Journal of Business Research 67 (2014) 77–82

Contents lists available at ScienceDirect

Journal of Business Research

Firm capability and performance in China: The moderating role of *guanxi* and institutional forces in domestic and foreign contexts

Zhigang Shou [a], Jun Chen [b,*], Wenting Zhu [c], Lihua Yang [c]

[a] Economics and Management School, Wuhan University, PR China
[b] Information Management, the School of Information Management, Wuhan University, PR China
[c] Business College, City University of Hong Kong, Hong Kong

ARTICLE INFO

Article history:
Received 1 June 2011
Received in revised form 1 March 2012
Accepted 1 November 2012
Available online 10 December 2012

Keywords:
Marketing capability
Technology capability
Guanxi importance
Legal support
Firm performance

ABSTRACT

This study examines the moderating effects of institutional forces on the capabilities–performance link by combining the resource-base view and institutional theory. From a survey of 324 Chinese manufacturers, this study tests the impacts of the importance of *guanxi* (an informal institutional factor) and legal support (a formal institutional factor) on the performance advantages of firm capabilities. The results indicate that both marketing and technology capabilities relate positively to performance, but the performance advantage of technology capabilities is less prominent when *guanxi* is important and the legal system is ineffective. In addition, *guanxi* importance strengthens the performance advantage of domestic firms' marketing capabilities but reduces that of foreign firms' marketing capabilities in China.

1. Introduction

The resource-based view (RBV) of the firm is one of the most influential theoretical perspectives on firm performance (Morgan, Kaleka, & Katsikeas, 2004; Peng & York, 2001). The performance advantage of resources and capabilities varies with market dynamics (Miller & Shamsie, 1996; Song, Droge, Hanvanich, & Calantone, 2005) and competition (Brush & Artz, 1999). However, a meta-analysis of 125 studies on the resource–performance relationship indicates sparse research for investigating environmental contingencies on firm resource/capability and performance (Crook, Ketchen, Combs, & Todd, 2008). Among the limited studies on this topic, scholars mostly draw attention to the task environment which focuses primarily on economic variables, such as market demand and technological change but neglect studying the impact of institutional forces on the link between firm capability and performance (Peng, Wang, & Jiang, 2008).

Oliver (1997) argues that institutional environments, such as formal (e.g., laws and regulations) and informal (e.g., cultures and norms) institutions, profoundly influence firm competitive advantage arising from resources. Peng and York (2001) further emphasize the importance of incorporating institutional factors into RBV in the context of emerging economies, because government and societal influences are stronger in these emerging economies than in developed economies. Brouthers, Brouthers, and Werner (2008) postulate that for firms operating in emerging economies, ignoring the institutional context in which resource advantages are embedded may result in normatively inferior outcomes.

The study here explores the impact of institutional forces on the relationship between firms' capabilities and performance, in the context of China—the largest emerging economy in the world. This study examines separately the moderating effects of legal support and importance of *guanxi* on the capability–performance link. Legal support refers to the adequacy of firm legal protection in the industry, which differs across regional institutions in China (Cai, Jun, & Yang, 2010). The importance of *guanxi* reflects the role of interpersonal connections for firm performance, which is a critical and informal institutional factor in China (Child, Chung, & Davis, 2003).

In terms of firm capability, this study focuses on marketing capability and technology capability because they underlie firm strategy that results in a sustainable advantage (Krasnikov & Jayachandran, 2008). From a sample of 324 Chinese manufacturers in different Chinese regions, this study's findings include positive effects of both marketing and technology capabilities on firm performance. The performance advantage of technology capability is more prominent when legal protection is in place, but the importance of *guanxi* attenuates the positive effect of technology capability on performance.

In addition, the moderating effects of institutional factors on performance advantage of marketing capability differ between Chinese firms and foreign firms. High levels of *guanxi* strengthen the performance advantage of domestic firms' marketing capability but reduce that of foreign firms' marketing capabilities.

* Corresponding author. Tel.: +86 13871038755.
E-mail addresses: mkshou@whu.edu.cn (Z. Shou), christina.cj@hotmail.com (J. Chen), zhu_wenting0322@yahoo.cn (W. Zhu).

0148-2963/$ – see front matter © 2012 Elsevier Inc. All rights reserved.
http://dx.doi.org/10.1016/j.jbusres.2012.11.014

2. Conceptual development

2.1. Firm capability and performance

Firm capability is a complex bundle of skills and accumulated knowledge, embedded in organizational processes, which enable firms to coordinate activities and deploy their resources to achieve a desired end (Day, 1994; Helfat & Peteraf, 2003). This study limits attention to firms' marketing and technology capabilities, which represent two primary ways that firms can achieve competitive advantage (Day, 1994; Krasnikov & Jayachandran, 2008; Song et al., 2005).

"Marketing capability" refers to firm competence that supports market sensing and market linking (Day, 1994; Krasnikov & Jayachandran, 2008). The processes underlying market sensing enable the firm to acquire, manage, and use market information more effectively and to excel in finding attractive markets, anticipating customer needs, and developing goods and services to meet those needs (Vorhies, Harker, & Rao, 1999). The capability of market linking spans the processes that enable a firm to build durable and closer relationships with customers and channel members (Day, 1994). As a result, the literature views marketing capability as an important mechanism to obtain a competitive edge and generate economic rents (Palmatier, Dant, Grewal, & Evans, 2006).

"Technology capability" refers to a firm's ability to apply technical knowledge to develop and improve products and processes (McEvily, Eisenhardt, & Prescott, 2004). A firm with high technology capability can provide more innovative products and services to customers than competitors can, which should create more opportunities for differentiation and proprietary position (Kleinschmidt & Cooper, 1991). Technology capability also likely optimizes the processes of procurement, manufacturing, and distribution to cut relevant costs and, in turn, increase firm profitability.

Although a substantial amount of literature documents the positive impact of marketing and technology capabilities on firm performance, this study retests these relationships because they serve as baseline hypotheses.

H1a. Marketing capability relates positively to firm performance.

H1b. Technology capability relates positively to firm performance.

2.2. Moderating effects of institutional forces

Institutional constraints may come from informal social norms and formal legal regulations (North, 1990). Correspondingly, drawing on prior studies (e.g., Cai et al., 2010; Child et al., 2003), this study adopts two major institutional forces that reflect the unique characteristics of China's institutional environments—namely, importance of *guanxi* and legal support. The former refers to the extent to which *guanxi* is critical to firm performance, and the latter represents the degree to which firms receive legal protection.

2.2.1. The importance of guanxi

Guanxi refers to interpersonal connections that establish expectations and obligations to facilitate the exchange of personal resources in a hierarchical Chinese society (Lovett, Lee, & Raja, 1999). Lacking *guanxi* in a business community means lacking inside information, scarce resources, and extra support from business partners (Su & Littlefield, 2001); in such cases, firms must invest to build *guanxi* networks with key people in other companies and governments (Luk et al., 2008). The importance of *guanxi* reflects the degree to which firms invest in and benefit from *guanxi* in a Chinese market. Therefore, in a Chinese market in which *guanxi* is important for firm performance, firms can draw on *guanxi* to build and sustain their competitive advantage (Park & Luo, 2001).

The performance advantages of marketing capability may be prominent for firms when they operate in a *guanxi*-oriented market. Marketing capability enables firms to compete by comprehending customer preferences and creating and managing durable relationships with customers and channel members (Day, 1994). The process of acquiring and comprehending customers' needs requires firm boundary agents to have empathy orientation, that is, the ability to view a situation from the customers' perspectives. Empathy is valuable in nurturing *guanxi*, and members in the *guanxi* network should exhibit empathy toward one another (Wang, 2007).

Thus, firms with high marketing capability are likely to have competent personnel who are good at developing close *guanxi* with key stakeholders. At the same time, the process of creating and managing durable inter-firm relationships entails that boundary personnel have more communication, negotiation, and coordination skills, which may also be helpful for cultivating interpersonal connections.

Therefore, in the market in which *guanxi* is important for business success, firms with greater marketing capability are better able to exploit *guanxi* networks and thus obtain superior profit.

H2. The importance of *guanxi* positively moderates the effect of firm marketing capability on performance.

In contrast with marketing capability, technology capability may be less valuable when *guanxi* is crucial. Technology capability is the ability to apply scientific and technical knowledge to develop and improve products and processes (McEvily et al., 2004). When *guanxi* as an institution is critical to firm performance, firms invest in *guanxi*, which may undercut the performance advantage of technology. In addition, competitors may leverage their *guanxi* (e.g., politic ties, see Sheng, Zhou, & Li, 2011) instead of relying on technology to sustain competitive advantage. For example, competitors in a *guanxi*-oriented market may obtain orders, inside information, and extra support from their *guanxi* partners and/or governments, which devaluates the effect of technology capability in generating performance.

H3. The Importance of *guanxi* negatively moderates the effect of firm technology capability on performance.

2.2.2. Legal support

Legal support provides a safe market environment for firm competition (Cai et al., 2010; Child et al., 2003). Competitive advantage produced by marketing capability may relate closely to the firm's brand and trademark. If the legal system fails to safeguard against counterfeits, the premium of brand and trademark may decrease. In addition, although marketing capability enables firms to obtain higher sales, superior profit may not materialize if the legal system cannot safeguard payment. Account receivable management has proved a challenge for firms doing business in China. For example, the incidence of payment default in China is 20 times higher than that in the United States (Hu, Guan, & Times, 2005).

Therefore, when firms operate in a legally safer market, marketing capability can lead to a higher level of firm performance.

H4. Legal support positively moderates the effect of firm marketing capability on performance.

Technology capability enables firms to create more opportunities for differentiation and proprietary position through innovation (Kleinschmidt & Cooper, 1991). However, developing and maintaining technology capability usually entail continued research-and-development investment and, thus, high risk. If the legal system fails to impose punishments on unlawful behaviors, such as patent infringement, the competitive advantage produced by technology capability will decrease because the firms that illegally copy innovative products would be able to compete at very low cost and risk, which undercuts the focal firm's performance advantage of technology capability.

Therefore, firms operating in a legally safer market can secure a higher level of performance through technology capability.