



# What drives the internationalization of Chinese SMEs? The joint effects of international entrepreneurship characteristics, network ties, and firm ownership



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## ABSTRACT

The paper first investigates how Chinese small-to-medium enterprises' (SMEs) network ties at home moderate the relationships between different international entrepreneurship (IE) characteristics and the degree of internationalization of the firm. The paper further explores how the Chinese SMEs' ownership arrangement might explain the boundary conditions of the proposed moderating effects of network ties on the relationship between IE characteristics and internationalization. Findings of our empirical study generally support the hypotheses derived from our theoretical framework. The paper offers new insights into the internationalization of Chinese SMEs by ascertaining the differential contingent value of business versus political ties in the relationship between IE characteristics and internationalization and explores the bounds of our findings in terms of the ownership arrangement unique to the Chinese context.

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## 1. Introduction

The drivers behind small-to-medium enterprises (SMEs) from the emerging market going international has been a subject of increasing interest in international entrepreneurship (IE) research (Boehe, 2013; Tang, Kreiser, Marino, & Weaver, 2010; Yamakawa, Peng, & Deeds, 2008). The existing IE literature focuses on the explanatory variables associated with the internal characteristics of such firms. It is now generally established that a firm's IE characteristics, such as innovativeness, proactiveness and risk-taking, have positive effects on the internationalization behavior of SMEs from both the developed world (Coviello & Munro, 1995; Lindqvist, 1990; McDougall & Oviatt, 1991) and emerging markets, such as China (Yiu, Lau, & Bruton, 2007).

However, the extent to which the possession of IE characteristics can result in the internationalization of emerging market SMEs is likely contingent upon their ability to overcome resource

constraints through their social networks (Tang, 2011). How exactly IE characteristics and network ties interact with each other in influencing the internationalization of emerging-market SMEs remains under theorized and poorly understood in practice. Therefore, we first examine how home-based business and political ties might exercise different influences in moderating the relationship between IE characteristics and the degree of internationalization among Chinese SMEs.

Second, we explore the boundary conditions of the proposed moderating effects of business and political ties on the relationship between IE characteristics and internationalization. We consider ownership as a major factor. A prominent issue closely related to the role of network ties in the internationalization of Chinese firms is that many of these firms are state-owned enterprises (SOEs) (Kling & Weitzel, 2011). Indeed, a growing number of researchers have looked at the effect of state ownership on Chinese firms' international expansion behavior (e.g., Cui & Jiang, 2012; Du & Boateng, 2015; Luo, Xue, & Han, 2010; Rui & Yip, 2008), but most focus on large SOEs to the neglect of the ownership effect on the internationalization behavior of Chinese SMEs. In this paper, we postulate that the ownership of SMEs plays an important role. Specifically, we conceptualize how the proposed moderating

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effects of network ties on the relationship between IE characteristics and internationalization differ depending on the ownership arrangement (i.e. state owned versus non state owned) for the Chinese SMEs.

The present study enables us to advance our understanding of the organizational contingencies under which emerging-market SMEs' IE characteristics drive their internationalization behavior. First, we focus on the organizational contingencies of the moderating role of Chinese SMEs' home-based networks and their firm-specific ownership arrangement. Recently, *Mesquita and Lazzarini (2008)* examined the role of home-based networks in fostering emerging market firms' access to global markets, but their emphasis was on the influences of business ties to the neglect of political ties. Such neglect is unfortunate, as both business and political ties have long been identified as important social capital affecting emerging-market firms' business decisions in earlier literature (*Luo & Chen, 1997; Peng, 1997; Peng & Luo, 2000*). In this study, we extend this line of work by examining the role of both political and business ties in shaping the relationship between IE characteristics and internationalization. Second, China today provides a unique setting with a multitude of ownership types due to its ownership-reform, and ownership is widely regarded as an important institutional facet of the research on Chinese enterprises behavior (*Zhu, Cooper, D, Thomson, & Zhao, 2008*). Thus, among many peculiarities about the Chinese institutional environment, one important aspect is the ownership arrangement of Chinese SMEs. Reliance on personal and organizational networks in managing internationalization dynamics is another (*Mathews & Zander, 2007*).

Thus, by adopting a theoretical lens that incorporates the joint effects of IE characteristics, network ties, and firm ownership, we are able to embed the unique Chinese context in theorizing the SMEs' internationalization and answer the increasing call for integrating context-free and context-embedded (China-specific) elements in studying the international behavior of Chinese enterprises (*Alon, Child, Li, & McIntyre, 2011; Li & Peng, 2008; Tsui, 2009*). We test the hypotheses derived from our contingency framework by using an empirical study of 117 exporting SMEs in China.

## 2. How IE characteristics drive Chinese SMEs' internationalization: the moderating effects of network ties

IE is a multi-dimensional concept defined as "a combination of innovative, proactive, and risk-seeking behavior that crosses national borders" (*McDougall & Oviatt, 2000; McDougall & Oviatt, 2000, p. 903*). It has been well established in entrepreneurship research that in the dynamic and turbulent global market, SMEs possessing these IE characteristics will fare better than those that lack such qualities (*Knight, 2000*). However, compared with large multinational enterprises (MNEs) or SMEs based in developed economies, emerging-market SMEs are subject to more severe resource constraints for international competitiveness (*Yamakawa et al., 2008*). As a result, while IE characteristics often constitute the most important driver for these firms' international expansion, they provide only the necessary but not sufficient conditions for actual internationalization. In fact, current researchers rarely address the extent to which possessing IE characteristics can result in the actual exploitation of international business opportunities (*Ellis, 2011*).

For the emerging-market SMEs who lack resources, social capital embedded in their local networks has important implications for their international entrepreneurial strategies. In the Chinese context, there is widespread acceptance of the classification of networks into business versus political ties (*Luo & Chen, 1997; Peng, 1997; Peng & Luo, 2000*), but limited efforts have been

made to delineate their different implications for firms' behavior (*Chen & Wu, 2011*). Both business and political ties enable Chinese SMEs to access and acquire complementary resources held by network partners and enhance the effects of innovativeness on internationalization. However, studies show that business ties and political ties do not have the same weight of influence on the operations of Chinese firms (*Chen & Wu, 2011; Yiu et al., 2007*). We argue that political ties might play a stronger role than business ties in moderating the innovativeness-internationalization relationship for a number of reasons.

First, to encourage Chinese firms' international competitiveness and export performance, governments in China often help innovative firms to expand their production capabilities indirectly and to reduce costs in R&D through providing low-cost regulatory resources, such as land, bank credits, or tax subsidies (*Sheng, Zhou, & Li, 2011*). However, a salient feature of the government-business relationship in China is that such low-cost regulatory resources are not accessible to all SMEs; rather they are available selectively only to those firms with strong political connections with officials in charge. Chinese SMEs with political connections are more likely to receive favorable government incentives to engage in innovation, which may further facilitate their international expansion.

Second, political ties can help Chinese SMEs to establish legitimacy for their innovative products in developed markets in a way that business ties cannot achieve, and these ties provide innovative firms with a stronger ability to turn their intention to internationalize into action. Since innovative SMEs tend to be the first to introduce new products, they are in greater need of legitimacy for their innovations (*Aldrich & Fiol, 1994*). Such a legitimacy issue is especially a threat for Chinese SMEs introducing innovative products to customers in developed countries. Relying on home-based business ties may not help much, as other Chinese SMEs face the same legitimacy problem when going abroad. However, political ties may facilitate the association with successful organizations, such as large state-owned companies with well-established presence overseas or educational or scientific institutions with an international reputation. Hence, political ties may enhance the legitimacy of Chinese SMEs' innovative products by permitting "piggybacking" on the credibility of other organizations (*Stam & Elfring, 2008*). Therefore:

**Hypothesis 1a.** The moderating effect of political ties on the relationship between innovativeness and the degree of Chinese SMEs' internationalization is stronger than that of business ties.

The moderating effects of business and political ties in the proactiveness-internationalization relationship may differ for two reasons. First, in China, where almost all SMEs are at the early stage of internationalization, the function of business ties as an information-sharing mechanism is less effective in helping firms to acquire critical knowledge related to international business opportunities (*Zeng & Williamson, 2003*). The complementary assets that each Chinese SME can draw upon from its local partners are of limited use for international expansion compared with the network assets held by SMEs in developed countries. Therefore, although business ties strengthen the positive effect of proactiveness on the degree of internationalization of SMEs from developed countries, they are less effective in encouraging Chinese SMEs to seek international opportunities proactively.

Second, China's rapid economic development has resulted in an uncertain and ever-changing institutional environment. Old government policies and institutions are either quickly outdated or the targets of ongoing reform, but new policies and institutions are constantly emerging and often not very well crafted and/or implemented. As a result, China's institutional transition has

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