

RESEARCH ARTICLE

Study of the Driving Factors of MNCs Subsidiaries' Absorptive Capacity on the Perspective of dual Embeddedness

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Abstract

The paper studies MNCs' organizational mechanism setting (Decentralization, Normative integration, Innovative organizational culture) play a role in promoting subsidiary absorptive ability, as well as the host country environment play a role in promoting MNCs' organizational mechanism setting on the perspective of dual embeddedness, and then builds a conceptual model of the driving factors of MNCs' subsidiary absorptive ability. Finally, the paper takes the world's largest retailer Wal-Mart as an example, analyze How Wal-Mart adjust the organization mechanism under the change of Chinese retail market environment, and then enhance subsidiary's ability to absorb knowledge that are initiated by the MNC parent, which further demonstrates the conceptual model in the paper.

Keywords: *Dual embeddedness, Absorptive capacity, MNC organizational mechanisms, Host country environment.*

Introduction

Researchers in the management field believe that the long-term prosperity of organizations depends on their ability to transfer and absorb knowledge, particularly for multinational corporations (MNCs). MNCs' competitive advantage comes from managing the flows of knowledge within their global networks [1].

Here, parent-subsidiary knowledge flows are especially important for MNCs' survival and growth, as they affect the ways in which parents leverage their advantages internationally. At the same time, subsidiaries use the knowledge to respond successfully to the challenges faced in their host market environments [2] [3]. But the ability of the subsidiary to absorb and integrate MNC parent-initiated knowledge varies, and how to improve the absorptive capacity is particularly important.

In the past 20 years, the theory of absorptive capacity has attracted wide attention of scholars. There has been a large amount of literature on absorptive capacity in the field of strategic management theory, organization theory and innovation theory.

Few studied the absorptive capacity of MNC subsidiaries, and most study tended to examine the ability to absorb knowledge that is external to the firm (i.e. knowledge generated in collaboration with suppliers or customers), few study focused on knowledge absorption by organizational units. while the absorption of knowledge within the organization (i.e. subsidiaries' absorption of knowledge from the MNC parent) are similar, with some obvious differences. Because subsidiaries embedded in the MNC network and the host country, it is necessary to study the absorption capacity of subsidiaries from

the perspective of the dual embeddedness of MNCs' subsidiaries. In addition, the analysis of factors affecting the absorption capacity is mostly involved in R&D investment, prior knowledge, learning methods, human capital and so on. [4-8], few studied the influence of organizational structure and organizational management factors on absorptive capacity.

Lane [9] proposed organizational structure and process characteristics affect the absorption ability; Zhang Jie [10] found that the innovation strategy and organization flexibility have positive influence on corporations' absorptive capacity. In general, there are few researches on the impact of organizational mechanisms for knowledge absorption in different parts of an organization. What specific organizational mechanisms are conducive for subsidiary to absorb MNC parent-initiated strategies still largely unknown?

Base on the dual embeddedness of MNCs' subsidiaries, the study explores what organization configurations can promote subsidiaries' absorption capacity to absorb MNC parent-initiated knowledge and whether these mechanisms are, at the same time, the best response to competitive and dynamic subsidiary markets. The study makes important practical contributions. It provides reasonable suggestions for MNCs on how to set up organization mechanisms to

enhance subsidiaries' absorption capacity to absorb MNC parent-initiated knowledge, and to better respond to the competitive and dynamic subsidiary markets.

Theoretical Background

Dual Embeddedness

The concept of embeddedness first appeared in the book of great changes, and many literatures refer to the embeddedness theory as an important theory of economic analysis. Network embeddedness can not only reflect the status of the actor in the network, but also reflect the relationship among the actors in the network.

The quantity and quality of actors acquiring, integrating and diffusing knowledge in the network depends on the characteristics of network structure and network relations. According to the subsidiary dual embeddedness network model constructed by Achcaoucaou [11], subsidiaries embedded in the internal and external networks, internal network including headquarter and other sister companies, external network including all relevant institutions or interest groups, such as customers, suppliers, universities, research institutions and other policy maker. See figure 1.

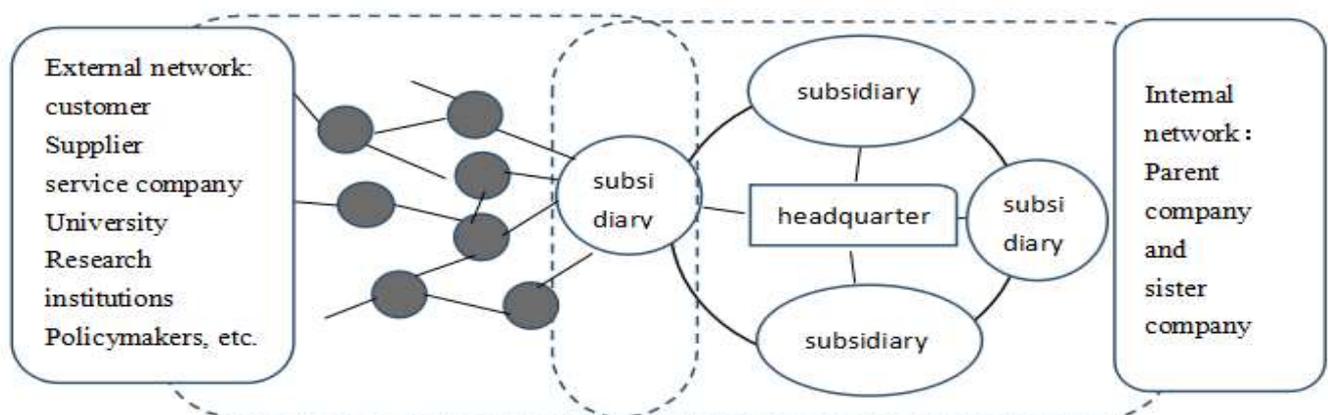


Figure 1 Dual embeddedness model of MNCs' subsidiaries

Knowledge Transfer

The internal knowledge transfer of MNCs includes horizontal transfer and vertical transfer. The study focuses on one common knowledge flow only, especially the one-way knowledge transfer from parents to subsidiaries, that is, the parent company is the sender of knowledge, and the subsidiary is the receiver of knowledge.

Unlike knowledge absorption between competing MNC subsidiaries, parent-subsidiary Knowledge transfer enables overseas subsidiaries to establish the corresponding knowledge base in the short term, to accelerate the localized management, to survive and create value in the fierce competition (P Wang, 2004) [12]. Therefore, the parent company would like to improve the absorptive capacity of the subsidiary.

That is to say, as to the knowledge transfer between parent and subsidiary companies, the parent company not only has the desire to transfer knowledge, but also has the motivation to improve the absorptive capacity of subsidiaries.

Absorptive Capacity

Absorptive capacity first appeared in macroeconomics, mainly referring to the ability of an economy to absorb and make use of external information and resources. Cohen and Levinthal apply the concept to the enterprise during analyzing the role of R&D. In the paper published in 1990, Cohen and Levinthal [13] redefined the absorptive capacity of enterprises as "the ability to evaluate, assimilate and commercialize new external knowledge".

Zahra and George [14] reexamined the concept of enterprises absorptive capacity from the perspective of constitution dimension, extending three dimensional concepts of Cohen and Levinthal to four dimensions, namely the dynamic ability of enterprises to acquire, assimilate, transform and Exploit knowledge. The research of Zahra and George is regarded as an important development of absorptive

capacity theory, and many scholars carry on the research on this basis. The study follows the definition of absorptive capacity by Zahra and George.

Theoretical Framework

Organizational Mechanism

It is not appropriate for parent companies to plan, organize and command subsidiaries directly for both parent companies and subsidiary companies are separate legal entity, so parent companies have to realize their strategic intention through management control [15]. Zhang Wenkui [16] believes that management control is to ensure the smooth realization of the company's strategic objectives and mission in the whole enterprise or enterprise group through a set of systems and methods.

According to A.D. Chandler' structure follows strategy, multinational companies which use knowledge transfer to achieve advantages internationalization would set up specific organization mechanism to improve subsidiaries' knowledge absorption.

A non bureaucratic centralized decision making system reduces centralized decision making process, enables the grassroots to have autonomy as much as possible, which helps to improve knowledge absorptive capacity [17].

Organizational integration can expand the knowledge stock of an organization, and even generate new knowledge by attacking original knowledge, which can improve enterprises' absorptive capacity [18]. Standardization can effectively reduce the impact of individual differences on the organization [19], manage knowledge orderly, and then improve enterprises' absorptive capacity. Under open organizational culture, organizational members have more knowledge exchange with external knowledge sources; accept innovative knowledge from each member of the supply

chain, which help enhance the overall organizational absorptive capacity [20]. Combined with the existing literature, the study mainly uses Schleimer [21] organizational mechanism model for reference, including three dimensions: Decentralization, Normative integration and Innovative organizational culture.

Decentralization means the subsidiary have power to make decision; it is a reflection of the size of subsidiaries' autonomy [22]. Normative refers to the amount of written documents in an organization. These documents include work procedures, job descriptions, regulations and policy manuals. Integration refers to the in ter organizational coordination between organizations in order to achieve strategic results from cooperation, and then promote the sharing of information, opportunities and competitive advantages among organizations [23].

Therefore, normative integration refers to regulate and standardize the management of subsidiary, and establish good cooperation mechanism between parent and subsidiary companies. Innovative organizational culture refers to a series of ideas and methods of doing things which influence how the organization manages innovation and change. Innovative organizational culture emphasizes open to new ideas and quick response to decisions within the organization [24]. The study discusses the influence of organizational mechanism on subsidiaries' absorptive capacity from the above three dimensions.

Decentralization

Decentralization is an important mechanism related to absorptive capacity for it is closely related to organizational efficiency and adaptability [25]. The higher the degree of decentralization, the more diverse the knowledge structure and the form of participating organizations [26]. Compared with a centralized organization, a decentralized organizational structure

encourages all units and members to participate spontaneously in the absorption and accumulation of new knowledge [27]. In centralized organizations, the individuals involved in decision-making are at the head office, which causes subsidiaries need not participate in decision-making and manage existing knowledge and to actively absorb new knowledge.

The decentralization of decision-making power enables subsidiaries to participate in the process and will help to absorb more new knowledge and apply it to products or services [28], and at the same time, more people in the organization can absorb new knowledge selectively, filter the irrelevant knowledge for the organization, and then enhance knowledge absorptive capacity [29]. Therefore, Setting up decentralized organizational mechanisms helps to enhance the absorptive capacity of subsidiaries in MNCs.

Normative Integration

Setting up normative integration mechanisms helps to build a common environment between parent companies and subsidiaries, and then enhance knowledge absorption [30]. Moreover, the effectiveness of knowledge absorption is generally reflected in "easy communication and intimacy between sources and receivers" [31].

Good collaboration can eliminate misunderstandings, form consensus and help to improve the understanding and digestion of the acquired knowledge [32]. In addition, normative integration can also reduce the risk of not-invented-here syndrome [33], promote the identification of the knowledge value of other organization within MNCs. So, the organization mechanism of normative integration of parent companies can enhance subsidiaries' absorptive capacity in MNCs.

Here, we have to pay attention to the relationship between decentralization and

standardization. Decentralization refers to the parent company delegating decision-making power to subsidiaries, while standardization refers to standardization of rules, procedures, instructions, orders, control systems between parent and subsidiary companies, the purpose of standardization is to ensure effective monitoring of power through a variety of cross checks and regulations so as to prevent abuse of power and cause losses. Therefore, the relationship between decentralization and standardization should be well coordinated in MNCs.

Innovative Organizational Culture

Innovative culture is designed to continuously update new strategies using core resources through its unique and excellent methods [34]. Cohen and Levinthal believes that the resulting diversity of knowledge provides a more solid learning base for these organizations for it increases possibility that input information is relevant to existing knowledge. In addition, innovative organizational culture will reduce resource contention and not-invented-here syndrome among different organizational units [35].

Therefore, the stronger the organization's ability to learn new knowledge, the easier it will be to recognize the value of new knowledge, to absorb new knowledge and to apply new knowledge [36]. For MNCs, if the parent company develops innovative organizational culture, then the absorptive ability of subsidiaries would be increased [37]. So, for the parent company of MNCs, building an innovative organizational culture would enhance subsidiaries' absorptive capacity to complex and implicit part of the management strategy of parent companies.

Host country's Environment

MNC subsidiaries have dual embeddedness; it not only embedded in multinational network, but also embedded in host environment. That is to say, on the one hand, subsidiaries embedded in a multinational network, and the advantage can be used to

absorb parent company knowledge. Usually, the knowledge provided by parent company is difficult to obtain from an open market, such as advanced management experience and experience in dealing with the international market. On the other hand, like an independent company in the host country, subsidiaries are embedded in the host environment and are affected by local uncertainty environment.

In strategic management, environmental uncertainty is usually considered to contain two aspects, the variability and complexity of the environment. When the dynamics and complexity of the environment are beyond the level of understanding among managers, we say that the environment is in high uncertainty; when the dynamics and complexity of the environment are recognized by the business operators, we say that the environment is in relatively low uncertainty [38].

The uncertainty degree of host country environment will lead to different depths which subsidiaries embedded into the host country and MNCs, and then subsidiaries adopt different knowledge transfer models, such as globalization, localization or global localization [39]. However, the study only focuses on how the uncertainty of the environment affects the setting of the organizational mechanism of MNCs, and how it affects the absorption capability of subsidiaries.

According to contingency theory, organizational performance is the result of organizational structure adapting to environment. That is to say, the external environment is an important contingency factor that affects the design of organizational management and control methods [40]. For the sake of the overall interests of MNCs, when facing a uncertain environment, the subsidiaries will be given greater autonomy in decision-making, so as to respond to the uncertainty of the environment more promptly and effectively [41].

When the organization faced enormous pressure which is likely to threaten short-term survive, enterprises will strengthen management control and implement formal control which is conducive to providing predictive information to cope with unknown change [42]. In addition, when external environment is highly uncertain, enterprises need to strengthen coordination and integration capabilities, strengthen communication between parent and subsidiaries so as to reduce the uncertainty and risk in the work. When external environment changes fast, the openness and externality of organizational management behavior would be enhance, so the organization should adopt open management

and control method. For when the environmental uncertainty is higher, the competitive advantage of the enterprise relying on the existing technology is gradually reduced, and enterprise should make great innovation and adopt new strategies to gain new competitive advantages. In a word, the uncertainty of the host country environment will further promote the decentralization, normative integration and innovative organizational culture, and then enhance subsidiaries' absorption capability.

According to the third part and the fourth part of the study, the driving factors of subsidiaries' absorptive capacity can be summarized as Figure 2 model from dual embeddedness perspective.

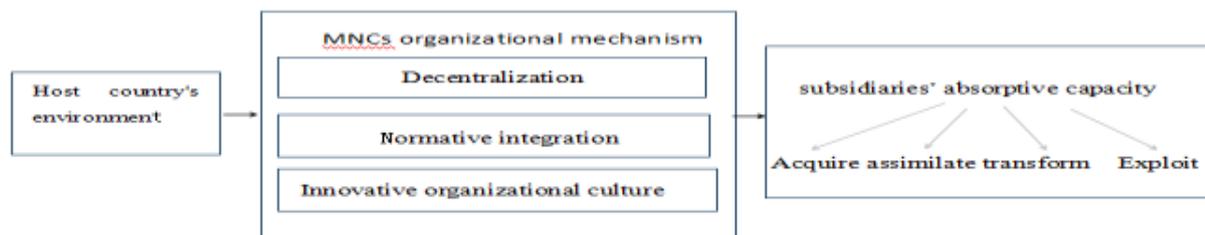


Figure 2 Driving factors of MNCs subsidiaries' absorptive capacity

Case Study

As the world's largest retailer, WAL-MART topped the list of world top 500 in Fortune magazine with \$482130 in sales in 2016. Since its entry into China in 1996, WAL-MART has been in the Chinese market for 20 years and it has more than 400 stores in China.

The competitive advantage of WAL-MART in the Chinese market is largely due to the effective transfer of its transnational operations knowledge accumulated to Chinese market. Therefore, taking the world's first retail giant WAL-MART as an example has strong representativeness to analyze how to promote subsidiaries' absorption capability to parent company knowledge.

Throughout the development of WAL-MART in China, it can be roughly divided into two stages: 1996-2004 and 2004 until now. On the first stage, due to policy restrictions and do not understand Chinese market, WAL-MART take the form of joint ventures.

Since December 2004, China has cancelled restrictions on foreign investment in commercial enterprises in terms of regional equity and quantity, and Chinese retail market is fully open to the outside world. WAL-MART started to open stores in Chongqing, Wuhan and other places by sole proprietorship. In this stage, the rapid development of Chinese retail industry have attracted more and more foreign retailers to land or plan expansion in China, which cause fierce competition in the retail market, at the same time, the rapid development of

information technology and electronic commerce and the multiple changes in consumer demand made Chinese retail market full of variable. So, the paper further analyzes WAL-MART's management strategy in china, It can be found that WAL-MART has succeeded in coping with the changes in the retail market environment in China through the adjustment of the following organizational mechanisms which help to promote the absorptive capacity of subsidiaries to the parent company.

In the early days its entry into China, WAL-MART take the management mode of "Head office decisions - subsidiary Executive", which means most decision is made by headquarters, and the decision-making power of each subsidiary is very limited, and the main task of each subsidiary is to implement all the rules and regulations issued by headquarters. This centralized organization mechanism makes the subsidiaries in a low position and lack of flexibility in internal network, thus not adapted to local market.

Since 2004, WAL-MART has increased its adaptability of retail professional skills by increasing informal communication through decentralization, Such as each subsidiary has the right to choose the product category, product quantity, and product pricing and supplier quantity. This helps each subsidiary adjust the product mix in time according to the local demand, and set a reasonable product price.

Decentralized organizational mechanism give the subsidiary more decision-making power to deal with specific details, and help subsidiaries to absorb new knowledge selectively, to filter irrelevant knowledge, to enhance the absorptive capacity of knowledge, and made the knowledge absorbed better adapted to the local retail market.

It is also important to strengthen the company's internal control over another company under the complex and dynamic Chinese retail market. First of all, Wal-Mart

standardized employee management and customer service, keep a good company image in front of customer through the introduction of behavioral norms, the infiltration of corporate beliefs and corporate culture.

Secondly, WAL-MART carry out internal control to ensure that different entities achieve the same business results by standardizing subsidiaries' workflow. The implementation of this standardized management, establishing the same values, norms and processes between parent-subsidiary company not only can reduce costs, but also more convenient for subsidiaries to absorb and implement the implementation details of headquarters. In addition, with regard to high implicit knowledge such as store management, personnel service, communication system, commodity structure and sales promotion, WAL-MART strengthen communication between parent and subsidiary companies and enhance the subsidiaries' ability to acquire and absorb new knowledge through expert consultation, classroom teaching, personnel training, on-site learning, regular meeting, personnel assignments, practical operation and other forms.

In a fiercely competitive Chinese retail market, WAL-MART must be able to respond quickly to the market in order to survive and make a profit. Therefore, the cultivation of innovative organizational culture enables the subsidiaries to respond quickly to changes in Chinese market, and innovate the knowledge absorbed by the parent companies to better adapt to the host market.

For example, WAL-MART in the United States does not advocate use a large amount of advertising, shops rarely see price promotions. However, due to the culture difference, Chinese consumers are accustomed to the advertising effects and supermarkets have a clear discount every day. So in order to meet customer demand, WAL-MART in china copied the basic idea of its low price promotions, and at the same

time WAL-MART tried to change and innovate. In specific promotions, such as in some stores WAL-MART launched "preferential products", put smiling face as a sign to guide customers and achieved good results.

In general, as Chinese retail market environment becomes complex and variable, WAL-MART set up the corresponding organization mechanism: decentralization, normative integration and cultivate innovative organizational culture, which enhanced Chinese subsidiaries' absorption ability, and enable subsidiaries to maintain dynamic balance in embedded multinational companies and embedded in the local market, and thus achieved a competitive advantage in Chinese retail market.

This indicates that subsidiaries' absorptive capacity is influenced by both multinationals' specific organization and the host country environment, which further validates the conceptual model of the driving factors of subsidiaries' absorption capacity.

Result and Discussion

From the perspective of subsidiaries' dual embeddedness, this study takes absorptive capacity as a key organizational ability, explores the influence of the transnational organization mechanism and the change of host country environment on subsidiaries' absorption ability to parent company knowledge. The results showed that: (1) the organization mechanism setting of decentralization, normative integration and innovative organizational culture can promote subsidiaries' absorption ability to parent company's knowledge. (2) Competition and dynamic host environment will promote multinational companies to set up the

above-mentioned organizational mechanism. Based on these, this study developed the conceptual model of absorptive capacity driving factors of MNCs' subsidiaries. To a certain extent, the study is a supplement to this research field. In terms of practical significance, the conclusion of the study can provide management suggestions for promoting the absorption capacity of multinational subsidiaries. Parent company could promote subsidiaries' absorptive capacity by giving decision-making power, training normative integration and innovative organizational culture, and then succeed in coping with the complex and dynamic host environment.

The limitations of this paper and future research directions are as follows: (1) the study has exploratory research on driving factors of subsidiaries' absorptive capacity from the perspective of dual embeddedness of subsidiaries, and a case study of WAL-MART is carried out to further verify the conclusions of the study.

However, the conclusions are still difficult to be generalized by analogy, which is the biggest limitation of this study. The future research needs to validate the conceptual model through empirical research. (2) The paper only discusses how to promote the absorptive capacity of subsidiaries to parent company's knowledge? The future research should also analyze how to promote the absorptive capacity of subsidiaries to host country's knowledge, and how can the subsidiaries keep a dynamic balance between absorbing the knowledge of the MNCs' network and the knowledge of the host country?

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