Theories of the firm have usually emerged to explain why firms differ in their performance (Chandler, 1962; Donaldson, 1995; Coase, 1937; Williamson, 1975; Wernerfelt, 1984; Barney, 1991) and these performance differentials emerge essentially as a result of a firm’s ability to create a sustained competitive advantage that generates, sustains and appropriates rents (Coff, 2003b: 245). Today, knowledge, learning and innovation are at the heart of our understanding of competitive advantage and firm performance. For the purposes of this chapter the two most important theoretical perspectives to have been applied to understand these issues are organizational learning and the RBV. Building upon Kogut and Zander (1992) and Tsai and Ghoshal (1998), Tsai (2001: 996) stated that ‘inside a multiunit organization … knowledge transfer among organizational units provide opportunities for mutual learning and interunit cooperation that stimulate the creation of new knowledge and, at the same time, contributes to the organizational units’ ability to innovate’. The intricate web of relationships that links these themes is currently the dominant paradigm in the strategy and international business academic literatures.

There are many examples that demonstrate the immense complexity of these conceptual links. For example, at the core of the RBV is the argument that sustainable competitive advantage arises only if the firm has the capability to safeguard its valuable, rare, not easily imitable and not substitutable resources (Barney, 1991; Collis and Montgomery, 1995). This argument also underpins internalization theory that sees the rise of the MNC as a product of innovating firms protecting their knowledge from appropriation by competitors by retaining that knowledge within firm boundaries. However, from the opposite perspective, others argue that sustained competitive advantages can arise from
knowledge sharing via spillovers from such things as extra-firm networks (Uzzi and Gillespie, 2002; Spencer, 2003) or industrial or regional clusters (Birkinshaw and Hood, 2000). Feinberg and Gupta (2004) found that MNCs appeared to anticipate spillover opportunities in these contexts and made R&D subsidiary location decisions on the basis of them. To add to the complexity, the entire domain is constrained by issues such as stickiness, individual vs organizational learning, knowledge tacitness, path dependence, absorptive capacity and so on.

It is a basic tenet of the international business literature that the internalization of its knowledge-based, firm specific advantage is the defining characteristic of the MNC. In particular, in many MNCs, the management of the knowledge resources of the firm is the primary means of generating and disseminating innovations (Bartlett and Ghoshal, 1989). It was argued in Chapter 5 that the distinguishing characteristic of the heterarchic MNC form is the management of the knowledge resources of the firm as a means of generating and disseminating innovations. Thus this chapter makes a contribution to the literature by investigating the place of various types of subsidiaries, in particular the innovator subsidiary, in the knowledge management and innovation networks of MNC. While Von Krogh, Ichijo and Nonaka (2000: vii) stated ‘the creation of knowledge cannot be managed, only enabled’, this study will use the term knowledge management to include the enabling process.

The contribution of this chapter is to extend the understanding of knowledge and innovation in MNCs by investigating the characteristics of subsidiaries that are involved in knowledge management and innovation processes and some of the enabling mechanisms that are being used. The task is approached by presenting some basic associations between a range of predictive variables and the embeddedness of subsidiaries in the knowledge management systems and innovation networks of the MNC. The chapter deals predominantly with the understanding of outbound as opposed to inbound knowledge. More specifically, outbound knowledge is primarily concerned with how organizations deploy and leverage collective knowledge to improve responsiveness and gain an advantage in the market place (Hult, 2003).

The chapter is structured in the following manner. First it provides a brief overview of the commonalities of the organizational learning and RBV approaches in understanding and managing knowledge. These well-established literatures ground the conceptual apparatus and underpin the hypotheses. The next section covers the variable construction