



Overcoming distrust: How state-owned enterprises adapt their foreign entries to institutional pressures abroad

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Abstract

State-owned (SO) enterprises are subject to more complex institutional pressures in host countries than private firms. These institutional pressures arise from a weak legitimacy of “state ownership” in some countries, which arises from a combination of ideological conflicts, perceived threats to national security, and claimed unfair competitive advantage due to support by the home country government. These institutional pressures directed specifically at SO firms induce them to adapt their foreign entry strategies to reduce potential conflicts and to enhance their legitimacy. Testing hypotheses derived from this theoretical argument for subsidiaries of listed Chinese firms, we find that SO firms adapt mode and control decisions differently from private firms to the conditions in host countries, and these differences are larger where pressures for legitimacy on SO firms are stronger. These findings not only extend institutional theory to better explain differential effects on different entrants to an organizational field, but demonstrate how foreign investors of idiosyncratic origins may proactively build legitimacy in host societies.

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INTRODUCTION

The increasing international presence of multinational enterprises (MNEs) in state ownership raises new questions about if and how firms’ ownership matters for their strategies (Buckley, Clegg, Cross, Liu, Voss, & Zheng, 2007; Morck, Yeung, & Zhao, 2008; Wang, Hong, Kafourous, & Wright, 2012) and for their reception in host countries (Globerman & Shapiro, 2009; Sauvart, 2010). Specifically state-owned (SO) firms differ from privately owned (PO) firms with respect to, for example, objectives, resource access, and corporate strategies. In this study, we argue that as a consequence of these differences, SO and PO firms face different institutional pressures abroad, and hence adapt their international business strategies in different ways.

MNEs are exposed to institutional pressures in each country where they operate (Kostova, 1999; Xu & Shenkar, 2002), which they have to accommodate while also aligning with the MNE’s global values and practices (Kostova & Roth, 2002; Kostova, Roth,

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& Dacin, 2008; Westney, 1993). In particular, MNEs have to conform to rules and belief systems in each host country to establish local legitimacy (Kostova, 1999). Such legitimacy can be enhanced by foreign investors aligning their organizational practices to local norms and regulation (Kostova & Roth, 2002), by adopting organizational structures to imitate incumbents (Chan & Makino, 2007; Yiu & Makino, 2002), or by cooperating with actors that enjoy high levels of legitimacy locally, for example, in a joint venture (Lu & Xu, 2006). Moreover, organizational forms such as low-level equity investment or greenfield operations lower an investor's public profile, and thus reduce the likelihood of being challenged for its legitimacy (Meyer & Thein, 2014).

We extend this line of theoretical work by exploring how such host country institutional pressures vary between firms in different types of ownership, and how these firms in consequence vary in their local adaptation strategies. We build on observations that SO firms face greater institutional pressures than PO firms in at least some host societies (Cui & Jiang, 2012; Globerman & Shapiro, 2009; Nyland, Forbes-Mewett, & Thomson, 2011; Sauvart, 2010). However, we propose that as an outcome of social and political processes in the host countries, this differential pressure on SO and PO firms is not homogenous across countries. Specifically, two host country conditions – one technological and one institutional – likely shape the extent of additional institutional pressures imposed on SO firms. In countries with strong technological development, concerns might arise about losing critical technologies to foreign competitors as well as to foreign governments. In countries where a strong rule of law limits the direct government interference in business, ideological inconsistencies are likely to emerge with respect to firms closely associated with governments in foreign countries. In consequence, SO MNEs are expected to work extra hard to attain local legitimacy in countries with advanced technological and institutional development. These differential institutional pressures induce SO MNEs to show more local adaptation than PO MNEs in terms of both their establishment mode (acquisition or greenfield) (Hennart & Park, 1993; Slangen & Hennart, 2007) and the level of control over the foreign operation (Brouthers, 2002, 2013; Meyer, 2001).

We apply these theoretical arguments in the context of Chinese MNEs which have become a major source of SO MNEs.¹ Many of the SO firms among the largest MNEs are of Chinese origins, and many of the largest companies on the stock exchanges of

Shanghai and Shenzhen have a state entity as their main shareholder, or they are associated with business groups that in turn are controlled by a state entity (Yiu, 2011). We test our hypotheses on a dataset of 386 overseas wholly or partially owned subsidiaries of listed Chinese MNEs in 2009. Our results illustrate how host institutional pressures shape the strategies of Chinese SO MNEs. While SO MNEs prefer acquisitions to enter foreign countries more than their PO counterparts, this propensity to use acquisition is reduced in host countries with strong technological or institutional development. In acquired units, these same host country factors induce SO MNEs to use lower equity stakes in order to enhance their legitimacy.

We contribute to the literature in international business, especially the study of interfaces between MNEs and their institutional environment, in three important ways. First, we contribute to the literature on institutional pressures pertaining to MNEs (Kostova et al., 2008; Lu & Xu, 2006; Yiu & Makino, 2002). This literature has traditionally examined institutions without distinguishing pressures faced by different types of MNEs. Our theoretical extension explains why and how certain effects of institutional pressures in host countries selectively target one type of firm ownership more than other types, and why and how in consequence these targeted firms take extra initiatives to earn local legitimacy.

Second, we contribute to the key theme of this special issue theoretical understanding of SO firms in the global economy, by explaining how SO MNEs differ in their foreign entry strategies from their PO counterparts due to their distinct interactions in the *host* society. The institutional pressures on SO MNEs are particularly strong in places that perceive SO MNEs as inconsistent with their ideologies or as threats to their national security or competitiveness, that is, in host countries with high levels of technological or institutional development. SO MNEs therefore make additional efforts in such countries to reduce the level of institutional pressure and to increase their legitimacy.

Third, we contribute to the literature on foreign entry strategy (Brouthers, 2002; Hennart, 2009) by addressing the perennial question of how establishment mode and equity mode decisions can best be modeled (Kogut & Singh, 1988; Meyer, Estrin, Bhaumik, & Peng, 2009a). Specifically, we offer a staged model in which firms first decide establishment mode, and then equity control mode.



INSTITUTIONS AND SO MNEs

The institutional framework of host economies is a key determinant of foreign investors' entry strategies (Brouthers, 2002; Meyer, 2001; Meyer et al., 2009a). At the subsidiary level, MNEs face institutional pressures not only from the parent organization and hence home country institutions (Meyer & Thein, 2014), but also from host country institutions (Kostova, 1999; Lu, Liu, Wright, & Filatotchev, 2014; Regnér & Edman, 2014). These home and host institutional pressures are at times conflicting (Kostova & Roth, 2002; Kostova et al., 2008; Lu & Xu, 2006; Westney, 1993), and add to the "liability of foreignness" facing foreign firms (Eden & Miller, 2004).

MNEs respond to host country institutional pressures by adapting their entry and operation strategies with the aim to enhance their legitimacy. At a basic level, they may respond to isomorphic pressures by imitating the prevalent organizational practices and structures of other firms in the same organizational field (Meyer & Rowan, 1977), for example, in the host country (Chan & Makino, 2007; Kostova & Roth, 2002; Yiu & Makino, 2002). However, MNEs may have to do more than imitate local practices when facing fundamental challenges to their legitimacy, such as SO MNEs entering contexts dominated by PO firms. First, they may pursue "low profile strategies" that avoid the attention of critical stakeholders (Meyer & Thein, 2014). For example, they may avoid actions likely to trigger adverse reactions by local interest groups, such as hostile takeovers of local firms. The lower an entrant's profile in terms of media attention, the less likely its legitimacy will be challenged. Second, foreign investors may share ownership with local firms that enjoy high legitimacy in the host country, and thereby transfer the partner's legitimacy to their own operations (Lu & Xu, 2006). In this way, MNEs can "exchange ownership for legitimacy" (Chan & Makino, 2007: 623) as a form of symbolic or "ceremonial" adaptation (Meyer & Rowan, 1977) that helps demonstrate that the subsidiary has a local identity and merits legitimacy.

The institutional pressures on foreign investors, however, do not apply homogeneously to all foreign firms; they differ, for example, with ownership types (Cui & Jiang, 2012). In particular, firms with state ownership may have less legitimacy and face greater institutional pressures in a host society than PO firms. For example, local opposition to acquisitions by foreign SO MNEs emerged in context of privatization processes involving sales of SO firms to foreign SO firms, such as East European banks acquired by

Austrian state banks, utilities in Africa acquired by South African utilities, and France Telecom taking over Polish Telecom (Kulawczuk, 2007). Likewise, when Renault tried to acquire Volvo, opposition in Sweden was in part due to the fact that Renault was then controlled by the French state (Bruner & Spekman, 1998; Stevenson, 1993). As another example, Russia's state oil firm Gazprom frequently attracts political opposition in Central and Eastern Europe (Clifton & Diaz-Fuentes, 2010). More recently, investment in the mining industry by Chinese SO MNEs received considerable political resistance, especially in technologically and institutionally advanced countries such as the United States and Australia (Globerman & Shapiro, 2009).

Institutional pressures evolve as an outcome of social and political processes in the relevant organizational field (Hoffman, 1999). Specifically, foreign investors encounter historically evolved sets of cognitive, normative, and regulatory institutions in a host society (Kostova, 1999; Scott, 2001). In particular, an investor that is state owned may not "fit" a foreign institutional environment. At a cognitive level, widely shared beliefs about the nature of SO MNEs may create tensions that translate into normative or even regulatory pressures for SO MNEs to demonstrate their legitimacy. Such beliefs can arise from several perceptions as to how SO firms are different from PO firms: First, societies where the government plays a very limited direct role in business may find it difficult to appreciate how SO firms operate in other countries. Hence there may be an ideological tension between alternative variations of capitalism, specifically between free market economies and state-led market economies (Lin, 2011; Musacchio & Lazzarini, 2012; Tipton, 2009). Second, SO MNEs may be perceived not only as economic agents but also as political agents of their home government. In some cases, SO MNEs have even been portrayed as agents of an unfriendly government aiming to extract resources from the host country, and thereby damaging its economic infrastructure and possibly even threatening its national security (Globerman & Shapiro, 2009; Nyland et al., 2011). Third, SO firms tend to have preferential access to some resources from their government, for example, in form of loans from state banks or access to services of overseas diplomatic representations (Buckley et al., 2007; Knutsen, Rygh, & Hveem, 2011; Li, Newenham-Kahindi, Shapiro, & Chen, 2013; Luo, Xue, & Han, 2010). Although this access is normally conditional on providing services to the society or to the

government (Cui & Jiang, 2012; Li et al., 2013; Wang et al., 2012), it is by some considered as an unfair competitive advantage, a view promoted by some interest groups in host economies (Sauvant, 2010; Wong, 2013). Fourth, SO firms are typically viewed as less efficient than their PO counterparts, and therefore believed to generate limited spillover benefits to the host economy (Globerman & Shapiro, 2009). Finally, SO firms have a reputation for more bureaucratic organizational structures and less transparent business practices; as a result, they are seen with greater suspicion by both employees in acquired businesses abroad, and by other stakeholders in host societies (Liu & Woywode, 2013; Zhang, Zhou, & Ebbers, 2010).

These beliefs, which may or may not be supported by empirical evidence, shape reactions by local actors and hence the institutional pressures faced by SO firms. We therefore argue that these beliefs, and hence the differences of institutional pressures faced by, respectively, SO and PO firms, vary across countries. In particular, two host country conditions – one technological and one institutional – likely shape the level of additional institutional pressures faced by SO firms. In countries with strong technological development, fears might arise from losing critical technologies not only to foreign competitors but to foreign governments. In countries where a strong rule of law limits the direct government interference in business, ideological inconsistencies with SO firms are likely to arise. In these countries, institutional pressures on SO MNEs are likely more salient.

HYPOTHESIS DEVELOPMENT

Key decisions of a foreign entry concern whether to acquire a local firm or to establish a new subsidiary from scratch, that is, a greenfield project (Hennart & Park, 1993; Slangen & Hennart, 2007), and the level of equity control in the new operation (Anderson & Gatignon, 1986; Meyer et al., 2009a). Both decisions can be used to accommodate host country institutional pressures.

First, greenfield investors usually face fewer challenges to their legitimacy than acquirers of local firms. Acquisitions tend to have a higher profile in local media and political discourses, and they potentially involve short-term job losses, whereas greenfield investments bring more visible benefits such as new production capacities and new jobs (Globerman & Shapiro, 2009; Sauvant, 2010; Xu & Shenkar, 2002). Theoretically, the long-term effects of establishment mode on employment generation and

economic growth are ambiguous because of indirect effects such as crowding out and productivity increases (Meyer, 2004). However, political discourses tend to be driven by beliefs and interest group interventions, and therefore rarely consider such complex indirect benefits (Globerman & Shapiro, 2009).

Thus acquirers face stronger institutional pressures to demonstrate their legitimacy. These pressures originate from norms of legitimate organizational forms in the society, but may take regulatory form, notably competition law as applied to mergers and acquisitions, and national-security-related laws as applied to resources considered strategic by the host society. For instance, while mergers and acquisitions are subject to security review by the Committee on Foreign Investment in the United States, greenfield investments are exempted from such review (Sauvant, 2010). Pressures also arise from managers and employees of the target companies who are worried about their job security and attempt to influence the outcome of proposed acquisitions through, for example, lobbying regulatory authorities. Hence since more stakeholders in the host country are *directly* affected by foreign acquisitions than by greenfield investments, more institutional pressures are likely to emerge. Investors may thus aim to reduce such institutional pressures by investing in greenfield projects rather than acquiring local firms.

These institutional pressures, however, do not prevent all acquisitions because some strategic objectives, such as first mover advantages and access to resources that are embedded in local firms (Hennart & Park, 1993; Slangen & Hennart, 2007), call for an acquisition entry. In particular, foreign investors seek both resources that help local competitiveness (such as knowledge of the business environment and marketing assets) and internationally transferable assets (such as technologies) that investors aim to redeploy in their global operations (Anand & Delios, 2002; Meyer, Wright, & Pruthi, 2009b). In pursuit of such strategic objectives, entrants may use acquisitions even when facing contrarian institutional pressures. In such acquisitions, however, entrants can vary the degree of equity control as a means to alleviate legitimacy concerns in host countries (Chan & Makino, 2007; Yiu & Makino, 2002). In particular, a lower level of equity enables a low profile strategy (Meyer & Thein, 2014) and provides an important signal that an investor is working with local partners to align to institutional norms in the host economy (Cui & Jiang, 2012). Specifically, a low level of control

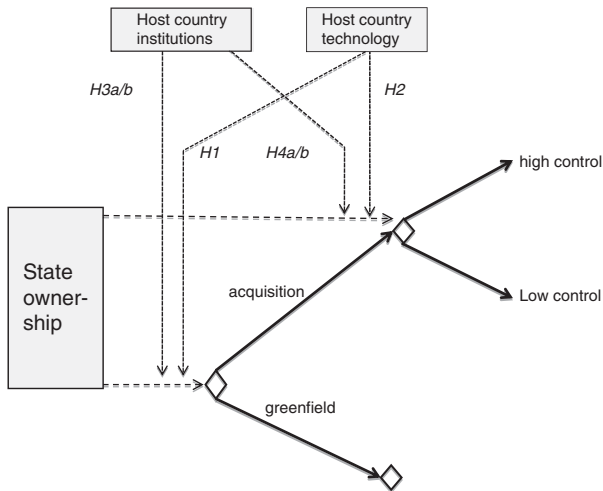


Figure 1 Host country technology and institutions and SO MNEs' entry strategies.

limits the ability of the owners of the investing firm to impose their objectives onto the local operations, and thus alleviates suspicions of local stakeholders. Moreover, shared ownership enables investors to leverage the legitimacy of the local co-owner (Lu & Xu, 2006), and facilitates local regulatory approval where that is required (Sauvant, 2010). Indeed, regulatory authorities seldom intervene in acquisition deals where the acquirer takes a non-controlling interest in the target.²

To sum up, entry modes involve two decisions that can be used to accommodate host country institutional pressures. First, acquisitions are subject to more institutional pressures than greenfield investments. Further, in acquisitions, the control decision is subject to negotiations with the sellers of the target firm and other local stakeholders (Hennart, 2009), which is not the case in greenfield entries. Hence we analyze equity stake decisions specifically for acquired units, which lead us to an entry mode choice of two-staged decisions where MNEs first choose their establishment mode between greenfield and acquisition and then choose their equity control level in acquired units (Figure 1). Our hypotheses explore aspects of the host country that are likely to trigger differential institutional pressures on SO MNEs, and the impact of such pressures on their entry strategy.

Host Country Technological Environment

Host societies may have major concerns about foreign takeovers when an acquirer could use acquired technology in ways that harm the competitiveness

of the host economy (Globerman & Shapiro, 2009). Such concerns can arise from the relocation of high value adding activities out of the country, from sharing of technology embedded in a local cluster with wider groups of competitors abroad, or from transfer of technology of military relevance to countries perceived to be hostile. Some of the technology that the foreign firm gains access to may not be owned by the acquired firm (and hence paid for in the acquisition) but shared knowledge in the local business community, perhaps even including the outcome of government sponsored research projects. Host countries or business communities whose international competitiveness relies to a large degree on their technological prowess are thus likely to be concerned about such "technology leakage" and develop institutional pressures to prevent acquisitions of technology.

Technology leakage concerns are likely to arise in particular when the acquiring firm is an SO MNE, for several reasons (Sauvant, 2010). First, emerging market MNEs enter technology-rich host countries often with the explicit goal of securing technological resources (Chen, Li, & Shapiro, 2012; Cui, Meyer, & Hu, 2013; Deng, 2009, Li, Li, & Shapiro, 2012; Rui & Yip, 2008). In case of SO MNEs, such acquired technologies may be diffused fast in the home country, in part in form of deliberate sharing with other state agencies or firms. For example, in China, the acquisition of world-class technologies and brands overseas is not only a corporate strategy but an explicit goal of government policy (Xinhua, 2011). SO MNEs might thus pass the acquired technology to other SO firms, including those in the military sector, to fulfill political objectives such as development of national economy and defense. Second, stakeholders in host countries often find it more difficult to monitor technology transfer activities of SO MNEs than those of PO firms because the organizational structures and processes of SO firms are generally less transparent than in private firms, which in itself can be a source of suspicions (Liu & Woywode, 2013).

The reverse transfer and dispersion of technology by foreign SO MNEs is therefore by some local stakeholders perceived to be a threat to their competitiveness, and perhaps even to their security. Such perceived consequences of technology leakage have in some countries led to new regulations that require special screening or approval of acquisitions by SO MNEs (Sauvant, 2010), which create additional regulatory pressures that SO MNEs have to manage.

We therefore expect that in countries with abundant technological resources, SO MNEs are more likely than their PO counterparts to encounter adverse host country institutional pressures when pursuing acquisitions. Consequently, we predict that SO MNEs are less inclined to use acquisitions as an establishment mode when entering technology-rich host countries.

Hypothesis 1: The higher the host country's endowment with technology, the less likely that SO MNEs will choose an acquisition entry relative to PO MNEs.

Once an entrant decided to acquire a local firm, for example, because that is the only way to access some sought resources, they can still address local legitimacy concerns by the way they structure the acquisition deal. Most important, they can choose a partial acquisition over a full acquisition as a means to benefit from the local co-owner's legitimacy (Lu & Xu, 2006) and to reassure local stakeholders of their mutually beneficial objectives (Cui & Jiang, 2012). Former owners that remain involved in the company stand for both business continuity and the protection of legitimate interests of the host society, such as the retention of technological competences, and thus lend legitimacy to the acquirer in the eyes of local stakeholders.

Where local stakeholders are concerned about technology leakage as a consequence of SO MNEs' strategic asset seeking, institutional pressures are likely to target specifically acquisitions by SO MNEs. As argued above, we expect this to be the case in particular in technology-rich countries. We therefore expect SO MNEs to design their acquisition deals so as to keep a low profile, avoid conflicts with local stakeholders, and leverage the legitimacy of a local co-owner. In consequence, SO MNEs would be more likely than PO MNEs to pursue lower equity control levels in acquisitions in high-technology countries.

Hypothesis 2: In acquired units, the higher the host country's endowment with technology, the lower the equity control level SO MNEs will choose relative to PO MNEs.

Host Country Institutional Environment

The institutional profile of a host country in terms of regulatory, normative, and cognitive institutions shapes the pressures that foreign investors face (Kostova, 1999; Yiu & Makino, 2002). Pressures that are directed specifically against SO MNEs are likely to be strong in countries where the dominant ideology promotes a free market economy. Such countries

organize their economies around markets and open competition between private firms. The efficiency of markets is secured by the rule of law, in particular private property rights, transparency in business relationships, and the protection of private shareholders (La Porta, Lopez-de-Silanes, & Shleifer, 2008). In such a context, governments are normally not directly involved in business, and SO firms are rare. Therefore the legitimacy of SO MNEs is likely to be challenged because they appear to be inconsistent with the leading ideology, and a potential threat to the economic system, as argued above. This belief creates normative pressures that can lead to additional regulatory requirements for acquisitions by foreign SO MNEs, such as a formal approval by committee on foreign investment (Sauvant, 2010). Such requirements strengthen the positions of local stakeholders and provide means by which they can prevent the implementation of an M&A deal (Zhang et al., 2010).

An important channel through which institutional norms can affect the outcomes of acquisition negotiations is the legal protection of minority shareholders. A strong shareholder protection makes it more complex for acquirers to obtain equity stakes because of requirements for transparency of the acquisition process, and the need for minority shareholders to approve proposed acquisition deals (La Porta et al., 2008). Hence an acquirer has to earn legitimacy with minority shareholders as well.

These arguments suggest that institutional pressures opposed to acquisitions by SO MNEs are particularly strong in countries with strong legal development, with shareholder protection being a particular important aspect of the rule of law. In such countries, local stakeholders are both more motivated and more equipped with legal means to deter acquisitions by SO MNEs. Therefore we expect that in these contexts SO MNEs are more inclined to use greenfield investments that grant them more legitimacy.

Hypothesis 3a: The stronger the host country's rule of law, the less likely that SO MNEs will choose an acquisition entry relative to PO MNEs.

Hypothesis 3b: The stronger the host country's shareholder protection, the less likely that SO MNEs will choose an acquisition entry relative to PO MNEs.

Host country institutional pressures specifically affect the ownership stake that foreign investors take (Yiu & Makino, 2002). In countries with strong rule of law, local stakeholders are more motivated to exert pressure on SO MNEs acquiring a local



company because of the perceived discrepancy between the principles of a free market economy and the notion of state ownership. If SO MNEs wish to acquire a firm in such a country, they face strong pressures to use other means to signal their commitment to the rules of a market economy. An important and highly visible means to appease such pressures when acquiring a local operation is to retain a local partner as shareholder (Chan & Makino, 2007), in particular when that partner enjoys strong local legitimacy (Lu & Xu, 2006). Such partial acquisitions also tend to have a lower public profile, and are hence less likely to attract public debates and challenges to the legitimacy of the acquirer. Thus to deal with strong institutional pressures in countries with strong rule of law, SO MNEs are more likely than PO MNEs to reduce their equity stake when acquiring a local firm.

This effect is likely to be particularly evident where existing minority shareholders can use their power provided by their legal protection to ensure that the acquisition is aligned to institutions of the host society. For example, stock market regulation may require investors to go public with a formal bid for all outstanding shares when increasing their equity stake beyond certain threshold levels.³ Such shareholder protection rules make it more difficult to acquire full control because a public battle for control over a firm may open for debates over the legitimacy of the acquirer.

Hence acquirers have strong incentives to proactively demonstrate their local legitimacy in contexts with strong rule of law, especially where shareholder protection is strong. Since SO MNEs are, as argued above, under stronger pressures than PO MNEs, we predict SO MNEs to be more inclined to take lower equity control:

Hypothesis 4a: In acquired units, the stronger the host country's rule of law, the lower the equity control level SO MNEs will choose relative to PO MNEs.

Hypothesis 4b: In acquired units, the stronger the host country's shareholder protection, the lower the equity control level SO MNEs will choose relative to PO MNEs.

METHODS

Data and Sample

To analyze our research questions, we constructed a data set of foreign subsidiaries of listed Chinese

MNEs with and without state ownership. Our unit of analysis is overseas subsidiaries, which include wholly and partially owned subsidiaries of listed Chinese firms.⁴ We constructed our data set from all Chinese firms listed in the Shanghai and Shenzhen Stock Exchanges in 2009. The development of the Chinese stock market since the early 1990s is closely connected with China's economic reform, in particular, the reform of SO enterprises (Sun & Tong, 2003). A major initial political objective of establishing the stock markets was to transform SO firms into modern corporations and to improve their performance. As a result, most of the largest Chinese SO firms, such as Sinopec, China National Petroleum, China Mobile, and Baosteel are listed on either stock market. This provides legitimacy for the use of listed firms to study SO firms' internationalization activities.

The identification of SO enterprises in China is complicated by the complex patterns of ownership change over the past two decades (Yiu, 2011; Zou & Adams, 2008). For our purposes the critical aspect is whether a state entity or an organization indirectly controlled by a state entity has a controlling influence over the firm. Therefore following earlier studies (Ding, Zhang, & Zhang, 2008; Jones & Mygind, 1999), we used the principle of the largest shareholder to define a firm as SO if the single largest shareholder is a government department or another SO firm,⁵ and as PO if it is an individual or a private company. This definition is based on the observation that, at least in the Chinese context, government entities have a controlling influence even as minority shareholders as long as no other shareholder holds a larger stake. As of the end of 2009, among a total of 1686 Chinese A-share listed companies, 914 companies were SO by this definition.

For the 1686 listed companies, we then hand-collected from their 2009 annual reports the information on their outward investment activities. Chinese listed firms are required to disclose information on their subsidiaries, domestic as well as overseas, which includes location and the listed company's voting rights and cash flow rights in the subsidiary. We traced back in the annual reports year by year, in order to find the year of establishment and data associated with that point in time. Based on this information, we constructed a list of 1154 entities invested by listed firms. However, subsidiaries in Hong Kong, Macao and the tax havens of British Virgin Islands and the Cayman Islands serve primarily as holding organizations or as financing instruments for operations in third countries, or in fact in China itself (Ding, Nowak, & Zhang, 2010; Hong & Sun, 2006), and hence fall

Table 1 List of host countries and the number of investments in our sample

Host country	Acquisition	Greenfield	Total	Host country	Acquisition	Greenfield	Total
Argentina	0	1	1	Myanmar	0	1	1
Australia	5	14	19	The Netherlands	9	11	20
Bangladesh	0	2	2	Nigeria	0	1	1
Belgium	3	2	5	Pakistan	0	1	1
Brazil	1	4	5	Panama	4	0	4
Canada	5	6	11	Philippines	1	5	6
Colombia	0	1	1	Poland	1	1	2
Cyprus	0	1	1	Qatar	1	1	2
Czech Republic	0	2	2	Romania	1	0	1
Denmark	1	1	2	Russia	2	7	9
Egypt	0	1	1	Singapore	7	23	30
Ethiopia	0	1	1	Slovakia	0	1	1
Finland	0	2	2	South Africa	2	5	7
France	1	3	4	Spain	0	3	3
Germany	4	15	19	Sri Lanka	2	0	2
Ghana	0	1	1	Sudan	0	1	1
India	0	10	10	Suriname	0	1	1
Indonesia	1	5	6	Switzerland	0	1	1
Iran	0	1	1	Taiwan	0	1	1
Italy	3	6	9	Tanzania	0	1	1
Japan	8	12	20	Thailand	4	1	5
Jordan	0	3	3	Turkey	1	1	2
Korea	0	9	9	Uganda	0	1	1
Liberia	1	24	25	Ukraine	0	1	1
Luxembourg	1	3	4	The United Kingdom	2	8	10
Malaysia	3	6	9	The United States	22	56	78
Mexico	0	2	2	Venezuela	1	1	2
Mongolia	0	4	4	Vietnam	0	13	13
				Total	97	289	386

outside the scope of our research. We kept investments in Panama and Liberia in our sample because they are in the shipping business and are not for tax purposes. Moreover, we have taken out observations in the sectors of energy, telecommunication services, and utilities because in those sectors, almost all overseas subsidiaries are controlled by an SO MNE, and hence a meaningful comparison between SO and PO MNEs is not possible.⁶ After exclusions, we had 569 observations of overseas subsidiaries of Chinese SO and PO listed companies. Due to missing values on host country variables, our final sample for regression analysis ranges from 298 to 386 observations. In Table 1 we provide the list of host countries and the number of investments in our sample.

Variables and Measurements

Dependent variables

We traced each subsidiary back in the annual reports to the year of its establishment, in order to

determine whether it was established through acquisition or greenfield. Based on this information, we constructed a dummy variable: *acquisition* is one if the subsidiary is acquired and zero otherwise.

We measured an MNE's *level of control* in a subsidiary using its cash flow rights in the subsidiary. As a robustness check, we ran the same tests using voting rights, which may vary because pyramid ownership structures are quite common in China (Yiu, 2011).⁷ The difference between these two measures is small, as the correlation between the two variables is 0.97, and the results were substantially identical. To save space, we report the results based on the cash flow rights only.

Explanatory variables

Our main explanatory variable is *state ownership*, which we measured using the ultimate controlling shareholder approach discussed above. Hence we defined a dummy *state* that equals to one if the firm's ultimate controlling shareholder is a state entity or

owned by a state entity, and to zero if it is an individual or a private company. We dropped a few companies that have other types of ultimate ownership, such as foreign and collective. Note that in China collectively owned companies are typically “township and village enterprises”, which are controlled by town or village governments and are different from either SO or private firms (Naughton, 1994).

Three variables capture the host country moderators. To capture a country’s level of technological resources, we measured *host technology* by the log value of a country’s annual number of patent applications to the US Patent and Trademark Office, divided by the country’s GDP, to control for the size and economic development of the host economy (Buckley et al., 2007; Kogut & Chang, 1991). The patent data were obtained from the OECD Patent Statistics and refer to the year of the subsidiary’s establishment (as does the GDP data).

Our *rule of law* variable is based on the Law and Order dimension at the year of the subsidiary’s establishment in the International Country Risk Guide (ICRG) database published by Political Risk Services. This dimension is an assessment of the strength and impartiality of the legal system, as well as the popular observance of the law. The ICRG indicators are among the most widely used measures for quality of institutional environments (e.g., Hall & Jones, 1999). *Shareholder protection* in the host country is measured by Lopez-de-Silanes, La Porta, Shleifer, and Vishny’s (1998) anti-director rights index, which captures the easiness for outside investors to protect themselves against the expropriation of either the controlling shareholders or the managers. The index is formed by adding one when: “(1) the country allows shareholders to mail their proxy vote to the firm; (2) shareholders are not required to deposit their shares prior to the General Shareholders’ Meeting; (3) cumulative voting or proportional representation of minorities in the board of directors is allowed; (4) an oppressed minorities mechanism is in place; (5) the minimum percentage of share capital that entitles a shareholder to call for an Extraordinary Shareholders’ Meeting is less than or equal to 10% (the sample median); or (6) shareholders have pre-emptive rights that can only be waived by a shareholder’s vote” (Lopez-de-Silanes et al., 1998: 1123). The index ranges from 0 to 6 and is time invariant. As a robustness check, we also used the anti-self-dealing index by Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2008) and the revised anti-director rights index by Spamann (2010) in place of the anti-director rights index to find largely

consistent results. Note that the concepts of *rule of law* and *shareholder protection* are nested, that is, shareholder protection concerns are a specific aspect of the rules of law. Hence they are entered one-at-a-time in the analysis, not simultaneously.

Control variables

Our control variables capture variations at parent firm and host-country level. At parent level, we included *international experience*, which is the difference in years between the parent’s first establishment of a foreign subsidiary and the focal overseas subsidiary. Moreover, we controlled for firm financial characteristics in the year before the establishment of the focal subsidiary, which include *parent size* (total assets) and *parent profitability* (return on assets (ROA)). The data were obtained from the database published by Wind Information.

At host country level, in addition to the country level variables mentioned earlier, we first included *political risk* at the year of the subsidiary’s establishment based on the Government Stability dimension in the ICRG database (Asiedu, Jin, & Nandwa, 2009; Buckley et al., 2007). Government stability assesses the government’s ability to carry out its declared programs as well as its ability to stay in office. The maximum score for government stability is 12. To facilitate the interpretation of the results, we used 12 minus the government stability score to obtain the measure for political risk. Thus a higher number implies a higher risk.

Finally, we included nine industry dummies based on the two-digit industry classifications by Global Industry Classification Standard to control for industry effects.

Model Specification

We have two sets of regressions to estimate:

- (1) $\text{Probability}(\text{acquisition}) = f(\text{state, host country variables, interactions, controls})$
- (2) $\text{Level of control in acquired units} = f(\text{state, host country variables, interactions, controls})$

We used a Logit model to estimate the probability of acquisition (vs greenfield) being chosen as the establishment mode. To test Hypotheses 1, 3a, and 3b, we examine the interaction effects of *state* with, respectively, *host technology*, *rule of law*, and *shareholder protection* on the probability of acquisition. *Level of control* in acquired units has a distribution with a high number of observations at the upper limit of 100%, such that we chose a

Tobit model to capture this non-linear distribution (Tobin, 1958; Wooldridge, 2002). To test Hypotheses 2, 4a, and 4b, we examine the effects of the three interactions between *state* and the host country variables on level of control in acquired units. For comparison, we also report results for the greenfield subsample.

As discussed in detail in the robustness check section, we also used the Heckman two-stage estimation techniques to address potential selection biases (i.e., unobserved factors jointly determine the choice of acquisition and the level of control in acquired units) but did not find the selection bias a concern for our study. We therefore report the results of the separate regression models.

RESULTS

Table 2 provides descriptive statistics of our sample and illustrates some characteristics of Chinese SO and PO MNEs as well as the *t*-tests of their

mean differences. It provides already some interesting contrasts between SO and PO firms regarding their FDI entry mode as well as their level of control in their foreign invested firms: SO firms tend to use more acquisitions while PO firms prefer greenfield investments. Nonetheless, we must be cautious in interpreting these univariate differences that might be driven by other differences between these two subgroups. We also notice that 60% of foreign invested firms belong to SO parents. In line with characteristics reported in earlier studies (Ding et al., 2008), the SO firms in our sample are more than two times larger by assets, while PO firms are more profitable in terms of ROA, 11.87% compared with 9.34% for SO firms. SO firms also have more international experience than PO firms.

Table 3 reports the correlation matrix for the variables. We observe that host technology and shareholder protection are correlated at 0.506,

Table 2 Descriptive statistics

Variables	Full sample		SO firm sample		Private firm sample		Difference between SO and private firms	
	Mean	s.d.	Mean	s.d.	Mean	s.d.	<i>t</i> -statistics	<i>p</i> -value
<i>Acquisition</i>	0.252	0.435	0.307	0.462	0.168	0.378	-3.13***	0.002
<i>Control level</i> (cash flow rights, in percentage)	83.338	23.113	79.768	23.912	88.639	20.754	3.76***	0.002
<i>State</i>	0.600	0.491	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<i>Host technology</i>	0.361	0.342	0.375	0.449	0.341	0.110	-0.88	0.380
<i>Rule of law</i>	4.484	1.166	4.495	1.254	4.472	1.022	-0.19	0.850
<i>Shareholder protection</i>	3.651	1.474	3.558	1.460	3.778	1.491	1.27	0.205
<i>International experience</i>	4.452	5.544	6.030	6.484	2.077	2.124	-7.33***	0.000
<i>Political risk</i>	3.019	1.597	2.984	1.595	3.060	1.603	0.46	0.648
<i>Parents size</i> (RMB 100 billion)	0.095	0.173	0.128	0.210	0.045	0.067	-4.75***	0.000
<i>Parent ROA</i> (in percentage)	10.364	6.990	9.337	6.879	11.869	6.882	3.54***	0.000

*** *p* < 0.01.

Table 3 Correlations

Variables	1	2	3	4	5	6	7	8	9	10
1. <i>Acquisition</i>	1.000									
2. <i>Control level</i>	-0.194*	1.000								
3. <i>State</i>	0.158*	-0.189*	1.000							
4. <i>Host technology</i>	-0.028	0.054	0.049	1.000						
5. <i>Rule of law</i>	0.104*	-0.066	0.010	0.013	1.000					
6. <i>Shareholder protection</i>	-0.060	0.003	-0.074	0.506*	0.191*	1.000				
7. <i>International experience</i>	-0.018	0.065	0.350*	0.205*	-0.405*	-0.061	1.000			
8. <i>Political risk</i>	0.095	-0.104*	-0.023	-0.041	-0.072	-0.119*	-0.153*	1.000		
9. <i>Parents size</i>	0.321*	-0.106*	0.236*	-0.007	0.026	-0.056	0.235*	0.120*	1.000	
10. <i>Parent ROA</i>	-0.035	0.100*	-0.178*	0.015	0.036	0.046	0.046	-0.025	0.058	1.000

* *p* < 0.05.

which is expected given the nested nature of the two constructs; in order to avoid the multicollinearity problem, we do not include them in the same regression analysis and instead enter them separately in different models.

We start our analysis by estimating a Logit regression of establishment mode choice. Table 4 reports the results with positive coefficients indicating a preference for acquisitions and negative coefficients for greenfield entries. Column (1) includes only the control variables. As the host country variables are correlated with each other we first introduce them one at a time (Columns (2)–(7)) and then combine two not highly correlated moderating effects (Column (8)). The average VIF values of the variables included in Column (8) of Table 4 is 3.64, well below the threshold value of 10 for concerns of multicollinearity (Chatterjee, Hadi, & Price, 2000).

In countries with high level of *host technology* endowments, we find that acquisitions are more likely; the direct effect is positive and significant. Hence *host technology* principally may be attractive for foreign investors. To test our Hypothesis 1, we turn to the interaction effect between *host technology* and *state*, which is negative and significant in both Columns (3) and (8) ($p < 0.05$ and $p < 0.01$, respectively). In addition, the inclusion of the interaction between host technology and state in Column (3) also results in a significant increase in its explanatory power over the model in Column (2), as reflected by the significant incremental improvements in the log-likelihood ratio test ($p < 0.01$).

Due to the non-linear nature of Logit regression, however, caution is needed when we interpret the moderating effect of host technology. Following the method in Wiersema and Bowen (2009), we calculated the “true interaction effects”, that is, the marginal effects of host technology on the relationship between state and the likelihood of acquisitions. We found that the values of the true interaction effect range from -0.58 to -0.43 , with a mean value of -0.49 , and that the z-statistic values range from -3.08 to -2.17 , with all values of the true interaction effect significant. Hence as predicted, SO firms are less likely than PO firms to acquire local firms in countries with high levels of technologies. Thus we find strong support for Hypothesis 1, that is, SO MNEs adapt to stronger institutional pressures (compared with PO MNEs) where locals may be concerned about technology leakage.

In Columns (5) and (8) of Table 4, the critical effect is the interaction effect of *rule of law* with *state*,

which is positive and not statistically significant, and hence fails to provide support for Hypothesis 3a. However, we find support for Hypothesis 3b in Column (7), which suggests that stronger influence of minority shareholders, as reflected in stronger *shareholder protection* would deter in particular SO firms from using acquisitions. While the direct effect of shareholder protection is not significant, the moderating effect with *state* is negative and significant ($p < 0.10$). In addition, the inclusion of the interaction between shareholder protection and state in Column (7) also results in a moderate increase in its explanatory power over the model in Column (6), as reflected by the marginally significant improvements in the log-likelihood ratio test ($p < 0.10$). We further calculated the true interaction effects of state and shareholder protection and found that the values range from -0.067 to -0.045 , with a mean of -0.057 , and that the z-statistics range from -1.67 to -2.84 , with all values of the true interaction effects significant. Hence as expected, shareholders in existing firms may use their power under strong laws that protect their interests to inhibit acquisitions, especially when the potential acquirer is an SO MNE.

Of the control variables, state ownership has a positive and significant effect on acquisitions in most specifications, suggesting that the resource advantage that strengthens SO MNEs' ability to finance acquisitions overrides any contrarian host country institutional pressures. The parent size is consistently significant across specifications, as one would expect that companies with more resources are more able to finance foreign acquisitions. International experience is negative and significant in three models, indicating that more experienced MNEs hesitate to use acquisitions, perhaps because they are less in need of local partner helping them navigate the host economy.

Turning to the choice of the *level of control*, we report two sets of results, respectively, for the subsamples of acquired units (Table 5) and, as a robustness check, of greenfield projects (Table 6).⁸ Our theoretical considerations suggest that the local context variables influence the level of control in acquired subsidiaries (though not necessarily in greenfield entries), and hence we turn to Table 5 to assess our hypotheses.

With respect to host country technology, we note that the direct effect of *host technology* is significant in the case of acquisitions: firms tend to acquire high control over acquired companies in technology rich countries in order to better internalize technological

Table 4 Results of Logit models predicting the probability of acquisition entries

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
<i>State</i>	0.632** (0.306)	0.534 (0.325)	3.731*** (1.396)	0.594* (0.309)	0.598* (0.329)	0.335 (0.322)	1.637* (0.841)	4.674*** (1.741)
<i>Host technology</i>		-0.262 (0.601)	6.240* (3.185)					7.977** (3.893)
<i>State</i> × <i>Host technology</i>			-9.330** (3.726)					-11.426*** (4.408)
<i>Rule of law</i>				0.118 (0.127)	0.111 (0.233)			-0.293 (0.298)
<i>State</i> × <i>Rule of law</i>					0.010 (0.278)			0.376 (0.346)
<i>Shareholder protection</i>						-0.043 (0.095)	0.188 (0.171)	
<i>State</i> × <i>Shareholder protection</i>							-0.354* (0.206)	
<i>International experience</i>	-0.066** (0.031)	-0.006 (0.043)	0.007 (0.046)	-0.056* (0.033)	-0.056* (0.034)	-0.017 (0.042)	-0.010 (0.043)	0.005 (0.045)
<i>Political risk</i>	0.052 (0.081)	0.036 (0.085)	0.034 (0.089)	0.065 (0.081)	0.065 (0.082)	0.064 (0.085)	0.074 (0.085)	0.019 (0.092)
<i>Parent size</i>	5.844*** (1.238)	5.311*** (1.328)	5.603*** (1.358)	5.724*** (1.233)	5.713*** (1.269)	4.861*** (1.315)	4.771*** (1.305)	5.291*** (1.358)
<i>Parent ROA</i>	-0.013 (0.021)	-0.009 (0.022)	-0.006 (0.022)	-0.015 (0.021)	-0.015 (0.021)	-0.010 (0.022)	-0.012 (0.023)	-0.006 (0.023)
Constant	-1.410*** (0.503)	-1.457*** (0.564)	-3.878*** (1.363)	-2.011** (0.819)	-1.977 (1.243)	-1.232* (0.676)	-2.127** (0.897)	-3.118** (1.581)
Pseudo R^2	0.126	0.121	0.144	0.128	0.128	0.097	0.106	0.147
χ^2	54.643***	45.768***	53.445***	55.518***	55.520***	34.669***	37.800***	54.658***
<i>N</i>	386	318	318	386	386	298	298	318
Log likelihood		-166.62	-185.62	-217.61	-189.85	-179.06	-160.16	-158.29
Compared to model		(1)	(2)	(1)	(4)	(1)	(6)	(3)
Changes in likelihood (d.f.)		12	13	12	13	12	13	15
Likelihood ratio χ^2		0.27	7.56***	0.88	0.00	0.21	3.13*	1.21

Notes: Standard errors in parentheses. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$. Nine industry dummies are included.

Table 5 Results of Tobit models predicting level of control in acquired subsidiaries

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
<i>State</i>	-23.656** (11.231)	-18.713 (12.467)	91.686 (57.025)	-21.803* (11.226)	-35.883*** (12.920)	-25.131* (12.655)	30.652 (26.098)	67.514 (68.159)
<i>Host technology</i>		57.512 (47.023)	320.428** (150.179)					285.650* (169.921)
<i>State</i> × <i>Host technology</i>			-314.284** (155.356)					-254.539 (173.834)
<i>Rule of law</i>				-4.704 (3.721)	11.626 (7.607)			1.498 (8.526)
<i>State</i> × <i>Rule of law</i>					-20.602** (8.631)			-9.260 (9.652)
<i>Shareholder protection</i>						3.004 (2.781)	15.787** (6.140)	
<i>State</i> × <i>Shareholder protection</i>							-16.102** (6.895)	
<i>International experience</i>	-1.952* (1.128)	-1.175 (1.263)	-1.060 (1.206)	-2.434** (1.198)	-2.552** (1.160)	-2.207* (1.226)	-1.869 (1.170)	-1.606 (1.275)
<i>Political risk</i>	0.902 (2.270)	-0.468 (2.438)	-0.101 (2.513)	0.701 (2.265)	1.874 (2.254)	-0.101 (2.488)	0.879 (2.419)	-0.029 (2.532)
<i>Parent size</i>	73.478** (28.733)	66.761** (30.106)	72.509** (28.833)	74.399** (28.983)	83.218*** (28.318)	79.114** (31.125)	73.205** (29.402)	76.257** (29.388)
<i>Parent ROA</i>	0.502 (0.650)	0.289 (0.700)	-0.033 (0.687)	0.672 (0.661)	0.261 (0.666)	-0.162 (0.716)	-0.654 (0.727)	0.095 (0.717)
Constant	-41.248 (42.341)	-56.193 (48.265)	-153.994* (78.993)	-17.140 (46.309)	-98.050* (57.070)	-52.436 (48.519)	-88.083* (48.705)	-148.594* (79.114)
Pseudo R^2	0.046	0.046	0.056	0.048	0.057	0.056	0.066	0.062
χ^2	29.754***	26.840***	32.249***	31.374***	36.988***	32.593***	37.941***	35.328***
<i>N</i>	97	89	86	97	97	86	86	86
Log likelihood		-275.99	-270.31	-310.89	-308.09	-273.10	-270.42	-268.78
Compared to model		(1)	(2)	(1)	(4)	(1)	(6)	(3)
Changes in likelihood (d.f.)		14	15	14	15	14	15	17
Likelihood ratio χ^2		1.51	4.12**	1.62	5.61**	1.17	5.35**	3.08

Notes: Standard errors in parentheses. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$. Nine industry dummies are included.

Table 6 Results of Tobit models predicting level of control in greenfield subsidiaries

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
<i>State</i>	-21.052*** (7.321)	-24.077*** (7.525)	-31.699 (25.103)	-21.514*** (7.389)	-26.588*** (8.017)	-15.998** (7.940)	-41.069** (20.709)	-39.954 (28.139)
<i>Host technology</i>		47.033 (34.999)	38.255 (44.475)					28.622 (48.773)
<i>State</i> × <i>Host technology</i>			22.178 (69.580)					40.535 (75.025)
<i>Rule of law</i>				1.556 (3.236)	8.821* (5.258)			2.889 (5.770)
<i>State</i> × <i>Rule of law</i>					-11.497* (6.585)			-4.810 (7.329)
<i>Shareholder protection</i>						-0.722 (2.549)	-4.404 (3.806)	
<i>State</i> × <i>Shareholder protection</i>							6.770 (5.120)	
<i>International experience</i>	1.649** (0.746)	-0.881 (1.070)	-0.893 (1.071)	1.803** (0.812)	1.497* (0.833)	-1.973* (1.086)	-2.033* (1.080)	-0.865 (1.075)
<i>Political risk</i>	-3.708* (2.082)	-4.226** (2.082)	-4.149** (2.093)	-3.498 (2.126)	-3.445 (2.119)	-4.648** (2.234)	-4.722** (2.216)	-4.030* (2.146)
<i>Parent size</i>	11.228 (40.070)	20.628 (40.046)	20.935 (40.062)	8.929 (40.331)	21.642 (41.094)	39.229 (41.290)	36.308 (41.201)	24.794 (40.741)
<i>Parent ROA</i>	0.320 (0.478)	0.442 (0.536)	0.435 (0.536)	0.313 (0.477)	0.404 (0.481)	0.576 (0.597)	0.482 (0.595)	0.466 (0.538)
Constant	126.950*** (13.385)	118.113*** (17.918)	120.702*** (19.713)	118.775*** (21.529)	83.755*** (28.995)	141.710*** (17.940)	156.624*** (21.618)	109.299*** (29.781)
Pseudo R^2	0.016	0.023	0.023	0.017	0.019	0.017	0.019	0.024
χ^2	22.178**	26.197***	26.298***	22.409**	25.498**	16.329	18.089	26.730**
<i>N</i>	289	232	232	289	289	212	212	232
Log likelihood		-553.14	-553.09	-661.20	-659.66	-477.78	-476.90	-552.88
Compared to model		(1)	(2)	(1)	(4)	(1)	(6)	(3)
Changes in likelihood (d.f.)		13	14	13	14	13	14	16
Likelihood ratio χ^2		3.72*	0.1	0.23	3.09*	0.08	1.76	0.43

Notes: Standard errors in parentheses. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$. Nine industry dummies are included.

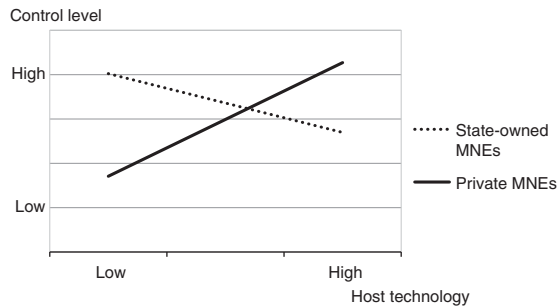


Figure 2 Moderating effect of host country technology level on control level in acquired subsidiaries.

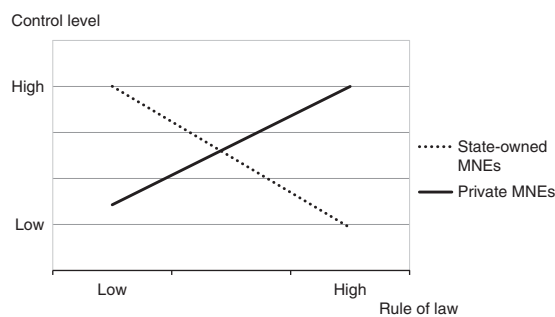


Figure 3 Moderating effect of host country rule of law on level of control in acquired subsidiaries.

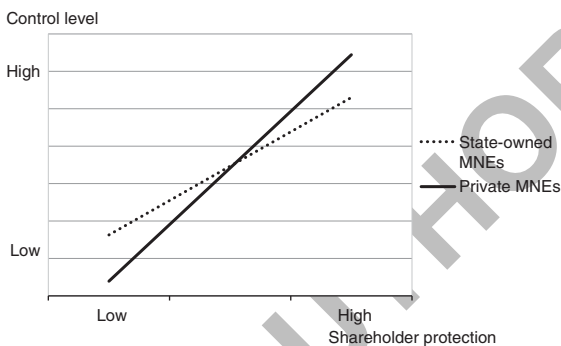


Figure 4 Moderating effect of host country shareholder protection on control level in acquired subsidiaries.

resources. We hypothesized in acquired units a negative moderating effect of host technology on the relationship between state ownership and control level. As expected, the results show a negative effect of the interaction term statistically significant at a 5% level (see Column (3) in Table 5). Further, the inclusion of the interaction term in Column (3) also results in a significant increase in its explanatory power over the model in Column (2), as suggested by the significant improvements in the log-likelihood

ratio test ($p < 0.05$). Hence Hypothesis 2 receives strong support.⁹

In terms of host institutions, we note that the direct effect of *shareholder protection* is significant and positive in the case of acquisitions: when the local institutional environment strongly protects shareholder rights, firms tend to take higher equity stakes. However, this benefit accrues less to SO investors, as the interaction effects of *state* with *rule of law* and *shareholder protection* are negative and significant at a 5% level (Table 5, Columns (5) and (7)). Thus consistent with our predictions in Hypotheses 4a and 4b, in countries with strong rule of law and shareholder protection, SO MNEs are perceived as inconsistent with the dominant ideology, and thus reduce their control level to attain local legitimacy for their acquisitions. This argument carries particular weight where minority shareholders have a strong leverage on how the company is sold to a foreign investor. By limiting themselves to a lower level of equity, SO MNEs can signal that they operate consistently with the principles of a market economy. The inclusion of the interactions in Columns (5) and (7) also result in a significant increase in their explanatory power over the models in Columns (4) and (6) ($p < 0.05$), which provides additional support for Hypotheses 4a and 4b.

We further drew Figures 2–4 to illustrate how the three host country moderators affect the level of control in acquired subsidiaries, based on the results in Columns (3), (5), and (7) of Table 5. The three figures present changes in level of control when each of the moderators changes from its low value (one standard deviation below the mean) to its high value (one standard deviation above the mean) and when all other variables are kept at the mean level.

Figure 2 shows that when host technology increases from low to high, SO firms tend to decrease their control level or cash flow rights in their acquired subsidiaries, whereas PO firms tend to increase their control level in their subsidiaries. Figure 3 shows similar patterns: SO firms tend to decrease their control level but PO firms tend to increase their control level when rule of law level improves. Figure 4 shows that when shareholder protection strengthens, both SO and PO firms tend to increase their control level; however, the changes in PO firms' control level are more significant. Taken together, these figures provide additional evidence to support Hypotheses 2, 4a, and 4b that SO firms are less likely than PO firms to increase their control level in acquired subsidiaries in host countries with better technological or institutional development.

The results we obtained for acquisition entries do not, however, pertain to greenfield entries. Table 6 show that the coefficients of the interaction terms in Columns (3) and (7) are insignificant, suggesting that in countries with strong technology or protection of shareholders, SO MNEs do not differ from PO MNEs in their control level in their greenfield investments. In countries with strong rule of law, however, SO MNEs are more likely to take lower control level than PO MNEs. The coefficient of the interaction between *state* and *rule of law* is significant in Column (5) of Table 6 but both the magnitude and the significance level of this coefficient are smaller than its corresponding part in Column (5) of Table 5. We investigated this further using a Chow test to compare the two coefficients and found that the moderating effect of rule of law is significantly weaker for the greenfield entries than for the acquisition entries ($p < 0.05$). Thus consistent with our arguments, SO MNEs are less subject to host institutional pressures in countries with strong technological or institutional development when they use greenfield investments rather than acquisitions.

Turning to control variables, we note them to be in line with expectations. Large companies take higher levels of control in acquired units. In both acquired units and greenfield projects, SO MNEs take a lower equity stake compared with private firms. This might be because they are more likely to adopt a collaborative approach in their international expansion, in line with the policy advocated by the Chinese government (Cui & Jiang, 2012). Interestingly, we find that *political risk* in the host country has a negative effect on control of greenfield units, suggesting that shared control provides a means to manage exposure to political risk in newly created units.

Robustness Checks

We used the Heckman two-stage model to control for potential selection bias. In the first stage, we included the number of prior acquisitions in a specific country as an instrumental variable, along with the variables included in Model (8) of Table 4, to predict the likelihood of a focal firm's choice of acquisition in that country. In the second stage, we used the variables in Model (8) to predict the control level of a firm given that an acquisition has been chosen. We found that the number of prior acquisitions in a specific country has a statistically significant and positive effect on a firm's choice of acquisition ($p < 0.05$) while its correlation with level of control in the acquisition subsample is as low as 0.05, indicating this is a good

instrumental variable. However, the inverse mills' ratio is not statistically significant ($p = 0.27$), suggesting that selection bias is not a concern for our study (results are available upon request). Therefore it is appropriate to run the two regressions separately.

We moreover included additional control variables to test for the possibility of an omitted variable bias. Specifically, we controlled for "distance" between home and host countries, a key concern in earlier entry mode research (Estrin, Baghdasaryan, & Meyer, 2009; Slangen & Hennart, 2007; Tihanyi, Griffith, & Russell, 2005; Zhao, Luo, & Suh, 2004), using two measures from Dow's distance indices (Dow & Karunaratna, 2006), namely democracy and education, as well as geographic distance.¹⁰ Since these distance measures are correlated with the two host country variables (technology and rule of law), as indicated by the VIF values of above 10 for these variables, we did not include them in our main regression analysis. However, our robustness checks with these distance measures led to similar results: the interaction of state with host technology and the interaction of state with shareholder protection have significant and negative effects on the likelihood of an acquisition entry ($p < 0.05$ and $p < 0.10$). In the acquisition subsample, the interactions of state with host technology, rule of law, and shareholder protection all have significant and negative effects on control level ($p < 0.05$ in all three cases). Thus our main findings without the distance measures do not suffer from an omitted variable bias (results are available upon request).

Finally, we used two alternative measures for shareholder protection, the anti-self-dealing index by Djankov et al. (2008) and the revised anti-director rights index by Spamann (2010), whose correlations with the anti-director rights index are 0.60 and 0.53, respectively. We found that consistent with our main results, the interaction of state with the anti-self-dealing index has a significant and negative effect on the likelihood of using acquisition as an establishment mode ($p < 0.05$), and that the interaction of state with the revised anti-director rights index has a significant and negative effect on control level in acquired units ($p < 0.01$).

DISCUSSION AND CONCLUSION

SOEs, Institutions, and Foreign Entry

The strategies of MNEs are influenced by the interplay of institutions in home and host economies (Kostova et al., 2008; Meyer & Thein, 2014; Westney, 1993). This is particularly evident in the case of SO MNEs,

where representatives of the state influence decisions not only as regulators, but as owners of the firm. Theoretical considerations suggest that home country institutions provide SO MNEs with preferential access to resources conditional on alignment to government policy objectives (Luo et al., 2010, Wang et al., 2012). This support, however, triggers responses in host economies, where SO MNEs face more intense institutional pressures than their private counterparts to demonstrate their legitimacy. We have examined two avenues through which SO MNEs can adjust their foreign entry strategies to build local legitimacy: by choosing greenfield rather than acquisition entry, and by taking lower control level in acquired units (Figure 1).

We argue that host country institutional pressures specifically directed at SO MNEs are likely to arise in countries that are technology-rich and/or have strong rule of law, specifically a strong protection of minority shareholders. First, these pressures arise from local stakeholders' perceived technology leakage due to possible transfers of technology out of the country. We find that these pressures inhibit acquisitions by SO MNEs (Table 4, Column (3)), and when they acquire local firms, they acquire lower equity stakes in the local firm (Table 5, Column (3)). These moderating effects work against the direct effects of technology attracting more acquisitions and higher control over acquisitions, which are due to the greater attractiveness of local target firms. Figure 2 further illustrates the differences between SO and PO MNEs; although SO MNEs tend to choose lower control level in response to institutional pressures in countries with strong technology development, PO MNEs are not subject to these pressures and are indeed inclined to increase control level in those countries.

Second, we predicted institutional pressures on SO MNEs to be particularly strong in countries with high levels of rule of law because of inconsistencies between the leading free market ideology and state ownership. We predicted such pressures to undermine foreign acquisitions. We find such opposition in particular confirmed with respect to the role of minority shareholders in foreign acquisitions: where the minority shareholders enjoy strong legal protection, they are more likely to deter takeovers by SO MNEs (Table 4, Column (7)), and in the case of acquisitions to deter high levels of ownership by SO MNEs (Table 5, Column (7)). With respect to the broader concept of the rule of law, we find it to be associated with lower levels of control by SO acquirers (Table 5, Column (5)), but not with fewer

acquisitions (Table 4, Column (5)). Furthermore, Figure 3 suggests that while SO MNEs tend to lower control levels in acquired subsidiaries to enhance their legitimacy in countries with strong rule of law, PO MNEs do not face similar levels of pressures and take more equity control in those countries. Hence pressures for local legitimacy induce SO MNEs to avoid acquisitions, and/or to reduce their level of control in acquired units.

Theory Advancement

These theoretical and empirical analyses suggest several important insights for theory development. First, the emergent field of studies on SO MNEs (Li, Cui, & Lu, 2014; Wang et al., 2012) needs to consider not only institutions in their home environment, but their interactions with businesses and institutions overseas. When SO firms go overseas, particularly to technologically or institutionally advanced countries, they face not only a more competitive market environment but specific challenges to their legitimacy that they need to address. Further theoretical advances in the study of SO MNEs may explore not only the objective advantages or disadvantages of this ownership form, but the beliefs of relevant stakeholders such as host country societies.

Second, the study of MNEs and institutions, which has progressed from analyzing the effects of host country institutions (Kostova, 1999; Meyer, 2001; Meyer et al., 2009a) and home country institutions (Buckley et al., 2007; Meyer & Thein, 2014) to the dual pressures pertaining to MNEs (Kostova et al., 2008), needs to take into considerations that such pressures do not pertain to all firms in a homogeneous way. In this paper, we have focused on the institutional pressures in host countries arising from beliefs about SO firms. However, this line of argument can be extended to beliefs with respect to other forms of ownership, such as business groups or family owned firms, or to more fine-grained differentiations of state firms (e.g., listed vs non-listed SO firms, or central vs local government controlled SO firms). A starting point for such work may be to hypothesize that firms in the same or similar ownership form find it easier to work together. As a recent high-profile example, the acquisition of Putzmeister in Germany by Sany from China is widely reported to have been facilitated by the fact that both were privately held, and controlling entrepreneurs built a strong personal rapport (Schütte & Chen, 2013). More generally, one might hypothesize that countries with more similar structures of business ownership and governance would enjoy more intensive

direct investment relationships and fewer conflicts over investors' legitimacy.

Third, we contribute to the understanding of how MNEs build legitimacy in host societies. Earlier research pointed to the adaptation of practices (Kostova & Roth, 2002; Regnér & Edman, 2014), the formation of joint ventures with local partners (Lu & Xu, 2006; Yiu & Makino, 2002), the use of low profile strategies (Meyer & Thein, 2014), and the proactive use of social responsibility initiatives (Zhao, Park, & Zhou, 2014). We suggest that legitimacy can also be enhanced by using greenfield rather than acquisitions, and by taking lower equity stakes in acquisitions. Future research may explore a broader range of strategies and tactics beyond organizational forms, such as target selections and co-opting local opinion leaders. For example, many early Chinese SO MNEs acquired German machine tool manufacturers that were in insolvent before the takeover.¹¹ The challenge to build legitimacy after acquiring Dürkopp Adler in Germany has been described by Zhang Min, CEO of ShangGong Group in an interview:

[Back in 2005], as a Chinese shareholder, the biggest challenge was to be trusted by our partners, employees and banks. ... I was asked to attend the employees' meetings to promise that the production would not be moved to China. My answer was clear: According to my strategy, Bielefeld [Dürkopp Adler's HQ] will be the Sales and R&D center for the whole company. I promised to keep the Bielefeld factory as high-end production plant. ... After that [the restructuring], Dürkopp Adler immediately became profitable again. And suddenly everybody trusted us because we obviously had made the right decisions. (Boning, 2013)

In this example, a commitment to continue key activities and to provide additional resources helped the investor to build legitimacy and later acquire two other businesses in Germany. More generally, foreign investors take a variety of actions with the aim to build legitimacy, and thus lay out a foundation for longer-run strategies. Hence the concept of host country legitimacy provides a fruitful foundation for studying such strategies.

Finally, we extend the study of entry strategies (Brouthers, 2002; Hennart, 2009; Meyer et al., 2009a) by modeling entry strategies as a two-step decision process, first acquisition vs greenfield entry, and second, the choice of ownership level. Earlier studies raised concerns regarding the assumption that establishment mode and equity level are independent decisions (Kogut & Singh, 1988; Meyer et al., 2009a, b). We suggest that the two step model may provide an avenue forward, especially to explore some of the

inconsistencies in the empirical entry model literature (Tihanyi et al., 2005; Zhao et al., 2004). Such research may in particular test whether determinants of equity mode choice are *significantly* different between acquired and greenfield projects, as we found significant differences with respect to the three host country moderators (i.e., comparing results of Tables 5 and 6) even though our subsamples are relatively small for that sort of analysis.

Country Level Moderators

While SO MNEs originate from a variety of different economic and political systems, our theoretical arguments focus on generalizable arguments.¹² Hence a natural question is to what extent home country characteristics moderate the effects that we have hypothesized. In particular, it is possible that host society beliefs vary not only by ownership type but by country of origin, and that SO firms from one type of country attract more distrust than those from other countries. Consequently, the effects that we have examined in this study may be moderated by home country level variables. For example, institutional pressures in host countries are, at least in part, a consequence of the perceived support that SO MNEs receive in their home country. In the case of China, these resources are both eclectic and substantial, and include financial resources that enable firms to make investments overseas (Buckley et al., 2007; Li et al., 2013; Luo et al., 2010; Wang et al., 2012). In other contexts, these resources may be far more limited to, for example, support through diplomatic representation, as in Norway (Knutson et al., 2011).

This suggests considering country-of-origin level moderators such as the degree of resource support available to SO MNEs in their home country, or the direct influence of political actors on SO MNEs. On the other hand, it may also be that state ownership is a convenient smoke screen used by domestic interest groups with protectionist motives, rather than the true cause of the adverse institutional pressures (Nyland et al., 2011). These considerations suggest that institutional pressures directed specifically toward SO MNEs may be weaker when these SO MNEs originate from a home country that has a more market-oriented structure, more transparent corporate governance structures, and less direct support to SO MNEs. Future research may explore these extensions by introducing home context level moderating variables at subnational (Li et al., 2014) or national level.

Even deeper theoretical insight may be gained by exploring the interactions between institutional



pressures in home and host countries (Child & Marinova, forthcoming). In particular, institutional pressures on international business engagements with a particular foreign country are in part driven by perceptions about that country (Meyer & Thein, forthcoming). Applying this line of argument to our research question suggests that *host* country perceptions of the home country institutions supporting SO firms lead to pressure exerted upon SO MNEs. It may be that an attitude toward the *home* country in combination with an attitude toward an unfamiliar organizational form, SO MNE shapes institutional pressures (Child & Marinova, forthcoming). Future research may address this issue by conducting deeply contextualized studies that trace the interactions between institutions in different fields in which an MNE is operating.

This discussion highlights that international business scholars are frequently handling simultaneously general theories with claimed universal validity and distinct local contexts in which these theories are operationalized (Meyer, 2013). In this field, it is thus necessary to pay close attention to the implicit assumptions about context when operationalizing general theory constructs. Moreover, scholars should be more courageous to pursue deeply contextualized theorizing to explain new and perplexing phenomena, without limiting themselves *ex ante* to effects that they would expect to be relevant elsewhere (Tsui, 2007).

Empirical Limitations and Future Research

As usual for empirical studies, limitations arise from the nature of the data set. First, we have prioritized comprehensiveness aiming for an inclusive coverage of listed Chinese firms, starting out from a complete list of firms listed on Shanghai and Shenzhen stock exchanges, and using a wide variety of archival sources to construct our explanatory variables. This approach, however, has limitations in that we have a substantive number of missing variables, especially on host countries because a high share of Chinese investments goes to countries for which commonly used indices are not available. Moreover, our use of archival data precludes capturing perceptions of decision makers of the pivotal variables such as institutional pressures in the host economy. Future research may thus use survey instruments to complement our archival data.

Second, a limitation is the correlation between various variables that measure characteristics of the host economy. In addition to the reported results,

we have also experimented with other measures to capture institutional development, but these were highly correlated with the two variables we report, *rule of law* and *shareholder protection*. In addition, we did robustness tests with additional controls, such as cultural and geographic distances between home and host countries and found that our main results remain the same. We did not include these variables in the main analysis because they were highly correlated with other variables we report. Since we already have a wide variation of host countries including both emerging and industrialized economies, further widening the range of hosts is not possible. Perhaps, future research may use a time series approach to investigate the impact of institutional changes over time. However, most institutional variables are fairly stable over time, which imposes limits on the power of such tests.

Third, SO MNEs may use means other than their entry strategy to adapt to or cope with local institutional pressures. On a macro level, they may decide to abstain from direct investment in countries perceived to be hostile; there is some evidence that Chinese SO MNEs indeed invest more in less advanced economies, while private firms focus more in Europe and North America (Ramasamy, Yeung, & Laforet, 2012). On a micro level, they may adapt their business practices to gain legitimacy (Kostova & Roth, 2002). For example, they may retain the local management team, engage with local stakeholders like media and unions directly, or pursue a loose integration strategy (Liu & Woywode, 2013). Future research may explore how such practices of stakeholder engagement and human resource practices relate to institutional pressures on different types of MNEs.

Policy and Management Implications

Policymakers in host countries may be most interested in our findings in view of the controversial nature of SO MNEs in some places (Globerman & Shapiro, 2009; Sauvart, 2010). Our results are consistent with the view that SO MNEs strategically acquire sought after resources such as technologies abroad (Deng, 2009; Li et al., 2012). However, we also find evidence that they make deliberate efforts to attain local legitimacy in countries where ideological inconsistencies or concerns of technology leakage are likely to be high, notably by using greenfield investments or by taking lower equity stakes in their acquired subsidiaries. Hence in a world of increased diversity of capitalisms, SO enterprises are building bridges across economic systems. Anecdotal evidence from Australia, Canada, and the United States

illustrates this pattern. For example, Yanzhou Coal Mining Company successfully acquired Felix Resources in 2009 and merged with Gloucester Coal in 2012 by following the guidance of the Australian Treasury by, among others, being listed on the Australian Securities Exchange and reducing equity shares in subsidiaries (Grant, 2012). From a host country perspective, such cooperative ventures provide opportunities to get to know an unfamiliar type of foreign investor, and experiences with that cooperation will then determine whether the investor, and firms of similar type, merit legitimacy in the host society. Such a path is like the evolution of private foreign investment into China, where in the 1980s private capital was considered illegitimate by key local players, and constrained by both normative and regulatory rules, such that foreign investment occurred mainly in joint ventures. Over the next three decades, host institutions evolved, private ownership gained legitimacy, and foreign investors increasingly take full ownership, and even acquire local firms.

For home country politicians, especially those involved in SO firms as owners, our study points to limits of political influence over such firms when they operate abroad. When SO firms operate in a competitive market environment, their ability to pursue political objectives is constrained by the rules of the game in the host society, which are designed to create a level playing field (or at least a field not skewed in favor of a foreign investor). Therefore advantages enjoyed by SO firms at home may turn into disadvantages abroad because they trigger adverse host country institutional pressures. In other words, the association with the home government is likely to create additional entry barriers on SO firms and force them into suboptimal organizational forms. Home country politicians may thus want to strengthen SO MNEs' ability to earn legitimacy in host societies. In this study, we have studied how adaptation at the level of the subsidiary can strengthen local legitimacy. Beyond this, SO MNEs themselves may gain legitimacy abroad if they adopt more transparent structures of corporate governance and reduce the direct involvement of political actors in corporate decision processes. For example, the EU bans state aid to SO companies (with some exceptions) with the aim to create a level playing field between SO and PO firms (Morgan, 2009). Such higher level changes may reduce the need for subsidiaries to locally overcome distrust in host societies.

For managers in SO enterprises, we show how they can manage the additional institutional pressures they are exposed to in host countries by making the

attainment of local legitimacy a guiding principle for their foreign entry strategies. In fact, such strategies may turn to their advantage in the long run. Several studies show a tendency for emerging economy MNEs to undertake large overseas investments that generate weak financial performance (Aybar & Ficici, 2009; Chen & Young, 2010; Hope, Thomas, & Vyas, 2011). With easy access to financial resources yet limited experience in international business, they are taking high risks. By engaging with stakeholders in host countries, SO MNEs can not only demonstrate that they merit legitimacy, but lower their investment risk and create learning opportunities. Once they have built up local competences and legitimacy, they may then also be able to run wholly owned subsidiaries without being challenged for their legitimacy.

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NOTES

¹According to the UNCTAD FDI database, Chinese outward FDI flows increased to US\$84.2 billion in 2012, accounting for more than a quarter of FDI from Asian emerging economies (i.e., Asia excluding Japan). Of the Chinese outward FDI, according to the estimates by the Heritage Foundation, 96% of the dollar value from 2005 to the middle of 2012 came from SOEs (Scissors, 2012).

²For instance, additional screening and approval by the government are needed in Canada only when foreign SO investors attempt to take controlling



interests (“acquisition of control”) in Canadian firms (Investment Canada Act, 2013).

³In the Euronext market, a shareholder of a listed company wanting to increase its equity stake beyond 30% must make a public bid for all outstanding shares, while Hong Kong Stock Exchange requires controlling shareholders to make a public bid for all outstanding shares if the floating shares go below 25% of total issued shares.

⁴Following international accounting standards, these are reported as subsidiaries (IAS 27, §13), joint control (IAS31, §7), and significant influence (IAS28, §§6–7). “Significant influence” is associated with ownership levels of 20% or more and thus still meets the definition of FDI commonly used in the IB literature.

⁵Since 2007, China Security Regulatory Commission have required all the listed companies to disclosure in their annual reports the controlling chain and the identity of the ultimate controller of the listed entities, which makes our distinction of SO vs PO quite reliable.

⁶We thank the action editor for this suggestion.

⁷For example, when a listed parent company holds 80% ownership in a son company and this son company in turn holds 80% ownership in an overseas subsidiary, the parent firm’s voting right in the overseas subsidiary is 80% and cash flow right is 64%.

⁸The descriptive statistics for the subsamples used in Tables 5 and 6 are available from the authors upon request.

⁹Note that in Column (8) of Table 5 the interaction between host technology and state is not significant. We examined VIF values of the variables included in this column and found that host technology and rule of law have VIF values of well above 10, suggesting high correlations between the two variables, which might lead to the insignificance of the interaction term. Thus estimating the two interaction effects in separate models, as in columns 3 and 5, is appropriate.

¹⁰We thank a reviewer for suggesting this. Geographical distance was computed based on the latitude and longitude of the city where the Chinese firm is located and the capital city of the host country. It was measured as the log of geographic distance in kilometers. The information is from the CEPII.

¹¹In 2004–2005, German machine tool manufacturers Wohlenberg, Schiess, Waldrich Coburg, Kelch, and Grosse Jacquard, all of which were undergoing insolvency procedures at the time, were acquired by, respectively, Shanghai Electric Group, Shanyang Machine Tool Group, Beijing No. 1 Machine Tool Plant, Harbin Measuring and Cutting Tool Group, and Hisun Group, all of which were SO firms (Jungbluth, 2013, Table 1). Similarly, Dürkopp Adler was facing financial challenges but not insolvency at the time of its takeover by the SO MNE ShangGong Group, and has since been successfully restructured while maintaining key operations in Europe (Klößner, 2013).

¹²We thank the special issue editor’s guidance on this matter.

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