

**A double-edged sword: The impact of institutions and political relations on the  
international market expansion of Chinese state-owned enterprises**

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**Abstract**

This study examines how home country government involvement and host country institutions, as well as bilateral political relations, affect the post-entry market expansion of Chinese state-owned enterprises (SOEs) in emerging and developing countries, and developed countries, using the case study method. The findings show that home country government involvement can either support or constrain SOEs' subsequent market expansion. In emerging and developing countries, under-developed institutions create difficulties which can deter the market expansion of Chinese SOEs, whereas in developed host countries the challenges associated with unfamiliar institutions can be overcome through experiential learning. The impact of host country institutions on the market expansion of Chinese SOEs is contingent on political relations between host and home countries.

Keywords: Chinese SOEs; internationalisation; post-entry market expansion; institutions; global political economy

## 1. Introduction

One of the major trends characterizing the beginning of the 21<sup>st</sup> century is the rise of multinational enterprises (MNEs) from emerging economies (EEs) such as China. By the end of 2011, Chinese firms from non-financial sectors were engaged in outward FDI in 177 countries, including emerging and developing countries, and developed countries (MOC 2012). One particular phenomenon that has drawn the attention of both academics and practitioners is the important role played by Chinese state-owned enterprises (SOEs) in outward FDI. In 2012, SOEs accounted for 90.5% of Chinese outward FDI flows (The Economist 2013).

Despite the fact that SOEs have become a dominant force in Chinese outward FDI, little is known about their post-entry market expansion. Previous studies have examined factors affecting the emergence of Chinese MNEs and have found that Chinese outward FDI is influenced by a variety of firm, industry, and country-related factors (Buckley *et al.* 2007; Li and Ding, 2013; Lu, Liu and Wang 2011; Luo, Xue and Han 2010; Rui and Yip, 2008). The findings from existing studies have shed new light on this issue and enhanced our understanding of the characteristics of Chinese outward FDI. However, most existing studies have mainly focused on the motivation and entry mode selection of Chinese MNEs and have not explicitly examined their post-entry market expansion (e.g. Cui and Jiang 2010; Lu, Liu and Wang 2011). In particular, the role of the home country government and host country institutions in the subsequent market expansion of Chinese MNEs has been under-explored.

The dominant position of SOEs in Chinese outward FDI indicates their vital role in the internationalisation of Chinese firms, and the importance of studying factors leading to their international success or failure. Hence, our research departs from previous studies by focusing on the post-entry market expansion of Chinese SOEs. In particular, drawing on the institution-based

view and global political economy perspective, our study aims to investigate how the home country government and host country institutions, as well as political relations between home and host countries, influence SOEs' post-entry market expansion.

The institution-based view has become an increasingly relevant and insightful approach when examining the internationalisation strategy and strategic outcomes of EE firms as it takes account of the interaction between institutions and internationalisation strategies (Meyer *et al.* 2009; Peng, Wang and Jiang 2008; Wright *et al.* 2005). Hence it is appropriate to adopt the institution-based view to examine the role of the home country government and host country institutions in the market expansion of Chinese SOEs. We further draw on the global political economy perspective to explore the impact of bilateral political relations between host and home countries on the international market expansion of EE firms. This is particularly important in studying Chinese SOEs that are, by definition, assets of the home country government. Hence, SOEs' objectives can be politically motivated and may be determined by the government's consideration of China's political and economic influence in the world. Such an affiliation can affect the way they are perceived by host country governments when investing overseas (Cui and Jiang 2012). In other words, the perception of Chinese SOEs by host country governments or government agencies is influenced by how these countries perceive China. Such a perception may be determined by the bilateral political relations between home and host countries and can consequently create institutional advantages or pose challenges to SOEs' further market expansion in host countries.

This study makes several contributions to the existing literature. First, using Chinese SOEs as our research setting, this study enriches the institution-based view by drawing insights from the global political economy perspective and helps to enhance our understanding of the impact of

home and host institutions and the inter-relationship between them on the international market expansion of MNEs from EEs. By doing so, we move beyond a simplified application of the institution-based view within the boundary of individual countries by considering interaction between home and host countries through their political relations. We find that EE MNEs' post-entry expansion is not only influenced by the institutions of home and host countries, but also the inter-state political relation between them. Since these MNEs, especially SOEs, carry the identity of their home country, the political relation between home and host countries could determine whether they receive favourable or hostile treatment from host country institutions. Second, the home country government and its agencies play a complex role in SOEs' post-entry market expansion. The influence of the home country government is not limited to providing governmental support as identified in existing studies (Lu, Liu and Wang 2011; Luo, Xue and Han 2010), but also extends to operational intervention in SOEs' post-entry market expansion in a host country. Finally, this study serves the interests of international executives by providing a better understanding of the role of the home country government and host country institutions as well as the impact of international political relations on international expansion. Managers can take advantage of the institutional support from both home and host countries to avoid potential harm caused by institutional intervention. They can also lobby their home country government to build closer international political relations with host countries, which can be beneficial.

This paper is organized as follows. Section 2 discusses the literature background. Section 3 introduces our research design and is followed by case evidence in Section 4. Section 5 discusses case findings, derives propositions, and presents limitations and implications.

## **2. Literature background**

This study draws on both the institution-based view and global political economy theory to explore how individual country institutions and inter-state relations affect the post-entry expansion of EE firms. Defined as the ‘rules of the game in a society’ (North 1990, 3), the idea that ‘institutions matter’ is hardly debatable, though ‘how institutions matter’ is of more interest and is still under-explored (Peng, Wang and Jiang 2008). It is widely recognized that MNEs are influenced by institutions in both home and host countries (Goldszmidt, Brito and Vasconcelos 2009). On the one hand, firms are subject to regulations set by their home country on outward FDI, and on the other hand they have to act under the regulatory restrictions on inward FDI of the host countries.

While prior research has examined the impact of home and host country institutions on internationalisation (Guler and Guillén 2010; Li and Ding, 2013; McGahan and Victor 2010; Pangarkar and Lim 2003; Schwens and Kabst 2011; Wan and Hoskisson 2003) and has found that contextual factors play an important role in overseas expansion, this line of research has largely focused on institutions within the boundary of individual countries (Kostova, Roth and Dacin 2008). Several researches have extended this line of research by exploring the role of institutional distance between home and host countries in order to provide a more holistic view (e.g. Gaur and Lu 2007; Berry, Guillen and Zhou, 2010). However, the concept of institutional distance only captures the differences between home and host country institutions without taking account of the impact of political relations between host and home countries. This suggests that the institution-based view in isolation is inadequate to pinpoint the role of contextual factors in the international expansion of EE firms (Kostova et al. 2008).

In order to fill this gap, we adopt global political economy as an additional lens to examine the role of political relations between home and host countries in the international expansion of EE firms. Traditionally, political economy is an interdisciplinary field studying how political institutions, the political environment and the economy influence each other (Drazen, 2000; Persson and Tabellini 2000). Political economists have long recognized the complex and dynamic inter-relationship between governments and businesses, where governments create legislation to regulate the behaviour of businesses while businesses attempt to shape governmental policies for their own interests (Henisz 2000; Kofele-Kale 1992; Rugman and Verbeke 1998). However, this perspective mainly focuses on the impact of governments within national boundaries and overlooks the inter-connections between nations. As the current world economy becomes more closely integrated than in any previous era, the global political economy has emerged as a new field drawing on both political economy and international relations literature to cross national boundaries (O'Brient and Williams 2010).

### ***2.1. The role of the home country government***

While prior research on MNEs from developed countries has mainly focused on institutions in MNEs' host countries (Globerman and Shapiro 2003; Pangarkar and Lim 2003) with a few exceptions (Wan and Hoskisson 2003), the emergence of EE MNEs has attracted research interest into the role of the institutional characteristics of the MNEs' home countries (McGahan and Victor 2010; Luo and Tung 2007; Witt and Lewin 2007; Lu, et al., 2014). Government intervention represents an important factor affecting the economic behaviour of EE firms. In particular, the home country governments of EEs play a more active role in the internationalisation strategies of EE firms than those of developed countries (Luo, Xue and Han 2010). For example, China is in the process of transition from a centrally planned economy to a

market economy and the government has great power to influence firm strategies through regulations, policies and even direct state intervention. Since the implementation of the 'Go Global' strategy, the Chinese government has established a set of guidelines to promote outward FDI by simplifying administrative procedures, easing capital control, informing firms about investment opportunities, and reducing political and investment risks (Buckley *et al.* 2008). As latecomers, Chinese firms which lack international experience have an increased resource dependence on home country government support when venturing abroad (Cui and Jiang, 2012; Lu *et al.*, 2014). However, limited studies have examined how government support and intervention affect EE firms' post-entry market expansion.

In addition to government direct involvement, institutions within EEs are undergoing rapid changes and these can represent challenges for domestic firms. Previous studies have found that EE firms have to deal with changing institutions, which can influence their performance both directly and indirectly (Holburn and Zelner 2010; Luo 2003). Originating in the context of under-developed and changing institutions in their home country, firms from EEs may have developed the capability of dealing with such institutional changes. Moreover, the capabilities developed from their home country experience can be exploited by these firms when entering a new market (McGahan and Victor 2010; Morck, Yeung and Zhao 2008). For example, Holburn and Zelner (2010) found that firms from home countries characterized by weaker institutional constraints on policymakers have higher organisational capability for managing political risk and are less sensitive to such risks in a host country. In the Chinese context, while supportive institutions provide resources needed for overseas success, burdensome government intervention also provides Chinese SOEs with a training ground for dealing with similar institutions in host countries, especially in other emerging and developing countries (Morck, Yeung and Zhao 2008).



## ***2.2 Host country institutions***

The institutions created by the host country government and its agencies for foreign investments play an essential role in the success of MNEs (Pangarkar and Lim 2003). Host country institutions affect MNEs' ability to access resources, as well as the overall risk of operations in the host country (Schwens and Kabst 2011). Specifically, well-established institutions help firms to reduce information and search costs associated with accessing critical resources for foreign operations, and facilitate knowledge acquisition (Uhlenbruck *et al.* 2006). Effective market institutions in host countries make interactions between foreign and local firms predictable in product and factor markets, which help lower transaction costs and encourage sustained investment by foreign firms operating in host countries (Menard and Shirley 2008).

Host country institutions associated with inward FDI represent the 'rules of the game' in the local market for all foreign firms, including financial and legal regulations. The host country government can build its country's location advantages by improving its institutions in order to attract foreign firms who are looking to prosper in the local market (Guler and Guillén 2010). Well-established host country institutions help reduce the regulatory ambiguity associated with investment projects and so increase perceived business familiarity in host countries. This increased perceived business familiarity encourages firms to further expand. Researchers have found that changes in FDI policy influence MNE investment strategies, which affects investment outcomes (Peng 2002, 2003). Child, Chung and Davies (2003, 243) argue that '*firms operating under more favourable external circumstances have a better chance of prospering*'. Guler and Guillén (2010) found that host country institutions determine the attractiveness of that country for foreign firms and have a large impact on entry into new markets by foreign firms. Hence,

government policies and institutional arrangements have important implications for MNEs' internationalisation outcomes (Chung and Beamish 2005; Gaur and Lu 2007; Pangarkar and Lim 2003).

### ***2.3. Political relations and SOEs***

According to the global political economy perspective, the impact of one government's policy is no longer limited by its national border because it can trigger a series of reactions from other countries which will consequently influence MNEs operating in those countries (Ravenhill, 2008). As a result of the political relations between national states, the interaction between government and business has become ever more complex and dynamic in a global context as businesses have to deal not only with institutions in the host countries in which they are operating, but also with political environments shaped by the international political relations between the home and host countries (O'Brien and Williams 2010; Ravenhill 2008).

This perspective is particularly relevant to the internationalisation of SOEs, given that SOEs are not only business enterprises but also often perceived as manifestations of national interests. State ownership of a firm naturally indicates political affiliation with its home country government (Cui and Jiang 2012). SOEs are unavoidably carrying more political identities than private firms and can be perceived by host countries not simply as business entities, but also as political actors (Globerman and Shapiro 2009; Zhang, Zhou and Ebbers 2011). Hence, the international expansion of SOEs may be viewed as politically motivated by some host countries (Cui and Jiang 2012; Lin 2010). Cui and Jiang (2012) argue that the image of the state power of China carried by Chinese SOEs creates difficulties for them when seeking to attain host country legitimacy. However, there is an implicit assumption in this argument which is that the image of

China carries a negative perception in the host country. This is not always the case in all the host countries in which Chinese SOEs operate, especially in some emerging and developing countries where the Chinese government has established close political relations and has provided foreign aid. This potentially positive image created by close political relations between home and host countries may represent an advantage for SOEs in emerging and developing host countries. In this regard, SOEs' market expansion in a host country is not only affected by home government support and host country institutions, but also inter-state relations due to their quasi-political status. SOEs are therefore more sensitive to and more likely to be affected by the international political relations between their home and host countries. As such, international political relations can influence the institutional response of host countries towards SOEs (Luo, Xue and Han 2010), which in turn can impact on SOEs' further market expansion in host countries.

### **3. Research design**

In our research we employed a multiple case-study method. Our intention was to establish a clearer understanding of the role of the home country government (i.e. China in this case) and host country institutions, as well as the political relations between home and host countries in the post-entry market expansion of Chinese SOEs. We used this method because multiple cases can serve as discrete experiments and enable the researcher to make replications, contrasts and extensions to the emerging theory (Yin 2003).

As suggested by Yin (2003) and Silverman (2010), we chose cases where the length and scale of internationalisation should be sufficient for us to explore the internationalisation outcomes and post-entry overseas activities. However, we allowed for heterogeneity of outward

FDI in terms of host countries, business markets and operational modes, in order to compare and contrast case evidence.

The study included evidence from five Chinese SOEs (Table 1): the first is a white goods manufacturing company with overseas manufacturing plants in Europe, North America, Asia, Oceania and Africa; the second is a leading telecommunications company with overseas subsidiaries in Asia, Europe and America; the third is a trade company with 14 overseas subsidiaries, one trade center, and eight overseas representative offices in Asia, Latin America and Africa; the fourth is a construction company with 11 overseas subsidiaries in Asia, Africa and Europe; the fifth is a telecommunications company with six subsidiaries in Asia, North America and Europe. Table 2 further illustrates the expansion strategies adopted by the five SOEs in both emerging and developing countries, and developed countries.

**INSERT TABLE 1 & 2 HERE**

We used two criteria to identify appropriate respondents: a) they must be knowledgeable about the firm and its competitive environment, and b) they must be familiar with international strategies and international operations. Hence, directors of international business departments at headquarters were considered to be the most appropriate respondents. Table 2 provides the list of managers interviewed for this study.

**INSERT TABLE 3 HERE**

Semi-structured interviews were conducted in this study in order to encourage respondents to give their opinions on how institutions and international political relations influence post-entry market expansion. Two rounds of interviews were conducted in 2008 and 2009, respectively. This longitudinal approach enabled us to understand the impact of changing external environments on SOEs' overseas market expansion. In total, we conducted 14 interviews, each

of which lasted approximately two hours. All interviews were transcribed, coded and analysed using Atlas software. We further sought information from annual reports and media coverage on the case companies' overseas operations to enrich and triangulate our data collection. The key themes that we focused on during the analysis of our data included the role of the home country government (i.e. China) and host country institutions, as well as the political relations between the home and host countries and the effect of this relationship on the market expansion of Chinese SOEs.

We conducted within-case and cross-case analysis focusing on examining how host country institutions and the home country government involvement, as well as the political relations, impact the post-entry market expansion of SOEs (Miles and Huberman 1994). The within-case analysis provided a preliminary understanding of the role of these factors in any subsequent market expansion of SOEs in host countries. Building on this, we conducted cross-case analyses to compare and contrast the similarities and differences across cases. Such analyses enabled us to identify common features or patterns that emerged across cases, and this helped strengthen internal validity (Yin 2003).

Figure 1 provides an overview of our data structure. We adopted a three-step process to analyse the data (Gioia et al. 2013). In the first-order analysis, we identified 11 codes using the interviewees' own terms. In the second-order analysis, we identified five theoretical themes. In the third-order analysis, we classified these categories into the three key themes which have a profound impact on Chinese SOEs' overseas expansion.

**Insert Figure 1 near Here**

## 4. Findings

### 4.1. Home country government involvement

The case evidence reveals that home country government involvement plays a role in both helping and hindering Chinese SOEs' post-entry market expansion. The international expansion of these SOEs is financially and politically supported by the Chinese government.

*“The central government provided some valuable information and resources for our market expansion, such as the Analysis of Investment Risks by Country report published in 2008. This kind of support is important for us as we have limited experience in terms of overseas market expansion.”*

----Firm E

All our interviewees stated that when investing abroad Chinese SOEs were financially supported by preferential loans offered by the central policy bank, the Export-Import Bank of China (EIBC). Cheap financial capital enlarges the resource pool, which can be used to support overseas subsidiaries. The Chinese government and its agencies also provide information about potential host countries through local embassies, and publish guidelines on overseas investments. Such support from the home country government, to a large extent, helps mitigate the challenges of Chinese SOEs in host markets and enables SOEs to gain local knowledge without involving experiential learning.

Furthermore, SOEs are the preferred contractors for foreign aid projects funded by the Chinese government. In fact, some SOEs enter foreign markets as the contractors of such aid projects. They subsequently expand into those markets, mostly in developing countries, by both exploring business opportunities and fulfilling foreign aid contracts funded by the Chinese government. Very often, the label 'foreign aider' helps SOEs to build a good reputation in the

local market and this local acceptance in turn enables SOEs to explore more business opportunities.

*“However, the government can also cause us many problems because the government and its agencies can interfere with our decision-making which really slows down our response to potential expansion opportunities.”*

----*Firm E*

The business activities of SOEs are under surveillance by government officials, which often results in a high level of bureaucracy and inefficiency, hindering SOEs’ overseas market expansion. Firm D provided an interesting example illustrating the effect of government intervention. The central government set a standard allowance for overseas travel expenses in the 1980s which expatriates cannot survive on in the 21<sup>st</sup> century. SOE officials who travelled abroad had to fill in the standardised expenses claim form upon return and much time and energy was diverted to fulfilling this requirement. In 2003, Firm D had to go through a lengthy bureaucratic process to obtain the institutional approval to reset the allowance in order to bring it up-to-date.

In addition, the home country government, or its agencies, have a profound influence on SOE managers’ mindset. The State Asset Supervision and Administration Commission (SASAC) has explicit requirements for the performance of SOEs’ overseas investments, especially after the financial crisis. The SASAC is now paying more attention to the financial performance of overseas investments. Since the financial crisis, the SASAC has cautioned all SOEs about international investment and required the management team to take full responsibility for any international investment loss.

*“The political and career future of SOE managers is directly related to the performance of the firm. Managers tend to consider whether they can meet the finance targets, which are focused on now rather than growth in the future. This kind of mindset may discourage them from taking risks by seeking further market expansion”*

*----Firm B*

*“Managers are extremely cautious and pay great attention to financial performance in the short term rather than in the long term. Therefore, we focus mainly on generating positive cash flows from existing contracts rather than investing further in market expansion which would be more beneficial to the long term development of the subsidiaries.”*

*----Firm C*

Because the future career of managers is based on evaluation by the SASAC, the emphasis on finance performance by the SASAC has encouraged managers to focus on short-term returns on capital rather than on the long-term development of overseas subsidiaries. Managers focus their managerial attention on generating a positive cash flow because they may put their jobs at risk if they cannot improve the financial performance of subsidiaries within a short time frame. The emphasis on financial performance overshadows the importance of activities increasing future enterprise value, such as market expansion. This shift in managerial mindset leads to cut-backs in investment in further market expansion.



## ***4.2. Host country institutions***

### *4.2.1. Emerging and developing countries*

Chinese SOEs with relatively little international experience are in a comparatively vulnerable position in host countries when they face challenges associated with the ambiguity and unfamiliarity of overseas institutions in other emerging and developing countries.

*“In Africa, without host country government support, projects with an investment of over \$10 million are unlikely to succeed. Hence, gaining host country government support is the most crucial condition for our post-entry expansion in African countries. Actually, this aspect is quite similar to how we operate in China”*

*----Firm D*

In order to counter balance the negative effect of such ambiguous and unfamiliar institutions, SOEs pay particular attention to the host country's policies and try to build a close connection with local governments to gain institutional support. SOEs that have been beneficiaries of close relationships with governments at home, understand the importance of governmental support when regulations are ambiguous and institutions are unpredictable. For example, Firm D often invites the local government to become shareholders, even if the firm itself already has adequate financial resources. By doing so, Firm D can relatively easily obtain local government support or approval when proposing further expansion. SOEs often engage with local governments or government agencies in order to become local SOEs. In turn, local governments provide the protection and favourable treatment that SOEs enjoy in their home country. With the support and protection from local governments, SOEs can much more easily navigate in the local market, explore potential opportunities and expand their investments.

However, although Chinese SOEs can mitigate the risks caused by unfamiliar and unstable host country institutions through collaborating with local governments, in some cases SOEs are very cautious about taking on further business opportunities in these countries in addition to foreign aid projects assigned by the Chinese government. This is mainly because of unstable political environments; for example, the governmental policy towards foreign investments may take a U-turn when there is a change of regime. This is particularly true in emerging and developing countries where complex institutions are accompanied by political instability.

*“In some African countries, the political environment is not stable. The government’s regulations can change overnight. This poses a serious risk and creates great uncertainty to our investment so we are very cautious about market expansion in these countries.”*

----Firm C

Unstable and unpredictable institutions increase the difficulty and uncertainty of expanding SOEs’ market positions in host countries, and reduced their willingness to commit to further expansion in these countries.

#### *4.2.2. Developed countries*

Developed countries generally have well-established and detailed regulations and legal systems, thus drawing boundaries within which firms operate. The Chinese SOEs that enter these countries face the challenge of collecting information on relevant regulations and understanding such regulations. They have to invest a huge amount of time and resources in order to acquire knowledge about local regulations and rules.

*“We realised later that there was a rule for everything. We didn’t expect them (subsidiaries) to make any profit for a couple of years despite of the heavy investment. Their*

*responsibilities were to gather information and gain knowledge about the host country in order to build a solid foundation for later expansion.”*

*----Firm A*

Our interviewees realise that in developed countries regulations are rigorously enforced by governments and their agencies, which provides a level playing field for all firms competing in the market. In such circumstances SOEs have to change any perception about gaining special treatment and legitimacy by manipulating regulations and building special relationships with local governments.

*“At home, we are the ‘big brother’ in the industry. We are different from anyone else. But in America, we are the same as everybody else. We change our position from rule-makers to followers. Sometimes, this is difficult to swallow. What I mean is that we can’t, or it’s impossible to find ways, to manipulate policy or regulations here through which we can gain advantages or opportunities in further market expansion as we often do at home.”*

*----Firm E*

Chinese SOEs have always enjoyed a superior position in the domestic market. The special bond between SOEs and the Chinese government enables SOEs to gain various privileges in the Chinese market. They not only receive special support and preferential treatment from the government but are also involved in the legislative process and have the ability to influence rules. In many cases, they are able to change rules in their favor. However, when they enter developed countries where there are well-established institutions and properly-enforced legal systems, Chinese SOEs find that they need to operate under a set of rules which they are most likely unfamiliar with and which are enforced rigorously in the local market. These SOEs no longer have the lobbying power to change rules, and discard those that may cause obstacles. Therefore,

at the early stage of SOEs' investment, they often face difficulties when they try to manipulate rules in ways that they have been doing at home. It takes SOEs a long time to understand local institutions and learn to play by the rules, which slows down their expansion in these countries. Therefore, at an early stage of investment, subsidiaries in developed countries tend to expand very slowly, if at all.

However, although regulations and laws on foreign investment or foreign firms in developed countries are very detailed and complex, they are consistent and mostly independent of governmental changes, thus reducing uncertainty related to political risk which SOEs need to confront in many emerging and developing countries. Therefore, once SOEs have passed the early learning stage in developed countries, and understand the rules and regulations, they can carry out their market expansion whenever business opportunities arise in host countries.

#### ***4.3. Political relations between the home and host countries***

In addition to the institutions of a host country, the political relations between the host country government and the Chinese government also affect SOEs' expansion. This is particularly important in emerging and developing countries where market-based mechanisms are still under-developed, and governments more frequently intervene in foreign investments than in developed countries. Although the complexity of a host country's institutions can cause serious problems for SOEs' overseas investments, especially in emerging and developing countries, a close long-term political relationship between China and the host country can reduce the uncertainty associated with ambiguous regulations.

*“We found that, by and large, political relations affect economic relations when we operate in foreign countries. For example, China offers foreign aid to many African countries with whom it has good political relations. Subsequently, as foreign aid contractors we receive*

*preferential treatment from local governments. Our senior management team realised we need to learn more about the political relations between China and host countries, and understand the implications of such relationships for our overseas expansion.”*

*----Firm A*

*“In such countries, we receive favourable treatment from the local government and local people. When we run into bureaucratic difficulties, we can even ask the Chinese Embassy to negotiate with the local government since the host country government is more likely to listen to the opinions of the Chinese government. We feel more comfortable and confident about expanding our business in these countries.”*

*----Firm E*

In particular, the interviewees felt that SOEs were carrying the identity of the Chinese government. A close and friendly political relationship between China and host countries helps SOEs to avoid the hostile attitude of local people and the damaging intervention of host governments. This creates a more favourable investment environment that can lead to more opportunities for SOEs to further expand in the local market.

Compared with the favourable treatment from host governments in emerging and developing countries, thanks to the close political relations between China and the host countries, SOEs face more challenges in developed countries, which often have more tense political relations with China.

*“These countries have much lower tolerance and acceptance of us than those with whom China has better political relations. We are not seen as an independent enterprise but part of the Chinese government which could pose a security threat to them (host countries). Therefore, we*

*cannot get into the B2C market. We can only do B2B, and the businesses we serve are limited to other Chinese companies investing in these countries.”*

*---Firm E*

In these countries, not only do SOEs lose their lobbying power because of the rigorous legal system, but they also face significantly higher hurdles due to ideological differences, especially in sensitive industries related to national security, such as infrastructure. Both Firm B and Firm E mentioned their concerns about the negative perception held by some host country governments and the further scrutiny needed to approve their expansion because of their political identity.

## **5. Discussion**

Our findings reveal that both home country government involvement and host country institutions have a profound and complex impact on SOEs' market expansion in host countries, and in addition the political relations between home and host countries influence the market expansion of SOEs. Their political identity represents both advantages and disadvantages when they operate and seek further expansion overseas thanks to the different political relations between China and host countries. In this section, we will start with our propositions derived from the case evidence followed by discussing of each proposition.

### **5.1. Propositions**

#### *5.1.1. The role of home country government*

*Proposition 1:* Home country government support in terms of finance and information can help to mitigate the challenges and compensate for the lack of international experience by SOEs in host countries, but excessive state intervention with business

operations leads to low efficiency and low commitment by SOEs to further market expansion.

It is well documented that SOEs' strategies and strategic outcomes are largely shaped by government policies and direct intervention of the state (Lin and Germain 2003; Wei, 2007), and there is a special relationship between Chinese SOEs and the government. SOEs are supported by the government and often enjoy favourable treatment from the government, which is not available to private companies. This preferential treatment also applies to SOEs' internationalisation. For example, Chinese SOEs are financially supported by preferential loans offered by the central policy bank, EIBC, when investing abroad. The Chinese government also provides information about potential host countries through local embassies, and it publishes guidelines on overseas investments. This support helps mitigate the disadvantages of Chinese SOEs being late comers in host markets. Moreover, Chinese SOEs are often the preferred contractors of Chinese foreign aid projects in developing countries. This liaison provides Chinese SOEs with opportunities to explore the host markets, to generate stable cash flows and to prepare for further market expansion. This finding is consistent with previous studies showing that the Chinese government plays a vital role in the internationalisation process of SOEs and overseas success (Lu, Liu and Wang 2011; Luo, Xue and Han 2010).

However, our findings further extend previous studies by revealing the complex role played by the Chinese government. While SOEs enjoy the privilege of access to valuable resources and information coming from the home country government, they are also subjected to the supervision and restraint of the Chinese government. Therefore, compared to private firms, Chinese SOEs have to deal with more bureaucratic interference, as the government and its agencies often exert their power to intervene in SOEs' overseas investment projects (Chen, 2008).

In particular, the Chinese government and the SASAC have added involvement in the daily operations of Chinese SOEs, rather than just setting the institutional environment. Many operational regulations set by the government are still in operation after SOEs become independent enterprises. These regulations, set a few decades ago, are out-of-date and incompatible with the modern business world. Many Chinese SOEs suffer from low efficiency caused by the constraints of these regulations as they are not able to independently exploit their existing resources for further market expansion.

Furthermore, the SASAC set expectations for the international performance of Chinese SOEs. After the financial crisis and the following economic downturn, the SASAC cautioned SOEs against any financial loss of international investments. SOEs are now focusing more on generating positive cash flows from existing projects and cutting back on investment towards future development and expansion as SOE managers try to meet the financial requirements set by the SASAC in order to protect their own careers. This has led to a reduced incentive for SOEs to commit more investment in further market expansion.

#### *5.1.2. The role of institutions in host countries*

*Proposition 2a:* In emerging and developing countries, SOEs can draw upon their past experience of operating in their home country with under-developed institutions to lobby local governments for further market expansion. However, instability and uncertainties associated with institutional changes slow SOEs' further market expansion.

*Proposition 2b:* In developed countries, SOEs face mindset challenges rather than operational challenges due to a lack of experience in dealing with such institutions. However, once they understand local institutions and adapt their behaviour accordingly, then further market expansion can speed up.



When investing in foreign countries, Chinese SOEs are subject to a series of unfamiliar legal, financial and industrial regulations which may be markedly different from those of their home country and which represent the ‘rules of the game’ in the local market for all foreign firms. Besides the tangible policies and regulations set by the host country government and its agencies, SOEs also need to deal with the intangible underlying rules of the local markets, such as local customs, culture and corruption, especially in some emerging and developing countries where the institutions are underdeveloped or unstable (Schwens and Kabst 2011; Wright *et al.* 2005). A lack of familiarity with the unwritten rules in host countries causes many difficulties for Chinese SOEs’ subsidiaries, especially when they are newcomers in a host country. Therefore, Chinese SOEs have to prepare to operate with different institutions and be willing to invest extra resources to gather the information necessary for local institutional adaptation. This experiential learning process can slow down the local market expansion of SOEs.

It is evident that there is a fundamental difference between developed countries and emerging and developing countries in terms of how the dissimilarity in institutional settings influences SOEs’ market expansion. Chinese SOEs are often able to settle more quickly into the institutional environments of emerging and developing host countries at the early stages of investment. They can draw upon their accumulated experiences of dealing with complex and under-developed institutions in order to gain their foothold in local markets. This confirms the assertion proposed by previous research that experience in dealing with ambiguous institutions at home can be exploited when entering a new market (Holburn and Zelner 2010; Morck, Yeung and Zhao 2008). However, SOEs also have to prepare themselves for the instability of local institutions in these countries. This type of risk is caused by unfavourable changes in the government of a host country, or in the policies issued by this regime, and thus is uncontrollable

by individual firms (Cuypers and Martin 2010). It poses a serious threat to Chinese SOEs' overseas investments and reduces their willingness to commit to further market expansion. Therefore, although Chinese SOEs can draw on their previous experience in dealing with complex and ambiguous institutions back in China, the instability of local institutions eventually leads to slow market expansion in emerging and developing host countries.

Institutional differences between China and developed countries with well-established and market-based institutions have been recognized as one of the proposed motives driving Chinese outward FDI (Luo and Tung 2007; Witt and Lewin 2007). However, such differences pose serious challenges to the post-entry market expansion of SOEs. In addition to the extra resources and time invested in gaining familiarity, SOEs have to accept the reality that there is a level playing field in the market and they cannot expect that they will get the favourable treatment that they receive at home. This requires SOEs to play by the rules, which not only brings the benefit of market-based institutions but also creates difficulties and inconvenience due to strict regulations. Case evidence shows that in developed host countries Chinese SOEs need to learn how to conduct market-oriented exchanges by following the rules of the game. This requires managers to change their managerial mindsets. They cannot transfer home country practices into these host countries. Instead they need to develop market-based capabilities. In other words, Chinese SOEs have to invest resources to adapt to the institutional environment in developed host countries. Although the new institutional settings in developed host countries can cause discomfort and delays to the subsequent market expansion of SOEs, it can be overcome by experiential learning. Once SOEs understand local institutions, they generally find it straightforward to expand in the local market as there are clear rules to follow.

### *5.1.3. The role of political relations between home and host countries*

*Proposition 3a:* A close political relation between a host country and home country helps to mitigate the impact of uncertainty and the risks associated with complex host country institutions on SOEs' further market expansion.

*Proposition 3b:* Political tensions and ideological differences between a host country and home country represent additional barriers to SOEs' further market expansion in developed host countries.

According to the global political economy perspective, political relations between two countries have a great impact on the economic partnership between the two countries in general, and MNEs in particular. Many emerging and developing countries have received foreign aid from the Chinese government because of their political relations with China, and SOEs are often the contractors who carry out these foreign aid projects. The political identity of Chinese SOEs can earn them favourable treatment from host country governments. This positive attitude towards China and Chinese SOEs can often compensate for the uncertainties and risks caused by unstable and unfamiliar local institutions, because a friendly bilateral relation and a positive attitude by local governments towards Chinese SOEs often leads to preferential treatment. Such a close relation between the Chinese government and host country government helps to reduce the uncertainty and operational risks associated with under-developed institutions in these countries (Luo, Xue and Han 2010; UNCTAD 2007). This is particularly the case when Chinese SOEs run into the hurdle of local bureaucracy and institutional barriers. In such cases, SOEs can turn to the Chinese government for help and request the home government to put political pressure on the host country government in order to achieve economic objectives. This finding is in line with previous studies which find that bilateral treaties improve the development of trust among

countries which in turn helps MNEs resolve disputes and contributes to their further expansion in host countries (Desbordes and Vicard 2009; Rangan and Sengul 2009).

The findings further reveal that in some developed countries SOEs face discrimination in national security-related industries due to ideological differences between their home and the host country government. Because of their association with the Chinese government, some host country governments are concerned about the potential political motivation behind SOEs' investment, and therefore reluctant to award SOEs equal economic status as with other private firms. This contradicts existing studies which show that foreign firms are likely to be granted national treatment in a developed host country (Moeller *et al.* 2013). This may be because the existing literature focused only on institutions within the boundary of individual countries, and ignored the impact of political relations between host and home countries on firms operating in a host country. By drawing on the global political economy perspective, our findings broaden the impact of local institutions beyond the boundary of a host country. It is shown that the perception of MNEs by host country governments is influenced not only by the relationship between MNEs and their home country, but also by the political relations between the home and host countries.

## ***5.2. Contributions***

The main theoretical contributions of this study are threefold. First, we draw on both the institution-based view and the global political economy perspective to explore the impact of institutions and political relations on the post-entry market expansion of Chinese SOEs. Prior research based on the institution-based view mainly focused on the influence of institutions within the boundary of individual countries. However, as globalization intensifies, MNEs are not only affected by the institutional environment of both home and host countries, but also the political relations between host countries and home country. The political relations can either

hinder firms' further market expansion or firms can exploit such relations to gain favourable institutional support in host countries. Therefore, the global political economy perspective is an important complement to the institution-based view when studying the international market expansion of SOEs. Incorporating this perspective into the institution-based view enables us to broaden the impact of institutional environments of both host and home countries in the context of political relations between countries.

Second, by incorporating the global political dimension to the institution-based view, this study sheds new light on how institutions matter. Specifically, this study moves away from investigating the institutional motivation of Chinese FDI (e.g. Cui and Jiang, 2012; Deng, 2009), and enriches our understanding of how contextual factors at macro level, including home country government and institutions of different types in host countries, influence the post-entry market expansion of SOEs. Home-country government involvement has much more complex effects on Chinese SOEs' expansion in the international market than simply providing support and our study moves beyond prior studies on the supportive role of home country government. Through the global political economy dimension, we have found that home country government acts as a double-edged sword which can both support and hinder SOEs' market expansion in a host country through direct intervention and political relations with the host country. Thus, our study adds a new dimension regarding the impact of home country governments on outward FDI from EEs.

Finally, our study goes beyond existing research which tended to treat host countries as a homogenous group in terms of their reaction to SOEs, or did not differentiate the responses of different types of host countries to SOEs, and assumed that all host countries responded to SOEs in the same way (Cui and Jiang 2012). Our findings show that the institutions of emerging and

developing and developed host countries have different influences on the market expansion of Chinese SOEs. Such an impact is also channeled through political relations between a host country and the Chinese government. This aspect has been largely neglected. Hence, we make an important contribution to the existing literature and call for more studies to further delineate the impact of institutions of emerging and developing and developed host countries by taking account of the complex interface between institutions and political relations.

### ***5.3 Limitations and future studies***

We acknowledge the limitations of this study and that further research is required. This study attempts to take the first step to explore the effect of political relations on EE firms' post-entry expansion by using case studies. Future studies could extend this line of research by gathering a wider source of data and empirically testing the findings of this study. Furthermore, this study focuses on the political relations between host and home country only, but does not take account of the impact of economic relations. An important avenue for future research, therefore, can be the exploration of the influence of both political and economic relations between home and host countries on market expansion. We have explored how the home country government and host country institutions, as well as political relations, affect market expansion of SOEs. Future studies should examine how these factors affect the financial performance of EE firms. In particular, it would be interesting to expand the impact of institutions of the home country beyond government involvement.

### ***5.4. Implications***

The findings of this study are particularly relevant to SOE managers. SOE managers from China or other similar institutional environments need to be aware of the different impact of institutions in developed and developing host countries. In emerging and developing countries,

under-developed institutions represent greater challenges and can be serious barriers to the further expansion of SOEs. In such countries, SOEs need to build a close relationship with the host country government and draw on the relations between Chinese and host country governments in order to reduce risks caused by unstable institutions. In developed countries, initially, SOE managers need to change their managerial mindsets and develop market-based capabilities in order to adapt to host country institutions and behave accordingly. Once managers pass this learning stage they will be able to concentrate on market expansion rather than being so concerned about institutional stability.

Furthermore, managers of MNEs need to pay attention to not only the institutions of both host and home country but also the political relations between the two countries. This is because the perception of MNEs in a host country is influenced by the political relations between host and home country. Therefore, MNEs can play up their national identities in host countries having good relations with their home-country, while playing down their ties with the home government in host countries having less favourable political relations with their home-country, or avoiding investment in such countries altogether.

The findings have further implications for local firms in host countries where Chinese SOEs have overseas investments. They can take the opportunity to develop good relationships with Chinese SOEs. This relationship can create mutual benefits for both sides. Chinese SOEs can gain much needed help in understanding local institutions and settling in the local market. Local firms can exploit this relationship in the Chinese market by taking advantage of the special relationship between SOEs and the Chinese government.

The policy implications of this study are mainly twofold. First, if host country governments desire to attract Chinese OFDI and subsequent investments, they should provide more guidelines

to help Chinese firms familiarise themselves with local institutions. For emerging and developing countries in particular, stable institutions and positive bilateral relations with China can reduce the risks perceived by Chinese firms and increase their commitment to further market expansion. Second, the Chinese government should reduce its intervention in SOEs' overseas operations and give more autonomy and flexibility to the management team of SOEs in decision making. It can help SOEs' overseas market expansion by establishing positive international relations with host countries and provide better protection for SOEs in some volatile markets.



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**Table 1 Description of the Sample Cases**

Case	Industry	Founded	State Ownership	Internationalisation <sup>1</sup>	Entry/Operation Modes	No. of Overseas Subsidiary	Registered Asset (RMB million)
A	Manufacturing	1969	100%	1996	Greenfield; JV; M&A	14	60
B	Telecommunication	2000 <sup>2</sup>	100%	2000	Greenfield	5	22,040
C	Trade	1959	100%	1994	Greenfield; JV; M&A	23	101.4
D	Construction	1950	100%	1995	Greenfield; JV	11	31.7
E	Telecommunication	2000 <sup>2</sup>	100%	2000	Greenfield; JV; M&A	6	30,000

Note: <sup>1</sup> The year when the first overseas subsidiary was set up. <sup>2</sup> The year when the two enterprises were separated from the former.

Ministry of Post and Telecommunication.



**Table 2 Current overseas expansion strategies of the Sample Cases**

	Emerging and developing countries	Developed countries
Firm A	Gradually set up manufacturing plants according to local institutional environment, resource availability and labour skills.	Set up research centre and manufacturing plants to serve local needs and raise market share.
Firm B	Set up local representative office to seek collaboration possibilities with local partners.	Serve expatriate customers and gather information to prepare for future expansion.
Firm C	Invest in countries with good relations with China and great market growth potential.	At information collection stage.
Firm D	Serve as foreign aid contractor for Chinese government to enter foreign markets and explore further business opportunities to expand in local markets.	Develop internal management capabilities to better manage further expansion.
Firm E	Choose countries with long-term good relations with China as expansion targets.	Set up research centre and representative office to collect more information for future expansion.

**Table 3 Description of Interviewees**

Case	Respondent Position
A	Interviewee A: Director of Strategy Development Department
B	Interviewee B: Director of International Business Department
C	<ul style="list-style-type: none"><li>• Interviewee C1: Uganda Subsidiary CEO (former director of International Department)</li><li>• Interviewee C2: Director of International Department (first round only)</li><li>• Interviewee C3: Executive manager of International Department (first round only)</li></ul>
D	Interviewee D: Director of International Department
E	<ul style="list-style-type: none"><li>• Interviewee E1: Director of International Department</li><li>• Interviewee E2: Vice-director of International Department</li></ul>

**Figure 1: Overview of data structure**



