



Why do Chinese firms tend to acquire strategic assets in international expansion?

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ABSTRACT

More Chinese companies are using cross-border merger and acquisition (M&A) to access and source strategic assets so as to address their competitive disadvantage. However, there is lack of research on the rationale for such strategic-asset-seeking M&A. This paper intends to address this critical issue from an institutional perspective. Building on institutional theory, we propose a model of resource-driven motivation behind Chinese M&A. To shed light on the explanatory power of this institutional framework, we draw on a multiple-case study of three leading Chinese firms—TCL, BOE and Lenovo. By arguing that cross-border M&A from Chinese firms represents a means to acquire strategic assets is the logic of Chinese unique institutional environment, this study is of importance not only to stimulate possible theoretical extensions but also to draw implications to other emerging market firms.

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1. Introduction

Strategic assets refer to those resources and capabilities that are valued by the firm for their potential to contribute to competitive advantage (Amit & Schoemaker, 1993). Among many alternatives for firms to access and source strategic assets, foreign direct investment (FDI) is arguably the most effective way (Chung & Alcacer, 2002; Wesson, 2004). This is particularly true for a number of emerging Asian firms who have acquired strategic assets. They establish their competitive advantage typically via acquisition of established firms in developed economies (Makino, Lau, & Yeh, 2002; Mathews, 2002). As a latecomer, Chinese multinational corporations (MNCs) are urgent to be engaged in strategic-asset-seeking FDI so as to catch up with the global giants (Deng, 2007). In addition, China has had the largest FDI outflows among emerging economies since the 1990s. Nearly half of Chinese outward FDI is via merger and acquisition (M&A) with the primary motivation of acquiring strategic

assets (UNCTAD, 2006). However, there is lack of research on the rationale behind resource-driven M&A particularly from Chinese MNCs (Child & Rodrigues, 2005). Building on institutional theory, this paper intends to fill this research gap by making an institutional explanation of why more and more Chinese firms are investing especially in developed economies to acquire strategic assets typically by aggressive M&A.

Institutional perspective is particularly appropriate for our purpose because it has established a rich basis for understanding MNC strategy by forcefully arguing that organizations sharing the same environment tend to choose similar strategies in order to achieve legitimacy (Oliver, 1991; Scott, 2001). As organizations are deeply embedded in institutional environments, their practices are often either direct reflections of, or response to, rules and beliefs built into their larger contexts (Meyer & Rowan, 1977). As institutional forces are likely to have had far-reaching and profound effects on the internationalization decision of Chinese MNCs (Buckley et al., 2007), it is imperative for us to examine how the institutional environment shapes resource-driven M&A from China. Following the institutional-based logic, we examine the premise that Chinese firms increasingly use cross-border

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M&A to acquire strategic assets because they are under pressures to conform to the home country institutional environment and the prevailing corporate values and norms. Within the institutional framework, we make case studies of three leading Chinese companies (TCL, BOE, and Lenovo). By emphasizing the importance of institutional forces embedded in national environments and corporate norms affecting Chinese investment motivation, our study is important not only to be a logical extension of institutional theory to a specific context, but also to draw implications for MNCs in other developing economies.

2. Literature review and theoretical foundation

2.1. Strategic assets and M&A

According to the resource-based theory (RBT), a firm's strategic assets determine its competitive advantage and performance (Barney, 1991). Strategic assets can be defined as “the set of difficult to trade and imitate, scarce, appropriable and specialized *resources* and *capabilities* that bestow the firm's competitive advantage” (Amit & Schoemaker, 1993, p. 36, emphasis original). They include reputation, buyer–supplier relationships, tacit knowledge, R&D capability, brand name, knowledge, and proprietary technologies (Teece, Pisano, & Shuen, 1997). Strategic assets may be acquired in factor markets (Barney, 1986), or built up through cumulative firm experience and “learning by doing” (Dierickx & Cool, 1989). Some researchers (Chung & Alcacer, 2002; Wesson, 2004) argue that FDI and M&A in particular are the most effective channel for firms to access and source strategic assets. The acquired strategic assets via FDI can help provide the acquiring firm with reputation and prestige and allow it to obtain and control resources such as knowledge base and human capital, and gain access to local markets (Chung & Alcacer, 2002). Acquisition can also promote organizational learning, especially technological learning, facilitating the development of skills and competencies that help the firm achieve competitive advantage (Vermeulen & Barkema, 2001). In addition, M&A provides firms with an expedient tool to close their resource gaps, allowing for a much faster reconfiguration of the product mix toward high profit products than, for example, internal development (Dierickx & Cool, 1989). Further, acquisitions allow firms to exchange firm-specific intangible assets and information that are subject to market failure because in the cases of tacit resources, the market for firms is often more efficient than the market for resources (Vermeulen & Barkema, 2001).

Strategic-asset-seeking occurs among latecomers or firms with few technological capabilities trying to reduce their gap by acquiring innovative firms for needed resources (Wesson, 2004). When FDI is motivated by the search for assets embodied in other firms, or driven by competitive pressures that force firms to access assets or restructure rapidly, firms increasingly use M&A as a means of market entry (UNCTAD, 2006). For Asian firms, they are most interested in seeking superior resources and skills in advanced host countries, that are not available at home (Makino et al., 2002). As newly international players, Chinese firms are generally conducting cross-border M&A

with the primary motive of obtaining and controlling strategic assets, and that is quite unique among all emerging economies (Deng, 2007; UNCTAD, 2006). Most relevantly, acquiring strategic assets via M&A may significantly help Chinese firms earn legitimacy, social support and prestige in the marketplace.

2.2. Institutional environment and strategic-asset-seeking M&A

In contrast to RBT's focus on firm heterogeneity, institutional theory asks “why there is such startling homogeneity of organizational forms and practices” (DiMaggio & Powell, 1983, p. 148). The basic thesis is that organizations conform to the rules and beliefs systems in the environment because this isomorphism (coercive, mimetic and normative) earns them legitimacy (DiMaggio & Powell, 1983; Meyer & Rowan, 1977), which “is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed systems of norms, values, beliefs and definitions” (Suchman, 1995, p. 574). As a result, organizations sharing the same environment will choose the same practices or strategies and become isomorphic with one another over time due to an overall pressure to conform to the institutional norms within the environment (DiMaggio & Powell, 1983). In addition, institutional forces affect firms' strategic decision making – such as M&A – through three fundamental “pillars”: regulative, normative, and cognitive (Scott, 2001).

As strategic and economic activity is embedded in social and normative contexts, this context motivates firms to seek legitimacy or approval for their actions, particularly from those constituents on whom the firms depend for critical resources (Oliver, 1997). Legitimacy profoundly affects strategic choices made by firms (Peng, 2003). Literature has highlighted that firms in emerging economies like China are constrained by an institutional environment with lower environmental munificence (Tsui, Schoonhoven, Meyer, Lau, & Milkovich, 2004), continuous economic liberalization and gradual institutional transition (Peng, 2003), and substantial roles played by governments (Deng, 2004). These institutional components have not been addressed in conventional FDI frameworks so far (Buckley et al., 2007). Any attempt to explore a firm's strategic choice requires an understanding of the institutional framework in which the firm is embedded (North, 1990). This is particularly true in China where various institutional constraints are prevalent and government endorsement is essential for cross-border M&A. For example, as China's economic reform has focused on improving firms' innovation efforts as a significant dimension of the institutional transition from planned to market economy (Hitt, Ahlstrom, Dacin, Levitas, & Svobodina, 2004), Chinese firms are expected to respond to government's development plan by building and/or acquiring strategic assets in order to compete successfully in the global landscape. After all, strategic assets are necessary to meet the needs for bolstering economic and social development at home and compensating firm-level competitive disadvantages (UNCTAD, 2006).

3. Theoretical framework and propositions

Firms are faced with multiple institutional pressures. The establishment and maintenance of legitimacy in home country environment is one of the most critical strategic issues. Although application of institutional theory in international business research dramatically increased in recent years, it does not have any application of institutional theory into the Chinese outward FDI so far. The internationalization process of Chinese firms, however, appears to be significantly affected by institutional forces (Buckley et al., 2007). In this paper, we contend that institutional theory can provide insights on why Chinese firms are increasingly conducting strategic-asset-seeking M&A particularly in advanced countries. Building on the literature, we propose an institutional model for the acquisition of strategic assets via M&A, as shown in Fig. 1. The institutional perspective proposed in this model suggests that Chinese firms are under institutional pressures and cultural-cognitive influences to adopt the asset-seeking M&A strategy which is viewed as appropriate for their environment.

3.1. Exogenous sources of institutional pressure: the role of government

Although institutional context influencing M&A design is multifaceted, government interference constitutes one of the core elements of institutional environment in a transitional economy, where government is a particularly important constituent that defines, diffuses, or enforces prevailing norms and requirements of acceptable firm conduct (Oliver, 1991). This is no exception for China, where the government authority over business is great and institutional constraints and incentives constitute the basis for Chinese firms' M&A decisions. As a part of economic reforms, the Chinese government has maintained political control and also maintained its ability to reward and discipline firms for their adherence to its directives (Hitt et al., 2004). In contrast to other transi-

tional economies, China has established clear direction about the types of outward FDI it would like to encourage, and has been able to compel firms to follow its policies (Deng, 2004). In addition, corporate strategic decisions in China are, to a large extent, governed by a mix of political and economic motives (Tsui et al., 2004). Importantly, Chinese government has been creating a supportive environment that particularly stimulates strong Chinese firms to invest abroad for the purpose of becoming globally competitive MNCs modeled on the example of the Japanese and Korean trading houses. As a result, the government has formulated a series of policies as institutional support for the acquisition of foreign knowledge in forms of value-added taxes and favorable financing (UNCTAD, 2005). With powerful support from the government, some strong Chinese enterprises have been undergoing rapid modernization and many of them have grown to be competitive on a worldwide scale largely through aggressive international expansion (Zeng & Williamson, 2003).

In addition, China is the only Asian government that not only actively facilitates and encourages outward FDI but also specifically encourages investment in R&D to enhance innovative capability (UNCTAD, 2005). The drive for Chinese companies to invest abroad has been gaining momentum with further implementation of the "go global" strategy (announced in 2001), which is described as one of four key thrusts to enable China to adjust itself to the trend of economic globalization. The government policy and incentives are especially critical when Chinese firms have adopted cross-border M&A as a major mechanism of overseas expansion. China's accession to the WTO in December 2001 brought another momentum for encouraging Chinese firms to invest overseas as part of China's overall strategy of joining global competition. Managerial and innovative deficiencies of Chinese firms have been of particular concern to the Chinese government as it continues its economic reform in an increasingly competitive global landscape. Therefore, the government has issued numerous rules and regulations

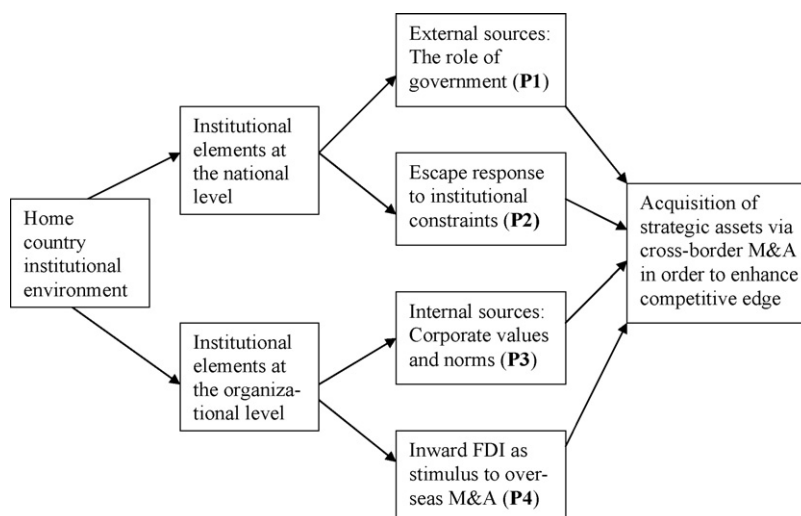


Fig. 1. An institutional model for acquisition of strategic assets via M&A.

on outward FDI for the purpose of providing a stable and supportive institutional environment so that strong Chinese firms can take a longer-term M&A strategy by focusing more on acquisition of intangible assets such as technology and managerial capabilities from global giants (Hitt et al., 2004). In October 2004, for example, the National Development and Restructuring Committee (NDRC) and Export-Import Bank of China (EIBC) issued a circular to especially promote such overseas investment as M&A that could enhance the global competitiveness of Chinese firms and accelerate their entry into advanced markets. Finally, as a country with the largest foreign exchange reserves in the world, reaching more than \$1.3 trillion by June 2007, China certainly has the capability to rapidly build up its overseas investment. Based on the above discussions:

Proposition 1. *The likelihood or intensity of acquiring strategic assets in international expansion will be higher when Chinese firms more actively (1) respond to the government's national development strategy, and (2) take advantage of political and financial incentives provided by the government.*

3.2. Cross-border M&A as escape response to home country institutional constraints

This discussion analyzes the institutional environment which involves favorable government policies that encourage Chinese firms to expand abroad. Now, let us turn to an unfavorable institutional content or “institutional voids”—lack of legal protection for property rights, poor enforcement of laws, underdeveloped factor markets, and inefficient market intermediaries that push firms to go global (Khanna & Palepu, 2006). Under this condition, firms attempt to alleviate and avoid institutional constraints at home by investing abroad. According to Witt and Lewin (2007), outward FDI can act as an escape response to perceived misalignment between firm needs and home country institutional conditions in which they are embedded. By escaping to and operating in an institutionally more efficient, transparent and encouraging environment, firms could be able to concentrate on building their knowledge basis and developing and upgrading their competitive advantages.

In emerging markets like China, formal institutional constraints such as inefficient legal frameworks and weak intellectual property rights discourage the pursuit of innovations, making it tough for businesses to invest in R&D or to build global brands (Khanna & Palepu, 2006). As a result, Chinese firms seldom create new products and process; they typically compete on volume and low price and often simply imitate each other's products. In high-tech industries, Chinese firms tend to adopt agency business activities (e.g., helping to sell and distribute foreign firms' products in the Chinese market) rather than focus on developing innovative capabilities (Ling, 2006). With continuing expansions of powerful global rivals into China, Chinese firms now find themselves in an increasingly disadvantageous position. As a result, Chinese firms have to pursue outward FDI to avoid the competitive

disadvantages incurred by operating exclusively in the domestic market where competition has been becoming increasingly fierce.

It is apparent that Chinese firms often have resource needs but they have difficulties in accessing technological capabilities and other intangible assets at home because local strategic factor markets are underdeveloped. In addition, given the pace and magnitude of technological and organizational change required to take advantage of joining the WTO, Chinese firms may not be able to internally develop competitive resources because the internal development of capabilities is time consuming and path-dependent upon the firms' existing capabilities. (Dierickx & Cool, 1989). Luo and Tung (2007) argue that facing institutional and market constraints at home, emerging marketing firms can use outward FDI as a springboard to aggressively acquire or buy strategic assets from advanced MNCs to compensate for their competitive weakness and to compete more effectively against global rivals. China's appetite for M&A has received a further boost from the simultaneous willingness of mature MNCs to sell or share their technology, know-how or brands due to financial exigency or restructuring needs. As established MNCs are increasingly willing to sell business units outside of their core strength, it is possible for the sharp increase in international acquisitions. In many cases, these business sectors have assets including patents, brand name, and established marketing channels which are either unavailable or cannot be substituted for at home (Hemerling, Michael, & Michaelis, 2006). Strategic assets can also be transferred relatively easily through M&A because resources acquired have the advantage of not being restricted by a firm's existing capabilities (Lane, Salk, & Lyles, 2001). Therefore:

Proposition 2. *The likelihood or intensity of acquiring strategic assets in international expansion will be higher when Chinese firms face (1) greater institutional constraints at home (e.g., underdeveloped factor market) and (2) increased difficulty in internally developing distinctive capabilities.*

3.3. Endogenous sources of institutional pressure: corporate values and norms

Conformity to the institutional pressures at the national level is not the only institutional element in determining the appropriate M&A strategy. Adoption of resource-driven M&A motivation may reflect the extent to which wider belief systems and cultural frames are adopted by individual actors and business organizations (DiMaggio & Powell, 1983), thereby enhancing internal legitimacy (Scott, 2001; Zucker, 1987). Unlike regulative institutional forces that are codified in formal legal restrictions and incentives, normative and cognitive forces, such as corporate values and norms are incorporated into the company's mission and vision and bounded by top management teams (TMTs). The strategic management in China is still very leader-oriented and not yet institutionalized within the firm (Tsui et al., 2004). Corporate executives have great authority over Chinese firms, but they generally concentrate their businesses almost exclusively in the Chinese markets before

launching large scale, cross-border M&A deals (Ling, 2006). Therefore, corporate values and norms are, to a large extent, a direct reflection of decision makers' domestic mindset—"the knowledge structures of TMTs, before starting any international activities, which are based mainly on their cumulative experience and learning in home markets" (Nadkarni & Perez, 2007, p. 163). The link between top managers' mindsets and the firm's international objectives was critical for proactive international strategic change in MNCs. As Chinese firms lack international experiential knowledge, they are likely to use TMTs' domestic mindsets to scan international opportunities and diagnose constraints imposed by foreign markets and guide alternative internationalization choices (Yiu & Makino, 2002).

It is well known that a number of strong Chinese enterprises are aspiring to become world-class firms and to join the listing of *Fortune's* Global 500 (Zeng & Williamson, 2003). To be globally competitive multinationals, Chinese firms have significant resources gaps to fill. Such strategic gaps are generally very large for Chinese MNCs whose lack of superior technology is the biggest disadvantage in their internationalization process (Huang, 2003; Nolan, 2001). Chinese firms do possess competitive advantage gained from access to home country resources or production capabilities, but still see themselves as having, at most, an average level of competitiveness, and have a powerful motive for asset-seeking especially in industries in which they face intensive competitive pressures (UNCTAD, 2006). What is more, the global ambitions of Chinese companies are reinforced by strong support from the Chinese government, which has a clear national interest in expanding Chinese businesses abroad.

Finally, after years of competition at home, Chinese corporate leaders recognize that to establish a competitive foothold in the global market, they must directly serve and win consumers in key foreign markets by entering their global rivals' home or backyard. To reach this end, they need managerial capabilities and know-how to move up the value chain and effectively compete in their domestic markets and, even more, in global markets. As TMTs act on their interpretations of environmental events as potential opportunities for, or threats to, gaining legitimacy (Oliver, 1997), they are very likely to regard M&A as a taken-for-granted alternative for strategic assets particularly when other options are not available or unknown (Zucker, 1987). Not surprisingly, one of the major forces driving the current wave of Chinese overseas M&A is the emerging of a new generation of Chinese firms determined to become players in the global economy (Luo & Tung, 2007). They have been successful in the Chinese market and are rapidly working to establish themselves globally as well. Therefore:

Proposition 3. *The likelihood or intensity of acquiring strategic assets in international expansion will be higher when Chinese firms' (1) entrepreneurial orientation and (2) going-global orientation are higher.*

3.4. Inward FDI as a stimulus to cross-border M&A

Proposition 3 emphasizes that corporate normative systems and cognitive elements serve as one of the key

factors underlying Chinese cross-border M&A to access and source strategic assets abroad. Some may wonder why Chinese firms with strong catch-up strategies are not taking advantage of huge inward FDI and particularly equity joint ventures (JVs) in China to source strategic assets. Indeed, literature has documented that Chinese firms have benefited substantially from inward FDI and especially equity JVs that were originally intended to serve the domestic Chinese market (Luo, 2004). From a managerial perspective, JVs may be the most effective vehicle with which to transfer tacit knowledge and hence makes more sense from the perspective of a player who needs to catch up (Lane et al., 2001). Moreover, inward investment has deepened Chinese firms' understanding of international markets and helped them accumulate international experience and considerable financial and operational assets. Building on their unique capabilities and learning experiences with inward FDI, Chinese firms are most likely to accelerate their subsequent outward FDI and increase their commitment to international markets (Luo & Tung, 2007). Based on an institutional approach (DiMaggio & Powell, 1991; Nadkarni & Perez, 2007; Zucker, 1987), the positive JV experiences in China may have influenced Chinese firms' attitude towards cross-border M&A and the establishment of JVs abroad, thereby boosting them to pursue outward FDI to further enhance their capabilities.

On the other hand, the inherent disadvantages of JVs (e.g., significant knowledge exposure) could act as another powerful stimulus for Chinese MNCs to engage in outward FDI. In equity JVs in China, foreign partners generally contribute superior technology and know-how. They are often concerned about the potential for opportunism by their Chinese partners who develop capabilities through alliances that can be used later to compete against them not only in China, but also in the global marketplace (Buckley, Clegg, & Tan, 2004). Because of significant knowledge exposure, foreign partners in China may intentionally impede transfers of knowledge or buffer the core competencies they believe crucial to their competitive advantage. As many foreign firms with superior technology are reluctant to transfer their superior technology, JVs in China do not appear to build Chinese proprietary knowledge (Nolan, 2001). Indeed, according to a survey covering 2334 Chinese industrial firms, technology transfer is very poor among partners of JVs in China (Guan, Mok, Yam, Chin, & Pun, 2006), and the transferred knowledge tends to diminish in quantity and quality (Buckley et al., 2004). Even for some of the most successful JVs in China like VW Shanghai and GM Shanghai, technology transfer to Chinese partners is far from satisfactory (Huang, 2003). Shanghai Automotive (SAIC) is desperately frustrated that Volkswagen and GM did not bring sufficient technology and it has now shifted its strategy toward acquisition. Recently, SAIC purchased a controlling stake in South Korea's SsangYong Motor Company in an attempt to build its own proprietary knowledge.

On top of that, strategic assets such as R&D capacity, design know-how and brand names are embedded in advanced country firms, which can be accessed usually by takeover of these firms or their subdivisions. Since inward

FDI and particularly JVs cannot bring in some types of strategic assets, M&A becomes a logical option to fill these resource gaps because it is taken for granted as “the way we do these things” (DiMaggio & Powell, 1991; Scott, 2001, p. 57). After all, compared with JVs in China, acquisition enables a firm to secure brands, tacit knowledge and innovation, which quickly adds to the existing cost advantage of Chinese firms (UNCTAD, 2006). M&A could also help Chinese firms engage in exploratory learning through establishment of partnerships with foreign sellers in developed markets, thus acquiring country-specific knowledge and leapfrogging to higher value activities. Put the above arguments together:

Proposition 4. *The likelihood or intensity of acquiring strategic assets in international expansion will be higher when Chinese firms’ accumulated inward internationalization is greater.*

4. Research method

To shed light on the explanatory power of the proposed institutional model, we employ a multiple-case research method. The case study approach is especially appropriate for addressing “how” and “why” questions in new topic areas (Yin, 2003). For the research purpose, we chose three well-known Chinese firms – TCL, BOE and Lenovo – as case firms. As Eisenhardt and Graebner (2007) argue, for theoretical building research like ours, the selected case should be particularly suitable for illuminating and extending the proposed conceptual model. The three cases are pertinent in demonstrating the institutional perspective for two major reasons. First, they are domestic leaders in their respective industries and also the strong enterprises that Chinese government is aggressively creating to compete globally. Second, they are aspiring to be global competitors and made noticeable cross-border M&A projects in the last few years with the primary motivation to acquire strategic assets.

To ensure validity, we collected two sources of data. The primary data were collected by interviews at the headquarters of the three firms during July and August 2006. Informed by the literature review, before the interviews, we had developed a set of open-ended questions focusing on their investment motivations and institutional environments. For each of the three firms, approximately three-hour interviews were made with three to five senior managers who were directly involved in international expansions of their firms. Participants were provided with anonymity and were requested to answer the M&A questions with respect to a specific acquisition that he or she was most familiar with. We interviewed in Chinese and translated the interview data into English. In addition, the interviews were supplemented with other sources of data, including observation, field notes and research journals, company documentation, intranet and internet data, and archival data. Due to diverse sources of information, we have constantly cross-checked information and data from different sources for triangulation purpose so as to increase the reliability and accuracy of our explanations.

5. Case studies of Chinese companies

5.1. Research setting

With a rapid growth of FDI outflows in the 1990s, China has become a leading outward investor among emerging countries. By 2006, more than 10,000 Chinese firms had cumulatively invested \$73.33 billion in nearly every country and territory worldwide (MOFCOM, 2007). In addition, M&A has rapidly become the dominant way for them to enter foreign markets. In 2001, Chinese MNCs acquired foreign assets amounting to \$450 million; in 2005, the value of such acquisitions exceeded \$5 billion, occupying almost half of the total Chinese outward FDI (UNCTAD, 2006). Beyond the energy sector, Chinese manufacturers increasingly use M&A as a major entry mode so that the most remarkable increase of Chinese outward FDI since the 1990s has been manufacturing investment (MOFCOM, 2006). Macroeconomic data suggest that there is plenty of room for further growth. Despite recent high profile deals, China remains a relatively small player in the global M&A market. Considering its GDP and foreign trade power as well as the potential evaluation of its currency, outward FDI from China “would have to increase tenfold to reach current levels in developed countries” (Hemerling et al., 2006, p. 13). On top of that, in the 1980s, the rapid accumulation of foreign reserves in Japan led to a surge in Japanese outward FDI. Because China has the world’s largest foreign exchange reserves which continue to increase at a fast pace (MOFCOM, 2007), a similar pattern could happen to China so that China is very likely to become an even more important source of FDI in the future.

In line with the trend, Chinese firms increasingly use M&A as a mode of entry to access and source strategic assets. As leaders in their respective industries in China, the three case firms made some of the most noticeable cross-border M&A deals in the past several years. A complete review of their FDI activities is beyond the scope of this paper; of particular interest here is the institutional rationale for their strategic-asset-seeking M&A. For the convenience of analysis, Table 1 summarizes the case firms regarding their major M&A activities. In the following section, we will present our empirical findings by using our theoretical model as a benchmark.

5.2. Exogenous sources of institutional pressure: the role of government

“When institutional rules or norms are broadly diffused and supported, organizations will be predicted to acquiesce to the pressures because their social validity is largely unquestioned” (Oliver, 1991, p. 169). As the government’s “go global” strategy is socially valid and pervasive in China, compliance with the regulative environment is likely to yield external legitimacy for the Chinese companies, thereby propelling them to invest abroad for strategic assets.

Growing out of a tiny cassette-tape assembler in 1982, financed by the Huizhou government, TCL is China’s largest color TV and second largest mobile phone maker. As one of the most prominent enterprises with minority state

Table 1
Business profile and key M&A projects by the case firms

	BOE Technology Group	TCL Group	Lenovo Group
Revenues (2006)	\$7.0 billion	\$6.0 billion	\$14.6 billion
Core businesses	Monitors, flat-panel TVs, display devices, and CRTs	Color TV sets, cellular phones and handsets, home theaters, and DVD players	PCs, mobile handsets, servers, motherboards, and digital products
Key M&A projects in advanced countries	(1) In January 2003, acquired Korea's Hydis (Hynix Semiconductor's flat panel display unit) for \$380 million; (2) In August 2003, purchased 26.36% stake in Korea's TPV, thus obtaining entire capacity to develop & manufacture display products	(1) In 2002, acquired Germany's Schneider Electronics; (2) In 2003, acquired US's GoVideo; (3) In July 2004, through M&A, set up \$560 million JV, "TCL-Thomson Electronics" (TTE); (4) In 2004, set up 55% owned cellular phone JV—TAMP, via merging Alcatel's mobile phone business	In December 2004, acquired IBM's PC unit for \$1.75 billion, the biggest overseas acquisition for Chinese manufacturing firms. The acquisition made Lenovo the world's third-largest PC maker immediately and also got IBM's brand, managerial teams, R&D centers, and distribution network

Sources: Companies' annual reports and official documents.

ownership in the Guangdong province, TCL got strong government support for its M&A deals particularly at the provincial level. As one of its senior managers said, "Before acquiring Schneider and merging with Thompson, we had numerous contacts with relevant government officials and we got their full support, both politically and financially. Particularly after establishment of TTE, we have been praised repeatedly by government leaders. The Guangdong government set our company a role model for other firms to follow particularly in terms of how to build global brand name via M&A." Apparently, the reason for TCL to obtain substantial government support is that acquisition of established firms in advanced economies can enhance TCL's global competitive position and brand name, which is consistently in line with the national and provincial development plan of China.

The two high profile M&A deals conducted by BOE are another example for Chinese firms to actively respond to the Chinese government's initiative for focusing on technology development and innovation. The fifth generation TFT-LCD production line is regarded as a national information industry development. As one BOE senior manager said, "Due to the strategic meaning of the development of TFT-LCD industry in China, we got solid support from different government agencies. The Beijing government regards TFT-LCD industry as what Chinese enterprises must win. The Ministry of Information Industry approved the acquisition of Hydis within 3 months." Financially, China Development Bank consistently supported the TFT-LCD industry and provided \$440 million low interest rate loans to BOE. By November 2006, the State-owned Assets Supervision and Administration Commission provided a \$1.12 billion soft loan for BOE 5G TFT-LCD. In May 2005, aided by the acquired technologies and with a \$1 billion fund from government financial sources, BOE established the TFT-LCD G5 production line, the biggest TFT-LCD plant in China. As such, BOE is expected to become a powerful competitor in the field, which is currently being occupied by Korea, Taiwan and Japan, and that certainly conforms to the government's grand plan by promoting abundant big Chinese firms which could be competitive in the global market with core competencies.

As a leader in the computer sector, Lenovo also actively responded to the government's "go global" strategy. To signal its emphasis on establishing a brand name that could be extended overseas, in 2003 it changed its name from Legend to Lenovo, meaning "leading innovation" (Biediger et al., 2005). Lenovo's acquisition of the IBM PC business was motivated primarily by the desire to obtain IBM PC's technology and capability for making products for high end users so as to become a globally competitive firm. The Chinese government has given Lenovo some support, such as financial underwriting as well as privileged access to domestic government and educational markets. In addition, in order to get the deal done, the Chinese government also permitted Lenovo to establish headquarters in New York, which would gradually be relocated to Raleigh, North Carolina; the permission avoided such difficult negotiation obstacles as taxation and corporate nationality. In addition, in the words of one Lenovo director, "The acquisition of IBM PC unit could be regarded as a government underwriting because when the negotiation was in progress, Lenovo was SOE [state-owned enterprise] and the state did hold a majority stake."

5.3. Cross-border M&A as an escape response to home country institutional constraints

For BOE, the essence of the acquisition was acquiring capability, imposing stringent management controls and coordinating operations worldwide as means of achieving a decisive cost advantage and fulfilling its longer term strategy. What is more, the acquired intangible assets including TFT-LCD production processes and R&D capabilities are not available at home. In the meantime, BOE urgently needs those strategic assets as competition in the home market becomes increasingly fierce. For the acquisition of Hydis, then the biggest purchase of foreign high-tech business in China, one of the BOE's managers commented, "After entering the WTO, China is merging into the global economy further. We have to and are determined to face up to this challenge by maintaining our leading position in China's IT industry. Acquisition of Hydis certainly provides us the means to be an effective global player."

One of the key strategic assets that TCL has been pursuing is to establish a globally recognized brand name, which is obviously not available at home and is difficult to build internally. TCL began to aggressively promote its brand internationally in 2000, and its efforts led to a series of cross-border M&A deals. The acquired Schneider Corp. gives it a platform to expand in Europe under the brand name of Schneider. By merging Thomson's TV and DVD operations, TCL established TCL-Thomson Electronics Co. Ltd. (TTE), enabling TCL to pursue a multi-brand strategy in the global market by obtaining Thomson brand in Europe and RCA brand in the U.S. The merged JV also helps TCL accelerate its expansion in high-end products, such as high-definition rear projection TV, plasma display panels and LDC TV. Also by M&A, it set up TCL-Alcatel Mobile Phones Limited (TAMP), through which TCL can take advantage of Alcatel's strong relationships with leading wireless telecommunication operators in the world.

The rationale for Lenovo to source strategic assets via M&A is similar to BOE and TCL because all of them are in globally competitive industries. These three firms have resource needs that cannot be filled at home nor easily be developed internally. Creating and sustaining brands in developed markets is complex, expensive, and uncertain. The biggest obstacle is that Lenovo did not have vital marketing skills that cannot be easily acquired or developed at home (Biediger et al., 2005). According to a Lenovo senior manager, "If Lenovo had done it itself, it would have taken several times the money and even 8–10 years. Even with those efforts, we would have not necessarily achieved IBM's performance level." On the other hand, the acquisition of the IBM PC business gives Lenovo IBM's R&D capability, a world-class management team, international propensity, and confidence in and knowledge of operating in a foreign market.

Moreover, since 1996, Lenovo has been the largest PC manufacturer in China. With almost a 30% share of the Chinese market, it realized that its opportunity for further domestic expansion was limited. Since the global PC market was estimated at around \$200 billion, it could pose huge potentials. Besides, before 2003, only 10% of Lenovo's revenues came from outside China, which may represent an inherent competitive disadvantage for Lenovo. With China entering the WTO, Chinese PC markets have become intensively competitive. In particular, Lenovo's archrival, Dell has aggressively challenged Lenovo's domestic market position and its distribution networks. Lenovo's purpose in buying IBM PC and its distribution network is largely to respond to Dell's home turf in the U.S. In the meantime, since 2003 when Lenovo set globalization essentially via M&A as its target, IBM repeatedly approached Lenovo about buying its PC business. IBM's intension to sell its PC business was the continuation of its overall strategy of focusing on its software and service businesses. For Lenovo, acquisition of IBM's PC unit not only obtains numerous strategic assets but also helps pursue the synergies between the two firms. For instance, IBM's Thinkpad would be targeted toward high-end products for large- and medium-sized businesses, while Lenovo's PCs would be directed at the consumer market and the majority of small- and medium-sized businesses. By

taking advantage of these synergies, Lenovo expects itself to be able to compete in more market segments.

In sum, in order to compete successfully both domestically and globally, the three firms urgently need strategically valuable resources that are not available at home. While they have cost competitive advantages in low and medium end product design and manufacturing, they are normally in a competitive disadvantage at the high end products. Acquisition of strategic assets permits them to move up the value chain (from manufacturing to R&D, branding and distribution), thereby enhancing their global competitiveness.

5.4. Endogenous sources of institutional pressure: corporate values and norms

Li Dongsheng, chairman of TCL, who has spent his entire career at TCL and has led it since 1997, is widely credited as the force behind the company's expansion. He is known for aggressive marketing and a relentless focus on cost control. He is very ambitious and determined to put TCL's own stamp on the global marketplace. Li's mindset is well reflected in TCL's mission, "Creating a world-class corporation with international competitiveness." In the words of its CFO, "We aspire to be the next Sony or next Samsung." Despite being a consumer electronics leader in China, TCL lacks core proprietary technologies which are held by global giants such as Sharp, Philips, and Sony. Outside China, TCL's brand is limited only to Southeast Asia. TCL's weak competitiveness is admitted by several senior managers by saying, "Compared with global giants, we obviously still lag behind, particularly in LCD and plasma HDTV technologies." In addition, due to liability of foreignness, firms like TCL need to acquire knowledge specific to local market, especially the knowledge that is tacit and complex. TCL's investment in Thomson is the latest and most dramatic example of its determination to be a truly global MNC, which is consistent with the company's core values and norms.

Founded in April 1993, BOE Technology Group Co. has witnessed a rapid growth so that since 2005, it has been ranked third place among China's Top 100 electronic enterprises just behind Haier and Lenovo. BOE's vision is "being a world-leading display company and becoming the most respected brand in the field." This vision is essentially supported by its pioneer spirit of "converting impossible to possible." This pioneer spirit is persistently advocated by the corporate executives exemplified by CEO Wang Dongsheng. Mr. Wang was only 30 years old when BOE was launched in 1993. His mindset focuses on globalization and maintaining technical advancement so as to become a product leader in the international market. Under his leadership, in the mid-1990s, BOE was already strongly internationally oriented, with an increasing emphasis in strengthening the competitiveness of its technology, quality and service.

Lenovo began as a spin-off of the Institute of Computing Technology (ICT), a research institute under the CAS (Chinese Academy of Sciences), in 1984 (Biediger et al., 2005). Lenovo's corporate culture is aggressive and innovative, and is determined to make possible the things

others think impossible. Facing more cut-throat competition in the domestic marketplace, Lenovo's decision makers and particularly CEO Mr. Liu Chuanzhi increasingly believe that international expansion is an essential stepping-stone for growth. Indeed, Mr. Liu became the principal architect behind Lenovo's acquisition of IBM PC unit and hence is commonly referred to in the press as the "Man who acquired IBM PC". With Lenovo aiming to compete globally, it needs to move into high technology, sophisticated products and services. Lenovo considered the acquisition of IBM PC as a historic opportunity for it to put its values and norms into practice since the acquired firm has expertise in technological innovation and managerial know-how, thereby strengthening its existing line of business and later transferring the know-how of PC businesses to other regions. Moreover, as some R&D activities were also included in the transaction, the takeover has contributed to Lenovo's R&D intensity and enhanced its innovative capabilities.

The three examined firms typically encounter a strong internal institutional environment dominated by legendary CEOs with deeply held beliefs about how M&A should be conducted—acquiring knowledge and penetrating higher value activities so as to leapfrog to global status. Institutions create coercive, normative, and mimetic pressures for isomorphism (DiMaggio & Powell, 1983). The dominant group's power (i.e., TMTs) tends to become culturally embedded, thereby critically influencing the internationalization process of the firms. Obviously, the M&A deals taking place in the firms are largely the outcome of centralized vision of strong leadership, that is, becoming first-class world enterprises with globally recognizable brand names.

5.5. Inward FDI as a stimulator to cross-border M&A

Establishment of partnership and alliance with foreign firms in China has been BOE's strategic priority since it was founded. BOE has established strategic alliances with MNCs from Japan, South Korea, America, Europe and Southeast Asia, and has been benefiting from these partnerships for improving its technologies and contributing to the certification of international standards including ISO9000 and ISO14001. BOE has also accumulated a lot of experiences through working with foreign partners, and in the words of one manager, "the most important experience is a global perspective, from which we can make plans for the company's development in line with the situation of global IT market." For example, in May 1999, BOE set up OTPV, a JV with Korea's TPV Technology Limited to help it enter into the monitor field and then purchased a 26.36% stake in the Korean company; partnership with Philips has also secured BOE to take over the responsibility of Philips' existing OEM Monitor business. Before 2003, BOE still lacked core competencies which could not be obtained through partnerships. BOE also lacked proprietary technologies which constitutes the bottleneck for BOE to upgrade its value chains. According to one of the directors, "We believe that to strengthen our global competitiveness, strategic alliances including JVs are necessary but insufficient. Some cutting-edge knowledge and process can be

obtained only through acquisition. Acquisition also strengthens our global sales network and service system." With the acquisition of three TFT-LCD production lines (including all the intangible assets) from Hydis, the core technology of TFT-LCD is held for the first time by a Chinese enterprise. Aimed with the acquired resources including the AFFS wide viewing angle technology, BOE has significantly improved its TFT-LCD Display device and VFD products. Boosted by the acquisition, in July 2006, BOE was officially selected as one of the most valuable brands of electronic enterprises in China.

Inward FDI also benefited Lenovo substantially and accelerated its international expansions. Even in the 1980s, Lenovo established an equity JV with a Hong Kong company and the JV helped Lenovo trade and later manufacture motherboards and primarily add-on cards. While producing its own brand beginning in 1991, Lenovo continued to distribute PCs for foreign MNCs including HP, Toshiba, and IBM. These partnerships not only accumulated needed capital and organized sales channels, but also provided Lenovo with the opportunity to closely scrutinize foreign product designs and customer response. It is no wonder that several senior managers said, "Our earliest and best teacher was foreign MNCs and especially Hewlett-Packard". A number of other strategic alliances with IBM, National Semiconductor, D-Link, and Intel also helped Lenovo accumulate knowledge by building key technologies and designing leading-edge products. However, because of the breadth of technologies and capabilities, Lenovo recognizes that it must possess its own proprietary technology. To this end, Lenovo acquired IBM's PC business to strengthen its capabilities not only in the domestic market but also in global markets.

TCL started as a small JV firm specializing in telephone equipment in the early 1980s and its development path is intertwined with inward FDI, ranging from OEM (original equipment manufacturing), cooperative alliances, contractual and equity JVs. For example, through the license agreement with Walt Disney, TCL could penetrate a niche market of consumer electronics, thus strengthening its ability in product design and brand management. TCL and InFocus set up a 50–50 owned JV named South Mountain Technologies (SMT) for development, manufacturing and distribution of front and rear-projection engines and projectors, thereby expanding into digital video products. To become a truly global MNC, however, TCL has to acquire country-specific knowledge and particularly the knowledge that is tacit and complex.

What the case firms have in common is that they had experienced inward FDI including equity JVs before expanding abroad. JVs in China did act as a partial vehicle for them to source some valuable resources. To obtain country-specific expertise, establish a consumer base in advanced markets, and build global brand name, they have to turn to the acquisition strategy. In addition, the beneficial experiences with the JVs in China positively influence their subsequent cross-border M&A designs. That is evident in that almost all of their M&A deals have embraced the hybrid integration model, which combines an outright acquisition with a partnership between the Chinese acquirers and the foreign sellers. The partnerships

normally take the form of equity JVs in which the Chinese firms hold the majority stake. TCL's acquisition of Thomson's TV business is a typical example. In the merged JV, TTE, TCL has a 67% share and Thomson the remaining 33%. Lenovo's IBM deal is also structured as a partnership. As part of the acquisition, IBM took an 18.9% equity stake and three private institutional investors (Texas Pacific Group, General Atlantic LLC, and Newbridge Capital LLC), with an investment amount of \$350 million together, hold a 10.2% share. From the Chinese perspective, such partnership helps smooth the integration by ensuring the continuity of key management and technical personnel and, over the long term, by transferring advanced managerial expertise to the Chinese firms and achieving the synergies that generate most of the value in the M&A. Such partnership simultaneously benefits the sellers because they exit an unattractive business while still participating in ongoing revenue streams with minimal risk.

6. Discussion and conclusion

This study provides a logical extension of the institutional theory to a specific context by examining how firms undertake strategic-asset-seeking M&A in response to the unique institutional characteristics of China. It is clear that to understand resource-driven M&A from Chinese MNCs, there is a need to better understand the institutional environment in which they are embedded. Specifically, Chinese firms tend to conform to the broadly defined legitimating requirements of the national-institutional factors as well as the narrowly defined legitimating requirements of the normative and cognitive elements which are largely reflected in the corporate values and norms. Our study also highlights the importance of institutional constraints and previous experiences affecting M&A strategy. In highly competitive markets, Chinese firms need strategic assets to compete successfully, particularly in the global marketplace. As strategic assets are not available at home nor are easily developed internally, acquisition of foreign firms may act as an effective escape response to the home country institutional constraints. In the meantime, there is an increasingly supply of deals as established global companies review their portfolios and decide to divest from noncore sectors. Huge FDI inflows into China stimulate Chinese firms to pursue cross-border M&A for the purpose of acquiring some types of strategic assets that inward FDI and particularly JVs cannot bring in. Although all three firms acknowledged that they benefited significantly from their strategic alliances in China, one of the true reasons that they used M&A was to stimulate the foreign partners to make more commitment to the JVs, such as upgrading new technology and transferring more intangibles. In short, by using three Chinese firms as prominent examples, we have demonstrated that the calculus of institutional arrangements at different levels captures the logic underlying the Chinese resource-driven M&A. In so doing, we provide institutional evidence for previous research (Child & Rodrigues, 2005; Luo & Tung, 2007), which claims that Chinese firms go overseas to primarily enhance a firm's critical competencies rather than to exploit existing assets.

Our studies also open up some exciting new avenues for future research. First, although acquisition of firms having valuable resources creates opportunities to become globally competitive firms, possession of strategic assets *per se* is a necessary but not sufficient condition for Chinese firms to create sustainable competitive advantages. A key reason for this is that effectively integrating acquired resources is a process fraught with uncertainty and ambiguity. The challenges for companies are not just to acquire knowledge base but also to integrate it so as to improve the post-M&A innovative performance. For instance, due to difficulties in integrating its acquired overseas operations, including the TV business of Thomson, in the 2 years of 2005–2006, TCL cumulatively lost RMB 5.07 billion (approximately \$650 million) and had withdrawn most of its overseas investment by the end of 2006. The underlying reasons for the low performance and the challenges of M&A integration need to be further analyzed in the future. By incorporating the concept of absorptive capacity (Cohen & Levinthal, 1990) into resource-driven M&A intent, we may get a complete picture of the process of acquisition of strategic assets for sustainable competitive advantage. Second, interactions between the firms and government can have substantial influence on government policies. In the future, it is useful to examine how the government responds via its interactions with the firms and how it is willing to take action to address firms' concerns, especially in the area of creating and strengthening a legal framework. Third, our study has highlighted the importance of incorporating institutional components into existing FDI theories. However, the institutional contexts examined here all concern the environment of the home country only. Future studies could expand to examine how institutional elements in both home and host countries simultaneously affect strategic choices like cross-border M&A. Fourth, limited by our data material, our study does not discuss the mimetic forces in the organizational fields. It is possible that Chinese firms have been watching and copying each others' FDI activities, spurred by the egos of the top decision makers. In the future, it is worthwhile to examine this important issue, thereby extending the relevant literature. Finally, our results may only apply to strong Chinese enterprises in fairly high technology industries with resource-driven intent; they are hardly applicable to other Chinese firms with different investment motivations such as market seeking. To shed light on Chinese MNCs in general, there is a need for more research on other investment motivations from different dimensions of companies in China.

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