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Does state ownership facilitate outward FDI of Chinese SOEs? Institutional development, market competition, and the logic of interdependence between governments and SOEs

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ABSTRACT

Outward foreign direct investment (OFDI) of manufacturing state-owned enterprises (SOEs) from emerging economies (EE) has emerged as a significant phenomenon in global markets. Although previous research has emphasized the bright-side of state ownership in facilitating SOEs' OFDI, the stream of research largely overlooks its dark-side effects. Drawing on resource dependence theory (RDT), we argue that state ownership creates dependence of SOEs on their home governments, which may undermine manufacturing SOEs' willingness to conduct OFDI, autonomy and market orientation, and legitimacy in overseas markets. Thus, substantial state ownership may counteract with manufacturing SOEs' OFDI from EE. Our empirical results, based on a sample of 507 Chinese publicly-listed manufacturing SOEs during 2007–2013, show that a high percentage of state-owned shares exerts negative effects on SOEs' OFDI. Relative to local SOEs, central SOEs are less likely to engage in OFDI. Further, the negative effect of the percentage of state-owned shares on SOEs' OFDI will be alleviated by institutional development and competition intensity. The study contributes to literature by making a real theoretical case for the dark-side effects of state ownership on manufacturing SOEs' OFDI from EE.

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1. Introduction

Outward foreign direct investment (OFDI) of state-owned enterprises (SOEs) from emerging economies (EE) has emerged as a significant phenomenon in global markets (The Economist, 2012). While some SOEs in natural resource and services sectors engage in international expansion in initial period of new century, manufacturing SOEs in EE only recently engage in OFDI (Cuervo-Cazurra, Inkpen, Musacchio, & Ramaswamy, 2014). Because manufacturing firms in EE are often lacking of firm-specific expertise to outcompete rivals in overseas markets, many scholars attribute these firms' rapid OFDI to the support from their home governments (Lu, Liu, Wright, & Filatotchev, 2014; Wang, Hong, Kafourous, & Wright, 2012). Compared to other types of firms, SOEs are more capable of obtaining support from governments, because they are assets of governments (Okhmatovskiy, 2010). Multiple advantages that SOEs can leverage to facilitate their OFDI have

been identified, including financial support, preferential treatment, and backing in adverse circumstance (Luo, Xue, & Han, 2010). Based on these advantages, scholars contend an enabling view on the role of state ownership in manufacturing SOEs' OFDI (Liang, Ren, & Sun, 2015; Pan et al., 2014).

However, the straightforwardness of this enabling view has received limited empirical support in literature. Many empirical studies report either insignificant or even negative effect of state ownership on EE firms' OFDI (Hu & Cui, 2014; Lu, Liu, Filatotchev, & Wright, 2014; Xia, Ma, Lu, & Yiu, 2014). The inconsistent findings imply that the association between state ownership and SOEs' OFDI may be more complicated than the enabling view. In fact, the dark-side effects of state ownership have been identified in many research fields like corporate governance and strategic management (Zou & Adams, 2008). Scholars contend that governments may leverage their property relations to divert SOEs' resources to achieve political goals (Okhmatovskiy, 2010). Therefore, it is necessary to go beyond the enabling view and adopt alternative perspective to test how state ownership affects EE SOEs' OFDI.

Resource dependence theory (RDT) sheds additional light on how state ownership affects SOEs' OFDI (Choudhury & Khanna, 2014). According to the theory, substantial state ownership leads to SOEs' dependence on governments for vital resources (Xia et al.,

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2014). However, the dependence may not necessarily benefit SOEs' OFDI, because it may cause three aspects of dark-side effects. First, the dependence may enable SOEs to obtain support from governments. Though the advantage makes SOEs better off in domestic markets, it may also reduce these firms' willingness to expand internationally. Second, the dependence may make SOEs more vulnerable to governments' intervention. Thus, SOEs may suffer lower levels of autonomy and market orientation (Lioukas, Bourantas, & Papadakis, 1993). Finally, the dependence may decrease SOEs' legitimacy in host countries, because audience in host may view these SOEs' OFDI as political instruments of home governments (Cui & Jiang, 2012). At that time, these SOEs would face increased institutional pressures in host countries.

By garnering insights from the RDT, the study aims to reveal the dark-side effects of state ownership on EE manufacturing SOEs' OFDI. In addition, since the RDT suggests that the necessity to obtain resources from external environments leads to firms' dependence on external actors, changes in environments may alter the dependence relations between SOEs and home governments. In EE, because institutional and market environments are undergoing significant changes (Cuervo-Cazurra & Dau, 2009), we identify institutional development and market competition as two moderators of the effect of state ownership on OFDI. Given that institutional development and intense competition are intertwined during market-oriented transitions in EE, we also test how the two factors jointly moderate the effect of state ownership on EE manufacturing SOEs' OFDI.

The contribution of our research is three-fold. First, given the prevalence of the enabling view, our study highlights the necessity to realize the dark-side effects of state ownership on EE SOEs' OFDI. To our best knowledge, this may be the first try to make a real theoretical case for the dark-side effects of state ownership on EE SOEs' OFDI. Second, we reason and test institutional and competition contingent views on the effect of state ownership on EE SOEs' OFDI. Third, the study contributes to the RDT by pushing the theory into the emergent context of EE manufacturing SOEs' OFDI. Although the RDT has been frequently adopted in research on OFDI from mature economies, it is less often to be adopted to understand SOEs' OFDI from EE. On top of that, our study shows the predictive power of the RDT on this new phenomenon in international business.

2. Theory and hypotheses

2.1. Resource dependence theory

The RDT emphasizes the interdependence of firms with external actors (e.g., individuals, firms, and governments) and the influence of these external actors on firms' behaviors (Pfeffer & Salancik, 1978). A premise underlying the RDT is that firms are open systems and need to depend on external actors for vital resources, such as physical resources, information, and social legitimacy. However, the dependence leads to imbalanced power among firms and external factors, which may result in dominant actors' constraints on firms' behavior (Hillman, Withers, & Collins, 2009). At that time, the firms' discretion in decision-making will decrease accordingly (Bradley, Aldrich, Shepherd, & Wiklund, 2011; Lioukas et al., 1993).

Dependent firms may deal with constraints from dominant actors via adaptation and avoidance strategies (Pfeffer & Salancik, 1978). Adaptation suggests keeping compliance with the requirements from dominant actors in order to stabilize resource exchanges, while avoidance emphasizes obtaining alternative sources of vital resources to reduce dependence on dominant actors. Scholars have contended OFDI as an avoidance response of EE firms to constraints that they are facing in domestic markets

(Witt & Lewin, 2007). For instance, Choudhury and Khanna (2014) argue that Indian SOEs seek a global footprint in order to achieve resource independence from state actors. Although these studies offer novel insights on EE firms' OFDI, an assumption behind is that EE firms have adequate discretion to expand overseas so as to escape from the constraints. However, the assumption would be less realistic because dominant actors may intervene in firms' avoiding endeavors (Casciaro & Piskorski, 2005). The possibility of intervention would increase when governments are the dominant actors and when SOEs are the dependent actors. Specifically, EE governments would leverage constraints on SOEs to pursue their political and social goals. In addition, SOEs are particularly vulnerable to governments' constraints because they are assets of governments by its very nature. It is hence necessary to examine how state ownership affects SOEs' OFDI with considerations of governments' intervention on SOEs.

2.2. SOEs in emerging economies

SOEs are firms founded by governments or governmental agencies (Stan, Peng, & Bruton, 2014). In EE, state ownership can be utilized by governments for serving two purposes: economic goals and political goals (Cuervo-Cazurra et al., 2014). Governments' economic goals toward SOEs is acquiring surplus values and accelerating development of national economies, while governments' political goals toward SOEs is achieving social desirable objectives, such as maximizing employment rate and social welfare (Lin, Cai, & Li, 1998). Co-existence of economic and political goals toward SOEs results in both support and intervention from governments. On the one side, EE governments may provide SOEs with subsidy, favorable treatment, and backing in adverse circumstance. On the other side, EE governments may intervene in SOEs' decisions and operations via imposing complicated administration procedures and policy burdens, by which the governments can strictly control SOEs' strategies and activities (Lin et al., 1998; Lioukas et al., 1993).

Due to market-oriented reforms of SOEs in EE, it is necessary to understand EE firms' state ownership from two different dimensions, namely, the percentage of state-owned shares and the type of affiliation to governments (Li, Cui, & Lu, 2014; Wang et al., 2012). Prior to market-oriented transitions in EE, central governments directly create and operate SOEs as their affiliation to control national economies (Peng & Heath, 1996). In such institutional arrangements, SOEs strictly follow input and output quotas mandated by central governments (Zhou, Tse, & Li, 2006). However, the approach to coordinate economic activities leads to unsatisfied efficiency and triggers privatization programmes (Park, Li, & Tse, 2006). Two major changes hence take place in ownership structures of SOEs. First, EE governments start to transfer state-owned shares in SOEs to private investors. The reform leads to emergence of hybrid SOEs, which possess inconsistent percentages of state-owned shares (Xia et al., 2014). Second, central authorities gradually transfer oversights of substantial portion of SOEs to local governments. SOEs hence become heterogeneous in affiliation levels to governments, forming different type of SOEs, such as central and local SOEs (Li et al., 2014).

2.3. State ownership and EE manufacturing SOEs' OFDI

In literature, there is an enabling-view on the role of state ownership in SOEs' OFDI from EE. Because EE firms usually lack advanced firm-specific expertise, scholars have contended that the support from home governments is an impetus behind EE firms' OFDI (Lu, Liu, Wright et al., 2014; Luo et al., 2010). Among various types of firms, SOEs are more capable of obtaining support from home governments (Pan et al., 2014). Thus, some scholars have

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