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The Internationalization of Chinese Firms: A Case for Theoretical Extension?[1]

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ABSTRACT This paper examines the patterns of, and motives for, internationalization by prominent market-seeking Chinese firms. Case studies of these firms indicate that they are seeking technological and brand assets to create a competitive position in international markets. While mainstream theory tends to assume that firms internationalize to exploit competitive advantages, Chinese firms are generally making such investments in order to address competitive disadvantages. They are engaging in 'inward' internationalization by means of original equipment manufacture (OEM) and joint venture partnerships, and 'outward' internationalization by means of acquisition and organic expansion abroad. Each of these routes offers certain benefits coupled with its own challenges or risks. The paper concludes that the Chinese case offers an opportunity to extend present theorizing in four primary areas concerning the latecomer perspective and catch-up strategies, institutional analysis with reference to the role of government, the relations between entrepreneurs and institutions, and the liability of foreignness.

INTRODUCTION

Considerable attention to date has been paid to China as a host country for internationally expanding investing firms (e.g., Huang, 2003).[2] This is understandable in the light of the fact that China has absorbed huge amounts of inward foreign direct investment (FDI), and is today the world's largest recipient of such investment (UNCTAD, 2004). In addition, China's export performance has attracted much comment, not least in the light of its large trade imbalance with the United States and the growing concentration of world manufacturing in Chinese plants. With exports reaching a record US$342.3 billion in the first half of 2005, China has become the world's third largest exporter after Germany and the United States (Finfacts, 2005; Williams, 2005). These are two very significant indications of China's growing integration into the global economy. A third trend has, however, received rather less attention. This is the expansion of outward foreign direct investment (FDI) which has grown rapidly to the point where China has become the world's fifth largest outward direct foreign investor with a total of US$37 billion by the end of 2004 (Ministry of Commerce, 2005). This last development points to a growing direct involvement by Chinese firms in activities abroad.

If internationalization is defined as 'the crossing of national boundaries in the process of growth' (Buckley and Ghauri, 1999, p. ix), then China is currently the most active internationalizing economy among the developing countries. Its outward economic expansion is taking place at a number of different levels of engagement. The first level, exporting, though by far the most significant aspect of China's international business in terms of economic value, does not necessarily involve any direct investment or active organizational presence abroad. The second level takes the form of original equipment manufacture (OEM) or subcontracting production for foreign companies, and other forms of partnership with them. While much of this activity will be included within the figures for exporting, it is qualitatively different in offering more direct channels for the transfer to Chinese firms of the international standards of management and technical competence necessary for entering higher added-value markets and establishing overseas operations. The third level involves the physical and organizational expansion of Chinese firms into overseas locations funded by outward FDI. Outward investment can be used either to purchase overseas assets or to fund organic expansion outside China. This is a more advanced level of internationalization in the sense that it entails a commitment to manage and organize operations located outside China. Mainland Chinese firms had established 7470 companies in over 160 countries or regions by the beginning of 2004 (Chung, 2004).

The sheer scale of China's internationalization warrants analysis of its forms and motives. There has been relatively little so far, with Deng (2004) and Warner, Ng and Xu (2004) among the exceptions. More specifically, the question arises of whether the internationalization of Chinese firms can be explained in terms of mainstream theory derived largely from western multinational corporations, or even in terms of the analyses that have so far been offered for developing country multinationals. Previous studies into the internationalization of firms from developing countries have tended to conclude that while it takes on distinctive though varying characteristics, concepts deriving from the analysis of developed country experience can usefully be applied (Lecraw, 1993; Wells, 1983). Nevertheless, China's emerging system of capitalism has its own special institutional and cultural characteristics (Boisot and Child, 1996; Child and Tse, 2001), which raises the possibility that an examination of Chinese internationalization may indicate the need for some extension of existing theorizing.

With this in mind, the present paper examines the patterns of and motives for internationalization by prominent Chinese overseas-investing firms. It focuses on the levels of internationalization beyond exporting at which firms are managerially and organizationally engaged with foreign companies and/or environments.

It also concentrates on internationalization that is directed toward expansion into foreign markets rather than at securing supplies of raw materials. In suggesting areas where theorizing might usefully be extended, the paper compares the factors that appear to influence the international expansion of Chinese firms with those emphasized in existing theory and in previous research on firms from developing countries. In the absence of more systematic firm-level data, we shall rely upon case study evidence.

The aim of the paper is to stimulate discussion in a relatively new area of study rather than to provide definitive general conclusions. It proceeds as follows. First, relevant background is provided by briefly summarizing mainstream and alternative explanations for the internationalization of firms, as well as key points drawn from studies of developing country multinationals. Evidence on Chinese internationalizing firms is then examined. This provides a basis for identifying salient features of Chinese internationalization. The closing discussion develops the broader implications of the analysis, including areas of theoretical extension that it suggests.

THEORETICAL BACKGROUND

Mainstream and Alternative Perspectives

The mainstream perspective in international business assumes that firms will internationalize on the basis of a definable competitive *advantage* that allows them to secure enough return to cover the additional costs and risks associated with operating abroad (Buckley and Ghauri, 1999; Caves, 1971). The eclectic paradigm developed by Dunning (1981; 2001) draws together elements of previous theories to identify ownership, location and internalization (OLI) advantages that motivate internationalization. Ownership advantages are firm-specific factors such as superior proprietary resources or managerial capabilities that can be applied competitively in a foreign country (Barney, 1991). Location advantages can account for decisions to invest in foreign countries that offer superior market or production opportunities to those available elsewhere and/or opportunities to secure valued inputs. Internalization advantages accrue to firms that can reduce transaction costs by investing abroad so as to undertake transformation or supporting processes more effectively than can be achieved through market transactions (Buckley and Casson, 1976; Safarian, 2003). Internalization may offer clear efficiency advantages in the management of interdependencies concerning know-how, reputation, the value chain, and marketing, and these advantages offer a powerful explanation for the rise of the multinational enterprise (Hennert, 2001). The realization of internalization advantages depends on ownership capabilities and, in general, the latter have been accorded prominence in mainstream explanations for internationalization, especially through FDI.

This influential perspective has derived primarily from research on large western enterprises, which can be presumed to enjoy considerable domestic strengths before they internationalize. The predominant assumption in mainstream theory has been that internationalization is motivated by a firm's wish to exploit its existing ownership advantages. The conventional view therefore focuses on the overseas possibilities for asset-exploitation.

Compared to the mainstream perspective, the possibility that some firms develop international links in order to seek assets because they are entering international business to address a relative *disadvantage*, has not attracted so much attention in the literature (Wesson, 1999). Here, the notion of 'late development' offers a potentially useful contribution. The 'late development' thesis has classically been applied to nations, initially Japan (Dore, 1973), and subsequently the emergent new economies of East Asia, notably Taiwan, South Korea, Hong Kong, and Singapore. China's recent emergence as a major industrial power also qualifies it to join the same category. These countries had to 'catch up' with early developing countries in terms of technology and know-how, as well as in the development of business environments supportive of international competitiveness. The comparable notion of the 'late coming' firm draws attention to late entrants to international competition from such countries, firms that have become remarkably successful like Samsung and LG from Korea, and Acer and TSMC from Taiwan. It is significant that latecomer firms did not start from positions of strength, but rather 'from the resource-meager position of an isolated firm seeking some connection with the technological and business mainstream' (Matthews, 2002, p. 471). While such firms had some initial competitive advantages, such as low labor costs, these became less crucial as the firms moved into more sophisticated markets with higher-value products.

The significance of the latecomer perspective lies in the way it directs attention to international investment as a means of addressing competitive disadvantages. In this way, outward FDI may allow firms that are not initially competitive in the world market to close the gap that separates them from leading companies through acquiring appropriate assets and resources.

It is also noteworthy that the mainstream perspective on the internationalization of the firm focuses strongly on the firm as an actor and less on its embeddedness in its wider society. Indeed, it tends to view the subject primarily through an economic rather than a social or political lens. Developing and transition economies are typically characterized by an active governmental involvement in business, both through ownership and through regulation (Peng, 2000). This is certainly the case in China, which in the literal sense remains a political economy despite the development of a market system (Child and Tse, 2001). The consequences for the internationalization of Chinese firms could be significant. For instance, it will be seen that many of the larger Chinese firms, which have been singled out as 'national champions', receive financial support and protection from the Chinese authorities. If a late-coming disadvantaged firm is to acquire assets that enable it to compete in the world market, it may indeed require direct or indirect governmental funding to make the purchases. Thus, China may provide a good instance of the need to expand international business theory to take greater account of the political and sociological factors that operate through a country's institutions (cf. Toyne and Nigh, 1998).

At the same time, the very firms that might be expected to internationalize with the advantage of support from national governments could be weakened by the way they remain beholden to administrative approval and bear a legacy of institutional dependence. This legacy can inhibit strategic action either through promoting a conservative attitude or through more direct constraints (Lewin, Long, and Carroll, 1999). Thus there have been instances in which Chinese governmental authorities have removed leaders of state-owned enterprises who demonstrated the kind of entrepreneurial initiative on which internationalization depends (Nolan, 2001). This paradox suggests that, in order to internationalize successfully, firms coming from a heavily institutionalized environment must negotiate ways of combining the material support it may offer with a sufficient degree of strategic freedom.

Another social aspect of internationalization is suggested by the concept of 'psychic distance'. This concerns the cultural, linguistic, institutional, developmental level and other dimensions of difference between a firm's country of origin and other countries to which it may internationalize (Johanson and Vahlne, 1977; Johanson and Wiedersheim-Paul, 1975). These differences can give rise to costs associated with a need to adapt to local contexts or with problems of control over foreign affiliates. Psychic distance may therefore increase the 'liability of foreignness', which has been defined as 'the costs of doing business abroad that result in a competitive disadvantage for a multinational enterprise (MNE) subunit' (Zaheer, 1995, p. 342). China's distinctive cultural and institutional legacy, including the tendency to rely on close personal relationships in business transacting (Chen and Chen, 2004), may be expected to increase the liability of foreignness faced by its firms as they seek to internationalize. This implies that even if the lack of tangible assets such as technology and branded products can be met through their purchase abroad, a liability of foreignness may still jeopardize the effectiveness of how they are put to use. Distinctive Chinese styles of management (Chen, 2004) could thus prove a handicap for the management of overseas affiliates.

Developing Country Multinationals

The late 1970s to the mid-1980s saw a stream of research on FDI by firms based in then developing countries such as Argentina, Brazil, Hong Kong, India, Indonesia, Mexico, the Philippines, Taiwan, and Thailand (e.g., Kumar and Mcleod, 1981; Lall, 1984; Lecraw, 1977; Ting, 1985; Wells, 1983). It applied the mainstream perspective to such firms, concluding that developing country multinationals invested abroad based on firm-specific advantages in product and process technologies that suited conditions in the host countries in which they invested. They competed on price rather than product differentiation, normally utilizing smaller scale, more labor-intensive and more flexible technologies than did other multinational corporations (MNCs) (Lecraw, 1993). Some studies concluded that developing country multinationals generally suffer from significant competitive disadvantages compared to MNCs from developed countries. These disadvantages can include outdated technology, heavy reliance on expatriates caused by underdeveloped personalized management systems, and limited knowledge of overseas markets. With a few exceptions, they also suffer from a lack of internationally known brands or trade names (Wells, 1983). These conclusions are consistent with the thesis that MNCs from developing countries need to catch up if they aspire to become global players.

Studies of multinationals based in the newly industrializing countries of East Asia have pointed out considerable differences in some of their features. They contrast, for instance, in the extent to which they took on the role of 'intermediators' (such as sub-contractors) dependent on foreign companies, and the extent to which their governments initiated policies to ensure local independence from those foreign companies (Buckley and Mirza, 1988). Among the similarities noted was a tendency, especially among overseas Chinese firms, to rely heavily on ethnic and other networks in host countries for FDI for the provision of relevant information on business opportunities, assistance in dealing with local officials and the management of local labor (Brown, 1995; Lecraw, 1977; Yeung and Olds, 2000). Lecraw (1977) also found in his study of firms from developing countries investing in Thailand that networking with relatives and fellow countrymen was a very important source of knowledge regarding profit-making possibilities. Networks have become increasingly important to firms as opportunities to secure information and access knowledge under modern competitive conditions (Gulati, Nohria, and Zaheer, 2000). The cultural familiarity to Chinese business leaders of networking as a means of reducing transaction costs and exploring new opportunities might be expected to make them particularly active in fashioning wider international connections through this means (Boisot and Child, 1996).

The institutional context of developing countries, especially government and its agencies, tends to feature importantly in the context of developing country business. China, together with India and Indonesia, are larger developing countries where government involvement has been particularly significant (Dunning and Narula, 1996). Cai (1999), reviewing China's outward foreign direct investment up to the mid-1990s, notes the heavy involvement of central and local governmental authorities in encouraging and directing overseas direct investment through specialized foreign trade corporations oriented toward promoting exports and large state transnational corporations, many of which invested abroad to secure raw material supplies. Some of the state transnationals also used outward FDI as a means of acquiring foreign technology and management skills. As China's economic reform has progressed, government direction of outward FDI by firms has lessened so allowing greater scope for entrepreneurial initiative. Studying Chinese multinational firms in the early 1990s, Zhang and Van Den Bulcke (1996) concluded that the differences they found among them were to a large extent determined by the balance between these two factors: 'the influence of the governmental bureaucratic system' and the 'development of a real entrepreneurial logic'. They hypothesized that 'those enterprises which developed an early link between these two factors are likely to be more successful and competitive than those which have based their international business strategy only on the privileged position which they received from the government.' (p. 161). China therefore may well provide new insights, possibly unique to itself, regarding the relevance for firm internationalization of the interplay between government and entrepreneurship.

INTERNATIONALIZATION AMONG CHINESE FIRMS

Several scholars have traced the way that the internationalization of Chinese enterprises has evolved through a number of stages (e.g., Cai, 1999; Tseng, 1994; Warner, Ng and Xu, 2004). The earlier stages up to the 1990s were largely experimental and subject to strong state regulation. The 1990s witnessed a significantly greater spread of overseas Chinese affiliates, but problems often arose from a lack of strategic focus, from the limited scale and fragmentation of many projects, and from inexperience of coordinating overseas operations (Warner, Ng and Xu, 2004; Zhang and Van Den Bulcke, 1996). Many of these overseas affiliates lost money (Cai, 1999; Quan, 2001).

It is only recently that a number of leading Chinese firms have begun to internationalize with a view to becoming global players in international markets. They are characterized by a more focused and longer-term strategic view and appear to be developing the capacity to organize overseas operations systematically. It is on these firms that we shall concentrate. We therefore exclude the state-owned material processing enterprises that are also investing heavily abroad, particularly in developing countries, with the purpose of securing raw material supplies to power the country's consistently rapid economic growth. This latter type of firm is not going abroad with the primary intention of competing in international markets.

The Rationale for Chinese Internationalization

Nolan (2001, p. 187) has argued that 'the competitive capability of China's large firms after two decades of reform is still painfully weak in relation to the global giants'. He points to factors such as their weakness in R&D, their limited marketing capability, their lack of brand development, and the administrative constraints that government agencies continue to impose on them. While Nolan's focus is on large state-owned enterprises that have been groomed to be national champions, he also expresses skepticism about the ability of leading non-state enterprises to compete internationally with the major multinationals. Although admitting that some non-state enterprises have demonstrated considerable entrepreneurial ability, Nolan argues that their success has been fostered by a protected domestic market and by considerable state support in the form of soft loans, government procurement, and protected marketing channels.

Nolan's detailed case study evidence raises the question of whether or not Chinese enterprises can overcome the weaknesses he identifies. Nolan thinks this unlikely, but he bases that conclusion on his detailed examination of their present *domestic* circumstances. Whereas another interpretation is that the international expansion which an increasing number of Chinese enterprises are now undertaking may signify a determined attempt to escape the limitations of their domestic situation and, in order to achieve this, to remedy their main competitive weaknesses.

Thus Boisot (2004, p. 6) has argued that, in contrast to the assumptions of conventional international business theory, 'many Chinese firms will not be moving abroad to exploit a competitive advantage that was developed in the domestic market, but to avoid a number of competitive disadvantages incurred by operating exclusively in the domestic market'. He lists a range of disadvantageous domestic conditions: regional protectionism that limits the opportunities otherwise offered by a large domestic market to exploit economies of scale; limited access to capital that prevents investment in plants of optimal scale; lack of developed intellectual property rights that limits access to state-of-the-art technologies; under-provision of training and education that limits access to skilled human resources; poor local infrastructure that increases transport costs; and regional markets that are fragmented by provincial and municipal protectionism (see also Zhang, 2005). Moreover, in industries such as mobile phones, electronics and white goods, Chinese firms now face fierce competition from leading international brands. This competition together with over capacity is driving profit margins down to wafer-thin proportions (Fang, 2002). Government interference also continues in various forms and at different levels. For example, the central authorities have intervened to constrain domestic mergers and acquisitions, while fees and other transaction costs are imposed in an arbitrary and often illegal fashion by local authorities (Huang, 2003; Meyer and Lu, 2004; Nolan, 2001). Transaction costs are also raised by the continuing complexity and uncertainties in the way the Chinese legal system operates (Peerenboom, 2001).

The presence of these domestic constraints and pressures adds to the attractiveness of producing for foreign markets. In order to do this, however, Chinese firms need to build up new capabilities through investment or partnership abroad. Building up their strength abroad offers the prospect of providing needed assets much faster and also of increasing the firms' bargaining power against local stakeholders who are constantly acting to reduce their profitability (Boisot, 2004). Having developed an international presence, they would be in a stronger position to compete against multinationals in their domestic market as well.

It will be seen that the motives for the foreign investment undertaken by some of China's most dynamic firms are consistent with the view that they regard internationalization as the means to better equip themselves to gain competitive strength. It will also be noted how they benefit from government support in this aspiration. Many Chinese firms already enjoy a cost advantage due to their low wages and to the production improvements achieved in recent years, often by learning from partnerships with multinationals (Guthrie, 2005). The high levels of competition in many of China's domestic markets have also fostered cost effectiveness. However, as Zhang (2003) points out, while a cost advantage is a relatively important competitive factor for simple products and lower income markets, in order to compete in other higher value-adding markets, differentiation and brand advantages are also required. Differentiation is gained when the market perceives products to stand out from those of competitors in a way that customers approve. A brand advantage is gained when customers are willing to pay a higher price for a product even though it has the same qualities and functions performance as competing products. Differentiation may be sufficient to compete internationally in industrial markets such as automotive components where customers are able to judge the substantive quality and performance of a product through their professional knowledge. Brand recognition, with the reputation (and sometimes cachet) that it signifies, is particularly important in consumer markets, such as those for automobiles, beverages, clothing, consumer electronics, household goods, and mobile phones.

As will become apparent from the cases now to be considered, the strengthening of differentiation and/or brand advantage features as an important driver for the outward FDI being made by leading Chinese firms. Often they are going abroad to acquire advanced technology and R&D capabilities, which provide the means to develop a differentiation advantage. Some are acquiring or developing global brands as the basis for securing a brand advantage. Even before going abroad, some have used long-term contracts or partnerships with leading foreign companies as a means to learn about international production and quality standards as a preparation for internationalization.

Routes toward Internationalization

Case studies suggest that there are three routes being taken by Chinese firms toward internationalization. These are: (1) the partnership route through OEM or joint venturing; (2) the acquisition route; and (3) the organic expansion route. The partnership route is a channel for realizing what may be termed 'inward internationalization', whereas the second and third routes are ones to fulfill 'outward internationalization'.

The original equipment manufacture (OEM)/joint venture (JV) route. Forming joint ventures with foreign enterprises, entering into a partnership with them through original equipment manufacturing or licensing their technology, is a route chosen by many Mainland enterprises. Evidence suggests that partnership with a multinational enterprise, more so than with an overseas Chinese firm, can be an effective means of transferring modern practices to the Chinese firm thereby helping to strengthen its eventual international competitiveness (Child and Yan, 2001; Guthrie, 2005). This route amounts to a kind of 'inward' internationalization in which there is a close, continuing, operational and organizational relationship with one or more multinational enterprises of a kind that permits the transfer of competencies and knowledge relevant to eventual 'outward' internationalization through exporting and/or investment abroad.

OEM combines the cost advantage of a Chinese enterprise with the brand advantage of a foreign firm. Galanz illustrates the successful application of this strategy. A township and village enterprise (TVE) based in Shunde, Guangdong Province, Galanz has become the world's largest manufacturer of microwave ovens. It also commands two thirds of the Chinese domestic market. Originally, Galanz wanted to build its own brand in the international market, but failed to do so. It then chose the OEM route, producing microwaves for many different international brands (its website claims as many as 250). In so doing, Galanz has moved towards an 'Intel-inside' strategy. As it grew into a dominant manufacturer, and as its bargaining power increased accordingly, so it was able to print the label 'made by Galanz' on all the microwaves it produces. Its website now invites prospective customers to order directly from Galanz (www.galanz.com/news, October 27, 2004). Clearly, this strategy is enabling the company to build up its own strong international brand for the future (Zhang, 2003). Moreover, Galanz has now invested US$20 million in an R&D center in Seattle in order to improve its own independent technological capability (Chung, 2004).

The Chinese authorities have consistently favored international joint ventures as a means of transferring technology and expertise to Chinese firms (Peng, 2000). Many joint ventures also involve the licensing of foreign technology. Technology partnerships, in particular, have enabled some Chinese firms to acquire knowledge of considerable competitive value. Indeed, the hand of government policy can be seen here in that a willingness to provide Chinese firms with access to technology has often been a condition of permitting foreign firms to establish in China. Huawei provides an example of how the joint venture route strengthened a Chinese company's international competitive capabilities. A collective enterprise founded by a former army officer in 1988, Huawei is now seriously challenging the global market position of multinationals such as Cisco Systems in the field of network equipment. It has entered into a number of joint ventures – for example, to develop and make 3G phones with NEC and Siemens, and with the Electronic Data Systems Corporation to market Huawei's equipment in the USA. In 1999 it established a software development center in Bangalore (*Business Week*, 2003). Another example is Ningbo Bird, a leading mobile phone producer, which acquired its system designs through a partnership with France's Sagem and has other technology partnerships with LG of South Korea and BenQ of Taiwan. Ningbo Bird has become a major exporter, encouraged by fierce domestic competition and aided by the technology it has acquired. (*Business Week*, 2002).

In the process of developing a sufficient corporate reputation for the eventual launching of an international brand, the OEM route offers Chinese firms the advantages of preserving their own identity, achieving economies of scale, and gaining a reputation in their own right for manufacturing excellence. OEMs can also permit an accumulation of financial resources that can be used to acquire international assets later on. By contrast, the formation of a joint venture with a foreign partner ties a Chinese firm more closely into the internal network of that partner. This can offer a more effective channel for the transfer of tacit knowledge to the Chinese partner, not just in production and distribution but also in other areas where internationally competitive standards need to be achieved (Inkpen, 1995; Simonin, 2004). The transfer of tacit knowledge can be especially important for enabling the Chinese recipient to make good use of technology. However, the Chinese partner's identity tends to be subsumed into that of the joint venture, which is often associated with the foreign partner's name and reputation rather than with those of the Chinese partner. The Shanghai Automotive Industry Corporation (SAIC), discussed in the next section, is a case in point. Thus, while joint ventures may offer an effective path towards securing the technological basis for a differentiation advantage, they may not be as effective as the OEM route for Chinese firms to build up an independent international reputation.

The acquisition route. The number of international acquisitions by Chinese firms has grown markedly in recent years. They were valued at US$2.85 billion in 2003 and have been forecast to reach as much as US$7 billion in 2004 (*Business Week*, 2004a). The 44 foreign acquisitions by Chinese companies in the year to October 2004 were one-third higher than those in the previous year (McGregor and Guerrera, 2004). Some major acquisitions have been undertaken by large state materials processing corporations with the intention of securing raw material supplies and this type accounts for just over one half of all Chinese overseas acquisitions by value (McGregor, 2005). However, while such acquisitions may eventually support a strategy of global competition, they currently do not appear to be motivated by this consideration and we shall therefore not consider them further here.

The dominant motive among non-primary producing Chinese companies for undertaking foreign acquisitions has, by contrast, been to accrue market strength. They have undertaken acquisitions to gain access to technology, to secure research and development skills, and to acquire international brands. Acquisition provides a fast route to these benefits and it can also deny them to competitors. The 'push' factor of domestic institutional restriction can also apply in that while international acquisitions by Chinese firms are usually officially encouraged, domestic acquisitions often are not, which removes one path for growth. Governmental authorities concerned at the political consequences of creating industrial giants have sometimes thwarted the take over by Chinese firms of other enterprises within China, and local officials have opposed them even more frequently because of their fears of losing control of the local firms that are acquisition targets (Meyer and Lu, 2004).

The Holly Group provides an example of foreign acquisition aimed at securing proprietary technology (Warner, Ng, and Xu, 2004). Holly, which began in 1970 as a rural township and village enterprise (TVE), specializes in the production of energy-meter equipment and instruments. In 2000, it published an 'Internationalization Strategy for the 21st Century', in which it stated its objective of positioning itself as a successful multinational enterprise on the basis of acquiring highly competitive competencies in its specialized field. A major step forward towards implementing this strategy was Holly's acquisition in September 2001 of the CDMA hand-set reference design operation from Philips Semiconductors in the USA. Through this acquisition, Philips Semiconductors transferred to Holly its equipment, assets, know-how, and intellectual property rights connected to hand-set reference designs. Holly also secured an exclusive license to process the CDMA software protocol that Philips had earlier developed. Moreover, Philips undertook to supply Holly with key silicon components thus enabling the latter to continue to develop and market the licensed products.

The deal that SAIC negotiated for many months in 2004/05, and then decided not to pursue because of contingent liabilities, would have involved an acquisition of the UK's MG Rover Group (or at least a majority stake in its ownership). This would have given SAIC control over MG Rover's automotive brands, design, and technology. The project illustrates a major Chinese acquisition aimed both at boosting technological capability and securing access to an international brand (albeit a fading one). SAIC had already paid about US$90 million to MG Rover and its associate Powertrain to secure the rights to engines and transmissions technology. SAIC has publicly stated that it seeks to sell 1 million vehicles a year, including 50,000 of its own branded cars by 2007. It already has two successful joint ventures in China with Volkswagen and General Motors, but these large MNC partners own the brands and the crucial technology. SAIC is therefore motivated to acquire its own technology and brand through an international purchase (*Financial Times*, 2004a; *The Guardian*, 2004).

The acquisition by Lenovo (previously Legend) of IBM's PC division for US$1.75 billion, announced in December 2004, allows it to use the IBM brand for five years and gives it control of the Think trademark of IBM's popular ThinkPad laptops. The deal not only provides Lenovo with IBM's brand, it also enables it to acquire IBM's laptop production lines, product developers, and distribution networks. The President of Lenova clearly stated that this move was intended to make it possible for his company to challenge Dell and HP in global markets. He is quoted as saying that 'we are not satisfied to be only number three' (*Financial Times*, 2004b).

This particular acquisition illustrates a number of factors of importance in an analysis of Chinese internationalization. First, there is the impact of tough domestic conditions, which both impel a Chinese company to enhance its competitive advantage and also add to the attraction of foreign markets. Lenova's margins have come under increasing pressure in its domestic market from local and foreign competitors. Although still China's PC market leader, its position is coming under growing attack, especially from Dell. Its share price fell by 23 percent in 2004. Its gross margins have been less than 15 percent, while IBM's gross margins in its PC business are 20 percent.

Second, while an acquisition of this magnitude requires the formal approval of the Chinese authorities, their role in facilitating it goes much further. The Chinese government holds a 57 percent stake in Lenova's ownership, and there can be little doubt that the financing of the deal is also underwritten by the state (*Business Week*, 2004b).

Third, the acquisition offers Lenova a dramatic step up the world league table, quadrupling its annual sales to over US$12 billion, so long as it can retain IBM's customers and employees, and manage a large foreign business. It is, however, a major challenge for a Chinese firm without significant international experience to manage global expansion of this order. The management of this major internationalization will have to overcome major differences in managerial culture and style. It will incur a heavy liability of foreignness. This raises questions concerning its ability to build a global reputation sufficiently rapidly to retain loyalty to the acquired brand in the international marketplace. Doubts have been raised about Lenovo's ability to preserve confidence in the IBM PC brand; for example, one IBM user commented that 'it feels uncomfortable; international IBM has become domestic Lenovo' (*Financial Times*, 2004c). In order to reduce these risks and the liability of foreignness, Lenova is appointing a senior IBM vice-president as its chief executive, transferring its head office to New York, and retaining IBM as the preferred supplier of after-sales service outside China. IBM will also take an 18.9 percent stake in Lenova. This indicates the company's recognition that it has to acquire the competencies to manage a large foreign operation, which is an additional type of asset that internationalizing Chinese firms in general need to seek.

A further condition for value in an international brand is that it needs be a strong rather than a failing one. This condition is not always met. An example, just mentioned, is the Rover marque that SAIC considered purchasing. TCL's purchase of a controlling stake in France's Thomson gave it a loss-making business with a severely faded TV brand (RCA). Moreover, in the case of TCL and Thomson, major differences in culture and corporate practice have created greater management problems than expected, especially over issues such as pay levels and communication across two languages (*The Economist*, 2004).

In short, the acquisition route for securing international differentiation and brand advantage is being favored by an increasing number of Chinese firms. It appears to offer a rapid advance toward achieving these objectives, though it is too early to assess the extent to which Chinese companies can handle post-acquisition integration and management challenges successfully. Such problems can be formidable for acquisitions in general, and international ones in particular (Child, Faulkner and Pitkethly, 2001). Nevertheless, an increasing number of Chinese companies are undertaking international acquisitions. While some have cash resources through achieving reasonable profits – for example, Lenovo made a profit of US$128 million in 2003, despite falling domestic margins, and TCL's profit was US$163 million – it is unlikely that they could bear the financial risk without support from governmental authorities whose approval is in any case required. The revaluation of the Chinese yuan against the US dollar, by reducing the price of foreign assets, may accelerate the process of acquiring foreign assets, just as the strength of the yen encouraged a wave of Japanese foreign acquisitions in the 1980s.

The organic international expansion route. This route toward international expansion involves the greenfield establishment of subsidiaries and facilities within targeted markets. It is initially aimed at securing differentiation advantages in terms, for example, of adjustment to local market needs and tastes. It may, as in the case of the Haier Group, also be the main component of a strategy aimed at gaining global brand recognition. It is also a route that maximizes managerial control and the possibilities for global integration.

Haier is the best-known example of a Chinese firm that has internationalized primarily through the organic expansion route. It was also one of the first Chinese enterprises to implement an internationalization strategy, when it started to export to Europe and the USA in 1990 and to Japan in 1991. Today, Haier is considered to be 'the official template for the Chinese MNC of the new millennium' (Warner, Ng, and Xu, 2004, p. 334), and its CEO Zhang Ruimin is probably the most respected Chinese business leader worldwide (Zhang, 2003).

Haier began in 1984 as a collectively-owned enterprise – the Qingdao Refrigerator Factory. Its range of manufactured goods today includes various white goods, air conditioners, microwave ovens, and color TVs. It has 19 production factories outside China and two 'production parks' in the USA and Pakistan. Although it established subsidiaries after 1996 in nearby developing countries such as Indonesia, the Philippines and Malaysia, its main internationalization thrust has been directed at highly developed regions. Thus Haier started exporting to Europe, Japan and the USA in the early 1990s, in keeping with the philosophy of CEO Zhang, namely 'enter a difficult advanced market first, then go to easy, underdeveloped markets' (Kiran, 2004, p. 2). The idea behind this strategy is to build an international brand name by competing in the markets that are the hardest to enter and then gradually to expand to other markets. Addressing difficult markets first is seen as a way of obliging the company to achieve high quality, innovation and customer service – foundations on which a recognized brand can be built. This approach reflects the company's own historical experience. Its emphasis on quality dates from its near bankruptcy in 1985 due to a collapse in sales of poor quality products. After this crisis, Zhang Ruimin, as newly appointed CEO, introduced a rigorous total quality system. The company at that stage imported a considerable amount of foreign know-how and technology.

Despite undertaking some acquisitions and joint ventures in its overseas expansion, Haier has to a significant extent followed the path of organic diversification. This has been particularly apparent in the United States. Haier started to export to the US market in 1990, but realized that it was handicapped by not having a locally recognized brand name. It was also vulnerable to American quota restrictions and potential anti-dumping suits (Deng, 2004). Returning in the late 1990s, it invested US$40 million in a new production plant in South Carolina that started operation in 2000. It established a design center in Los Angeles and a trade center in New York. Haier initially aimed its US production at niche segments in the household appliances market with innovative products, having the intention to enter the regular white-goods market later. After gaining customer loyalty through product differentiation, such as small refrigerators and wine coolers where US manufacturers had a small presence, Haier's products started to be sold in large chain stores such as Wal-Mart and Sears. By 2003, it had gained 50 percent of the compact refrigerator market and 70 percent of that for wine coolers (Kiran, 2004).

Haier is in some respects an unusual case among Chinese internationalizing firms, but it is nonetheless a leading example that others may follow. Its policy of opening up sophisticated foreign markets with direct investment after only a short period of exporting does not conform to the economic argument that firms will engage in international business primarily on the basis of factor advantage. On those grounds, Haier should have concentrated its entry to international markets on the advantage of low-cost production from China, producing conventional appliances of standard quality for developing country markets. Although it has targeted some nearby developing country markets in south east Asia, it focused on Europe and the USA quite early on. It has also opted for local manufacture at a relatively early stage even in high-cost locations, most notably in the USA followed by Europe. Despite the apparent success of its strategy so far, judgment has still to be reserved. For Haier could be said to be pursuing a high-risk policy, and the company does appear to be incurring high initial investment costs which have been financed by a steady cash stream from its domestic operations. Doubts have been expressed as to how long this policy can be maintained in view of the mounting pressures it is facing on margins in its domestic market (*Business Week*, 2004c). Moreover, the company's distinct approach is very much a reflection of an outstanding CEO and it also remains to be seen whether it can support its rapid international expansion with sufficient management in depth. Like Lenova, it is trying to enhance the managerial assets it requires through local recruitment.

Internationalization through organic expansion exhibits elements both of asset-exploitation and asset-seeking. Haier had worked hard to establish domestic strengths based on a combination of innovativeness and high quality. These became assets that it *exploited* when entering sophisticated developed country markets. In Germany, for example, it helped to establish its local reputation for quality through encouraging the 'blind' testing of its products against those of local manufacturers. In the US market, the company soon became known for the innovative extra features that its products offered. Moreover, Haier may continue to seek to exploit the asset of low-cost production in China when acquiring new assets abroad. It is, for example, reported that in bidding for the troubled US white goods Maytag company, Haier saw an opportunity of reviving the competitiveness of the Maytag brand by shifting production from high cost USA to mainland China (*The Economist*, 2005).

Nevertheless, the fact that Haier felt obliged to establish design, manufacturing and marketing facilities in the USA, staffed by Americans, indicates that it has been continuing to *seek* appropriate assets in its internationalization. In particular, Haier has justified its policy of moving into advanced markets as a means of forcing an acceleration in its learning process which reflects an awareness of a need to catch up with the top players.

Pros and Cons of Different Routes toward Internationalization

We have identified three primary routes toward internationalization by Chinese firms beyond the level of exports: 'inward' internationalization through partnerships in the form of original equipment manufacture (OEM) and joint ventures (JVs); and 'outward' internationalization through acquisition and organic expansion. Each route offers certain advantages, but is at the same time accompanied by its own challenges or risks. Table 1 summarizes these advantages and challenges. While inward internationalization appears primarily to serve as a preparation for eventual outward internationalization, a given firm can pursue more than one of these routes at the same time.

Table 1. Routes to Chinese internationalization

Route	*Advantages*	*Challenges*
OEM/JV (including licensing)	• Capitalizes on low cost production in China. • Requires less and lower-risk investment. • Opportunity to learn international technology, practices and standards, so reducing the liability of foreignness. • Opportunity to build sound reputation as basis for international branding.	• Danger of dominance by foreign partner, especially if it retains rights over brands and technology. • Hostile reaction by foreign partner when launching own brand and turning into a competitor.
Acquisition	• Fast route to securing technology and/or international brand. • Denies access to competitors. • Prospect of effecting a turnaround of a poorly performing acquired company.	• Risk of over over-paying. • Need to acquire strong rather than failing assets. • Faces high liability of foreignness: problem of managing acquired assets and preserving equity of acquired brand.
Organic international expansion	• Facilitates a localization strategy. • Strengthens credibility of own brand. • Enables introduction of own management, staff and practices from the outset – reduces liability of foreignness. • Improves chances of achieving global integration.	• Slower route to internationalization. • Requires high investment which may impose financial strain. • Capacity to manage overseas organic expansion may be limited.

The original equipment manufacturer/joint venture (OEM/JV) route enables a firm to capitalize on low cost production in China and normally involves less financial commitment and risk. At the same time, it offers an opportunity to learn international practices and standards, which in turn should provide a basis for it to build a sound reputation that will later stand it in good stead when it seeks to launch its brand in the international market. In this way, it has an opportunity to lessen its future liability of foreignness. As against the lower risk, this mode tends to subject the Chinese firm to the dominance of its foreign partner(s) in regard to technology and identity, and it may incur the opposition of those partners if it launches its own brand and turns into a competitor.

In manufacturing, the acquisition route is aimed primarily at securing technology and/or brands quickly, and it can preempt similar moves by competitors. It is an attempt to add differentiation and brand advantages to existing cost advantage.

The challenges experienced in effecting this internationalization mode are those that normally accompany acquisitions: the danger of over-paying, the need to ensure that assets acquired are not failing or tarnished ones, and the very large challenge of overcoming the 'liability of foreignness' in managing acquired assets and preserving the equity of the acquired brand.

The organic international expansion route is likely to prove a slower route to internationalization. As with Haier, it may well involve the establishment of production abroad in addition to technical and marketing facilities. It therefore tends to be a high-investment route that can impose financial risk and strain on the company. It can also stretch managerial capabilities and these are likely to be in short supply within a Chinese company. On the positive side, organic expansion makes it easier to implement a localization strategy, which can permit a Chinese firm to hire its own personnel and introduce its own practices afresh. This enables the firm to train its locally selected staff into its own administrative heritage, which is one way of reducing its liability of foreignness (Zaheer, 1995). By being present as a local company in a highly critical and competitive market such as the USA, organic expansion also strengthens the acceptability and credibility of the company's brand which it can support on the basis of an inherent strength such as high quality. Since that brand and supporting technology both emanate from within the company itself, organic expansion should offer the best chance for the firm to achieve a high level of global integration. It combines asset-exploitation and asset-acquisition.

Drivers and Facilitators of Chinese Internationalization

There are a number of factors conducive to internationalization by Chinese firms, which are listed in Table 2. Several may be operative for any one firm. They include both drivers towards investing abroad and facilitators of the process. Some, like the pressure of competition in the domestic market, characterize an increasing number of countries as globalization advances. Others, such as those relating to government, appear to be more distinctive to the Chinese case.

Domestic conditions are among the drivers of internationalization. China has already established a clear exporting advantage based on exploiting its asset of low-cost production. However, cost advantage tends to be accompanied by low margins as long as the technology applied to products and their manufacture remains only of a conventional standard and as long as those products do not enjoy any brand advantage. Cost and price have been driven down in many domestic markets, a process heightened by over capacity, to the extent that it is increasingly hazardous for Chinese firms to depend on a cost-leadership strategy in those markets. This provides an incentive to go further and attempt to secure the differentiation and brand advantages that hold the promise of higher margins. Once secured, these advantages may possibly be combined with low-cost produc-

Table 2. Drivers and facilitators of internationalization by Chinese firms

Drivers

- Hazard of relying on a highly competitive domestic market, with low margins.
- Opportunities to export based on domestic cost advantages.
- Potential to complement domestic cost advantages with differentiation advantages acquired abroad.
- Need to secure and develop advanced technology and internationally recognized brands.
- Desire to gain entrepreneurial and managerial freedom.

Facilitators

- Strong governmental support for globalization, especially financial backing and tolerance of domestic moves (such as M&A) that build corporate strength.
- Ability to reach a favorable accommodation with government, so as to combine support with strategic freedom to act entrepreneurially, raise capital abroad, etc.
- Access to state-supported scientific and technical research.
- Willingness of foreign firms to sell or share international-standard technology, know-how, and brands.

tion in China. The cases examined indicate that internationalization is seen as an important way of obtaining these sought-after assets. On the whole, seeking efficiency in terms of cost minimization is not a major motive for Chinese companies to invest abroad, and in this respect they differ from most MNCs from developed countries (Deng, 2004).

Thus, an incentive for Chinese firms to commit to a higher level of internationalization is that it promises access to both superior technology and brands. This is particularly the case when foreign firms are willing to sell or share their technology, know-how and brands, due to financial exigency (as in the case of MG Rover) or because that part of their business is relatively unprofitable (as in the case of IBM). Technology and brands are assets that Chinese firms may seek to acquire through internationalization. Haier has gone further in localizing its technology, brand, and production within large sophisticated markets like the EU and the USA in the belief that this would provide it with the best chance of securing a significant position in those markets.

Chinese government policies also promote internationalization. The OEM/alliance route has long enjoyed official support when directed toward genuine capability enhancement. Hitt et al. (2004) present evidence that the institutional context created by the Chinese government is conducive to Chinese firms seeking to improve their competitiveness through long-term alliances with foreign firms that possess unique capabilities. In 1999, the Chinese government launched its 'Go Global' policy, encouraging strong Chinese enterprises to invest more overseas in order to improve their competitiveness and secure an international business presence. This policy signifies the determination of the government to promote outward FDI in the context of huge inflows of foreign exchange. One of the most important ways it sponsors overseas expansion is through the provision of low interest loans to fund the purchase of foreign companies from sources it controls such as China's state banks (*The Economist*, 2005).

The distinctive role that the state can play in Chinese internationalization is particularly apparent when it retains some (but not total) ownership in the companies concerned or, as with Haier, raises them to the status of national exemplars. Thus, the Chinese government's stake in Lenovo has given the company certain advantages in pursuing its international acquisition in addition to financial underwriting by the state (*Business Week*, 2004b). These include privileged access to domestic government and educational markets, as well as to state sources of scientific and technical research. These domestic advantages have made Lenovo a more attractive partner for IBM to enter into the deal that takes Lenovo into the international arena and provides IBM with a stake in the company. At the same time, despite the government's significant ownership stake, Lenovo enjoys the entrepreneurial freedom of being classified as a 'state-owned, non-government managed enterprise'.

Other companies have enjoyed government support for internationalization without losing their strategic autonomy. Haier is a collectively-owned company that has nevertheless benefited from financial and other support from the state, without this unduly restricting its entrepreneurial freedom. It was restructured in its early days with funds raised from state banks and government agencies, was permitted to grow through a series of mergers and acquisitions with domestic firms, and was granted permission in 1993 to go for an IPO and to become listed on the Shanghai Stock Exchange. CIMC is another instructive example. This producer of marine shipping containers was by 2002, earning some 95 percent of its sales revenues from exports. CIMC is a joint venture with two major state-owned parent companies, and has been able to secure considerable managerial freedom through its joint venture status. This arrangement has been conducive to its successful competition in the international market, as an exporter, on the basis of domestic production strengths built up through a series of acquisitions of other domestic container producers. The acquisitions not only provided additional production capacity but also access to refrigerated-container-manufacturing technology through a 1997 purchase of Hyundai's container-making operations in China. CIMC has thus been able to build a strong international competitive base through gaining government support for a domestic M&A policy while at the same time retaining its entrepreneurial freedom (Meyer and Lu, 2004; Zeng and Williamson, 2003).

Institutional support therefore has to be counted as a factor that can help lay the foundations for the internationalization of Chinese firms, so long as at the same time those firms retain their freedom to pursue their own strategies. It was noted earlier that many earlier instances of outward FDI from China were governmentally directed and that they under-achieved. It is unlikely to be a coincidence that many of the currently successful internationalizing Chinese firms are either non-state-owned enterprises or enjoy arrangements that insulate them from bureaucratic interference. For example, Galanx and Holly are town and village enterprises, while Haier and Huawei are collective enterprises. Lenovo and TCL do have major government ownership stakes, but that ownership is now shared with other investors including multinationals such as IBM (Lenovo), and Toshiba and Sumitomo (TCL). This strengthens their managerial autonomy from bureaucratic intervention. CIMC also enjoys considerable managerial autonomy, as just noted. Zeng and Williamson (2003) call these 'hybrid' arrangements, which provide the firms concerned with competitive advantages because they permit them the support of institutional arms of the state without having to pay the penalty of governmental interference.

While the ownership status of these successfully internationalizing firms helps to distance them from bureaucratic intervention, their relative autonomy also owes something to the ability and prestige of their leaders. One of the important entrepreneurial competencies clearly displayed by the leaders of firms like Haier lies in their ability to negotiate a degree of strategic freedom from the bureaucracy while retaining its support. The relationship between institutional and entrepreneurial factors is thus reciprocal in that arrangements that lessen dependence on the state give greater scope for entrepreneurial initiative, while the exercise of that initiative is partly directed to increasing the autonomy of firms to raise capital abroad and in other ways further their internationalization policy. Although entrepreneurship *per se* has undoubtedly strengthened in China, encouraged by developments such as the official legitimization of private firms in 1999 (Garnaut and Song, 2004), the cases examined nevertheless suggest that Chinese entrepreneurs are more effective in the cause of promoting internationalization when they retain their connections with the state, as Zhang and Van Den Bulcke hypothesized (1996, p. 161). This adds a distinctly Chinese dimension to the notion of 'strategic entrepreneurship' which refers to a combination of the opportunity-seeking behavior of entrepreneurs with the advantage-seeking behavior of the strategist (Hitt, Ireland, Camp, and Sexton, 2001). For the entrepreneurs behind Chinese internationalization realize the opportunities that there are overseas, while at the same time appreciating the need to secure advantage from their good relations with government at home.

These beneficial arrangements qualify the assumption that one of the drivers behind internationalization by Chinese firms is to escape domestic institutional restrictions. The situation appears to be rather more nuanced than this assumption allows. Institutional constraints such as legal uncertainties, obstruction of domestic acquisitions, and regional protectionism through license restrictions do remain a problem, but it seems that successful firms have found ways to accommodate or circumvent them. On the other hand, the competitiveness in many of China's domestic markets is becoming ever more fierce and margins are being reduced. It would therefore probably be correct to conclude that, in comparison with the undoubted pressures to internationalize in order to reduce dependence on competitive domestic markets, the 'push' factor of seeking to escape institutional and structural impediments is of less significance.

DISCUSSION: THE CASE FOR THEORETICAL EXTENSION

It has been argued that China does not require theories that are specific to itself and that would differ substantially from mainstream, primarily Western theories (e.g., Peng, 2005). The cases discussed in this paper suggest that China presents an opportunity to extend, rather than replace, existing theorizing on the internationalization of firms including that applied to developing country multinationals. Four primary areas in which this opportunity arises concern the latecomer perspective and catch-up strategies, institutional analysis with reference to the role of government, the relation of entrepreneurs and institutions, and the liability of foreignness.

The Latecomer Perspective

Those studying late-coming developing country multinationals have tended to be pessimistic about the chances of such firms eventually catching up with the global giants. Wells (1983, p. 157), for example, concluded that 'only a few [developing country] enterprises have the strengths that would enable them to extend the lives of their subsidiaries once the initial advantages have been copied'. Even in the case of relatively strong non-state-owned Chinese firms such as those discussed in this paper, Nolan (2001, p. 193) maintains that 'without continued state support they were most unlikely to be able to build on their considerable entrepreneurial achievements, and mount a serious challenge to the global giants in their respective sectors.'

In contrast to these views, the cases we have considered suggest that the determination of these Chinese firms to address their international competitive weaknesses, and the strategies they employ to do so, have been inadequately recognized in a literature that remains too wedded to the thesis that internationalization proceeds on the basis of *prior* competitive advantage. This thesis gives insufficient weight to the role of both 'inward' and 'outward' internationalization in addressing competitive disadvantages through learning and/or asset acquisition. Commentators like Nolan (2001) who doubt the ability of Chinese firms, even those favored with government sponsorship, to catch up with leading MNCs are in the light of the cases discussed here probably too pessimistic about the ability and determination of the Chinese to learn and acquire key assets and competencies. Rather, the internationalization process of Chinese firms lends support to the view that their capacity for organizational learning should not be underestimated and that is one of the most important of all competitive advantages (Moingeon and Edmonson, 1996).

The Chinese case conforms more closely to the latecomer perspective than to analyses derived from the exploitation of firm-specific advantages by already strong companies. While *exporting* from China *is* based primarily on the intrinsic advantage of low-cost labor, combined in some cases with modern production facilities that may have been developed with foreign inward investment (Marsh, 2005), moves toward a higher level of internationalization require the remedying of *dis*advantages through the seeking of new assets (Deng, 2004). Leaving aside outward investment aimed purely at securing raw materials, the most important assets being sought are intangible ones, such as brand reputation, technical knowledge and competence to manage a global corporation.

The question also arises as to the path toward internationalization adopted by late-coming firms. Zhang and Van Den Bulcke (1996) concluded that it was not possible to distinguish either a clear time sequence or distinct stages of internationalization among Mainland Chinese multinationals. This conclusion is not challenged by the cases we have considered. Although most outward FDI from China has gone to other Asian countries (*Asian Pacific Bulletin*, 2004), the internationalization paths followed by contemporary leading companies like Haier, Galanz, and Lenovo do not appear to attach priority to entering geographically proximate developing country markets. Rather, the attractions of large developed country markets may more than offset any problems of psychic distance, because these companies are pursuing long-term globally-oriented strategies. Indeed, Haier's CEO has explicitly stated his belief in the long-term payoff of targeting the hardest markets first, thus prioritizing learning how to compete globally. In addition to the appeal of their markets, developed country destinations also provide the source of the crucial technological and brand assets that are being sought to support a globalization strategy.

We maintain that the 'late-comer' to global business deserves to be granted greater theoretical attention, particularly with respect to the processes whereby firms in this category can develop international competitive strengths. This is not to deny the fundamental insight that firms have to possess competitive advantages, particularly ownership and internalization ones, in order to sustain a successful presence in international markets. It is, however, to argue that greater attention needs to be given to the ways in which initially disadvantaged firms from countries like China can acquire the necessary assets to offset these disadvantages through a close association with foreign MNCs or obtaining them abroad. In the case of major Chinese internationalizing firms undertaking FDI, they are using financial strength, often supported by governmental sponsorship and financial underwriting, to secure other advantages through purchase and associated opportunities to learn.

Institutional Analysis and the Role of Government

The process of internationalization by Chinese firms appears to be significantly impacted by institutional factors. Because the close 'relational framework' (Meyer and Scott, 1983) that Chinese firms enjoy with supporting governmental agencies is extremely confidential, its economic and psychological significance cannot be assessed precisely. However, Warner et al. (2004, p. 340) are likely to be correct in their speculation that 'the State's sponsorship and funding support are a key factor that may make possible the frequent acquisitions initiated by the PRC-based enterprises as a "normal" mode of entering and penetrating a host economy'. We have seen how companies that have entered the international market in a major way, such as CIMC, Haier, and Lenovo, have benefited significantly from government support at critical stages in their development.

The case of China strongly suggests that international business theory needs to take fuller account of the potential relevance of domestic institutional factors in developing and transitional countries. It is significant that many other developing countries are also characterized by a heavy institutional and political involvement in their business systems (Dunning and Narula, 1996). Insofar as the role of government and its agencies has been taken into account, this tends to be more with regard to the legislation and regulation of host country conditions for *inward* FDI than to the activity of governments as sponsors of internationalization and outward FDI. Those familiar with China rightly emphasize the support that its government is giving to the globalization of its leading firms. Given the level of involvement of the state in the industrial policies of other significant emerging economies such as India, South Korea, and Russia, there is a danger within analyses derived from western experience of understating the role that domestic governments can play in underwriting the process whereby their leading firms seek to achieve international competitiveness, not least when the foreign currency reserves for purchasing overseas assets are available.

Moreover, the continued process of economic reform in China, and in many other emerging economies, is witness to the ability of the state to evolve its stance toward the regulation of business. Whereas in the past Chinese governmental agencies have tended to control and limit outward FDI, more recently they have adopted the role of sponsor and fund-provider for firm internationalization. This shift toward institutional entrepreneurship calls into question the assumption widely made by institutional theorists themselves that institutional dependence means path dependence and a constraint upon the exercise of entrepreneurship by the firms concerned.

Entrepreneurs and Institutions

A specific issue raised by consideration of Chinese internationalization concerns the extent to which the pattern of firm internationalization is *institutionally embed-*

ded rather than reflecting a *strategic choice* by the leaders of firms. Institutional theory tends to assume the former, in that it conceives of isomorphism in structures and behaviors between institutions and firms as resulting from the embeddedness of business in the social and economic relations of a society, including the constraints that governmental and other agencies impose on business actions (Granovetter, 1985; Scott, 1995). This implies that although the motivation to internationalize among Chinese firms can be explained in terms of the same strategic factors that apply to western firms, namely the need to compete by exploiting or seeking assets, the decisions that they make about the pattern of internationalization will be informed by established mind-sets and existing practice, reinforced by institutional norms. Evidence on the internationalization of Chinese firms up to approximately the mid-1990s does point to a heavy embeddedness stemming from pre-transition conditions in that strong administrative guidance continued to be imposed, low-risk investments were preferred, and little strategic analysis was evident (Cai, 1999). Since the beginning of the present century, the government's role seems to have evolved into a much more strategic one, giving encouragement and support for key firms to globalize within the rationales of their own needs and policies.

The Chinese entrepreneurs who have successfully steered their companies into internationalization appear to have found ways of accommodating to the institutional embeddedness that remains in China. They have not so much 'escaped' domestic institutional restrictions as to have found ways of co-opting political support that has given them the freedom to pursue internationalization strategies of their own choosing. Nolan (2001) offers some comparable examples of entrepreneurial negotiation from his case studies of the domestic strategies of leading Chinese firms. It is likely that the interaction between the institutional legacies of developing economies and the dynamic capabilities of their corporate entrepreneurs will be crucial for understanding the internationalization strategies that the latter pursue. While entrepreneurship and related strategic capabilities are fully recognized in existing theorizing on internationalization (e.g., McDougall and Oviatt, 2000), Chinese examples call for an extension of conventional theory so as to take closer account of the scope of business leaders to negotiate strategic choice within their domestic institutional context. International business theory should be encouraged to address this phenomenon, perhaps borrowing concepts to describe it such as the notion, mentioned earlier, of a 'relational framework' between firms and institutions. A degree of networking between firms and the external bodies which can materially affect the process of their internationalization is undoubtedly present in all societies, but its prominence in China serves to draw particular attention to it.

A co-evolutionary perspective would provide an appropriate analytical framework for such an extension because in eschewing institutionally-imposed path dependency it allows for entrepreneurial initiative in the negotiation of evolving policies that change both contexts and firms themselves (Lewin et al., 1999).

Indeed, co-evolutionary analysis is now starting to be applied to highly institutionalized environments comparable in many respects to that of China (e.g., Rodrigues and Child, 2003).

Liability of Foreignness

Finally, our analysis of internationalization by Chinese firms has raised the issue of whether they face a liability of foreignness due to the distinctive social environment from which they come. One aspect of this environment has just been considered in the form of institutional dependence. Although there may be some truth in the argument that Chinese firms are motivated to internationalize to escape from the restrictions of that dependence, one has also to ask whether they are handicapped when entering new territories where the support of government and social connections that they are used to is not available.

It has been argued that the Chinese have a cultural preference for transacting in less codified regimes typified by fiefs and clan networks rather than by the codified formality and impersonality of bureaucracies or markets (Boisot and Child, 1996). A similar preference may also characterize other societies that continue to rely heavily upon traditional foundations of trust, based on 'who you know', rather than on legal and other formalized supports. Previous research on developing country MNCs indicates a preference for expanding to foreign territories where it is possible to access ethnically-based social networks, and this appears to be very characteristic of overseas Chinese firms. In earlier phases of internationalization from the Chinese Mainland, firms evidenced a preference to go to countries where Chinese social networks are present (Cai, 1999; Deng, 2004). This seems to have been less evident among the larger recent internationalizing firms, though the extent to which they tap overseas Chinese communities in developed countries such as the USA needs to be clarified. While not denying the potential strategic value of ethnic networks, some of the foreign investment projects being undertaken by the firms we have discussed relied on advice and expert backing from non-Chinese sources, Haier, Lenova, and SAIC being cases in point. Thus while embedded Chinese culture could be a factor limiting the willingness of firms to internationalize to countries where they cannot plug into ethnic and other familiar social networks, the aspiring global players considered in this paper appear to be finding ways of overcoming any such limitations.

Whatever the case may be, the internationalization of Chinese firms presents new questions regarding the ways they endeavor to overcome their socially derived liabilities of foreignness. Do they adapt successfully to different modes of managing and transacting that are suited to the environments into which they expand? Do they successfully access new overseas networks? Do they retain their administrative heritage relying on the support of modern communications technologies such as video conferencing to sustain personalized networks? Do they blend the strengths of their customary approaches with those of their new localities? The apparent preference of Chinese firms when investing abroad to pursue this through acquisitions and organic growth rather than through joint ventures with non-Chinese MNCs suggests that they may prefer to retain their distinctive administrative heritage.

CONCLUSION

We have argued that the internationalization of Chinese firms has a number of features that require more consideration in current theory. These concern the latecomer perspective and catch-up strategies, the institutional role of government, the relation of entrepreneurs and institutions, and the liability of foreignness. In addition to stimulating possible theoretical extensions, the subject may also turn out to have wider significance for policy as well. The authors are aware, for instance, that some aspiring global players among Brazilian companies are watching with interest how Chinese firms succeed in establishing a competitive position within international markets, including the overcoming of a liability of foreignness. We have also noted that the significance for internationalization of the relationship between government and business entrepreneurs, while particularly pronounced in China, also characterizes many other developing and transition countries. The internationalizing of Chinese firms is therefore of emerging interest not only for its potential to extend current theorizing but also for the policy lessons it may offer to other developing countries.

NOTES

[1] The authors wish to thank Yadong Luo, MOR Senior Editor, and reviewers for their insightful and positive comments on an earlier version of this paper.
[2] Throughout this paper, the term 'China' refers to Mainland China and excludes Hong Kong, Macau, and Taiwan.

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