The Impact of Home Country Institutional Effects on the Internationalization Strategy of Chinese Firms

Hinrich Voss, Peter J. Buckley, and Adam R. Cross

Abstract: Mainland Chinese firms have become important international investors. Many have gained their capabilities to internationalize in a domestic institutional environment characterized by significant market imperfections. In this study, we argue that the imperfections affect firm behavior depending on firm size, ownership form, and location. We find preliminary support for the notion that large, well-connected Chinese firms benefit most from institutional advantages, but that smaller firms internationalize because of institutional constraints. This represents a more nuanced view of the determinants of Chinese firm internationalization than is evident in prior research, with consequences for future theorizing and empirical research on Chinese MNEs.

Keywords: Chinese MNEs, internalization theory, institutional environment, internationalization, interview data

INTRODUCTION

Mainland China's stock of outward foreign direct investment (OFDI) has increased significantly over the past decade and was valued at US$148...
billion by the end of 2008 compared to US$28 billion in 2000 (UNCTAD 2009). The international expansion of Chinese firms has recently attracted considerable academic attention, much of which has sought to explain the industrial and spatial spread of Chinese OFDI (e.g., Buckley et al. 2008; Rugman and Li 2007; Child and Rodrigues 2005; Wong and Chan 2003; Wu and Chen 2001). Extant studies have analyzed cases of a small number of high-profile Chinese firms, such as Haier and Lenovo (e.g., Rui and Yip 2008; Warner, Hong, and Xu 2004; Liu and Li 2002), or infer international investment behavior from secondary data (e.g., Deng 2004; Rugman and Li 2007; Buckley et al. 2007). Among these, Buckley et al. (2007) in particular have theorized that the external environment in China has a significant effect on the internationalization behavior of domestic firms. More specifically, it is argued that the presence of domestic capital market imperfections facilitate OFDI, while the existence of an Overseas Chinese business and social network in a host country assists investment decisions by reducing information costs, amongst other things. However, the Buckley et al. (2007) study relies upon official Chinese OFDI data (which suffer the same limitations as many other official Chinese data) for their dependent variable, which means their study predominantly captures the OFDI activities of state-owned enterprises (SOEs), and their operationalization of the capital market imperfections construct is incomplete. Furthermore, and as is generally the case with this body of literature, insufficient attention has been given to understanding how regional, ownership, and size differences among Chinese firms influence outward investment behavior. Also, it has been argued that Chinese MNEs emerge from a specific and changing domestic institutional environment (e.g., Naughton 1995; Child and Rodrigues 2005; Boisot and Meyer 2008; Krug and Hendrichske 2008; Luo, Xue, and Han 2010) and that this has a significant effect on business strategy (e.g., Buckley 2004; Luo and Peng 1999; Shenkar 1996). However, the extent to which the institutional environment in China positively or negatively affects the internationalization of Chinese multinational enterprises (MNEs) is contested (cf. Voss, Buckley, and Cross 2009).

This study looks to close these gaps in understanding by examining the extent to which domestic institutions and capital market imperfections moderate the internationalization activities of different types of Chinese firms and how this has changed over time. An investigation is done of a small sample SOEs and private firms of varying sizes from three Chinese provinces. The primary data are complemented by interviews with a number of government agencies in China. Underpinning the study is the notion that domestic institutions and market imperfections facilitate the internationalization of specific types of Chinese firms only. In contrast
to Buckley et al. (2007), this study finds that the international expansion of smaller Chinese firms is constrained by prevailing domestic market imperfections, and that business and social networks in host countries are exploited primarily by smaller and private Chinese firms rather than by larger and state-owned ones. Evidence is also found that the impact of domestic institutions does indeed differ by sub-national location, size, and ownership form of internationalizing Chinese firms. In short, this study reveals that the domestic environment from which Chinese MNEs emerge, as well as the MNEs themselves, presents a more complex and nuanced picture than has been portrayed in extant literature. Thus, caution should be exercised in accepting the generalizability of prior studies to all Chinese firms, especially those employing secondary OFDI data or in-depth studies of selected, high-profile, Chinese MNEs.

The remainder of this paper is structured as follows. In the next section, four themes are identified from extant literature around which this study's data collection and analysis are grounded. The third section describes this study's methodology. Then, findings are discussed and from this four propositions are developed that are believed to be a useful guide for future research in this area. The paper concludes with some recommendations for future research and a short discussion of the managerial implications of this study.

DEVELOPMENT AND RESEARCH THEMES

From the prior international business and Chinese firm literatures, it is possible to discern four themes around which the external environment confronting Chinese MNEs can be conceptualized. Each one is related to the international investment strategy of Chinese firms. These themes have informed the data collection and analysis of this study.

Theme 1 – International Investment Strategy
Wu and Chen (2001) and Wu and Sia (2002), among others, argue that market-seeking motives have predominantly driven historical investment behavior of Chinese MNEs, especially during the 1980s. This investment behavior was conducted mainly to raise familiarity with international market behavior and requirements, to collect market information for subsequent investments and exports, to circumvent trade barriers, and, eventually, to facilitate exports of Chinese domestic firms. During the 1990s, the strategic focus of market-seeking FDI shifted from these trade supporting, defensive functions to a more offensive approach (Buckley et al. 2008). Further push factors were the inadequate distribution and
logistics networks and regional protectionism in domestic markets, which became highly competitive and saturated in some sectors, especially after China’s accession to the World Trade Organization (WTO) in 2001 (Sauvant 2005; Zeng and Williamson 2003; Boisot and Meyer 2008). Market-seeking investment behavior has seen Chinese firms increasingly invest, for example, in developing countries across Asia and Africa. Pangarkar and Yuan (2009), Deng (2004), and Zhan (1995) also highlight asset-seeking strategies as important drivers for Chinese ODI in developed countries. This is reflected in, inter alia, acquisitions and the establishment of R&D affiliates in Europe. The efficiency-seeking motive has been argued to be only a minor driver of Chinese ODI in the 1980s and 1990s (Buckley et al. 2007).

Theme 2 – Domestic Capital Market Imperfections
Buckley et al. (2007) posit that Chinese firms have enjoyed privileged access to capital on preferential terms because of domestic capital market imperfections. Such imperfections originate from a number of sources, including soft budget constraints, an inefficient banking system, intra-business group cross-subsidization, and personal capital. Shirai (2002) showed that larger, older, and less profitable Chinese firms in particular have received bank loans on attractive terms from Chinese state-owned banks. Preferential treatment and access to cheap money can spur Chinese firms to invest abroad, because abundant funding can (i) reduce the commercial and financial risks connected to overseas investment projects, (ii) mitigate disadvantages of “home country embeddedness” and institutional distance (cf. Makino, Lau, and Yeh 2002), and (iii) enable the subsidization of potentially less profitable technology- and brand-seeking ventures, especially in industrialized countries, which might otherwise threaten the long-term survival of the investing firm. In international business theory, the ability of firms to derive benefits from such capital market imperfections constitutes an ownership-specific (O) advantage, which may enable them to out-compete rival foreign firms (Dunning and Lundan 2008).

Theme 3 – International Networks
Buckley et al. (2007) argue that Chinese MNEs are able to benefit from access to international business and social networks in foreign markets. Networks can be defined as a “set of high-trust relationships which either directly or indirectly link together everyone in a social group” for the recursive exchange of information, services, and goods (Casson 1997, 813). Such networks represent the social capital (or relational capital) of a firm. They can enable companies to internationalize or foster the internationalization process by facilitating the exploitation of business opportunities, promoting the dissemination of information between actors previously

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unknown to each other, lowering transaction costs (Johanson and Vahlne 2003; Aharoni 1999; Chen and Chen 1998), and creating or augmenting their competitive advantages (Hitt, Lee, and Yucel 2002). Access to a network may also help firms raise capital, recruit employees, and connect to further businesses once the foreign affiliate is established (Hitt, Lee, and Yucel 2002; Zhou 1996). Again, the ability to access and tap these types of networks may constitute an O-advantage for the internationalizing firm (Dunning and Lundan 2008). This thinking indicates that Chinese firms will not necessarily invest to the most proximate country but, rather, to the location with the more pronounced and accessible network (Liu 2000) and where the firm can quickly become an insider (Johanson and Vahlne 2009). Indeed, in the case of China, members of the social network formed by the Overseas Chinese Diaspora, now the world’s largest transnational ethnic network (Rauch 2001), have been encouraged by the Chinese government to return and establish companies in China. This network has been shown in the past to foster economic exchanges (Sung 1996; Saxenian 2002). Business networks have recently become increasingly significant for Chinese firms as a consequence of China’s reintegration into the world economy and its interactions with foreign businesses (in China or through exports) and with business facilitators (such as consultancies and investment promotion agencies (IPAs)) from other countries that are increasingly establishing a presence in China with a view to assisting the internationalizing of Chinese firms, albeit often with certain investment destinations at home in mind (cf. Welch and Luostarinen 1993).

Theme 4 – Domestic Institutions
The internationalization of Chinese companies is not only triggered by their aspiration to internalize imperfect markets across borders, but it is also influenced by the domestic institutional framework (Voss, Buckley, and Cross 2009; Luo, Xue, and Han 2010). Institutions in the form of the judiciary and bureaucracy, government structures, and other market mechanism enablers determine the”playing field”for companies and their incentive and reward systems by accidentally or intentionally creating market imperfections (North 1990). The influence of the institutional framework is not restricted to the domestic realm but can also play a crucial role (both positively and negatively) in the internationalization of domestic companies (cf. Boisot and Meyer 2008). Examples of direct institutional intervention include domestic market protectionism enforced by local political entities to protect (and nurture) local companies, uneven industrial policy, and restrictive and promotional home country measures concerning OFDI (Buckley et al. 2010). Developing countries typically have, by and large, a restrictive institutional environment towards OFDI in order to minimize the outflow of capital, because this is often perceived to
be detrimental to national economic development (UNCTAD 1996). Companies affected by direct measures might seek to invest abroad to ensure sound growth and to keep up with international developments in their specific industry.

In China, the "[...] state is constituted to act [...] as an active player, promoting and controlling economic development" (Scott 2002, 65). It managed a restrictive and cautious regulatory OFDI framework during the 1980s and 1990s (Zhan 1995). However, this changed with the liberalization efforts of the "Go Global" policy at the end of the 1990s (Luo, Xue, and Han 2010). This key policy shift points to the need for better understanding of how the evolving institutional environment in China is moderating the internationalization strategies of domestic firms (Child and Rodrigues 2005).

**Methodology and Data**

Primary data was collected using semi-structured interviews in the Yangtze River Delta region between May 2006 and August 2006. This is an ideal location to conduct this type of research, as it is one of China's most economically dynamic regions and a major source of OFDI (MOFCOM 2008). Interview candidates were identified among three distinct groups, namely (1) senior managers in manufacturing firms with existing OFDI projects or the intention to invest, (2) Chinese government officials, and (3) stakeholders, such as foreign investment promotion agencies with an office in China. Interviews with government staff and investment promotion agencies (IPAs) were conducted for triangulation purposes to provide auxiliary, independent support to the data obtained from the core interviews, and as a means of identifying and accessing further Chinese firms for interview via the "snow-balling" technique.

Several sources were used to identify potential firms for interview, because no register or directory is publicly available on Chinese MNEs. This means that the total population to be sampled is unknown, a fact that restricts the generalizability of our findings. SOEs were added to our database from the annually published list of "Top 500" Chinese firms, which ranks firms by turnover (Xinhua News 2005). Multiple instruments were employed to identify privately-owned companies. The attendance of Chinese international trade and investment fairs, in particular the East-China Fair in Shanghai, was taken as an indicator of potential OFDI activities. The English website of participating firms was checked for information concerning ownership structure, international affiliates, and investment activities. International business and trade publications, such...
as the Financial Times, The Economist, and Business Week, were also used for identification purposes. The numbers of identified Chinese firms in the local region were as follows: Jiangsu province (29), Shanghai (22), and Zhejiang province (80).

Key government agencies interviewed included the provincial offices of the State Administration of Foreign Exchange (SAFE), the Ministry of Commerce (MOFCOM), and the National Development and Reform Commission (NDRC). To identify an interviewee in these organizations, interviewees at foreign IPAs who keep close contact with these agencies were asked to recommend an appropriate person in each of the provincial organizations.

The interview schedule was modified to account for the affiliation of the interviewee. The interviews of 60-120 minutes were mainly conducted in Chinese with the support of an interpreter and recorded where allowed. Anonymity was assured to raise the response rate and to allow the voice-recording of the interview in addition to the taking of interview notes. The interviewees’ employer is referred to numerically in this paper (see Tables 1 and 2).

The interviewed companies are mainly well established and large enterprises in terms of employee numbers (see Table 1). Their size ranges from twelve employees (F6) to more than 40,000 (F1 and F7). The age of the firms ranges from three years (F6) to more than fifty years (F1 and F9), with a median of twenty-two years. Inter-industry comparison is allowed for, as the automobile, fashion, and high-technology industries are represented by two companies each. Three firms are active in the consumer electronics industry, and one further company is mainly active in the machine tools sector. The coverage of three SOEs, six private-owned enterprises, and one collectively-owned enterprise allows for comparison by ownership type.

**Interview Findings and Proposition Development**

In this section, the data obtained through interviews are related to each of the four themes discussed above. From this, a set of propositions is developed under each theme in order to direct future research.

**Theme 1 - International Investment Strategy**
Among all the firms interviewed, there is a tendency to place particular
Table 1: Descriptive Analysis of Chinese Firms Interviewed

<table>
<thead>
<tr>
<th>Firm</th>
<th>Interviewee(s)</th>
<th>Location</th>
<th>Owner type</th>
<th>Industry</th>
<th>Size</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>F1</td>
<td>Vice General Manager</td>
<td>Jiangsu (Nanjing)</td>
<td>State</td>
<td>Automobile</td>
<td>Large</td>
<td>1947</td>
</tr>
<tr>
<td>F2</td>
<td>(1) Former Vice President and (2) Deputy General Manager</td>
<td>Jiangsu (Wuxi)</td>
<td>State</td>
<td>Electronic consumer products</td>
<td>Large</td>
<td>1979</td>
</tr>
<tr>
<td>F3</td>
<td>Executive Director</td>
<td>Shanghai</td>
<td>Private</td>
<td>Fashion</td>
<td>Medium</td>
<td>2002</td>
</tr>
<tr>
<td>F4</td>
<td>Vice General Manager</td>
<td>Shanghai</td>
<td>Private</td>
<td>High-technology</td>
<td>Small</td>
<td>2004</td>
</tr>
<tr>
<td>F5</td>
<td>Managing Director</td>
<td>Shanghai</td>
<td>Private</td>
<td>High-technology</td>
<td>Small</td>
<td>1993</td>
</tr>
<tr>
<td>F6</td>
<td>Chief Managing Officer</td>
<td>Zhejiang (Hangzhou) Private</td>
<td></td>
<td>Automobile</td>
<td>Large</td>
<td>1969</td>
</tr>
<tr>
<td>F7</td>
<td>(1) Special Assistant to Chairman and (2) Manager Overseas Marketing Department</td>
<td>Zhejiang (Yiwu)</td>
<td>Private</td>
<td>Fashion</td>
<td>Large</td>
<td>1995</td>
</tr>
<tr>
<td>F8</td>
<td>Former General Manager of the Australia affiliate</td>
<td>Shanghai</td>
<td>State</td>
<td>Electronic consumer products</td>
<td>Large</td>
<td>1995</td>
</tr>
<tr>
<td>F9</td>
<td>Vice President</td>
<td>Jiangsu (Danyang)</td>
<td>Private</td>
<td>Machine tools</td>
<td>Large</td>
<td>1992</td>
</tr>
</tbody>
</table>

Notes:
- "Size" - large: 2,500 employees; medium: 50 to 250 employees; small: 10 to 49 employees (Eurostat 2008).
- "Year" refers to the year the company was established in China.
- Two persons were present at the interview in firms 2 and 7.
- Source: Interviews and companies’ homepage.

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Table 2: Descriptive Analysis of Chinese Government Officials Interviewed

<table>
<thead>
<tr>
<th>Code</th>
<th>Interviewee</th>
<th>Location</th>
<th>Involvement of government agency in OFDI process</th>
</tr>
</thead>
<tbody>
<tr>
<td>G1</td>
<td>Assistant Director</td>
<td>Shanghai</td>
<td>little</td>
</tr>
<tr>
<td>G2</td>
<td>Business Developer</td>
<td>Sichuan (Chengdu)</td>
<td>medium</td>
</tr>
<tr>
<td>G3</td>
<td>Deputy Director (1) and Overseas Investment Division Chief (2)</td>
<td>Jiangsu (Nanjing)</td>
<td>strong</td>
</tr>
<tr>
<td>G4</td>
<td>Section Chief</td>
<td>Zhejiang (Ningbo)</td>
<td>strong</td>
</tr>
<tr>
<td>G5</td>
<td>Vice Division Director</td>
<td>Jiangsu (Nanjing)</td>
<td>strong</td>
</tr>
</tbody>
</table>

Note: The classification of OFDI involvement is based on Voss, Buckley, and Cross (2009) and Lue, Xue, and Hu (2010).

importance on market expansion strategies. Firms 1, 2, 4, 7, and 8 exported to the host country or a third market prior to their first foreign investment. Firm 8 believes that such investments build customer trust, because functions such as after-sales support can be provided locally more readily than from China. Consequently, Firm 8 has invested in eight developed and developing countries with high market potential. By contrast, Firms 2 and 9 did not invest abroad as a trust-building strategy but rather as a market-defense strategy. These two firms either faced existing trade barriers abroad (F2) or anticipated prospective trade barriers because of the host country’s political atmosphere (F9). In the case of Firm 2, a change in the customs system, which increased export prices while local demand remained high, caused it to establish in the mid-1990s complete knock-down (CKD) assembly lines in Indonesia and Malaysia in cooperation with local partners. The company invested for similar reasons in Argentina in 2000.

A similar route to internationalization was pursued by Firm 1. It has exported products to Vietnam since the 1960s on request of the principal shareholder, the Chinese government. After some success, F1 established CKD assembly plants in different developing countries before targeting an industrialized country for expansion. The first plant was established in Argentina in the 1990s but did not develop well, mainly because of a currency crisis in Latin America. F1 remained in the market and currently operates low-scale CKD assembly plants in Russia and Sudan, which all produce for local markets. In 2005 the company acquired a well-known manufacturing company in the United Kingdom (see also below).
A different internationalization process has been followed by Firm 4. The company was founded in 2002 and established its first foreign affiliate in Hong Kong at the end of 2005. Rapid internationalization was forced by internationally active competitors and limited infrastructure in China, which impeded domestic corporate growth. Several reasons favored Hong Kong over other locations. First, an agent of the company had established links to Hong Kong firms, and this secured customers. Second, Hong Kong was perceived to be a good hub for commencing business outside of mainland China, and, hence, the firm made its affiliate in Hong Kong its Asian headquarters. Third, Hong Kong has a well educated, English-speaking workforce but is culturally close to mainland China, which made it easier for the firm to conduct business there. And fourth, it was looking for a venture capitalist to provide financial resources, whom it found in Hong Kong. With additional funding and with the support of an international network (see below), Firm 4 invested in the UK in 2006 and, at the time of the interview, intended to invest in San Francisco and Los Angeles during 2007.

The generic investment asset-seeking strategies were of minor relevance to the interviewed companies across all ownership forms, locations, and firm sizes. Only Firms 1 and 3 acted in line with this argument. Firm 1 purchased an insolvent British manufacturing firm in 2005 to gain access to an established but ailing brand, with the intention of reviving it. The target company also presented Firm 1 with access to high quality physical assets and blueprints and, therefore, the opportunity to enhance production facilities and end-products in China. It was thought that the acquisition would strengthen its bargaining position in a related Sino-foreign joint venture in which the foreign partner was at the time the technology supplier. After finalizing the acquisition, the Chinese firm transferred part of the British production line to China to produce for the Chinese market. It follows from the above discussion that:

*Proposition 1* – The internationalization of Chinese firms is dominated by market-seeking reasons.

**Theme 2 - Domestic Capital Market Imperfections**

The interview-based evidence suggests that China’s capital market imperfections cannot be exploited similarly across all firms. Firms 1 and 2 (both SOEs) had invested in, respectively, South America and in Southeast Asia and South America before each region was hit by an economic crisis. This caused both firms to divest. The interviewees at Firm 2 stated that, though investments in developing countries are relatively cheap and the firm has been approached to invest in other developing countries,
unforeseeable political risks make investments in developing countries unpalatable. Thus, the interviewees argued that Chinese companies should invest in safe and stable countries – which they suggested to be large, developed countries in North America or Europe and Japan – or not at all. The interviewees commented that “investment-worthy” countries have high market entry and operational costs and require a well-established Chinese brand prior to investment. They further indicated that an investment in the Triad countries is therefore not feasible at the current point in time. The interviewees at Firm 2 suggested that Chinese firms should, rather, cooperate with foreign firms in China, and manufacture for, and learn from, them. The concern of economic feasibility was shared by the interviewee at Firm 8 who was responsible for the European operations before he was assigned to other foreign affiliates. Firm 8 had established an affiliate in a European capital from where to run and coordinate its European business. The firm subsequently relocated several times in Europe to find cheaper office space and then ultimately withdrew from the European market because of high office and labor costs and unfavorable labor regulations.

The evidence suggests that, firstly, capital is not readily available in China to carry overseas investments through an economic crisis, and that Chinese firms therefore cannot benefit from the opportunities presented by rivals exiting the market because of, for example, recessionary forces; and that, secondly, capital is not readily available to support investments even in the more secure Western markets. Moreover, the evidence obtained from larger, state-owned firms suggests that the reach of capital market imperfections is not as widespread a determinant for ODI as predicted by Buckley et al. (2007), whose dataset was confined to the activities of SOEs. From this, the second proposition is derived as follows:

*Proposition 2a – China's domestic capital market imperfections are exploitable by a limited number of firms only.*

The smaller firms captured in this study generally agree with the notion that capital market imperfection and privileged access to funding in China are important to the internationalization of Chinese firms. However, in contrast to Buckley et al. (2007), Firm 5 decided to invest outside of China to attract venture capital firms. Firm 4 is of similar size and age to Firm 5 and struggled to secure external funding for its international activities. Its manager indicated that “generally, [if] they [venture capitalists in China] find you have got some mature [product] and will expand in the future, they all come here. [If] they do not know whether you will be alive or dead, they will go away from you.” Firm 4 is therefore considering an investment...
in the UK to gain better exposure to foreign venture capitalists, which, in turn, could help it to better penetrate the Chinese market. Thus:

Proposition 2b – Smaller Chinese firms are pushed by domestic capital market imperfections to invest abroad to secure external funding.

Theme 3 - International Networks
Access and usage of business and social networks to facilitate internationalization was viewed differently across firms in the sample frame. For most firms interviewed, business links to customers and export agents are used for market information gathering purposes. It was reported that a sparse network of agents in particular can play a vital role in providing information about the foreign market and potential investment opportunities, which could help in setting up a business abroad (F 4, 5). Further information can be sought from other Chinese firms that have invested in the target region. Approaching Chinese firms in the target market for business intelligence is seen to be more fruitful when the information provider firm is not a direct competitor (F8). Consequently, only general information about the business and legal conditions in the target market is generally obtained from incumbent Chinese firms rather than, for example, product-related, customer-behavior, and competitor-specific information. It was found that business links can also be useful for acquisition purposes. For example, Firm 1 had established business contact with a European company in 1998 and subsequently acquired it in 2005. First-hand knowledge about the target company provided this firm with crucial information on which to base the purchase decision.

Self-experience and understanding as cornerstones of business development was also stressed by Firm 8. This company had been approached by IPAs that screen Chinese firms for potential investors to invest in a particular region. The interviewee maintained, however, that the services offered by the IPA were too expensive. The IPA attempted to indulge the company by offering high-cost lawyers, accountants, business sites, and so forth, all of which could have been achieved “in-house” at lower cost. The interviewee commented that “in-house” research would have to be done anyway, as no company would invest abroad without evaluating the proposed target region itself and against other regions. It was viewed that the contacts provided by the IPA may be revived later, after the foreign business had left the infant stage and became more prosperous. Similarly, Firm 6 reported satisfaction with the services provided by an IPA and the support it received in establishing potential business contacts in the target region, but the firm was reluctant to pursue the opportunity. Without having established a strong market position in China and lacking adequate
financial resources, a foreign commercial commitment may put the whole organization at risk, the interviewee stated. This was a gamble the owner was not willing to take. Instead, its investment decision had been postponed while it works on and extends business links to the target country.

In contrast, links to IPAs may have an important role in triggering the internationalization of smaller firms. A European IPA looking to attract high-technology Chinese firms to complement the economic structure of its home region had previously approached Firms 4 and 5. Both firms had been contacted by the IPA “out of the blue” and were invited to consider an investment in its home region. Because of the prompting of this IPA and the business connections it could provide, the two companies did not consider alternative locations either in the proposed European host country, in Europe in general, or outside of Europe. This meant that the firms were unaware if they had allocated funds to activities that would maximize profit generating opportunities or were closely aligned with long-term strategic objectives and development goals. Besides these uncertainties, at the time of the interview, Firm 4 signalled its intention to identify an IPA in California to take the role of a middleman and help it to establish an affiliate in the USA.

Throughout all interviews, social linkages were found to be of lesser importance than business linkages. Some firms stated that linkages to the Overseas Chinese communities and the Chinese Chamber of Commerce sometimes enabled them to collect information about target markets prior to investing. But in general the interviewees perceived these facilities to be relatively unimportant. It was commented that the Overseas Chinese Diaspora can be too assimilated to the local environment and may lack a reflective and objective opinion about the business environment and opportunities in the target country (F7) or may not be helpful when managing a large organization (F8). Rather, the interviews revealed that the Overseas Chinese are generally employed once the foreign business has been established. It was stated that Overseas Chinese people would be welcomed as employees in a foreign affiliate because they may help to bridge the communication gap between the parent, the foreign affiliate, and the host market because of their bilingual skills, and that this can help lower the transaction costs associated with running the foreign operation (e.g., F4, F7, and F8).

The evidence suggests, therefore, that the role and status of Overseas Chinese differs from expected models, though it still holds that Chinese firms invest in locations where ethnic social ties can be exploited (Buckley et al. 2007; Zhou 1996). No difference in this respect could be detected by
firm size or ownership form. One reason for this could be that foreign Chinese affiliates generally tend to be relatively small, regardless of the ownership form of the parent company. Chinese affiliates in the UK and in Germany, for example, often employ fewer than five people (Young, Hood, and Lu 1998). It follows from the above discussion that:

Proposition 3a – Smaller Chinese firms are likely to use international social and business networks when conducting OFDI.

Proposition 3b – Business networks are of greater importance to Chinese firms than social networks.

Theme 4 - Domestic Institutions
The Chinese government generally perceives OFDI positively and encourages it (Government 1, 2, 3, and 5). Chinese OFDI in manufacturing in Africa and Southeast Asia is seen as a good means to circumvent trade barriers and import quotas of major target markets. Investments in developed countries are viewed as a good channel to access superior technology and production facilities not readily available in China. The current trend is, therefore, to establish R&D facilities instead of trade offices in these countries (G1). The Chinese government provides preferential long-term loans for large Chinese OFDI projects and organizes seminars to inform potential Chinese investors about foreign business opportunities, market conditions, and legal environments, in conjunction with IPAs from the potential target country or region. To adjust these measures to fit “customer” needs, Government 2 regularly visits potential Chinese investors to gain a better understanding of their international business plans. Although they do advise the firm on location choice, the government agency interviewees reported that final investment decisions are taken by the firm (G2 and G3). Government 3 screens investment applications and points out to Chinese firms if there is the “danger” of entering into competition with other Chinese firms in the host market, which could potentially “cannibalize” overall Chinese market share. The government will not, however, reject the application on this basis. One interviewee (G4) stated that the whole OFDI application process is only a registration process to gather information about where and how many Chinese firms invest abroad. Based on this information, the local authorities can provide more focused host country and industry information to Chinese firms, it was reported.

The neutral to positive views on the role of Chinese government agencies in the outward investment process are mirrored by statements from SOEs and large private firms. The SOEs interviewed generally agree that
government is supportive and see no problem in the approval process. The large SOEs and private firms also acknowledged that they enjoyed good relationships with the local government, which is interested in having prosperous local companies. The interviewees argued that the type of government support typically received is helpful to understanding the legal and regulative environment in the host country and how to smoothly negotiate the outward investment approval process. But all the managers interviewed stated that the government neither interferes in business decisions directly, nor instructs the company to conduct a certain investment in a particular country.

The Jiangsu-based SOEs (F1 and F2) regard the institutional setting in China to be at least neutral towards their international ambitions. It was reported that this gives them enough leeway to make strategic decisions without interference and unnecessary administrative hurdles. The acquisition of a British company by Firm 1, for example, was supported by the local government and the Ministry of Foreign Affairs (MFA). The local government offices provided important advice about legal and taxation issues, while the MFA corresponded directly with the national and local government of the host country to support the acquisition process. The initiative to purchase the insolvent firm came, however, from Firm 1, and it did not receive any subsidies to carry out the acquisition. No formal approval system for this particular investment, nor for other investments abroad by the company, was recognised by the interviewee. Firm 2 acknowledged that they did benefit from the composition of its shareholders, as one shareholder is headed by a former highly-ranked national politician. This connection provided the company with access to resources and bargaining power at home. Likewise, the privately-owned Firm 7 had employed a former employee of the local MOFCOM office, where he was in charge of supervising local OFDI. Firm 7 perceived the local government authorities as supportive of the company’s international activities. It remains questionable, however, as to what extent the interviewee answered from a current company or a former government perspective. It is also unclear how his established contacts within MOFCOM and possibly other Chinese authorities facilitated the company’s internationalization process.

The interview data did detect an observable disconnect between the governments’ self-descriptions and the perceptions of smaller, private firms. The institutional environment was perceived as having long disfavored OFDI by private firms, F3 reported. One way of constraining OFDI, it was commented, is to have in place a highly cumbersome approval process, about which privately-owned firms do not receive the same level of
advice and assistance from domestic institutions as do SOEs. The smaller firms interviewed therefore invested in foreign tax havens, like the British Virgin Islands, which provided them with easier access to external funding and helped them to circumvent future OFDI approval requirements of the Chinese government (F3 and F4). One government agency interviewee (G2) acknowledged this behavior among private firms, while another (G3) stated that the objective of firms in this regard is to reinvest the money back in China (i.e., for round-tripping purposes) rather than to circumvent the Chinese outward approval system. This discussion enables the following proposition to be derived:

Proposition 4a – China’s domestic institutions impede the internationalization of smaller Chinese firms.

Differences in local government attitude were also found to play a role. The interviewee at Firm 9 has experienced the OFDI approval processes in both the provinces of Jiangsu and Hubei. He stated that individual project applications are normally finalized within four weeks in Jiangsu, whereas an OFDI approval submitted to an agency in Hubei is returned after around six months. This is supported by the interviews conducted in Sichuan Province. The Chengdu (Sichuan) branch of a national government agency (G2) has identified key industries in Sichuan Province that could be internationalized. At the time of the interviews, the agency was developing a long-term strategy for its local company membership to be able to internationalize in cooperation with the relevant domestic business associations. This includes considerations about the level of research intensity, supply chain improvements, a general “upgrade” of the industry, and identification of target markets, primarily in Russia and Southeast Asia (which have key resources and lag behind China, providing Sichuan-based companies with exploitable firm-specific advantages), but also Germany (which is the largest European market for Sichuan-manufactured products) (G2). To achieve these objectives, the agency was attempting to persuade other Chinese government authorities to provide better supportive measures to local companies in Sichuan.

These accounts reveal two important issues: First, the local government in China is not only supportive of OFDI but also actively attempts to provide a domestic institutional environment in cooperation with other agencies that nurtures the growth of domestic firms and enables them to venture abroad. Second, core local industries are identified and strengthened. This strategy may increase the likelihood that these firms are internationally competitive and also reinforces domestic economic growth. It may fail, however, to support capable companies outside of the core, target industries.

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Proposition 4b – China’s domestic institutions have developed to different levels of sophistication to support the internationalization of Chinese firms.

The propositions developed in this paper are supported with quotations from the interviews in Table 3.

CONCLUSION AND MANAGERIAL IMPLICATIONS

This investigation of manufacturing Chinese MNEs based in the Yangtze River Delta contributes to the literature on the emergence of developing country MNEs in a number of ways. First, it was found that firms in our sample invest abroad overwhelmingly for market-seeking reasons. Among the market-seeking firms, only two, Firms 4 and 5, seem to have followed an offensive strategy to access new markets to develop their companies quickly. The majority have internationalized for defensive market-seeking reasons. Despite a very small number of acquisitions in Europe by the firms studied here, the objectives of accessing advanced technology or an established brand are barely in evidence. This finding contrasts with Zhan (1995) and Deng (2004), for example, who report a wider range of important investment strategies.

Second, this study reveals that the ability of Chinese firms to assess host country business risk (connected to the political and economic situation) is often underdeveloped. Some firms enjoy well established connections to, and support from, their local governments, which cushions such unsuccessful endeavours – though this support does not allow them to expand their international businesses and to navigate through economic downturns around the world. This finding only marginally supports the notion that domestic capital market imperfections are an important determinant of Chinese OFDI (Buckley et al. 2007; Morck, Yeung, and Zhao 2008).

Third, contrary to the important role assigned to international networks by some scholars (e.g., Buckley et al. 2007), such networks are found to serve only an auxiliary role in this study. Business networks, such as contact with IPAs, are generally favored over purely social connections to gain and assess host market information. The Overseas Chinese are mainly viewed as communicative bridges to a foreign market and as customers and employees.
### Table 3: Interview Support for Propositions

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<tr>
<th>Proposition</th>
<th>Interviewee support</th>
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| **P1** The internationalization of Chinese firms is dominated by market-seeking reasons. | The market in China is huge and the bandwidth of China is not very good. Our last year revenues were about RMB 30mn. We believe that international markets have more revenue generating opportunity. It is a very large market. F3  
We must set up overseas subsidiaries to allow overseas customers to recognize our brand. F6  
Every country has different market channels which are best exploited by being local and understanding the local market. F7  
The single most important motivation to purchase the firm is to improve the technology on the platform of their main product. F1 |
| **P2a** China’s domestic capital market imperfections are exploitable by a limited number of firms only. | The Chinese government and regional bodies have preferential policies for outward investing firms if they fulfill certain requirements and the investment volume is fairly large. These companies can receive a special long-term interest from Chinese banks. G1 |
| **P2b** Smaller Chinese firms are pushed by domestic capital market imperfections to invest abroad to secure external funding. | November 2005 fundraising was completed of US$5 million. Afterwards a BVI company was set up as a fundraising platform. The venture capitalist and the founders are the shareholders of the BVI company. F3 |
| **P3a** Smaller Chinese firms are likely to use international social and business networks when conducting OFDI. | The local IPA offers us a good opportunity to recognize the local market and give us lot of convenience to connect to local partners. It covers accountancy and legal fees as well as our accommodation and local transportation costs. […] We have no sense of UK. In the location the IPA gave us the opportunity. We have not compared the location with other location worldwide. F3  
We do not communicate too much with overseas Chinese. Our judgement on value, market, and overall business is different. F5 |
Table 3: Interview Support for Propositions (continued)

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<tr>
<th>Proposition</th>
<th>Interviewee support</th>
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<td>F3b Business networks are of greater importance to Chinese firms than social networks.</td>
<td>The Overseas Chinese have merged into the society in some countries. They are therefore helpful as employees which speak the local language. F7 We listen to business services and advisors and institutions (consultants, lawyers, bankers) who can give professional, objective support and introduction to the market. If we open a market in UK we would like to communicate with professional service firms. F5</td>
</tr>
<tr>
<td>P4a China’s domestic institutions impede the internationalization of smaller Chinese firms.</td>
<td>The Chinese laws restrict the investment abroad. The Chinese company should go through the approval procedure, then they can invest in a foreign company. It is not very convenient to invest abroad. So, we invest in the UK or HK. We use the BVI so we do not have to go through the process. When we set up the BVI company there was no cash flow [between China and BVI] so we did not need to request permission from the Chinese government. F3 China is encouraging scientists and founders to internationalize. There are no restrictions. F4</td>
</tr>
<tr>
<td>P4b China’s domestic institutions have developed to different levels of sophistication to support the internationalization of Chinese firms.</td>
<td>There is no strict control of outward investments as the Chinese government actively encourages qualified Chinese firms to do this. F7 The application process is just a regulatory matter, with most applications being accepted. The whole process takes about four weeks. G4 The government agency might consult and advise a company to not invest in a certain country if it perceives the business environment as too competitive and if too many Chinese firms have already invested there. G3 We have much indirect and direct assistance from the government. Without the help of national government offices, Jiangsu provincial government and the office of foreign affairs, we cannot do such things. F1 The Chinese government is not 100% assisting the companies. F5 Before the regulations changed (in 2005) government procedures slowed down our overseas investment. F5</td>
</tr>
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</table>
Fourth, the institutional environment in China is perceived by the smaller firms interviewed to be a barrier to outbound investment. These firms have therefore looked to circumvent the official OFDI approval route. The SOEs and large privately-owned firms interviewed, in contrast, perceive domestic institutions more favorably. Recent reforms to the Chinese OFDI regime and an increasingly positive attitude towards OFDI by government authorities at both national and provincial levels may ease this apparent divide (Luo, Xue, and Han 2010). A new dimension arises from the intra-Chinese institutional differences observed. It was found that OFDI is better supported and nurtured in China’s coastal provinces, helping local firms to take advantage of international business opportunities. A stronger and more clearly articulated sub-national contextualization is required in future research in order to achieve a more accurate picture of the role of institutions on Chinese OFDI.

This research opens avenues for future research along the lines of the propositions advanced in this paper. In-depth, firm-level data on capital access and allocation in connection with outward investment are necessary to thoroughly test the domestic capital market imperfections theory advanced in Buckley et al. (2007). The exploitation of social and business networks by Chinese firms needs to be investigated across sub-national locations in order to better understand whether regional specificities exist among Chinese MNEs. Guangdong and Fujian Provinces are well known for their linkages to the Overseas Chinese Diaspora (in their role as an important source of migrant populations), and this could mean that social networks gain greater prominence in this geographical context. Because the influence of the institutional environment was found to vary across China’s regions, greater recognition of sub-national institutional heterogeneity is also required. Finally, in terms of managerial implications, this study shows that Chinese MNEs should not be perceived as a single, monolithic organizational form that is government supported and derive ownership-specific advantages from institutional support. Some firms, especially smaller ones, have the strength to internationalize despite the domestic constraints they face (cf. Boisot and Meyer 2008). This suggests they possess resources and capabilities that constitute long-term challenges to established international competitors, and that they act independently of government fiat. While Chinese MNEs are currently looking to develop and expand markets, in the main they seem to compete more on price than on proprietary technologies or brands. Chinese firms that do have the skills to internalize and exploit China’s capital market imperfections and are able to successfully access and exploit international social and business networks may be able to pose a significant challenge to established international competitors through the com-
bination of reduced transaction costs and extensive funding. It remains to be seen whether and to what extent these capabilities constitute a significant source of competitive advantage for Chinese firms into the future.

REFERENCES


THE MULTINATIONAL BUSINESS REVIEW


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The Impact of Home Country Institutional Effects on the Internationalization Strategy Firms...

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