (1998) framework is a critical topic in various streams of IB literature and economic geography [15]. Before reviewing how the embeddedness concept is understood in different approaches, the next section introduces and defines relevant terminology regarding embeddedness.

### *2.2. The embeddedness concept*

The concept of embeddedness has been used widely throughout the social sciences to reflect the view that firms are "embedded" in the social and institutional exchanges which determine their course of action and performance outcomes [16, 17, 18]. The basic idea underlying this concept is the recognition of the importance of social structure on economic behaviours of firms [19]. Yet despite its importance, this concept has different meanings in different circumstances [20].

This terminology was originally introduced by the economic historian Karl Polanyi in 1944 [17] in the work entitled "The Great Transformation". He argued that because individuals are always principally social beings, rather than economic ones, embeddedness is an essential key condition of the economy. In other words, the concept of embeddedness refers to the nature that an economic actor always embedded in not only isolated relations with other individual players, but an overall social structure, which could possibly have great impact on the firm's behaviour. As such, an economic entity and the entire economy needed to be figured out as a part of larger, historically derived, institutional or social structure. Polanyi's macro-sociological perception of embeddedness has become a crucial basis in criticizing the neoclassical notion of an atomized, self-interested economic agency [20, 21].

More recently, this concept was developed by Granovertter (1985) [16], which is more accessible for modern strategic management research, as he proposed "a less structural and more relational understanding of embeddedness" [16]. He used this idea for drawing attention to the social dimensions of economic action and assumes that behaviour is closely embedded in social networks.

The conception of embeddedness as developed by Granovetter (1985) [16], is in line with the business network perspective of internationalization presented by a group of Swedish researchers including Andersson *et al*. (2002) and Forsgren *et al*. (2005), etc. [8, 19]. In this theory, the closeness between two business actors is characterized by "trust, mutual adaptation of resources over time and expectations regarding the actors' future behaviour" [19, p.106]. Additionally, the business network theory also argues that such relationships are dependent on other relationships that are connected to the focal relationship through a wider network [19].

## 2.3. Embeddedness of the MNC in the host country

According to Birkinshaw and Hood (1998), a multinational operates in its own unique task environment which constrains or determines the courses of action and performance of that subsidiary [15]. The relationship of the MNC subsidiary to their unique set of conditions is captured in the concept of embeddedness.

In the debate on the embeddedness of the MNC in the external environment, there are different implications of this concept in different approaches. A summary of these diverse approaches is presented below in Table 1.

### 2.3.1. Transaction cost approaches

This first approach is related to the earliest approach in IB studies proposed in the PhD dissertation of Stephen Hymer in 1960 [22]. In this line of thought, the MNCs are conceived as multi-plant, multi-activity organisations to exploit domestic resources by appropriate location strategies to gain competitive advantages over local companies and competitors in the same market. The societal context of the host countries is summarized in location advantages in this theory. The locational advantages of a specific country are, for instance: existence of natural resources, low labour cost; low production cost, qualified labour resources or special taxes of tariffs, and advanced technological and scientific know-how [7].

The embeddedness of multinationals in a classical approach of IB studies is conceptualized in a Polanyian way: local resources and factors, national policies and domestic market regulations shape the courses of action and foreign locality of the multinationals [7]. However, this paradigm perceives the embeddedness of the MNC subsidiary in the host country is a "static asset" and provide a limited explanation about the dynamic role of local milieu on the evolutionary path of the MNCs [7].

### 2.3.2. Resource-based view and micro-political approaches

The second stream of IB studies has emphasized organisational power and influence within the internal network of the MNC, consisting of headquarters and peer subsidiaries. Andersson *et al*., (2007) [24] posit the embedding of a subsidiary into their external network of suppliers, customers and competitors creates an important power base for the subsidiary in bargaining for business mandates because they can access a variety of competences. It is assumed that the increased attention on the strategies of the subsidiary and their external resources reflect the expanding roles of these subunits and external organisations in the value chain of the multinationals [27].

The concept of embeddedness in this stream of studies is perceived by the control of the subsidiary over locally unique resources to develop their specific capabilities and competences which can be used as an organisational power base for the micro-political negotiation within the MNCs [7].

Table 1: Summary of different approaches on the embeddedness of MNC subsidiary on external environment

| Approach | Selected protagonists | Basic assumptions | Conceptualisation of embeddedness |
|---|---|---|---|
| Transaction cost approaches | [22] Hymer (1960)<br>[23] Dunning (1980) | Internalisation advantages of MNCs | Access to local markets and inputs. |
| Resource-based view and micro-political approaches | [24] Andersson *et al.* (2007)<br>[19] Forsgren *et al.* (2005)<br>[25] Bouquet and Birkinshaw (2008) | Negotiations for power within the MNC | External resources and capabilities are used as resources in organisational bargaining. |
| Network approaches | [8] Andersson *et al.* (2002)<br>[6] Ghoshal and Bartlett (1990) | MNC as a differentiated network<br>Market as a web of business relationships | Close relationships based on trust, commitment and mutual adaptation with business networks (suppliers, customers and sometimes competitors). |
| Approaches of economic geographers | [20] Henderson et al. (2002)<br>[26] White (2004) | Participation of subsidiaries' local clusters to access local resources | The degree of the MNC commitment to a particular location. |

*2.3.3. Network approaches*

In the third stream of the IB literature, network metaphors have been characteristically used to describe and understand the internationalization behaviour of firms because "now the business environment is viewed as a web of relationships, a network, rather than a neoclassical market with many interdependent suppliers and customers" [28, p.1411]. The network paradigm proposes the concept of embedded MNCs for companies "whose subsidiaries operate in business networks that, to a notable extent, are characterized by a high level of embeddedness among relationship actors [19, p.79]. The MNC subsidiaries exist simultaneously in two networks: the internal one of the head offices and sister subunits and the external one of interdependent business actors, as illustrated in Figure 1 below.

Although the external networks are unbounded as Forsgren *et al.* (2005) [19] describes, different scholars in this literature stream define and investigate different kinds of networks that differ substantially from one another. It is possible to distinguish two research areas which introduce two sets of network boundaries as follows.

There are studies that distinguish the international dimension from the national boundaries of the networks. Doz *et al.* (2001) [29] presents a meta-national model of the MNC where the organisation is formed by interlinked specialized unit networks spanning boundaries and integrating worldwide knowledge-seeking innovation and competitive advantage. Although Forsgren *et al.* (2005) make a very clear point about the existence of two different but interlinked networks, the corporate one and the external one, the most interesting features that this research finds about the boundaries of the network is that it is unbounded, as "business networks extend without limit across markets, industries, and national boundaries" (p.25) [19]. This argument is contradictory to the received view of internationalization which assumes that foreign subsidiaries manage the development of operations in specific country markets. According to Forsgren *et al.* (2005), even if their operations are focused on a specific country in the initial stage, it can be expected that the subsidiaries also recognize a need to develop strategic relationships in other foreign markets [19]. In such a case, a subsidiary is engaged in international development of the kind that has been labelled "internationalization of the second degree" [30].

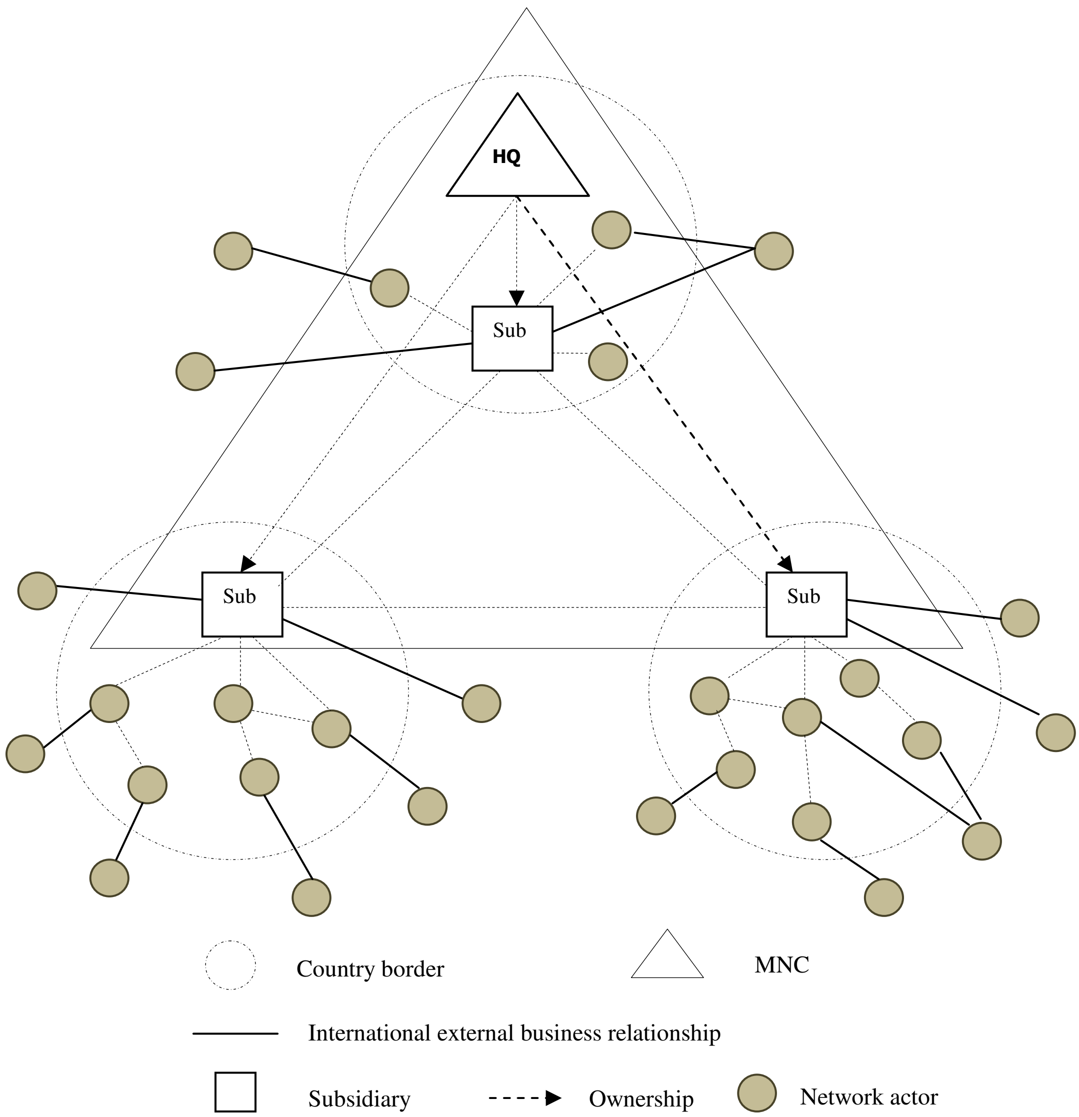


Figure 1: Internationalization of the subsidiary's business network.
*Source:* Forsgren et al. (2005, p.80) [19]

However, there are a substantial number of works focused exclusively on local embeddedness, i.e. the relationship with suppliers, customers, and competitors inside the host country. These researchers put considerable attention to the relationships that the MNC subsidiaries hold with local counterparts in order to set up the insidership, i.e. a long-lasting and close relationship with entities essential for success when crossing the borders to enter foreign markets [31, 28]. Almeida and Phene (2004) also analyse the effect of characteristics of knowlege networks of MNCs and host countries (technological richness and diversity) on a subsidiary's development of innovative capabilities [32]. A recent work by Collinson and Wang (2012) illustrates that the MNC subsidiaries develop relationships with external actors both inside and outside the host country. However, these authors are only concerned about the impacts of domestic relationships on the MNC susbsidiaries' development of innovation-related capabilities for production, design, and marketing [33].

The embeddedness argument of the subsidiaries implied in the network approaches is of Granovetterian types: the dyadic relationships with business actors which develop from arm's-length relations into relatively stable, trust-based relationships based on mutual adaptation and knowledge learning and creation [7, 19]. However, in this approach, the non-business local and regional actors are excluded. This reductionist interpretation of embeddedness has not gone unchallenged [7]. Birkinshaw and Pedersen (2009, p.272) model "the subsidiary as the interface between a leading-edge industry cluster and a leading-edge MNE" [34]. In a similar vein, Phene and Almeida (2008, p.914) point to the influence of regional and national innovation systems of the innovative performance of the MNC subsidiary and show that "knowledge absorption patterns are particularly strong in regions that demonstrate significant knowledge creation" [35]. These limitations of the network paradigm call for the review of other approaches which take regional/local actors into account, which will be presented below.

*2.3.4. Approaches of economic geographers*

This approach involves the spatial dimensions of the networks. By concentrating on conceptual issues, the economic geographers examine the extent to which the economic actions of the foreign affiliates are embedded within the particular spaces and places [26]. The spatialised conceptualisation of embeddedness is attributed to the importance of localised production systems, the success of some industrial clusters such as Silicon Valley and Route 128, and the need for special proximity in creating trust and commitment between business counterparts [36]. Henderson *et al.* (2002) offer the conceptualisation of embeddedness of the multinational subsidiaries as a part of a larger effort to tap into the understanding of global production networks. Particularly, this study identifies two different forms of MNC subsidiary embeddedness into local environment - territorial and network [20].

Territorial embeddedness, or "the degree of a firm's commitment to a particular location" [20, p.453] relates to "the manner in which firms become anchored in particular places" [26, p.245]. The most common indicator of territorial embeddedness employed by economic geographers is linkages with local suppliers [20, 27].

Network embeddedness examines "the connections between network members regardless of their country of origin or local anchoring in particular places" [20]. This concept implies the relationship of the MNCs not only of business actors, but also takes into account a broader institutional network including non-business actors such as government and non-government organizations. The reason is that close relationships with a wider institutional context reinforce the commitment of a subsidiary to a local environment. National and sub-national institutions such as national development agencies, research institutions or universities deepen firm embeddedness by supporting locally based subunits in their motivation to upgrade and develop their subsidiary-specific capabilities.

## 3. An integrated conceptual framework on MNC subsidiary embeddedness in host countries

As noted in the previous section, the concept of embeddedness is complex and no singular approach can capture its intricacies. From the general review on how this concept is adopted in the existing literature, the researchers try to integrate the four approaches to provide a comprehensive conceptual framework. This conceptual framework is also developed based on the notion that the embeddedness in the host country will influence the repeat investment decisions of the corporation on the subsidiary as well as reallocation decisions.

There are several assumptions that need to be taken into account when developing the conceptual framework of this research.

*Firstly*, the authors acknowledges that the host country environment and local networks are of great importance to the MNCs in the sense that these sets of conditions will constrain or determine the course of actions of firms. However, it is not the only network that matters. The MNC subsidiary actively develops its relationships, mostly with business actors in other countries. This is an important point to note when analysing how foreign affiliates become embedded geographically in a specific region.

*Secondly*, the authors do not seek to understand the quality of a dyadic relationship between business/non-business actors, since according to Forsgren *et al*. (2005), the content of a specific relationship is limited by the imagination of the researchers and no one without direct involvement can fully understand the relationship [19]. Moreover, although the content of relationships is conceptualized with trust, adaptation and interdependence, it is no easy task to quantify these variables [19]. The proposed definition of embeddedness in this paper is more in line with the concept of structural embeddedness which refers to a firm's advantages rooting from its position in a network. In particular, the advantages are the exposure to and usage of uniquely local resources and capabilities within a network, the increasing commitment to a specific country by competency development, and the relative position of the firm in an unbounded business network.

Among the different dimensions and aspects of embeddedness, there are three related forms of this concept that are of interest here: resource, territorial, and network. These forms are illustrated in the following figure:

*3.1.1. Resources embeddedness*

The definition of resource embeddedness evolved from the transaction cost, resource-based view, and micro-political approaches. The transaction cost approach, posits that local resources and factors, national policies, and domestic market regulations shape the course of action and foreign locality of multinationals. Additionally, the resource-based view holds that the resources possessed by an organization can influence its competitive advantage and attractiveness within its business network.

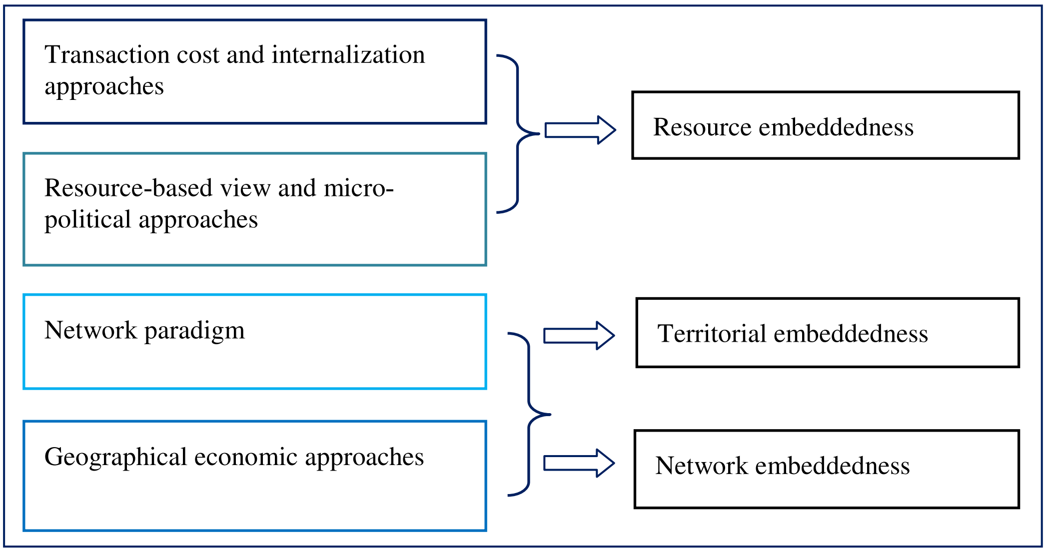


Figure 2: Conceptual framework.
*Source*: Proposed by the authors

By bringing this perspective into the conceptual framework, the authors demonstrates that domestic factors such as adequate supplies of skilled labour and government supports are fundamental conditions for embedding firms. The unique bundle of local resources and factors in an individual country are important factors that international organizations seek when making market entry strategies. The constant availability and sustainability of these factors and conditions create motivation for foreign investors for further investment and commitment in the host country.

*3.1.2. Territorial embeddedness*

The framework adopts the concept of territorial embeddedness developed from the definition of both economic geographers and network approaches. In the former approach, territorial embeddedness is defined as "a firm's commitment to a particular location" or "the manner in which firms become anchored in particular places" [26]. The latter approach refers to the extent to which a subsidiary's dyadic relationship with business partners is based on trust, commitment, and mutual adaptation. According to the borderless concept of the business network by Forsgren *et al.* (2005), the territorial embeddedness of the MNC subsidiary can be analysed to answer the question of whether the network boundary is local, regional or international, based on the examination of linkages with business partners [19].

*3.1.3. Network embeddedness*

This framework integrates the concept of network embeddedness proposed by Henderson *et al*. (2002) which implies that this form of embeddedness is fundamentally the result of the structure and evolution of MNC affiliates and the long-term future of this investment in the host country [20]. MNC subsidiaries will continuously leverage these relationships to access various external resources and competencies which could create opportunities for upgrading and expanding subsidiary operations. Subsidiary upgrading is not just the result of superior performance. "Intrapreneurialship" efforts, based on local management to improve the headquarters' perception of the subsidiary, also aid subsidiary upgrading [15, 26, 19, 24].

Moreover, the business relationships themselves alone do not determine the subsidiary embeddedness. The MNC subsidiaries not only develop their relationships with business actors, but also take into account a broader institutional network including non-business actors such as government and non-government organizations. Therefore, wider institutional networks in which the subsidiary is situated have to be checked to further inform the network embeddedness.

## 4. Conclusion

This study contributes theoretically to the discussion about the concept of external embeddedness of the MNC subsidiary by combining different understandings of this concept in IB studies and economic geography; although there is an extensive debate on this academic concept and each approach is significantly different from the others. Because one theory cannot capture all the complexity of this definition, this research project has brought together various aspects of MNC subsidiary embeddedness into the same framework. This study extends the understanding of the embedding status of an MNC subsidiary in a local host country.

MNC subsidiary embeddedness can be perceived in terms of transaction cost approach. In particular, the usage of location advantages (i.e. resources and factors) for making market entry strategies and further investments after the initial round of foreign inward investment add to the understanding of MNC subsidiary embeddedness. In this theory, the embeddedness of the MNC subsidiary in the host country is a static asset or "taken-for-granted" phenomenon which is the product of long-term investment in a country. However, these local resources are considered to be strategic assets which can be used to negotiate for organisational power within the MNC according to the resource-based view and micro-political perspectives of embeddedness. The network paradigm is based on the assumption that a market is a network of relationships and the embeddedness of a firm is measured by the degree of closeness of its relationships with business partners, i.e. to what extent these relationships are based on trust, commitment, and mutual adaptation. In the approaches of economic geographers, the embeddedness of the MNC subsidiary is described by local linkages with suppliers within a specific region and with non-business actors which can lead to the competency developments and evolution of the MNC as well. Although each approach addresses a number of interesting points on how the embeddedness of the MNC in the host country is branded, this study posits that no particular theory can sufficiently depict the intricacies of embeddedness due to the complex nature of this academic notion.

This paper developed a comprehensive framework to understand different aspects of MNC subsidiary embeddedness in a host country, based on a careful analysis of the above four theories. The author argues that the embedding status of an MNC subsidiary in a local environment has to be understood from different and interrelated dimensions, including resource, territorial, and network embeddedness. Therefore, researchers should not expect the same degree of embeddedness of the MNC subsidiary from different perspectives.

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