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## Ethnic ties, location choice, and firm performance in foreign direct investment: A study of Taiwanese business groups FDI in China

Ruey-Jer Bryan Jean<sup>a,\*</sup>, Danchi Tan<sup>a</sup>, Rudolf R. Sinkovics<sup>b,1</sup>

<sup>a</sup> National Chengchi University, 64, Sec. 2 Zhi-Nan Road, Taipei 11605, Taiwan

<sup>b</sup> The University of Manchester, Manchester Business School Booth Street West, Manchester M15 6PB, United Kingdom

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## ABSTRACT

This paper examines ethnic ties and their impact on FDI location choice and firm performance. Drawing on social network theory and using data from 88 Taiwanese business groups, the study tests the impact of ethnic ties on firm FDI location choice and performance outcomes in China. Results show that ethnic ties of top managers matter in facilitating firm FDI location choice. In contrast to our expectations however, ethnic ties do not help to improve firm performance in China. Implications of these results are discussed in view of existing literature and future research opportunities are delineated.

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### 1. Introduction

The growth in foreign direct investment (FDI) has resulted in a vast literature examining the location decision, entry modes and performance implications of firms venturing abroad. Various theoretical lenses, including transaction cost theory (TCE) (Williamson, 1975), resource based view (RBV) (Barney, 1991) and organizational learning theory (Ruigrok & Wagner, 2003) have been applied to these streams of research and advanced the understanding of FDI strategic behaviors and performance, either in developed or emerging countries. Recently, researchers have tried to adopt a network approach to examine firm internationalization (e.g., Ghauri, Lutz, & Tesfom, 2003; Zhou, Wu, & Luo, 2007). However, most of these studies focus on business networks and linkages such as alliances and joint ventures (e.g., Lu & Beamish, 2001). Ethnic ties, which refer to informal social or personal networks encompassing characteristics such as shared mother tongue, national origins, ethnic group and region of birth (Zaheer, Lamin, & Subramani, 2009), have been largely ignored in the international business literature. Past studies have corroborated the hypothesis asserting that family ties and co-ethnic bonds are instrumental in the growth of ethnic enterprises (Cobas & DeOlllos, 1989). Hence, managerial and personal ties may play a crucial role for firm strategic decision making and performance. For example, Luo and Chung (2005) examine the role of specific relationships including family and prior personal contacts and find that these ties can facilitate business groups' performance. Prior research also points at the importance of the circumstances to what extent these personal ties matter (Peng & Luo, 2000). This is because too strong ties and contacts may hinder creativity and thus be detrimental to firm strategies and performance (Burt, 1997). As such, extant literature has offered only limited or contradictory evidence on the role of ethnic ties on firm strategic decisions and performance outcome, especially in the international context.

In order to overcome these limitations of extant literature on the role of ethnic ties in international business, the purpose of this study is to examine the impact of ethnic ties on firm foreign market entry and performance implications. We focus on

\* Corresponding author.

E-mail addresses: [bryan@nccu.edu.tw](mailto:bryan@nccu.edu.tw) (R.-J. Jean), [dctan@nccu.edu.tw](mailto:dctan@nccu.edu.tw) (D. Tan), [Rudolf.Sinkovics@manchester.ac.uk](mailto:Rudolf.Sinkovics@manchester.ac.uk) (R.R. Sinkovics).

URL: <http://www.personal.mbs.ac.uk/rsinkovics/>

<sup>1</sup> Tel.: +44 161 306 8980.

particular strategic choices, i.e., foreign location decision. Location choice has been identified as a central theme in the domain of international business (Dunning, 1998). However, the association between ethnic ties and firm location choice has to date received a limited consideration in the extant literature. One exception is the recent work by Zaheer et al. (2009) [2009 #2138], who find that ethnic networks exert greater influence than cluster capabilities on location decisions in the services offshoring to India. We extend their work by examining firm location choice in entering China. China has attracted a great deal of FDI in recent years. It has been argued that social networks such as “Guanxi” and personal contacts played a crucial role in doing business in China (Buckley, Clegg, & Tan, 2006; Lee, Pae, & Wong, 2001) due to lack of sufficient institutional support in emerging markets (Park & Luo, 2001). In addition, our research examines the conditions under which ethnic ties can enhance firm FDI performance in China. We examine the influence of ethnic ties on firm performance under different levels of firm technological capabilities (R&D intensity). Prior research on multinationality and performance contends that firm specific assets such as technological capabilities are associated with greater firm international performance (Casson, 1985; Hennart, 2009). However, social capital theory argues that strong social ties may inhibit firm innovative capabilities (Burt, 1997). Accordingly, this study tries to examine whether higher level of firm technological capability would complement or substitute the strength of ethnic ties on firm FDI performance in China.

We specifically focus on Taiwanese business groups' FDI strategy in China as our empirical setting for the following reasons: first, people from China and Taiwan share a common language and heritage. Historically, the middle and south coast provinces of China are the ancestral home for many thousands who fled China for Taiwan after the establishment of People's Republic in 1949 (Filatotchev, Strange, Piesse, & Lien, 2007). Many of them rebuilt their businesses in Taiwan, but the ethnic and family links with China persist. The Taiwanese ethnicity has been divided into two groups: mainlanders and islanders. Mainlanders refer to people who moved to Taiwan from mainland China in the years since 1949, after World War II. Islanders are those who have been native Taiwanese for many generations (Tan & Yu, 2000). Mainlanders typically have stronger ethnic ties with Mainland China than islander. Until the present, many mainlanders still speak the same dialects as they or their parents did in China. Mainlanders in Taiwan emigrated from various regions of Mainland China. The largest ethnic groups of mainlanders in Taiwan, “Minnan,” are people who come from the South-East coast of Mainland China. Hence, it has been argued that the motivation for Taiwanese firms to locate their FDI investment in China is influenced by strong ethnic ties with the home country (Strange, Filatotchev, Lien, & Piesse, 2009). This can be more salient for business groups because prior research shows that Taiwanese business groups are characterized by family and social networks (Chang, Chung, & Mahmood, 2006). The second reason why Taiwanese FDI in China is an interesting setting for this study is that compared to their Western competitors, most Taiwanese firms have weaker firm-specific capabilities such as technological and marketing capabilities and thus it is more challenging for them to compete overseas on the basis of these firm-specific capabilities. Business networks and social ties have been identified as key drivers for Taiwanese outward FDI (Chen & Chen, 1998). In contrast to traditional FDI theory which contends that firms engaging in FDI must be equipped with strong specific advantages, Taiwanese FDI in China provide good opportunities to examine how weaker firms gain competitive advantages in their internationalization strategies in an emerging market.

This study contributes to existing knowledge in three ways. First, while prior studies have examined network linkages and their relationships with firm FDI strategies, most studies focus on business networks and relationships {e.g., Chen & Chen, 1998 #2228; Ghauri et al., 2003 #2230}. Managerial ties of ethnic links and their associations with firm FDI have been largely neglected. Accordingly, drawing from social network theory (Burt, 1997), this study extends network theory perspectives on internationalization to the interpersonal and ethnic ties level, by examining how the ties affect FDI location and performance. Second, prior studies examining relationships between different managerial ties and firm performance offer inconclusive results (Luo, 2003; Peng & Luo, 2000). By integrating social network theory with internalization theory in international business, this research explores the conditions under which ethnic ties can play their role for enhancing firm FDI performance (Chang et al., 2006). In this way, this study responds to the call for more research on examining the limitations and boundary of managerial and ethnic ties in firm performance. Third, by using Taiwanese business groups' investment in China as the empirical setting, our study offers additional empirical evidence on the internationalization of MNEs' from newly industrializing countries to the literature. This empirical context also enables us to enrich the understanding of the influence of ethnic ties in an emerging market context, which exhibits incomplete institutional structures and rather weak contractual enforcement. In such a context, informal networks and ethnic ties may be more salient for successful firm FDI strategies and performance.

The article is organized as follows. The literatures on social network theory and ethnic ties are reviewed to provide support for the links between each construct. Predictions regarding the interrelationships between ethnic ties, location choice and firm performance are then proposed. These hypotheses are tested empirically and results are presented. The paper concludes with a discussion of the findings and directions for future research.

## 2. Review of the literature and hypotheses

### 2.1. Social network theory

In this study, we draw on social network theory to analyze the impact of ethnic ties on FDI location choice and performance. Extant literature has used different terms to describe social networks such as social ties, interpersonal relationships, personal connections, and relational networks. Burt (1997) defines social networks as opportunities a player

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