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Who rides the tide of regionalization: Examining the effect of the China-ASEAN Free Trade Area on the exports of Chinese firms[☆]

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ABSTRACT

This study draws on the institutional economics and the resource-based view to examine the impact of regional institutional changes on firm exports. Specifically, we utilize the establishment of the China-ASEAN Free Trade Area as our research context. Our difference-in-difference analysis of a four-year panel of 700 Chinese listed firms lends support to our arguments that (1) regional institutional changes aimed at increasing economic incentives for intraregional business exchanges will stimulate firm exports in the regional market and that (2) private firms, more technologically competent firms, and firms with richer regional exporting experience are affected more strongly by this institutional influence.

1. Introduction

Regional institutions are emerging and strengthening as major forces that affect firm behaviors (Economist, 2015a). Despite the increasing prevalence and significance of regional institutional changes, few studies in international business and management have examined the impact of institutional changes at the regional level on firm internationalization activities, such as exports. Current studies have mainly focused on the influence of national and subnational institutions (e.g., Fox-Wolfgramm, Boal, & James, 1998; Gao, Murray, Kotabe, & Lu, 2010; Walker, Madsen, & Carini, 2002). However, not all elements of regional institutions will eventually be reflected in national and subnational institutions. Supranational institutions may include a variety of multilateral formal or informal institutions, such as dispute settlement mechanisms as alternatives to domestic courts, which cannot be applied to national or subnational institutions (Gopinath, Helpman, & Rogoff, 2014; Jandhyala & Weiner, 2014). Hence, country-level institutional factors are not sufficient to explain firm behaviors, especially in the context of international business where firms' choices may be shaped by institutional environments across countries and clusters of countries connected by particular institutional arrangements (e.g., Boschma, Makino, Qian, Ma, Li, & Mudambi, 2015; Iammarino & McCann, 2013; Jandhyala & Weiner, 2014). As a result,

more studies are needed to investigate the impact of changes in supranational institutions to better understand firm internationalization activities (Boschma et al., 2015; Jandhyala & Weiner, 2014).

Relatedly, although studies building on institutional economics have made theoretical arguments about the influence of institutional environments on firms' exporting behaviors, examining this relationship is met with empirical challenges. Prior studies usually test this relationship by comparing firm exporting behaviors in different national or sub-national institutions (e.g., Gao et al., 2010; Krammer, Strange, & Lashitew, 2017; Peng & Delios, 2006; Peng, Lee, & Wang, 2005). However, since institutional environments can be endogenously affected by firm behaviors (e.g., Hafsi & Tian, 2005; Leblebici, Salancik, Copay, & King, 1991), the static analyses may not be able to identify the causal mechanisms between institutional environments and firm exporting behaviors.

Further, in addition to institutional economics, scholars have analyzed firm exports from the lens of resource-based view (e.g., Estrin, Meyer, Wright, & Foliano, 2008; Krammer et al., 2017; López Rodríguez & García Rodríguez, 2005). While the institutional economics focuses on the role of institutional environments (e.g., home and host country institutions) played in firms' exporting behaviors (Gao et al., 2010; Krammer et al., 2017), the resource-based view concentrates on the role of firms' internal factors, such as technological

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competence and experiential knowledge (López Rodríguez & García Rodríguez, 2005; Zou & Stan, 1998). Although each theoretical perspective has advanced our understandings about firms' exporting activities, the joint impact of institutional factors and firms' internal factors on firm exports are relatively overlooked. However, because firm behaviors and performance are jointly determined by the resource-based and institution-based factors (Oliver, 1997), considering both types of factors simultaneously to explain firm exports will provide further insights.

In this study, we intend to address the above limitations by examining the impact of institutional changes on firm exports in a quasi-natural experiment setting. Specifically, we investigate the effects of regional institutional changes produced by a regional trade agreement (RTA), namely, the establishment of the China and the Association of Southeast Asian Nations Free Trade Area (CAFTA), on the exports of Chinese firms. CAFTA was officially established on 1 January 2010. It is the world's largest regional trade area by population and the third largest by intraregional trade volume (Chin & Stubbs, 2011). Examining its effect on firm export performance in the region will shed light on how regional institutional changes impact firm exports. Furthermore, the eventual launch of this RTA was the result of many rounds of multilateral negotiations among governments, which typically focused on macroeconomic consequences and national strategic interests and are unlikely to be dominated by the micro-level objectives and strategic motives of firms (Chin & Stubbs, 2011). Thus, such a regional institutional change can be considered as an exogenous intervention from the perspective of firms, as the latter are unlikely to influence the change event (Clausing, 2001; Li & Tallman, 2011). The exogenous nature of CAFTA, combined with a difference-in-difference approach to account for time-invariant firm heterogeneity, allows us to better overcome the endogeneity issue and examine the causal effects of institutional changes on firm exports.

Additionally, the resource-based view suggests that the impact of regional institutional changes on firm exports may not be identical across all firms; rather, the impact on individual firms is likely to be contingent on certain firm attributes (Teece, Pisano, & Shuen, 1997). Specifically, some firms are more capable of leveraging the changes of the "rules of the game", or "ride the tide of regionalization", than other firms. In our research context, we integrate the literature on firm exports and organizational adaptation and identify three firm-level factors, i.e., state ownership, technological competence, and past regional export experience, which form the core competence of firms, especially those from emerging economies, in coping with institutional changes in exporting markets.

This study makes several contributions to the literature. First, we contribute to the institutional change literature by zooming out the level of focus on institutional changes to supranational institutions (e.g., Boschma et al., 2015; Iammarino & McCann, 2013; Jandhyala & Weiner, 2014). Second, we contribute to the international business literature on firm exports by providing a more valid examination of the causal relationship between regional institutional changes and firm exports based on a quasi-natural experiment design. Third, we contribute to the literature on the effects of RTAs by developing a theory and providing direct firm-level evidence that firm-specific attributes explain the inconsistent impacts of RTAs on intra-bloc trade flows found in previous research. Moreover, our study highlights the importance of jointly considering institution-based factors and resource-based factors when explaining firm exports. In addition, as the first empirical study about the impact of CAFTA on the exports of Chinese firms, our findings also offer novel insights for business practitioners and policymakers regarding the opportunities associated with such regional integration agreements.

2. Research context: CAFTA

One salient feature of globalization over the past two and a half

decades is the rise of RTAs in both numbers and complexity (Fratianni & Oh, 2009; Lee, Park, & Shin, 2008). Regional institutions are thus becoming increasingly relevant to firms' internationalization (Dunning, 2000; Rugman, 2000). While existing studies have advanced our understanding by investigating the impact of subnational and national institutional changes on firm internationalization activities (e.g., Fox-Wolfgramm et al., 1998; Gao et al., 2010; Walker et al., 2002), their single-country focus neglects the influence of changes in regional institutions, which transcend national borders, on firm internationalization activities (Jandhyala & Weiner, 2014). In this study, the establishment of CAFTA provides the research context. Not only it is an important phenomenon per se, but also it allows us to better understand how institutional changes at the regional level lead to changes in firm internationalization activities.

ASEAN was inaugurated in 1967, with Indonesia, Malaysia, the Philippines, Singapore, and Thailand as the founding nations. By 2015, ASEAN comprised ten member countries with a total population of 628 million people and a total gross domestic product (GDP) of 2.57 trillion USD (ASEAN Secretariat, 2015; Narine, 2008). CAFTA was initially proposed by Rongji Zhu, the then Chinese Premier, at the 2000 ASEAN Summit. On 1 January 2010, CAFTA entered into force. It is the world's largest free trade area by population and the third largest by economic size (Chin & Stubbs, 2011).

CAFTA has significantly reduced trade barriers between China and the ASEAN countries. On the one hand, according to the *Agreement on Trade in Goods* (hereafter, the Agreement), tariffs on all goods in the "Normal Track" between China and the six long-standing members of ASEAN, which account for more than 90 percent of export products, should be eliminated beginning on 1 January 2010.² On the other hand, the Agreement requires member countries to lift any quantitative restrictions unless otherwise permitted under World Trade Organization (WTO) regulations, and it requires member countries to identify other non-tariff barriers and to eliminate them as soon as possible. In addition, as with other RTAs, CAFTA has further reduced intra-bloc trade costs by increasing transparency and facilitating local government coordination within each country.

3. Theory and hypotheses

3.1. Institutional economics and institutional change

Institutional economics regards institutions as the rules of the game in a society that incentivize and constrain economic activities (Davis & North, 1971; North, 1990). Firms, as economic actors, must take these rules into account when making choices to pursue their interests (North, 1990; Peng, Sun, Pinkham, & Chen, 2009). Since institutions directly determine the arrows a firm has in its quiver when it formulates and implements strategies and creates competitive advantages, understanding how institutional changes influence firm outcomes becomes central to the study and practice of business (Ingram & Silverman, 2002). An ongoing stream of research has sought to comprehend whether and under what conditions institutional changes promote changes in firm behaviors and performance (e.g., Barr, 1998; Peng & Delios, 2006; Peng et al., 2005). Overall, prior studies suggest that changes in formal and informal institutions, which can occur at different levels of the environment ranging from the sub-organizational level to the global level (Dacin, Goodstein, & Scott, 2002), will alter the incentive structures, resource values and choice sets of firms (e.g., North, 1990; Oliver, 1997; Peng & Delios, 2006; Peng & Heath, 1996; Peng et al., 2009). In this study, we focus on the impact of institutional changes at the regional level, an area that has

² Flexibility was allowed on no more than 150 tariff lines on 1 January 2010, but all tariffs on tariff lines placed in the Normal Track are to be eliminated no later than 1 January 2012.

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