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Outward internationalization of private enterprises in China: The effect of competitive advantages and disadvantages compared to home market rivals

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ABSTRACT

This study uses the resource-based view of a firm to examine the outward internationalization of private firms in China. We investigate the extent to which advantages/disadvantages of resource endowment and organizing capability of Chinese private enterprises (relative to both state-owned enterprises and foreign-invested enterprises at home) may drive outward internationalization and affect their risk-taking tendency when going international. Our analyses of 553 Chinese private enterprises show that a Chinese private firm's likelihood of venturing abroad is associated with resource endowment advantages vis-à-vis foreign-invested enterprises, organizing capability advantages vis-à-vis state-owned enterprises, and organizing capability disadvantages vis-à-vis foreign-invested enterprises. These same advantages (or disadvantages) in organizing capabilities also increase a firm's likelihood of choosing a high-risk entry mode. We also find that a firm's resource endowment and organizing capabilities interact with each other and mutually enhance each other's effect on the likelihood of outward internationalization.

1. Introduction

The internationalization strategy of firms is a core issue of business research. Internationalization can be defined as "the process of the firm's becoming integrated in international economic activities" (Mathews, 2006, p. 16). Such activities can occur in a firm's own country in the form of non-equity contracting relationships with foreign firms, joint ventures, or importing; or, these activities can occur outside the firm's country in the form of exporting, licensing, or foreign direct investment (Liu, Xiao, & Huang, 2008). In this paper, we focus on the latter type, which is often referred to as outward internationalization.

Past research and theory on outward internationalization posits two general views. The mainstream perspective argues that firms go international to exploit their firm-specific ownership advantages in new geographic locations (Dunning, 1980). An emerging perspective argues that firms go international to overcome competitive disadvantages originating from their own internal resources (Bartlett & Ghoshal, 1988; Child & Rodrigues, 2005; Luo, 2000; Mathews, 2002, 2006) and/or unfavorable domestic institutional environments (Cuervo-Cazurra & Genc, 2008; Luo & Tung, 2007; Witt & Lewin, 2007; Yamakawa, Peng, & Deeds, 2008).

These two perspectives emphasize the role of internal resources and capabilities of a firm, which constitute its competitive advantages or disadvantages, in driving the firm's internationalization decisions. Scholars have tested these two perspectives extensively in both developed and developing countries. Most of these studies however, focus on one or a few aspects of resources or capabilities (e.g., Yiu, Lau, & Bruton, 2007). There have been few studies examining more comprehensively both the resources and the capabilities of a firm and how they independently and jointly affect the firm's internationalization strategy.

The emerging perspective also suggests that unfavorable institutional environment is one of the drivers for firms to internationalize. This implicitly suggests that in transitional economies, where the institutions are not fully established, the emerging perspective applies. There also has been evidence that the mainstream perspective should apply in the transitional economy (Erdener & Shapiro, 2005). We have limited understanding on how the dynamics of institutional environment in transitional economies may affect the applicability of these perspectives (Yiu et al., 2007).

This study fills in these literature gaps by testing the applicability of these two perspectives in the context of Chinese privately owned enterprises (POEs). Specifically, we examine how the advantages and disadvantages of resources and capabilities of Chinese POEs, compared with their home rivals, affect the

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likelihood of outward internationalization and the risk-taking tendency of their internationalization strategy. We define privately owned enterprises as enterprises in which individuals are the largest shareholders (Tsui, Bian, & Cheng, 2006).[3] We suggest that the unique competitive and institutional environment in which Chinese POEs operate provides an excellent setting to test the applicability of these two perspectives.

While private firms are the dominant force in developed economies, firms with different ownership types such as state-owned enterprises (SOEs) (i.e., enterprises in which the state has the controlling stake), foreign-invested enterprises (FIEs) (i.e., enterprises in which foreign firms have the controlling stake and are managed by the foreign firms), and POEs coexist in transitional economies, such as Brazil and China (Child & Pleister, 2003; Liu et al., 2008). Each organizational form holds significant market share and they compete with each other in most industries. Therefore, private firms in transitional economies operate in a very different competitive environment from those in developed economies. The strategic behavior of Chinese POEs is more likely to be influenced by market forces than that of SOEs (Liu et al., 2008). These POEs' structures resemble those of private firms in developed countries. However, the institutional environment and the developmental stage of Chinese POEs are very different from those of private firms in developed countries. To respond to the different institutional and competitive environments, the private firms in China may have to either develop specific advantages or take different strategic actions when going international (Dunning, 2001; Peng, Lee, & Wang, 2005; Yiu et al., 2007). This context provides unique opportunities to extend the mainstream internationalization theories to transitional economies (Liu et al., 2008).

Although the emerging perspective was largely developed in the context of transitional countries (e.g., BRIC), a large portion of these studies have focused on large SOEs (e.g., Cui & Jiang, 2010; Deng, 2004, 2009; Hong & Sun, 2006). In the context of China, despite the increasing importance of Chinese POEs' outward internationalization, relatively little research has been conducted in this area. Prior to 2003, Chinese private firms were legally prohibited from investing abroad (Hong & Sun, 2006; Luo & Tung, 2007; Wright, Filatotchev, Hoskisson, & Peng, 2005). Additionally, empirical studies have either used aggregated secondary statistical data (e.g., Buckley, Clegg, Cross, Liu, Voss, & Zheng, 2007) or relied on case-based evidence to describe the pattern, trend, and characteristics of Chinese firms going aboard (e.g., Cui & Jiang, 2010; Liu et al., 2008; Yang, Jiang, Kan, & Ke, 2009). As a result, there is limited (albeit growing) evidence on how Chinese private firms go international based on first-hand firm-level data (for exceptions, see Cardoza & Fornes, in press; Cui & Jiang, 2009; Liu et al., 2008; Yiu et al., 2007; Zhou, 2007). We believe the unique institutional and competitive environment of Chinese POEs allow us to not only enrich the internationalization theory, but also provide timely empirical evidence with large-scale firm-level data on the internationalization strategy of Chinese POEs.

We propose a "comparative" view of competitive advantages and disadvantages relative to home rivals in studying private firms' international expansion in transitional economies. We argue that in responding to their complex competitive environment, Chinese private firms assess their resources and capabilities relative to their home rivals, with different ownership structures, such as SOEs and FIEs. While some competitive advantages or disadvantages result from different institutional environments faced by firms with different ownership structures, other advantages and disadvantages may result from the internal resources and capabilities of a firm. Consistent with Luo & Rui's (2009) ambidextrous view, we suggest that firms need to both exploit their advantages in resources and capabilities and enhance their resources and capabilities to overcome competitive disadvantages. We further provide empirical evidence on the conditions under which relative advantages/disadvantages in resources and capabilities of private firms, as compared with their home rivals, may affect the likelihood that firms will go aboard as well as affect the risk-taking tendency in internationalization.

[3] This includes: (a) privately operated enterprises (*siying qiye*); (b) individual/family business (*getihu*); and (c) those partnerships, cooperatives, limited liability companies, and stock holding limited companies where individuals have the relative dominance over equity ownership or exercise control as the largest shareholder. This follows the well-accepted definition of privately owned enterprise, which emphasizes the absolute or relative control in ownership and the leading position in decision-making right of private investors.

2. Theory and hypotheses

2.1. Theoretical background

Explaining why and how firms expand internationally has long been of central interest for researchers. Among substantial empirical literature, the eclectic paradigm or OLI framework developed by Dunning (1980) has received the most attention. OLI framework argues that firms expand internationally to exploit the ownership-specific advantages (O), location advantages (L), and internalization advantages (I). Ownership-specific advantages refer to the superior, intangible assets accrued to firms in terms of technologies, marketing capabilities, brand equity, or management competencies. Location advantages refer to the gains accumulated from integrating activities across different parts of the world where factor costs and resources vary. Internalization advantages come from centralizing activities within the boundary of a firm and from exploiting economies of scale.

Recent research has extended the OLI paradigm and applied it to firms in emerging economies. Erdener and Shapiro (2005) applied the eclectic paradigm to study Chinese family businesses and argued that the eclectic paradigm is valid in that context. Others have argued that firms in emerging markets (as compared with firms in developed markets) have some special ownership advantages including flexibility, relational assets, and networking skills (Dunning, 2001; Peng et al., 2005). Yiu et al. (2007) examined how home market conditions moderate the relationship between a firm's ownership advantages and international venturing among Chinese multinational firms. They found that the positive relationship between technological capabilities and international venturing is contingent on the intensity of industry competition in the home country.

While the OLI framework views a firm's internationalization efforts as a way to exploit its previously developed competitive advantages, the emerging perspective describes a firm's internationalization efforts as a catch-up strategy to overcome competitive disadvantages at home (Bartlett & Ghoshal, 1988; Child & Rodrigues, 2005; Luo, 2000; Mathews, 2006; Rui & Yip, 2008). Mathews (2006) argued that firms in emerging economies go international not to exploit ownership-specific advantages, but to tap into external resources (e.g., capital markets, brand, and technologies). He further proposed the Linkage, Leverage and Learning framework to explain such a process. Resource linkage suggests that firms expand internationally to acquire or access external resources. Resource leverage concerns how firms link their resources with other firms to leverage their resources. Learning refers to the repeated application of resource linkage and leverage, thereby allowing a firm to perform such a process more effectively over time. This framework explains the rapid emergence of some large multinational firms in emerging economies (Mathews, 2006).