Journal of Business Research xxx (2016) xxx–xxx

Contents lists available at ScienceDirect

Journal of Business Research

Institution, strategy, and performance: A co-evolution model in transitional China

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A R T I C L E I N F O

Article history:
Received 14 May 2014
Received in revised form 13 February 2016
Accepted 15 February 2016
Available online xxxx

Keywords:
Co-evolution
Institution
Strategy
Performance
China

A B S T R A C T

Over the last two decades, Chinese firms have grown quickly even in a complicated and conflicting institutional environment. Prior explanations focus on either government support at the institutional level, or imitation strategy at the firm level. We argue that these accounts are empirically inconclusive and theoretically insufficient in that they are unidirectional and contain a single perspective at a single level. Through a longitudinal case study of Geely Group, a leading private carmaker in China, we develop a co-evolution model of institutional environment, strategic ambidexterity, and innovation performance with a progression of positive feedback. We also propose a new managerial intentionality mechanism based on the positive feedback of innovation performance. Besides, we find that the role of government on firm growth is more complicated and dynamic than has been assumed. Overall, our co-evolution framework provides a more powerful and specific account of why transition economy firms have grown so fast.

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1. Introduction

Chinese firms have experienced rapid growth in the past two decades. The number of Chinese firms on the Fortune Global 500 list increased from zero in 1990 to 95 in 2013. Even more, 18 of the 31 new companies on the 2013 list are Chinese, and China had the most new entrants among all countries. One company, Alibaba Group, which was founded in 1999, has by some measures already become the world's largest e-commerce company. In 2012, two of Alibaba's portals together handled 1.1 trillion yuan ($170 billion) in sales, more than eBay and Amazon combined (Economist, 2013). Another case, which we will illustrate further later, is Geely Group. This firm entered the automotive industry in 1997, and since its humble origins acquired Volvo, Northern Europe's largest car maker, in 2010; by 2012, it broke into the Fortune Global 500.

High-growth Chinese firms have been operating in a transition economy characterized by a highly complicated and conflicting institutional environment. On one hand, Chinese entrepreneurs and managers have limited strategic choice (Child, 1997) in a highly constrained transition economy, in which government controls many scarce resources and intervenes in the firm's decision-making and operation through numerous approval processes (Tian, Hafsi, & Wu, 2007). In this type of economy, regulations are also highly uncertain (Peng & Zhou, 2005). These institutional characteristics of a transition economy are regarded as obstacles for developing competitive capability (Nee, Sonja, & Sonia, 2007; Peng, 2003). On the other hand, China, as a transition economy, has been undergoing large-scale institutional changes since it began its reforming and opening policies, a process which seems to be providing many potential opportunities for Chinese firms.

As such, we ask, "*How and why do firms in transition economy achieve rapid growth in such a complicated and conflicting institutional environment*?" There are two streams of research addressing this question. The first line of research builds on government steward logic (Luo & Rui, 2009), contending that government support is the key. For example, a case study demonstrated that the reason for Chinese firms' success is because "the Chinese state remains strategically involved in the national innovation system" (Lu & Lazonick, 2001, p.58). Despite this, empirical evidence of government support is not conclusive. For example, Nolan (2002) found that Chinese government's strategy of building national team corporations had failed. More importantly, the shortcoming of the government steward logic lies in its single dimensional and exogenous treatment of institutions and accordingly fails to capture the multidimensional and dynamic institutions in transition economies. The second line of research argues that Chinese firms, as latecomers to the global market, resort to imitation strategy. This puts them in a favorable position in reducing uncertainty on technology and the market, enabling them to enjoy a "free ride" (Cho, Kim, & Rhee, 1998; Shenkar, 2010). As such, they catch up with multinational companies from developed countries very quickly. This contradicts with diffusion literature which imply that imitations occur "slowly and selectly." Indeed, an empirical study based on large sample survey in the 1990s also shows that the Chinese firms had shifted away from importing technology and equipment, a form of imitation strategy, toward generating indigenous R&D (Guan, Yam, Tang, & Lau, 2009).

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http://dx.doi.org/10.1016/j.jbusres.2016.02.009
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Please cite this article as: Jiang, S., et al., Institution, strategy, and performance: A co-evolution model in transitional China, *Journal of Business Research* (2016), http://dx.doi.org/10.1016/j.jbusres.2016.02.009

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The fundamental limitations of the above explanations are that they are unidirectional, linear, and from a single perspective at a single level. To explain the rapid growth of the Chinese firms, we have to go beyond this paradigm. This is where co-evolution research comes in. As Lewin and Volberda (1999, p.520) noted, "the co-evolution lens has the potential for integrating micro- and macro-level evolution within a unifying framework, incorporating multiple levels of analyses and contingent effects, and leading to new insights, new theories, new empirical methods, and new understanding." Specifically, positive feedback, one of the key mechanisms in co-evolution research, has high potential to explain this phenomenon of fast growth.

The key idea that can be taken from prior literature is that co-evolution is the joint outcome of managerial intentionality, environment, and institutional effects. The object of co-evolution research is to unravel the mutual adaptation mechanisms (Dieleman & Sachs, 2008). While institutional effects are straightforward in institutional theory, certain ideas regarding managerial intentionality are not. For instance, how managers in transition economies influence the institutional environment remains relatively unknown. Although scholars use the co-evolution framework to explain various organization issues, such as new organizational forms (Lewin, Long, & Carroll, 1999), joint ventures (Inkpen & Currall, 2004), and adaptation and selection debates (Volberda & Lewin, 2003), we still lack a co-evolutional understanding of how Chinese firms grow so fast.

Given the theoretical limits of prior literature, we used a longitudinal case study approach (Eisenhardt, 1989). Our case is Geely Group (hereafter Geely), a leading private carmaker in China. China's automotive industry has been highly regulated, which is a unique feature of a transition economy. Geely is an ideal illustration of fast growth in transitional China. Geely entered this industry in 1997, virtually without any knowledge about car manufacturing and even worse facing an extremely hostile institutional environment. In 2001, Geely became China's first private firm entitled to produce passenger cars. Geely acquired Volvo, Northern Europe's largest car maker in 2010, and was listed in the Fortune Global 500 in 2012. We traced Geely's development for nearly 30 years. In doing so, we revealed how the co-evolution process occurred and drove its rapid growth.

Our key contribution is that we develop a co-evolutionary analytical framework to explain Chinese firms' growth. Compared to analysis that is unidirectional, linear, and providing a single explanation at a single level, our co-evolution framework provides a more powerful and specific account. Our case study also contributes to co-evolution research by offering a new mechanism through which managerial intentionality takes place. In addition to providing a political account, as prior literature suggests, this case study also shows how the positive feedback of innovation performance on the institutional environment is a new managerial intentionality mechanism to realize co-evolution. Finally, our study contributes an examination of the more complicated and dynamic institution and how this could be addressed in the context of transition economy. Our case study of Geely shows that the effects of government on firm growth are not single dimensional, homogenous, and static, but rather complicated, firm specific, and dynamic, depending on the firm's strategy and performance. We also have shown that how this could be addressed by using strategy ambidexterity.

2. Theoretical background

2.1. Prior explanations of why Chinese firms grow so fast

There are two explanations proposed for why private Chinese firms grow quickly. The first explanation is related to institutional theory, which is the most important theoretical perspective for strategy research in transition economies (Hoskisson, Eden, Lau, & Wright, 2000; Xu & Meyer, 2013). This theoretical framework views organizations as embedded in institutional arrangements. According to North (1990, p.3), institutions are "the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction." Scott (1995) further operationalized the concept into three pillars: regulatory, normative, and cultural–cognitive. Among these, the regulatory institution, which is our focus here, is known to affect firm behavior and outcome in more direct and pervasive ways.

The argument in particular is that successful Chinese firms are driven by governmental support, which suggests the government steward logic (Luo & Rui, 2009). A consistent goal of China's industrial policy has been to build national team companies that can compete on the global market (Nolan, 2002). For example, Lu and Lazonick (2001, p.58) demonstrated that the Founder group, the world leader in electronic pictographic-language publishing systems, succeed because "the Chinese state remains strategically involved in the national innovation system". Besides, Tjosvold, Peng, Chen, and Su's (2008) empirical study confirmed that in China, the government has been building cooperative goals with individual business to develop industries and their marketplace. However, the empirical evidences of government steward logic are not conclusive. For example, Nolan (2002) found that Chinese government's strategy of building national team corporations had failed. More importantly, the shortcoming of the government steward logic lies in its simple, static, and exogenous treatment of institutions, thus fails to capture the complicated and conflicting institutions in transition economies.

The second explanation is directly related to the firm-level learning characteristics of latecomer firms. Due to their latecomer position, their resources and capabilities are limited compared to their counterparts in the developed world (Hobday, 1995; Li & Kozhikode, 2008). As a result, they are not able to develop new products and technologies. Instead, they resort to imitation strategy, which puts them in a favorable position for reducing the uncertainty surrounding technology and the market, and also helps them to avoid dead ends, enabling them to enjoy a free ride (Cho et al., 1998; Shenkar, 2010). Therefore, they catch up very quickly with multinational companies from developed countries. However, the assumption that imitation happens rapidly seems inconsistent with a broad set of studies. For example, Greve (2009) found that performance-enhancing designs spread "slowly and selectively" in the shipping industry even though matching rivals by adopting these designs appeared to be trivially simple. Indeed, an empirical study based on a large sample survey in the 1990s shows that Chinese firms have experienced a shift away from technology and equipment importation, a form of imitation strategy, toward indigenous R&D to produce innovation (Guan et al., 2009).

The above limitations lead us to believe that we cannot rely on a single perspective at a single level to explain the fast growth of Chinese firms; instead, we need to employ a comprehensive analytical framework that incorporates various lenses at different levels. This is where co-evolution research comes in. In the next section, we will review co-evolution research and demonstrate its unique strengths and limitations in answering our research question.

2.2. The perspective of co-evolution

The idea of co-evolution originated in biology as the idea of reciprocal evolutionary change in interacting species, where change in one species was triggered by change in another related species. This concept was taken up by Lewin and others (Koza & Lewin, 1998; Lewin et al., 1999; Lewin & Volberda, 1999) to be applied to organizational theory. According to Lewin and Volberda (1999, p. 520), "the co-evolution lens has the potential for integrating micro- and macro-level evolution within a unifying framework, incorporating multiple levels of analyses and contingent effects, and leading to new insights, new theories, new empirical methods, and new understanding." For example, Huygens, Baden-Fuller, Van Den Bosch, and Volberda's (2001) integrated analysis at both the firm and industry levels shows how the interaction between the two makes industries and firms co-evolve over time. They conclude that search behavior drives co-evolution among new entrants and

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