HOW DO MULTINATIONAL ENTERPRISES MANAGE FOREIGNNESS IN HOST COUNTRIES: AN INSTITUTIONAL PERSPECTIVE

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ABSTRACT

Foreignness is the defining trait of multinational enterprises (MNEs) given that MNEs are unique in operating across national borders. As foreignness generates liabilities and advantages for MNEs in host countries, it is critical for MNEs to manage foreignness in order to survive and succeed. While there has been an increasing literature on the liability of foreignness, there has been little research discussing the advantage of foreignness and how to turn foreignness from liabilities into advantages. This thesis seeks to examine foreignness of MNEs from the institutional perspective, aiming to provide a unified framework and a powerful analytic tool to understand the nature and mechanisms that foreignness generates liabilities or advantages for MNEs and how MNEs manage foreignness in host countries.

The thesis identifies and analyses the concept of *institution-induced foreignness* and explores the role of foreignness in shaping the relationship between local regulators, competitors and stakeholders and MNEs. By utilising a multiple case study, the indicators for *institution-induced foreignness* found in empirical findings are presented not only in terms of regulatory rules and policies, but also in regard to norms, values, perceptions and patterned management practices. This is achieved through in-depth analysis of regulative, normative and cognitive sources of *institutional liability* and *institutional advantage*. Case study MNEs deploy different strategies over time, due according to the extent of institutional liabilities they suffered and the extent of institutional advantages they obtained. The organisational strategies adopted by MNEs are categorised into *acquiesce*, *compromise*, *exploit*, *avoid* and *explore*.

This thesis theoretically contributes to the literature in several ways. First, it conceptualises the foreignness of MNEs in a new way by providing a unique investigation of MNEs' experience in host countries. By focusing on *institution-induced foreignness*, the thesis has addressed three gaps in the existing literature: no absence of a unified framework of what foreignness means to MNEs; a lack of studies on how foreignness generates liabilities and advantages for MNEs; and an absence of empirical research on how MNEs manage foreignness in the host country. The second key theoretical contribution of the thesis is that it integrates several disciplinary areas – neoinstitutionalism, international business and strategic management — in one study. This thesis throws light on how MNEs tend to proactively manage *institution-induced foreignness* to achieve a better result. The third theoretical contribution of this thesis is that it adds to the scarce research on the organisational responses of MNEs to host country institutions.

DECLARATION

This thesis contains no material which has been accepted for the award of any other degree or diploma at any university or equivalent institution and that, to the best of my knowledge and belief, this thesis contains no material previously published or written by another person, except where due reference is made in the text of the thesis.

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LIST OF ACRONYMS

AOF	Advantage of Foreignness
CDBA	Cost of Doing Business Abroad
COO	Country of Origin
CSA	Country-specific Advantage
DFIA	Department of Foreign Investment Administration
EMNE	Emerging Market MNE
FDI	Foreign Direct Investment
FSA	Firm-specific Advantage
IB	International Business
IDP	Investment Development Path
LLL	Linkage, Leverage and Learning
LOF	Liability of Foreignness
MNE	Multinational Enterprises
MOC	Ministry of Commerce
OLI	Ownership, Location and Internalisation
RQ	Research Question
SOE	State-owned Enterprises
SQ	Sub-questions
UNCTAD	United Nations Conference on Trade and Development

CHAPTER 1: OVERVIEW OF THE THESIS

1.1 Rationale for the Study

A fundamental assumption in the international business (IB) field is that foreign firms are different from local firms in host countries. This difference, which emerges in various forms, comes from foreignness, which often leads to additional costs (Buckley & Casson, 1976; Hymer, 1976) and is referred to in the literature (Zaheer, 1995) as the liability of foreignness (LOF). Multinational enterprises (MNEs) must mitigate the effect of LOF in order to survive and succeed (Denk, Kaufmann, & Roesch, 2012). Conversely, recent studies have also claimed that there are potential advantages for MNEs in being foreign, operating on a multinational basis and straddling different institutional environments (Stahl, Tung, Kostova, & Zellmer-Bruhn, 2016). Foreignness may generate both liabilities and advantages for MNEs in host countries (Denk et al., 2012; Stahl & Tung, 2015). Given that foreignness is the defining trait of MNEs (Westney & Zaheer, 2001), a fundamental question for IB research is how MNEs manage foreignness in host countries to offset liabilities and capitalise on advantages.

Although there are different definitions and discussions about foreignness and the interactions it entails, very few studies discuss how MNEs proactively manage their foreignness (Regnér & Edman, 2014). To address this gap, further understanding is needed of what foreignness really means to MNEs, how and when foreignness generates liabilities and advantages and how MNEs can manage foreignness. This thesis aims to fill the gap in the literature by addressing these questions.

1.2 Research Question of the Study

The existing research on foreignness is rambling and bewildering and it also lacks a unified framework (Edman, 2016), which is necessary to understand the underlying mechanisms of foreignness. While the prior literature mainly discusses foreignness induced by distance and unfamiliarity (Stahl et al., 2016), an institutional perspective provides a powerful analytical tool to examine the nature and formation mechanisms of foreignness and helps in the identification of effective strategies to harness the potential benefits of this attribute (Kostova, Roth, & Dacin, 2008). To address the research gaps in the literature, the following overarching research question (RQ) is identified for this thesis:

RQ: How do multinational enterprises manage foreignness in their host countries?

To answer the RQ, three sub-questions (SQs) are presented as follows.

SQ 1: What does it mean for MNEs to be foreign in host countries?

SQ 2: How and when does foreignness generate liabilities or advantages?

SQ 3: What organisational strategies should multinational enterprises adopt to manage foreignness? Why?

This study has selected China as the empirical research context. The reason for setting the research field in China is that China has been one of the largest foreign direct investment (FDI) recipients in the world over the past decade (UNCTAD, 2016). It has received vast investments since the early 1990s, due to its enormous market potential and unprecedented economic transformation (Brandt & Rawski, 2008; Nee, 1992). China has attracted various types of MNEs in different industries (UNCTAD, 2016). Given the increasing significance of China as an emerging market and the huge institutional differences between China and Western cultures, China presents an ideal context for researchers to examine how MNEs manage foreignness in a popular host country.

1.3 Thesis Structure

The thesis consists of nine chapters. Chapter 1 offers an overview of the whole study, including background, research questions and structure. Chapter 2 sets the theoretical foundation of the thesis by reviewing concepts and theories regarding MNEs and foreignness and identifying gaps in the literature. It begins by reviewing and examining the characteristics of MNEs. Since foreignness is one defining trait of MNEs, this chapter then discusses the understanding of foreignness from different perspectives (foreignness as dissimilarities from domestic firms and as liabilities, advantages and organisational identities), illustrating both negative and positive sides of being foreign in host countries.

Chapter 3 addresses SQs 1 and 2 by conducting an institutional analysis utilising Scott's (2013) integrated model of institutions. The chapter begins by setting out the key elements of institutional theory and then analyses and examines how and when MNEs may experience liabilities or advantages while operating in host countries. From an institutional perspective, foreignness involves both non-institution-induced and institution-induced foreignness. *Institution-induced foreignness* refers to the liabilities and/or advantages experienced by MNEs in host countries as a result of local rules, norms, attitudes and patterned practices regarding MNEs. By utilising Scott's (2013) integrated model of institutions, this chapter explores regulatory, normative and cultural-cognitive sources of foreignness (SQ 1) and the liabilities and advantages arising from it (SQ 2).

Chapter 4 identifies possible organisational strategies for managing *institution-induced foreignness*, based on the review and analysis of existing literature. Managing *institution-induced foreignness* refers to how MNEs proactively capture the advantages of foreignness (AOF) and make efforts to reduce the liabilities of foreignness or transform them into advantages. The chapter begins by analysing strategies taken by organisations in response to institutional environments and presenting a theoretical framework of organisational responses towards institutions. This is followed by an analysis of MNE strategies towards *institution-induced foreignness* in the Chinese context to deepen our understanding of the issues raised by SQ 3.

Chapter 5 provides details of the methodology and research design of the thesis and methods used to collect and analyse data. It first examines methodologies used in empirical studies when analysing organisational responses to institutional environment in general; this is followed by discussion of the rationale of selecting a qualitative approach. After elaborating the procedure and general rules, including strategies for sample selection, data collection and data analysis, the process of data coding and analysis and the reliability and validity issues are explained.

Chapters 6 and 7 present the findings of interviews and case studies in relation to *institution-induced foreignness* currently experienced by case firms in China, including both liabilities and advantages and drawing on these findings chapter 8 presents conclusions as to the organisational strategies of case firms towards *institution-induced foreignness*. For instance, in order to be able to circumvent ownership restrictions on firms conducting financial leasing services, two case study firms form international joint ventures with local firms to obtain access to the Chinese financial service industry, even though their staffing structure and business operation procedures are the same as those of a wholly owned subsidiary.

Chapter 9 concludes the study and provides further insights into how MNEs handle foreignness when operating across national borders. At this point, the research findings obtained from interviews and case studies are set out in relation to each of the three research questions so as to advance our understanding. Contributions, implications and limitations of the study and suggestions for future research are identified.

CHAPTER 2: MULTINATIONAL ENTERPRISES AND FOREIGNNESS

2.1 Chapter Objectives

This chapter provides the theoretical foundation of the thesis by reviewing concepts and theories regarding MNEs and foreignness in host countries and identifies gaps in the literature. It begins by reviewing and examining the conceptualisation of MNEs, including definitions, major features and types. It then discusses foreignness from different perspectives, illustrating both the positive and negative sides of being foreign in host countries. Research gaps in the literature relevant to this study are identified.

2.2 Multinational Enterprises (MNEs)

MNEs, as the engine of the global economy, have attracted a great deal of attention among IB scholars over the past several decades (Buckley & Casson, 2009). International investment has not only created rich opportunities for MNEs engaging in global value-adding activities (Buckley, 2016), but has also generated various challenges for them in foreign markets (Dahan, Doh, Oetzel, & Yaziji, 2010). When conducting businesses outside their home countries, MNEs may be viewed as foreigners by local stakeholders and they may suffer additional costs. Foreignness is therefore inevitably one of the defining traits of MNEs. To examine how MNEs manage foreignness in host countries, it is necessary to understand what MNEs are, their major features and why MNEs from developed and emerging economies may face different types of foreignness.

2.2.1 Definition of MNEs

An MNE is a firm that owns businesses and controls activities in two or more countries (Buckley & Casson, 1976). Compared with those firms that only operate within a single market, conducting business across national borders grants MNEs access to more markets.

Furthermore, globalisation has enabled global manufacturing and worldwide marketing. In order to benefit from economies of scale, MNEs may operate multiple subsidiaries in different countries – "with some plants specialising in one kind of activity and other plants in another" (Buckley & Casson, 2009, p. 1565); thus an MNE may also be a multi-plant enterprise where different countries are involved.

2.2.2 Major Features of MNEs

Compared with domestic firms, MNEs have some unique characteristics. The first and defining, characteristic of MNEs is foreignness. In this study, foreignness refers to MNEs' experience of liabilities and/or advantages in host countries due to their foreign identity. To capture international opportunities, MNEs usually engage in investment outside their home countries, because the costs of internalising transactions are lower than the price of acquisition of goods in external markets and so MNEs are able to earn greater profits (Dunning & Lundan, 2008). Early studies on foreignness emphasised the negative side of foreignness; although more markets often imply more potential sales and revenues, the spatial distance between different countries leads to greater transaction costs compared to those incurred by local firms in host countries (Hymer, 1976). Apart from the additional financial costs, other negative impacts of foreignness (also known as liabilities) on MNEs were downplayed in research at this earlier stage. As being foreign usually means additional costs for MNEs, subsequent studies have termed all costs additional to those that would be incurred by MNEs in their home countries as the liability of foreignness (LOF) (Zaheer, 1995). The concept of LOF highlights that MNEs face additional costs compared with their local competitors in host countries. This initial conceptualisation of LOF mainly emphasised financial costs, whereas non-financial costs were mostly neglected, since earlier empirical studies on LOF were mostly confined to the financial service industry (Miller & Parkhe, 2002).

The second characteristic of MNEs is their high visibility in host countries. Non-financial costs such as regulatory constraints on foreign firms or stereotypes held by local stakeholders about MNEs are sometimes more challenging to MNEs than the financial costs. As foreign firms, MNEs tend to be considered as different from local firms and they have a higher visibility in terms of ownership and legitimacy (Kostova & Zaheer, 1999). For example, Nike, Shell and Cargill are large and well-known MNEs; they tend to be targeted by stakeholders in host countries, which often have a higher expectation of foreign firms (Kostova & Zaheer, 1999). The high visibility of MNEs brings MNEs under the close scrutiny of local communities (Epstein & Roy, 1998) and different interested groups (Gifford, Kestler, & Anand, 2010). Thus, the high visibility of MNEs can make it more difficult for them to achieve and maintain legitimacy (Kostova & Zaheer, 1999) than these are for local firms (Puck, Rogers, & Mohr, 2013; Tatoglu, Bayraktar, Sahadev, Demirbag, & Glaister, 2014). Therefore, MNEs need to carefully manage their foreignness in host countries, since any mistakes or inappropriate behaviour might be magnified and create difficulties for them.

The third characteristic of MNEs is that being foreign means that MNEs need to handle a greater number of challenges than does a local firm, including expatriation and localisation elements of the internationalisation process. Although MNEs must use some expatriate employees to ensure the control of foreign subsidiaries and foster knowledge transfer (Dabic, Gonzalez-Loureiro, & Harvey, 2015), given the high failure rate and high costs of using expatriates (DeNisi & Sonesh, 2016; Harzing, 2002) and other restrictions such as visa quotas, MNEs must also resort to localisation and rely on local employees (Harzing &

Pinnington, 2014). Hence, employee localisation in host countries appears to be a long-term trend (Fang, Jiang, Makino, & Beamish, 2010). Moreover, expatriation often involves high costs and reduced access to the added value of local expertise (Hebert, Very, & Beamish, 2005) since host country nationals have a better understanding of the local market and environment. Given that indigenous staff are valuable assets for MNEs, how they view foreign employers and executives and their attitude towards MNEs will shape the level of organisational commitment. Therefore, the foreignness of MNEs among local staff needs to be prudently managed.

In summary, three characteristics of MNEs are identified based on the literature: foreignness, high visibility and a greater number of challenges compared with local firms.

2.2.3 Developed Country MNEs and Emerging Market MNEs (EMNEs)

MNEs from different countries/markets may experience different types of foreignness in host countries. Developed economy MNEs predominate in studies of MNEs in the IB literature. Many IB theories, such as: Rugman's country-specific advantages (CSAs) (Rugman, 1990; Rugman, Lecraw, & Booth, 1985) and firm-specific advantages (FSAs) (Dunning & Rugman, 1985; Rugman, 1981); and Dunning's ownership, location and internalisation (OLI) eclectic paradigm (Dunning, 1980, 1988), as well as Dunning's investment development path (IDP) model (Dunning & Narula, 1996); are based on the experience of developed economy MNEs (Birkinshaw, Hood, & Jonsson, 1998). Developed economy MNEs tend to have firm-specific resources such as proprietary know-how (Rugman & Verbeke, 1992) or ownership advantages to compensate for the additional financial costs in foreign markets (Petersen & Pedersen, 2002). As some foreign markets have CSAs (e.g., abundant supply of raw materials or cheap labour force) or location advantages, developed economy MNEs tend to transfer FSAs to these foreign markets through their foreign direct investment (FDI) activities.

Emerging market MNEs (EMNEs), which represent a rapidly expanding group, are becoming important participants in the global economy, since FDI from emerging markets has continued to grow in recent decades (UNCTAD, 2015, 2016). EMNEs have thus become a hot topic in IB studies (Meyer & Peng, 2016). In contrast to developed economy MNEs, EMNEs are considered to have fewer firm-specific resources and they are less likely to transfer FSAs from home countries to foreign markets (Kedia, Gaffney, & Clampit, 2012). As CSAs are available to all firms operating in the same location (Bhaumik, Driffield, & Zhou, 2016), there are no identically distinct advantages for EMNEs in internationalisation. Furthermore, the intention of internationalisation for EMNEs is often not market-seeking as it is in the internationalisation of developed economy MNEs; rather, they may be seeking strategic assets, knowledge and capabilities, opportunities and leadership in implementing global strategies and they tend to rely on foreign markets as a springboard for leapfrogging (Wang, Luo, Lu, Sun, & Maksimov, 2014). As such, Luo and Rui (2009) claim that EMNEs have stronger motives to deal with external environments in a co-evolutionary manner and leverage co-opetition (simultaneous cooperation and competition) ties with business stakeholders to offset their latecomer disadvantages. As a result, the driving forces and strategies of EMNE internationalisation appear to be different from those for developed economy MNEs.

Traditionally, the internationalisation of developed economy MNEs takes different stages. MNEs normally move from importing or exporting goods to host countries, to setting up representative offices, forming joint ventures, or building a wholly owned subsidiary

(Ramamurti, 2012). However, EMNEs tend to accelerate their internationalisation process compared with developed economy MNEs (Bonaglia, Goldstein, & Mathews, 2007; Luo & Rui, 2009; Luo & Tung, 2007). This is because EMNEs come from less developed home countries and start to internationalise much later than developed economy MNEs (Ramamurti, 2012; Ramamurti & Singh, 2009). Developed economy MNEs have accumulated much more knowledge and experience in the mature stages of their internationalisation. EMNEs tend to be better at exploiting and leveraging CSAs than developed economy MNEs (Bhaumik et al., 2016). With different advantages and intentions, EMNEs have different internationalisation stages, as suggested by the linkage, leverage and learning (LLL) framework (Mathews, 2006). The key concept of the LLL framework is that EMNEs (termed 'dragon MNEs' by Mathews) could use strategic and organisational innovations to compensate for their latecomer shortcomings. Therefore, this framework helps to explain how EMNEs speed up the process to achieve a leapfrogging in their internationalisation. Furthermore, EMNEs use cross-border acquisitions as their major approach in international expansion, especially in developed countries, as a short-cut strategy to obtain strategic assets (Buckley, Elia, & Kafouros, 2014). Overall, developed economy MNEs and EMNEs tend to have different ways of internationalising. Developed economy MNEs follow the traditional stages of incremental internationalisation, while EMNEs speed up the process of entering foreign markets. Therefore, EMNEs and developed economy MNEs may be characterised by different levels of foreignness due to different internationalisation paradigms.

Many EMNEs, especially state-owned enterprises (SOEs) from emerging markets, tend to use their unique advantages, such as the close link to their home governments, to compete with developed economy MNEs. SOEs often affiliate with government agencies to conduct international expansion and look for resources and markets (Wang, Hong, Kafouros, & Wright, 2012). Home country governments have provided support for them and encouraged them to enhance competencies through internationalisation. Government involvement has a great impact on sizes, types and locations of foreign investments (Wang et al., 2012). For example, Chinese governments have provided promotional measures to stimulate Chinese firms to dive into the global market (Luo, Xue, & Han, 2010). These measures have included financial and taxation policies, risk-safeguard mechanisms, information service networks and directional guidance of outward FDI (Luo et al., 2010). In addition, the international experience and location choices of Chinese firms are largely influenced by the Chinese government's support (Lu, Liu, Wright, & Filatotchev, 2014).

EMNEs may also be more capable of dealing with less developed institutions than developed economy MNEs. Since EMNEs may have to deal with poor institutional environments in their home countries, they are more experienced than developed economy MNEs in engaging with less-developed institutional environments (Cuervo-Cazurra & Genc, 2008). Moreover, the weak institutional environments in home countries will provide EMNEs with stronger capabilities to deal with peculiar institutional environments in other emerging markets (Guillen & Garcia-Canal, 2009). On the other hand, developed economy MNEs are more used to well-established institutional environments that are generally more transparent and rule-oriented and hence often find it difficult to adapt to poor institutional environments. In contrast, the weaknesses of poor home country institutions, such as corruption, might be transformed into advantages for EMNEs in less developed countries, since EMNEs are more used to underdeveloped institutions (Cuervo-Cazurra & Genc, 2008). With different advantages in internationalisation, developed economy MNEs and EMNEs may also manage foreignness in different ways.

In summary, foreignness is a defining feature of MNEs. The foreignness of MNEs in terms of financial and non-financial costs requires close attention. In the literature, some researchers have argued that developed economy MNEs, with their home country origin effect, normally suffer a lower degree of foreignness (Moeller, Harvey, Griffith, & Richey, 2013); this assumption needs more empirical evidence and warrants further study. While developed economy MNEs and EMNEs have different firm-specific advantages and different ways of internationalising, they may also be characterised by different kinds of foreignness and may have different strategies to manage it. In the following section, the specificities of foreignness of MNEs are reviewed.

2.3 Foreignness

As stated in Section 2.2.2 above, foreignness refers to MNEs' experience of liabilities and/or advantages in host countries because of their foreign identity. However, there is no consensus regarding what foreignness means for MNEs. Although most studies of foreignness focus on LOF, some studies have looked at AOF (Cuervo-Cazurra & Genc, 2008; Regnér & Edman, 2014). Edman (2016) recently claimed that foreignness could be treated as an organisational identity. In order to obtain a comprehensive understanding of foreignness, it is necessary to review existing conceptualisations in the literature, as detailed below.

2.3.1 Foreignness as Dissimilarities

By definition, foreignness results from the fact that MNEs operate businesses outside their home countries and reflects the dissimilarities between their home and host country environments (Brannen, 2004). Existing studies have examined dissimilarities between foreign and local firms in terms of country-level factors such as spatial distance (Zaheer, 1995), institutional distance (Xu & Shenkar, 2002) and cultural and psychic distances (Eden & Miller, 2004). While all these studies emphasise that distances matter, foreignness is treated as an issue of dissimilarity between home and host countries of MNEs. However, foreignness means more than dissimilarities and non-distance factors may also shape the degree of foreignness.

For instance, the host country environment does matter; even in two host countries that have a similar spatial distance from the home country of an MNE, the firm may suffer from different host country regulation costs (Miller & Parkhe, 2002; Zaheer & Mosakowski, 1997). On the other hand, the home country environment of an MNE may be as influential as its host country environment (Witt & Lewin, 2007). Both Miller and Parkhe (2002) and Witt and Lewin (2007) have examined the importance of host and home country environments, but failed to show what roles institutions may play when discussing foreignness. Therefore, the foreignness of MNEs means more than the dissimilarities, since it reflects all impacts of country-level factors, including host country context, home country context and differences between home and host country contexts (Ramachandran & Pant, 2010).

2.3.2 Foreignness as Liabilities

The notion of LOF originates from the seminal work of Hymer (1976) on the costs of doing business abroad (CDBA). Zaheer (1995) defines LOF as all additional costs which lead to competitive disadvantages for MNE subsidiaries in host countries. Studies of LOF emphasise the negative effect of foreignness on MNEs. Substantial work has been devoted to the notion of LOF (Calhoun, 2002; Denk et al., 2012; Eden & Molot, 2002; Hennart, Roehl, & Zeng, 2002; Luo & Mezias, 2002; Luo, Shenkar, & Nyaw, 2002; Mezias, 2002; Miller & Richards, 2002; Petersen & Pedersen, 2002; Sethi & Guisinger, 2002; Sethi & Judge, 2009). The concept of LOF has been expanded from spatial and firm-specific costs to market-driven, structural/relational and institutional costs; all these additional costs imply a lower profitability of foreign firms compared to local firms when all else is equal (Zaheer, 2002). Market-driven costs refer to costs of meeting market trends, which have dominated in CDBA studies (Caves, 1982). Structural or relational costs are:

> costs associated with a foreign firm's network position in the host country and its linkages to important local actors, which are both likely to be less developed relative to those of a local firm, resulting in poorer access to local information and resources. (Zaheer, 2002, p. 351)

Institutional costs are "associated with a foreign firm's distance from the cognitive, normative and regulatory domains of the local institutional environment" (Zaheer, 2002, p. 352). The notion of structural or relational costs has expanded the dimensions of LOF by going beyond financial costs.

As CDBA for the most part arises from additional transaction costs, Zaheer (1995) explains that LOF can arise from costs directly associated with spatial distance, firm-specific costs, or host and home country related costs, although these costs will vary by industry, firm, the host country and the home country. Mezias (2002) argues that some costs are not exclusive to foreign firms, but foreign firms may be more significantly affected by them, because domestic firms have learned to mitigate these costs. Moreover, the benefits enjoyed by domestic firms (e.g., subsidies) but not available to foreign subsidiaries should also be considered when discussing LOF.

As discussed earlier, the extent of dissimilarities can shape the degree of foreignness. For instance, institutional distance exposes MNEs to LOF during internationalisation, placing them at a disadvantage compared to local competitors (Xu & Shenkar, 2002). Eden and Miller (2004) argue that cultural and psychic distances also influence the extent of LOF. Additional sources include a lack of embeddedness (Eden & Miller, 2004; Miller & Richards, 2002) and international experience (Calhoun, 2002), intensive competition (Miller & Richards, 2002) and insufficient knowledge of the host country (Petersen & Pedersen, 2002). As discussed earlier, both home and host country factors can be sources of LOF.

The IB literature argues that LOF has negative effects on the subsidiary operations of MNEs. Empirical studies have identified various effects of LOF, including lower efficiency, lower profitability, a higher failure rate and declining stock prices (Eden & Miller, 2004). For instance, Miller and Parkhe (2002) found that the efficiency scores of foreign banks were often lower than those of local competitors in 13 countries. Miller and Richards (2002) noted similar results in the European Union. Zaheer (1995) and Zaheer and Mosakowski (1997) found strong support for the existence of LOF in the fact that foreign-owned trading rooms often suffer lower profitability and a higher failure rate. Mezias (2002) claimed that foreign firms face a higher incidence of adverse lawsuit judgements in the US due to LOF. Although a number of lawsuits were not exclusive to foreign firms, local firms tended to be better at dealing with these lawsuits, so that even lawsuits of that kind make foreign firms less competitive. Bell, Filatotchev and Rasheed (2012) identified that LOF exists beyond the product market domain and they argued that the main sources for capital market LOF are focused on institutional distance, information asymmetry, unfamiliarity and cultural differences. This argument has been further supported by Baik, Kang, Kim and Lee (2013), who noted that foreign investors suffered from a high degree of capital market LOF costs in the US stock markets. Overall, these effects place a significant burden on MNEs in their business operations overseas.

Scholars have identified other liabilities that are highly relevant to LOF, such as outsidership (Johanson & Vahlne, 2009), emergingness (Madhok & Keyhani, 2012), origin (Ramachandran & Pant, 2010) and multinationality (Sethi & Judge, 2009). Liability research mainly analyses LOF from different but limited aspects, but no studies have systematically examined the relationship among these liabilities. In order to provide an extensive review of LOF, each of these different liabilities is discussed below including its definition, source and effects, which demonstrates why an institutional perspective is important for a better understanding of these liabilities.

The liability of outsidership – This concept comes from the revision of the Uppsala internationalisation process model (Johanson & Vahlne, 1977). When they revisited the previous model, Johanson and Vahlne (2009) proposed the importance of networks in the internationalisation of MNEs. Johanson and Vahlne (2009) define an insider as a well-established firm in a relevant network or networks and also claim that a firm that does not have a position in a relevant network is an outsider. The liability of outsidership mainly arises from a lack of local knowledge and networks. Coviello (2006) developed a model of networks that evolve during the internationalisation of firms and argued that insidership could be developed even before entering a new market. Johanson and Mattson (1988) discussed the internationalisation process in the context of a business network of MNEs and the relevant network structure in host countries. Specific business relationships turn internationalisation into a process of multilateral network development (Johanson & Vahlne, 1990). Denk et al. (2012) employed the liability of outsidership as a notion to reveal the importance of relational hazards/costs. Therefore, MNEs bear the liability of outsidership during the internationalisation process when trying to break into new markets as outsiders if they lack local knowledge and networks.

Networks allow MNEs to learn and build trust and commitment and hence are critical for MNEs to advance the internationalisation process. Insidership is a necessary but insufficient condition for business success (Johanson & Vahlne, 2009). If an MNE attempts to enter a host country without any relevant network position, it will suffer from the liability of outsidership and LOF and LOF probably complicates the process of becoming an insider (Johanson & Vahlne, 2009). As such, the source of the liability of outsidership can also be the source of LOF.

As outsiders, MNEs face high risk due to changes in currency and economic and political factors (Elango, 2009; Hymer, 1976; Zaheer, 1995). Miller and Richards (2002) argue that LOF causes a differential treatment between insiders (host country governments, consumers, firms) and outsiders (foreign firms), highlighting the importance of legitimacy in host country environments. Sun, Mellahi and Thun (2010) argue that MNEs from the US and Europe have not been able to profit in China and South Korea because of the lack of embeddedness and the concomitant absence of corporate lobbying and stakeholder support in a high-distance setting. This categorises the effect of the liability of outsidership as part of the effect of LOF. Additionally, Johanson and Vahlne (2009) claim that larger psychic and institutional distance will lead to a larger liability of outsidership; hence, with other things being equal, this effect makes it harder to build new business relationships. This argument makes an institutional perspective an essential part in the discussion of the liability of outsidership; but the discussion is still limited in relation to institutional distance, as the approach neglects other impacts of different institutional environments, such as the appreciation of or the discrimination against foreign firms by business networks in host countries.

The liability of emergingness – this term refers to "the additional disadvantage that EMNEs tend to suffer over other foreign [developed economy MNEs] by virtue of being from emerging economies" (Madhok & Keyhani, 2012, p. 28). The distinction between the liability of emergingness and LOF is that the former only refers to the additional burden of foreign firms from emerging economies, but the latter applies to all foreign firms entering new markets (Madhok & Keyhani, 2012). It is clear that the liability of emergingness focuses on the capability of EMNEs while operating in foreign markets.

The liability of emergingness generally arises from the home country effect of EMNEs. Madhok (2009) suggests that EMNEs tend to be less advantaged as they are generally based in countries with weak institutional environments and low-to-middle income levels. EMNEs have been distinguished from developed economy MNEs in the traditional internationalisation process as they tend to lack advantages in terms of technology and brand and are often latecomers (Ramamurti & Singh, 2009). The lack of advantages has pushed EMNEs to have a different path and speed of internationalisation in terms of choosing host countries to invest in (Madhok & Keyhani, 2012). For instance, Chinese MNEs tend to look for strategic assets, as often they have limited FSAs or locally available assets (Cui, Meyer, & Hu, 2014). Sirkin, Hemerling and Bhattacharya (2008) argue that EMNEs not only internationalise rapidly but also aggressively enter developed countries in the early stages through their outward FDI. EMNEs use mergers and acquisitions as a kind of entrepreneurship to overcome the liability of emergingness (Madhok & Keyhani, 2012).

As for the effects of the liability of emergingness, they are determined by EMNEs' headquarters and home countries. EMNEs generally have to bear greater liabilities than developed economy MNEs in terms of credibility and legitimacy. The liability of emergingness reflects the fact that EMNEs have fewer FSAs than do developed economy MNEs, such as innovation capabilities, knowledge sharing, organisational learning and marketing capabilities (Kotabe & Kothari, 2016). However, the liability of emergingness compels EMNEs to be more motivated to form strategic partnerships with developed economy MNEs (Kotabe & Kothari, 2016). As a result, the effects of the liability of emergingness are not generally reflected on a cost basis, but EMNEs' general effectiveness is limited, leading to a less competitive position. Therefore, a cost-oriented perspective may be useful when analysing the effects of LOF, but not for the analysis of the liability of emergingness. As the home country institutional environment is a significant source of the liability of emergingness, an institutional perspective is likely to be more useful in analysing the effects of this form of liability.

The liability of origin - similar to the liability of emergingness, the liability of origin refers to disadvantages facing MNEs in international markets because of many factors, such as a less-developed economy and poor institutional environments in their home country (Bartlett & Ghoshal, 2000). As the research focus has moved from developed countries to emerging markets (Peng, Wang, & Jiang, 2008), Ramachandran and Pant (2010) propose that mechanisms underlying LOF and the liability of origin are different. They define the latter in the following terms:

> liabilities of origin are disadvantages faced by MNEs in international markets as a consequence of their national origins and … these disadvantages emanate from three

> interrelated contexts of MNE activity – the home country context, host country context and the organizational context. (Ramachandran & Pant, 2010, p. 233)

In contemporary international markets, the liability of origin for the most part refers to EMNEs; however, it refers to developed economy MNEs as well in certain circumstances (Ramachandran & Pant, 2010). The liability of origin emphasises the national origin of MNEs, which is different to the liability of emergingness. The difference is not only reflected in the sources of these two liabilities, but also in different effects.

The source of liability of origin generally arises from discrimination against the home country of EMNEs. Unlike the liability of emergingness, which emphasises the capabilities of EMNEs themselves, the liability of origin emphasises doubts or negative judgements from host country stakeholders. For instance, the liability of origin could arise when MNEs' corporate reputation tends to be imbued with the political stance of their home country, even if they do not have direct relationships that could affect their home-country governments (Dunning & Lundan, 2008). Furthermore, EMNEs often suffer a liability of origin relating to climate change, since their home countries have high emissions (Pinkse & Kolk, 2012). Pant and Ramachandran (2012) empirically studied Indian software firms in the US and claimed that EMNEs had suffered from the liability of origin with regard to building legitimacy in more advanced economies. Further, the country of origin can affect the standardisation of human resource management practices between home and host countries when internationalising, especially for EMNEs, as they may suffer from the liability of origin while incorporating their international human resource management approach (Chung, Sparrow, & Bozkurt, 2014). Therefore, sources of the liability of origin can only apply to EMNEs and depend on the local environment/institutions in the host countries.

Ramachandran and Pant (2010) argue that the liability of origin can affect firm performance via a process that includes organisational imprinting, organisational identity, brand and company image, capability development and resource scarcity. They emphasise that MNEs are not just organisations pursuing optimal investment decisions, but also reflections of their national origins. Furthermore, EMNEs have often faced capability-based and legitimacy-based problems due to the liability of origin (Ramachandran & Pant, 2010). The cultural-cognitive distance between home and host country can also affect the legitimacy of foreign firms and enhance the extent of the liability of origin (Pant & Ramachandran, 2012). Similar to the liability of outsidership, an institutional perspective is taken when examining the effect of the liability of origin, but it is still limited to discussing the institutional distance and neglects other impacts of different institutional environments.

The liability of multinationality - This concept refers to 'additional costs incurred by the MNE subsidiary in interacting with entities outside the host country's context' (Sethi & Judge, 2009, p. 406). It is complementary to LOF (Sethi & Judge, 2009). The costs are incurred when an MNE subsidiary transacts with other subsidiaries and alliance partners and include: fluctuations of foreign exchange rates; constraints from headquarters in home countries; and interactions with economic institutions that affect them (Sethi & Judge, 2009). However, this conceptualisation is not yet widely and empirically supported.

The source of the liability of multinationality arises from increased global integration, which has led to a dramatic increase in the volume of multilateral transactions between MNE subsidiaries. It is important to distinguish the liability of multinationality from LOF. LOF is significant in the initial market entry but fades over time, while the liability of multinationality involves intra-firm transactions and interactions between foreign subsidiaries and financial entities and does not fade over time (Sethi & Judge, 2009). Therefore, the liability of multinationality arises from multilateral transactions between subsidiaries of MNEs across national borders. However, an important factor missing in this conceptualisation is that institutional environments from different countries would affect regulations and restrictions on foreign exchange, so as to affect this liability.

As for the effect of the liability of multinationality, it is highly relevant to additional costs, since multilateral transactions between different countries can be costly. In the case of embeddedness in the supranational context, a liability of multinationality complicates the decision-making process, as consumer perceptions and ethical norms show considerable divergence across countries (Donaldson & Dunfee, 1994). Additional costs are also reflected in transaction costs among intra-firm and allied entities and contribute to a less proficient position. However, further empirical examination of the liability of multinationality is required, especially from the institutional perspective, in terms of how different environments/institutions will affect mutual transactions. For instance, the European Commission has made an international tax decision that state aid from the Irish government to Apple is illegal (Russell & Graham, 2016).

Summary of liabilities – in conclusion, all of the above liabilities relate to additional costs for foreign firms in their efforts to obtain the same treatment as local firms. By definition, foreign firms have suffered LOF and liabilities of outsidership and multinationality. In particular, EMNEs tend to have liabilities of emergingness and origin. These liabilities are also related to each other and result in additional costs to foreign firms. For instance, the liability of outsidership is a de facto structural or relational cost (Zaheer, 2002) and hence can be part of LOF. As for the liability of emergingness and the liability of origin, they are special types of LOF that are for the most part encountered by EMNEs.

Various conceptualisations of the liabilities of MNEs are summarised in Table 2.1. The Table shows the definitions, sources and effects of the liabilities from which most ideas have been empirically tested and generated. The publication time also shows that the trend of research interest ranges from market-driven costs to costs needed to build up credibility and gain legitimacy.

Table 2.1: Summary of Liabilities

	Authors' (publication year)	Definition	Sources	Effects
Liability of foreignness (LOF)	Zaheer (1995)	All additional costs a firm operating in a market overseas incurs that a local firm would not incur.	(1) costs directly associated with spatial distance; (2) firm-specific costs based on a particular company's knowledge in a local environment; (3) costs resulting from the host country environment; (4) costs from the home country environment.	The LOF implies that foreign firms will have lower profitability than local firms, all else being equal and perhaps even a lower probability of survival.
	Zaheer (2002)		Separates and emphasises relational and institutional costs from market-driven costs.	The LOF affects access and legitimacy of foreign firms.
Liability of outsidership	Johanson and Vahlne (2009)	A firm that does not have a position in a relevant network is an outsider. The liability of outsidership refers to the additional costs of being an outsider.	If an MNE attempts to enter a host country without any relevant business networks, it will suffer from the liability of outsidership and foreignness and foreignness probably complicates the process of becoming an insider.	The liability of outsidership is the primary difficulty, as a firm's problems and opportunities in international business are becoming relationship- and network-specified; it affects knowledge learning, trust and opportunity development.

Liability of emergingness	Madhok (2009); Madhok and Keyhani (2012)	The additional costs that EMNEs tend to suffer over developed country MNEs by virtue of being from emerging economies	Disadvantages in standards and regulations. The extra burden of foreign firms from emerging economies entering new markets.	The liability of emergingness implies disadvantages for EMNEs to build up credibility legitimacy in host countries.
Liability of origin	Ramachandran and Pant (2010)	Disadvantages faced by MNEs in international markets as a consequence of their national origins.	These disadvantages emanate from three interrelated contexts of MNE activity – the home country context, host country context and the organisational context.	The liability of origin can affect firm performance via a process including organisational imprinting, organisational identity, brand and company image, capability development and resource scarcity.
Liability of multinationality	Sethi and Judge (2009)	Additional costs incurred by the MNE subsidiary in interacting with entities outside the host country's context.	The costs occur when: an MNE subsidiary transacts with other subsidiaries and alliance partners; incline of financial exposure; constraint from headquarters in home countries; and interactions with economic institutions that affect them.	The liability of multinationality complicates the decision-making process as consumer perceptions and ethical norms show considerable divergence across countries.

2.3.3 Foreignness as Advantages

Although LOF attracts the dominant research attention in studies of foreignness, recent studies have increasingly recognised the potential positive impacts of foreignness and call for further studies on advantage of foreignness (AOF) (Stahl et al., 2016). For instance, Brannen

(2004) and Sethi and Judge (2009) claim that foreignness can be an asset for MNEs in some host countries even if it is a liability elsewhere. In such a case, MNEs can benefit from foreignness.

When discussing the competitive advantage of MNEs, the IB literature divides it into CSAs and FSAs (Rugman & Verbeke, 2003). Where CSAs are location-bound and available to all firms, MNEs can only rely on their FSAs in host countries. A recent study claimed that MNEs might benefit from multinationality because they have knowledge of the global market and IB activities and access to global financial and human resources (Jiang & Stening, 2013). Both firm-specific and multinationality advantages can be reflected in foreign markets. For instance, Un (2011) empirically finds that local firms appear to have fewer product innovations in their home markets compared to foreign firms. Local firms may have a liability of localness in innovation (Jiang & Stening, 2013). In contrast, Un (2016) claims that MNEs tend to have an AOF in innovation, since they have more product innovations such as patents. In addition, MNEs can acquire unique human capital more easily than local firms, as they have subsidiaries in different countries (Yildiz & Fey, 2012). While these studies focus on FSAs and multinationality advantages to show the existence of AOF, there is a lack of research on whether external environments have any advantages for foreign firms.

There is a lack of understanding of the mechanisms by which foreignness generates advantages in host country institutional environments. The source of AOF seems to particularly rely on firm-specific resources and capabilities to create FSAs (Gaur, Kumar, & Singh, 2014); other possible sources in external environments are not yet identified. A recent study examined spillover effects of FDI in different regions of China and claimed that region-specific institutions have altered the market development and openness for both local and foreign firms (Yi, Chen, Wang, & Kafouros, 2015). However, the study of Yi et al. (2015) is limited to local firms that have benefited unequally due to regionally-specific institutions. The argument made by Yi et al. (2015) appears to support the conclusion that foreign firms receive different treatments in different regions, but it remains unclear whether foreign firms have benefited differently through the local institutional environment.

How MNEs manage foreignness and transform an LOF to an AOF is also under-researched in the literature. Battilana, Leca and Boxenbaum (2009) have demonstrated that MNEs seem to be more active in challenging host country institutions to gain legitimacy. By challenging host country institutions, MNEs are able to adjust projects to enhance their legitimacy. Such engagement with host country institutions may help MNEs to exploit CSAs. Although CSAs are available to local firms as well as foreign firms, local firms are accustomed to (and also benefit from) their home country institutions and are unlikely to challenge those institutions as often as MNEs do. Regnér and Edman (2014) have found that MNEs are able to obtain an institutional advantage by actively taking strategic responses to host country institutions to gain consumer preference and government support. Dealing with host country institutions to gain such an advantage is not only a strategy of responsiveness by foreign firms, but also a part of AOF. This is especially critical for those EMNEs that have limited FSAs. EMNEs may be able to transform disadvantages into advantages in the least developed countries through this strategy (Cuervo-Cazurra & Genc, 2008). However, it remains unexamined whether all MNEs are able to transform disadvantages into advantages in host countries. Therefore, there is still insufficient knowledge regarding how MNEs transform LOFs into AOFs.

2.3.4 Foreignness as an Organisational Identity

Edman (2016) conceptualises foreignness as an organisational identity which moderates the way factors of the home country affect MNE outcomes (e.g., performance). An organisational identity here refers to the issues of both who an organisation is and what the organisation's goal is (Edman, 2016). Edman (2016) argues that a foreign identity consists of several factors, including: 1) *cognitive attributes* that stand for foreign assumptions, mindsets and interpretive frames, which enable others to think of the MNE as a foreigner; 2) *structural attributes* that demonstrate that the MNE's foreign language, managerial culture, incentives and financial systems, are different to those of local firms; 3) *external network positions* that may show the weak embeddedness of an MNE in the local environment, with fewer business relationships than a local firm; and 4) *image attributes* that shape foreign perceptions of external actors on an MNE. Edman (2016) argues that foreignness can be managed through attenuating or accentuating these factors.

Although this is an organisation-level construct that focuses on identity, it emphasises the moderating role of the foreign identity on the effect of country-level factors (from both home and host countries) in determining the advantages and liabilities of foreignness. A foreign identity may enable MNEs to gain advantages such as innovation, human capital, market development and government support, or suffer liabilities, including operation costs, inter-relational risks and consumer antipathy (Edman, 2016). However, this organisation-level construct fails to explain which parts of AOF and LOF are related to or caused by the institutional environment. Further, Edman (2016) claims that the degree of foreignness varies depending on how MNEs respond to the host country's institutional environment, but he neglects the influence of the interaction between institutional environments and MNEs on the degree of foreignness. For instance, the institutional distance between the home and host countries of MNEs may affect the degree of foreignness (Xu & Shenkar, 2002). A strategic response framework to manage foreignness in a host country is also missing from current literature for MNEs.

2.3.5 Examining Foreignness from an Institutional Perspective

Kostova et al. (2008, p. 1003) describe an *institutional perspective* as an examination from a viewpoint "where the broad concepts of social embeddedness of organizations are intertwined with the ideas of agency, social construction and power and politics". Although institutional environments are important for understanding the foreignness of MNEs, there is rarely any examination of LOF and AOF directly in the context of the host or the home country institutional environment. In other words, the influence of institutions on LOF and AOF is under-studied. As noted in section 1.2, the existing research on foreignness has been rambling and lacking in a unified framework (Edman, 2016). The construct of institutional costs proposed by Zaheer (2002) emphasises the costs associated with regulative, normative and cultural-cognitive distances between home and host countries. This construct originates from the three pillars of an institution (Scott, 2013) (discussed in detail in Chapter 3), but focuses only on distances and neglects other costs that result from home and host country institutions. Although the institutional distance has generally been used as a country-level factor which affects LOF, other factors of the institutional environment are also related to LOF. For instance, van Hoorn and Maseland (2016) claim that the institutional environments of home or host countries matter in addition to the institutional distance between them. Furthermore, the country-of-origin (COO) effect (Moeller et al., 2013) may shape the degree of foreignness. It is different from the liability of origin, because the latter only focuses on negative spillover effects on MNEs, while the COO effect focuses on both positive and negative spillover effects.

Although the COO effect is not driven by the FSAs of MNEs, it is often reflected in the consumer behaviour of local customers towards foreign products of a specific country. Unlike dissimilarities and distances between home and host countries of MNEs, COO reveals how local stakeholders perceive MNEs according to the country they came from. Researchers note that if an MNE is from a developed country, the COO effect of this MNE is often more positive and if the MNE is from a developing or emerging economy, the perceived COO is often less positive or even negative (Sharma, 2011). Therefore, the perceptions of the COO effect can be either positive or negative and lead to LOF and AOF, which results from the cognitive stereotyping of foreign firms.

A unified framework will enable understanding of the underlying mechanisms of foreignness and how to transform LOF into AOF. There are other impacts that, like the COO effect, are driven by the institutional environment; their influence on LOF and AOF needs to be examined. Since regulative, normative and cultural-cognitive institutional factors may lead to different LOF and AOF, these three factors need to be examined separately (Scott, 2013). By doing so, the mechanism through which foreignness generates LOF and AOF can be identified for discussion. Just as MNEs can create an institutional advantage by taking proper strategic responses (Regnér & Edman, 2014), they may also be able to take strategic responses by dealing with host country institutions proactively.

The institutional perspective provides a powerful analytical tool to examine the nature and formation mechanism of foreignness and assists in identifying effective methods to manage foreignness. As discussed earlier in section 2.2.3, MNEs tend to suffer foreignness to varying degrees; the underlying mechanisms by which foreignness generates AOF and LOF for

MNEs can be examined through an institutional perspective. Henisz and Swarninathan (2008) claim that not only are MNEs affected by the host country institutional environment, MNEs are in turn also able to exert an influence on that environment. As such, MNEs are able to transform LOF into AOF by effectively managing the institutional influence. Therefore, an institutional perspective is needed for further examination of foreignness.

2.4 Gaps in the Literature and Research Questions for Further Study

Existing conceptualisations view foreignness as either a firm-level construct (Zaheer, 1995) which is specific to foreign firms, or a location-specific construct (Denk et al., 2012) which emphasises variances across national borders. However, foreignness is not just specific to any location or the distance between home and host country, but is also subject to how the host country's institutional environments treat different foreign firms. In other words, a host country may have different perceptions of and attitudes towards particular home countries, while an MNE may suffer different levels of foreignness in two host countries with similar institutional distance from its home country. Moreover, foreignness is dynamic, for there is no unified framework regarding what it means for MNEs to be foreign in a host country and defining the mechanisms by which foreignness generates liabilities or advantages (Edman, 2016). Understanding foreignness and taking an institutional perspective to examine LOF and AOF will allow a more transparent mechanism to be envisaged through which foreignness may generate LOF and AOF.

Furthermore, there is a dearth of studies examining how MNEs manage foreignness in host countries (Regnér & Edman, 2014; Edman, 2016). The extant research indicates that MNEs try to mitigate the effects of LOF by reducing the costs and building legitimacy. Although Luo et al. (2002) suggest defensive versus offensive strategies to mitigate the LOF, they neglect the possible AOF and strategies to create AOF. Therefore, few studies provide a comprehensive framework that delivers insights into the way that MNEs manage foreignness, such as whether some MNEs may inherently have an AOF, or how MNEs gain an AOF, or how an LOF could be transformed into an AOF (Stahl et al., 2016).

Based on the gaps identified through the literature reviewed, a logical and important research question (RQ) for this thesis is derived as follows:

RQ: How do multinational enterprises manage foreignness in host countries?

To answer this question, it is necessary to understand what foreignness means to MNEs from different countries. By adopting an institutional perspective, a study of the mechanisms by which foreignness generates liabilities or advantages may concentrate on aspects of LOF and AOF that are influenced by institutional environments. Furthermore, these institutional impacts may be managed differently by MNEs. To answer the RQ, three sub-questions (SQs) are presented as follows.

SQ 1: What does it mean for MNEs to be foreign in host countries?

SQ 2: How and when does foreignness generate liabilities or advantages?

SQ 3: What organisational strategies should multinational enterprises adopt to manage foreignness? Why?

2.5 Summary

The literature reviewed has contributed to understanding MNEs and foreignness. It has shown that foreignness can be perceived in terms of dissimilarities, liabilities, advantages, or organisational identity. Despite these contributions, IB research has not yet provided a comprehensive body of knowledge about how and when MNEs suffer foreignness and the extent to which this effect may be suffered. In the literature, researchers have argued that developed country MNEs normally enjoy more AOF than LOF, but this needs greater empirical support. Further, more attention has been paid to LOF and less to AOF. Few studies have examined the issue from an institutional perspective. As suggested by Kostova et al. (2008, pp. 1003-1004), an institutional perspective "better fits the complex theoretical nature of MNCs (multinational corporations) and allows for a more refined and relevant examination of institutional processes in these organisations". Given that the institutional environment has been significant in affecting LOF and AOF, the institutional perspective provides a powerful analytical tool to develop a comprehensive body of knowledge about the nature of foreignness. By taking an institutional perspective, researchers will be able to explore the mechanism by which foreignness generates LOF and AOF and identify effective methods to manage foreignness. In the next chapter, Scott's (2013) three pillars of institutions will be used as an analytic framework to understand LOF and AOF. Each pillar may form a component in the construction of *institution-induced foreignness*.

CHAPTER 3: INSTITUTIONAL LIABILITIES AND ADVANTAGES OF FOREIGNNESS

3.1 Chapter Objectives

Chapter 2 examined the various understandings of foreignness. It was argued that there is no unified framework to explain why foreignness may mean different things to MNEs and how foreignness generates liabilities and advantages for MNEs. This chapter attempts to address these issues through an institutional analysis based on the integrated institutional model of Scott (2013). It begins with a discussion of institutional theory and analysis, followed by an examination through an institutional perspective of the reasons why MNEs experience liabilities and advantages when operating in a host country. The aim is to build a framework for understanding why foreignness means different things to different MNEs in order to answer SQ 1, raised in section 2.4: *what does it mean for MNEs to be foreign in host countries?* The review of the literature on institutional liabilities and advantages presented here will assist in extending the understanding the issues relevant to SQ 2: *how and when does foreignness generate liabilities or advantages?*

3.2 Institutional Theory

Institutional theory has been one of the fastest growing approaches to the study of organisations in the years since the turn of the millennium (Kostova et al., 2008). An important building block of this theory is institutions, which are regarded as the rules of the game (North, 1990). IB scholars have examined the relationship between institutions and MNEs from different perspectives. Van Hoorn and Maseland (2016, p. 375) argue that institutional perspectives in IB studies draw upon both organizational and economic approaches to institutions.

Institutional economists have conceptualised institutions as having rules outside the control of decision-makers and maximising internal utility (North, 1990). Organisations may assist in constructing the rules, but existing rules or rule-setting processes are distinguished from the responses of players. The major research interest from this viewpoint is how actors behave within institutions which are often perceived as constraints (Peng et al., 2008). It is widely acknowledged by scholars that organisational adaptations in a given context are shaped by these institutional constraints (Meyer & Peng, 2016).

An alternative view comes from organisational institutionalism, which perceives institutions as having shared rules, beliefs and norms that define acceptable behaviours in certain circumstances (DiMaggio & Powell, 1991). The focus of this view is on the distinction between organisations and their institutional environments by highlighting connections between the structure and operation of organisations (Scott, 2013). As firms gradually increase their legitimacy in the local context, conditions for the conduct of business are most probably shaped by institutions when the context directly impacts on how MNEs enact strategies (Peng et al., 2008). Dobbin (1994) claims that rationalised organisational practices reflect the modern culture, as the core of the organisation is surrounded by instrumental rationality. Furthermore, organisations adopt rigid rules in the host country environment to conform to institutional pressures and gain legitimacy.

A third view is shaped by comparative institutionalism, which has also established significance in IB research and seeks to explain organisational differences between countries (Hotho & Pedersen, 2012). Comparative institutionalism has been used to understand strategies, structures and organisational practices of MNEs that are exposed to home country institutions and are affected by host country institutions (Hotho & Pedersen, 2012; Cui, Fan, Liu & Li, 2017). Recently, some researchers have used comparative institutional analysis to further the understanding of institutional complexity and the role of MNEs in society (Saka-Helmhout, Deeg, & Greenwood, 2016).

In summary, the importance of institutional theory has been widely accepted and institutions have been extensively discussed in social science studies. An institutional perspective is useful in understanding the relationship between organisations and environments. Hence, the following sections of this chapter will construct a framework for examining foreignness based on the institutional model of Scott (2013), presented in the next section.

3.2.1 An Integrated Model of Institutions

The institutional literature has expressed different understandings of institutions. Scott (2013) has constructed an integrated model to combine diverse views from various disciplines. According to Scott (2013, p. 56), "institutions comprise regulative, normative and cultural-cognitive elements that, together with associated activities and resources, provide stability and meaning to social life". These elements are identified as pillars that make up or support an institution. Moreover, each pillar can be examined in terms of compliance mechanisms, logic, indicators and types of legitimacy, as indicated in Table 3.1. Each of these three pillars is discussed below.

According to Scott (2013), the regulative pillar refers to a set of established rules supported by sanction. Regulative elements involve rules and surveillance mechanisms to shape behaviour (Scott, 2013). For example, institutional economists view institutions as a set of rules and laws (North, 1990). As such, institutional actors, including individual and collective players, seek to maximise their utilities within the institution's rules and laws to achieve their best interests. Its indicators include rules, laws and policies. The governmental systems and protocols act as carriers of this pillar, which operate the regulative rules of game (Zhang, 2016). Therefore, the regulative pillar functions through a coercive mechanism to ensure that actors follow rules to resolve conflicts and to receive benefits.

The normative pillar emphasises the influence of norms and values in shaping the behaviours of institutional actors. According to Scott (2013), values refer to the conception of preferences, while norms emphasise how things should be done. The appropriateness of behaviour is central to the norms of actions that are logical within the institution. In contrast to the regulative pillar, which emphasises external rules, the normative pillar specifies the power of internalised social patterns that shape individual beliefs and behaviours. This pillar is not legally sanctioned, but morally governed. Institutional actors behave based on their social obligations. Therefore, the indicators of this pillar are certification and accreditation. The carriers of the norms are hence expectations, regimes and the obedience to duty of the actor in each role (Zhang, 2016). As such, the normative pillar functions through the mechanism of widely accepted normative forces.

The cognitive pillar refers to shared understandings about the meaning of social reality (Scott, 2013). In this view, institutional actors respond to external stimuli based on their internalised representations of the world (Greenwood, Raynard, Kodeih, Micelotta, & Lounsbury, 2011). This understanding of institutions emphasises the role of socially established structures of meaning that form cultures. Culture can be viewed as the template that actors can adopt to respond to different external stimuli. Actors may use shared conceptions, patterns of action and stereotyped classifications. As such, actions are followed by a mimetic mechanism, which is characterised by the imitation of the behaviour of others. The indicators of this pillar are common beliefs and the isomorphism of social phenomena – a similarity process due to imitations or independent changes under similar constraints. The carriers are stereotypes, identities or scripts. This pillar is neither legally sanctioned nor morally governed, but recognised and culturally supported.

Table 3.1: Three Pillars of Institutions

	Regulative	***Normative***	***Cultural-Cognitive***
Basis of compliance	Expedience	Social obligation	Taken-for-grantedness Shared understanding
Basis of order	Regulative rules	Binding expectations	Constitutive schema
Mechanisms	Coercive	Normative	Mimetic
Logic	Instrumentality	Appropriateness	Orthodoxy
Indicators	Rules Laws Sanctions	Certification Accreditation	Common beliefs Shared logic of actions Isomorphism
Carriers			
Culture	Rules, Laws	Values, expectations, standards	Categories, typification, schema
Structure	Governance systems, power systems	Regimes, authority systems	Structural isomorphism
Routines	Protocols, standard operation procedures	Jobs, roles obedience to duty	Scripts
Affect	Fear, guilt/innocence	Shame/honour	Certainty/confusion
Basis of legitimacy	Legally sanctioned	Morally governed	Comprehensible Recognisable Culturally supported

Source: Scott (2013, p. 60); (Zhang, 2016, p. 20)

Scholars have observed that, although the three pillars have distinctive characteristics, an institution can be supported by a single pillar or various combinations of two or more pillars (Scott, 2013). Scott (2013) claims that stable practices are reinforced by different elements because they are backed by authorities and are normatively recognised and taken for granted. However, these elements may also be misaligned; in such cases, they may support and motivate different choices and behaviours and hence lead to institutional change (Kraatz & Block, 2008). This extensive integrated model is a powerful tool to conduct institutional analysis for foreignness, as it gathers different insights from the institutional environment.

3.2.2 Institution-Induced Foreignness

With the growing attention of IB scholars on the rise of institution-based viewpoints and the relations between MNEs and institutional environments (Henisz & Swarninathan, 2008; Kostova et al., 2008; Meyer & Peng, 2016), this section examines foreignness through an institutional perspective to establish an understanding of how institutions affect MNEs across national borders. As discussed in Chapter 2, although institutional environments have been shown to have great effects on MNEs (Powell & Rhee, 2016), few studies have examined foreignness as contrained, regulated and modified by institutions.

In this study, foreignness refers to the phenomenon that MNEs experience liabilities and/or advantages in host countries because of their foreign identity. Foreignness involves both non-institution-induced and institution-induced foreignness. Non-institution-induced foreignness comes from non-institutional factors such as geographical distance, unfamiliarity and transportation costs. *Institution-induced foreignness* refers to the liabilities and/or advantages experienced by MNEs in host countries as a result of local rules, norms, attitudes and patterned practices regarding MNEs. Every country has its unique combination of linked rules, norms, attitudes and patterned behaviour towards MNEs, constituting a unique institutional environment and business system for MNEs. This conceptualisation assists in the identification of different dimensions of *institution-induced foreignness* and its relevant effects on MNEs.

Compared with previous research that views foreignness as location-specific (Denk et al., 2012), or identity-specific (Edman, 2016) from the firm-level (Marano, Tashman, & Kostova, 2016), this study focuses on institution-induced foreignness at the national level. The study aims to explore how institution-induced foreignness generates liabilities and advantages for MNEs and how MNEs can manage institution-induced foreignness, enhance advantages, reduce liabilities and/or transform liabilities into advantages. Such institution-induced liabilities and/or advantages can be analysed through Scott's (2013) integrated model and recommendations derived for how such liabilities and advantages should be managed by MNEs.

Institution-induced foreignness may have negative and positive effects on MNEs, either institution-induced LOF and/or AOF. Although some researchers have discussed the impacts of institutional environments on LOF, such as institutional distance (Xu & Shenkar, 2002), institutional constraints (Luo & Tung, 2007) and weak home institutional environments (Ramamurti & Singh, 2009), they treat institutional environments as either drivers or causes of liabilities. But institutional environments are also drivers of advantages and enable the formation of both AOF and LOF. Thus, this thesis terms the *institution-induced* LOF and AOF proposed by this study *institutional liability* and *institutional advantage* respectively.

Institutional liability refers to all additional costs of MNEs associated with the regulative, normative and cultural-cognitive dimensions of a host country's institutional environment concerning MNEs. Although the terms 'cost' and 'liability' are often interchangeable in the liability stream of literature (Sethi & Judge, 2009), *institutional liability* is different from institutional costs. Institutional costs are proposed by Zaheer (2002, p. 352) as "costs associated with a foreign firm's distance from the cognitive, normative and regulatory domains of the local institutional environment". Zaheer (2002) includes institutional costs as a part of LOF to separate such costs from the initial conceptualisation of LOF, which has focused on market-driven costs (Zaheer, 1995). However, some other liabilities that are relevant to, or even a part of LOF, do not directly arise from or are not affected by institutional distance, as they may arise from business networks (the liability of outsidership) and from the deficit in credibility and legitimacy (liabilities of emergingness and origin). For example, the negative COO effect is, in fact, a reflection of negative cognitive stereotyping of foreignness. Therefore, the *institutional liability* of MNEs includes both financial and non-financial costs, such as being an outsider to local networks and denotes the disadvantages for MNEs when operating in specific host countries.

The IB literature has contributed dramatically to LOF research; however, there is a lack of examination of the positive effects of foreignness in organisational studies (Stahl et al., 2016). Unlike LOF, there are few studies regarding AOF in the field of IB research (Brannen, 2004; Jiang & Stening, 2013; Sethi & Judge, 2009). In contrast to *institutional liability*, *institutional advantage* refers to the benefits enjoyed by MNEs owing to the favourable regulative, normative and cultural-cognitive elements in a host country's institutional environment towards MNEs.

Although the term *institutional advantage* has been used in the literature before (Martin, 2014; Regnér & Edman, 2014; Soskice & Hall, 2001), this thesis defines the term differently from the definition used in previous conceptualisations. Kostova et al. (2008) suggest MNEs can take strategic responses to institutions in order to gain an institutional advantage compared to local firms; Regnér and Edman (2014) claim that the strength of this kind of institutional advantage depends on the strategic responses which are facilitated by different MNEs. Martin (2014, p. 59) argues that "a firm has an institutional competitive advantage when it is implementing a strategy, featuring distinctive resources and activities enabled by its interactions with the institutional environment, which generates economic value in excess of its competitors". Soskice and Hall (2001, p. 37) understand a comparative institutional advantage thus: "the institutional structure of a particular political economy provides firms with advantages for engaging in particular types of activities there".

Therefore, *institutional advantage* includes not only the part that results from strategic responses of MNEs, but also the part that results from the origin of MNEs and the institutional structure in both the home and host countries. Previous conceptualisations only emphasise a part of institutional advantages. However, institution-induced advantages may not only be gained through strategic responses, but also be induced by local institutions or even institutions of MNEs' home countries. An MNE subsidiary has an inherent *institutional advantage* or encounters an *institutional liability* even before its operations in the host country. The institutional environments in a host country may generate *institutional advantage* for a foreign firm even it does not take any strategic actions. This may have implications for making decisions in location selections and entry modes. Moreover, it is critical to find out if it is possible to transform institutional liabilities into institutional advantages. Similar to an *institutional liability*, an *institutional advantage* may contain both financial and non-financial benefits and denotes advantages in operating a business within host countries.

The following sub-sections examine *institution-induced foreignness* through the integrated model in Table 3.1 above.

3.3 An Institutional Analysis of Foreignness

Internationalisation is not only about learning or seeking strategic assets, market share or other resources in order to reduce institutional and market constraints of home countries, but is also about overcoming challenges and exploiting advantages in host countries (Luo & Tung, 2007). Orr and Scott (2008) state that the costs of foreignness stem primarily from three facets of institutional differences: regulative, normative and cultural-cognitive differences. Luo and Shenkar (2011) attempted to use cultural distance to interpret cultural-cognitive differences. Many researchers have studied the influence of host-country policies, such as regulatory enforcement actions on foreign banks (Wu & Salomon, 2017). However, there is a lack of evidence as to how institutions affect the firm's post-entry behaviour (Chen, Paik, & Park, 2010). Therefore, the institutional environment has played a critical role in affecting the business operations and behaviour of MNEs.

Foreignness actually involves different aspects of institutional environments in both home and host countries. The cost of unfamiliarity with the host country's institutional environment is reflected in the insufficient knowledge or experience of foreign firms (Bangara, Freeman, & Schroder, 2012). As special types of LOF, the liability of emergingness focuses on the poor institutional environment in the emerging economy compared with that of the more advanced economy; while the liability of origin emphasises the institutional differences between home and host countries of MNEs. MNEs need to carefully consider their strategies and levels of embeddedness in different host countries with different institutional environments to capitalise on the advantages and avoid disadvantages (Pinkse & Kolk, 2012). For instance, Thornberry, Sidani and Apaydin (2014) emphasise the critical role of an insider in informal networks of connections, such as *bazaaries* and *ulama* in the Iranian political institutional environment. This can be similar to the informal networks of connections such as *guanxi* in China. The transformation of an outsider into an insider is also constrained by the institutional environment (Thornberry et al., 2014). As such, MNEs are significantly influenced by increasingly complicated networks and the dynamic institutional environment. Therefore, an institutional analysis is critical and important for understanding the foreignness of MNEs and a more nuanced examination of foreignness from the institutional perspective is desirable, as it affects the ways in which firms pursue overseas business opportunities.

Every country constitutes a unique institutional environment for MNEs, which arises from regulative, normative and cultural cognitive sources. Hence, their foreign identity has made foreign MNEs different from local firms in host countries and created distinct characteristics, including relevant liabilities and/or advantages that are based on foreign status compared with local firms. LOF may push MNEs to become less foreign, while AOF may lead MNEs to become more foreign. These characteristics will be analysed through the three pillars.

3.3.1 The Regulative Source of Foreignness

Government policies and regulations towards MNEs constitute a major source of foreignness. Almost every country has government agencies that manage foreign direct investment (FDI) through corresponding policies and regulations regarding FDI and MNEs. In order to show how the institutional system could create either liabilities or advantages for foreign MNEs, it is necessary to select one country for analysis. China was chosen as an example for the purposes of this thesis, because it has recently become the largest recipient of FDI in the world. In China, one of the government agencies managing FDI is the Department of Foreign Investment Administration (DFIA), affiliated with the Ministry of Commerce of the People's Republic of China (MOC). China also has systematic FDI laws and regulations (MOC, 2019) such as the *Law of the People's Republic of China on Foreign-Capital Enterprises in China*; *Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures*; and *Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures*. These regulations define FDI in terms of industries of investment, ownership structure and entry modes and so on, representing the official attitude towards inward FDI and MNEs.

The laws and regulations vary over time. Based on the database of laws and regulations maintained by the general office of the National People's Congress of the People's Republic of China (2017), certain laws and regulations affecting foreign investment and MNEs are summarised in Table 3.2.

Table 3.2: China, Laws and Regulations towards Foreign Investment

Laws & Regulations	Adoption	Promulgation
Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures	Adopted at the Second Session of the Fifth National People's Congress on July 1, 1979	Promulgated by Order No.7 of the Chairman of the Standing Committee of the National People's Congress on July 8, 1979
Law of the People's Republic of China on Foreign-Capital Enterprises	Adopted at the Fourth Session of the Sixth National People's Congress on April 12, 1986	Promulgated by Order No.39 of the President of the People's Republic of China on April 12, 1986
Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures	Adopted at the First Session of the Seventh National People's	Promulgated by Order No.4 of the President of the People's Republic of China on April 13, 1988

	Congress on April 13, 1988	
Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises	Adopted at the Fourth Session of the Seventh National People's Congress	Promulgated by Order No. 45 of the President of the People's Republic of China on April 9, 1991
Decision of the Standing Committee of the National People's Congress Regarding the Application of Provisional Regulations on Such Taxes as Value-added Tax, Consumption Tax and Business Tax to Enterprises with Foreign Investment and Foreign Enterprises	Adopted at the Fifth Meeting of the Standing Committee of the Eighth National People's Congress	Promulgated by Order No. 18 of the President of the People's Republic of China on December 29, 1993
Law of the People's Republic of China on the Protection of Investment of Taiwan Compatriots	Adopted at the Sixth Meeting of the Standing Committee of the Eighth National People's Congress on March 5, 1994	Promulgated by Order No.20 of the President of the People's Republic of China on March 5, 1994
Provisions on Guiding Direction of Foreign Investment		Promulgated by Decree No.346 of the State Council of the People's Republic of China on February 11, 2002, effective as of April 1, 2002
Decision of the State Council on Amending the Rules for the Implementation of the Law of the People's Republic of China on Foreign-capital Enterprises		Promulgated by Decree No. 301 of the State Council of the People's Republic of China on April 12, 2001 and effective as of the date of promulgation
Provisions on Administration of Foreign-Invested Telecommunications Enterprises	Adopted at the 49th Executive Meeting of the State Council on December 5, 2001	Promulgated by Decree No. 333 of the State Council of the People's Republic of China on December 11, 2001 and effective as of January 1, 2002
Regulations of the People's Republic of China on Administration of Foreign-funded Insurance Companies	Adopted at the 49th Executive Meeting of the State Council on December 5, 2001	Promulgated by Decree No. 336 of the State Council of the People's Republic of China on December 12, 2001 and effective as of February 1, 2002

Regulations of the People's Republic of China on Administration of Foreign-funded Financial Institutions	Adopted at the 50th Executive Meeting of the State Council on December 12, 2001	Promulgated by Decree No.340 of the State Council of the People's Republic of China on December 20, 2001 and effective as of February 1, 2002
Regulations on Administration of Foreign Law Firms' Representative Offices in China	Adopted at the 51st Executive Meeting of the State Council on December 19, 2001	Promulgated by the Decree No. 338 of the State Council of the People's Republic of China on December 22, 2001 and effective as of January 1, 2002

Amendments to these laws and regulations have illustrated changes in laws from time to time. For example, the *Law of the People's Republic of China on Foreign Capital Enterprises* was approved in 1986 and was then revised in accordance with the *Decision to Revise the Foreign Capital Enterprises Law of the People's Republic of China* made at the 18th meeting of the Standing Committee of the Ninth National People's Congress on 31 October 2000. These amendments indirectly affected MNEs through increasing or decreasing institutional liabilities and advantages. For instance, foreign investments were covered under another general income tax law up to 1991. The amendment reflected the changing attitude of the local government towards foreign investments, from promoting all manufacturing industries to selectively promoting high-tech industries. In this way, the regulators were able to direct the foreign investment to certain industries.

In addition to these laws and regulations, the 22nd Meeting of the Standing Committee of the Twelfth National People's Congress (2016) decided to amend several laws on 3 September 2016, namely the *Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures, Law of the People's Republic of China on Foreign-Capital Enterprises, Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures and Law of the People's Republic of China on the Protection of Investment of Taiwan Compatriots*. This decision was promulgated by *Order No. 51 of the President of the People's Republic of China* on the same date. Further recent amendments to foreign investments — *Foreign Investment Law of the People's Republic of China* — were also adopted on 15 March 2019 and will be effective on 1 January 2020 (*Foreign Investment Law of the People's Republic of China*, 2019). Meanwhile, the *Chinese-Foreign Equity Joint Ventures Law*, *Wholly Foreign-Owned Enterprises Law* and *Chinese-Foreign Contractual Joint Ventures Law* will be abolished once the new foreign investment law becomes effective. The new law aims to boost investors' confidence in China while enforcing the effectiveness of foreign investment law.

The regulative sources of institution-induced foreignness include both institutional liabilities and advantages. Most studies of LOF focus on the constraints of organisational ownership structure and industry types. For instance, the Chinese government initially in the 1980s prohibited foreign investment in a number of industries, such as mass media, publication, broadcast, television and film; domestic commerce, foreign trade and insurance; and post and telecommunications. Foreign investment in some other industries was partially restricted at the same stage, such as public utilities, communications and transportation, real estate and trust investment and leasing. The Chinese government has gradually reduced restrictions for investment in certain industries such as telecommunications, insurance, financial institutions and law firms since the early 2000s. However, these restrictions have generated institutional liabilities for MNEs in particular industries. For instance, ownership by foreign firms in the automobile industry in China remains capped at a maximum of 50 per cent at the present time, which implies that joint ventures are the only option within this industry. All automobile MNEs are required to follow the law to form joint ventures in China, without having a major shareholder position to control the operation, regardless of the strength of the position the foreign firm may hold in the industry globally. This situation will change once the new foreign investment law becomes effective, since it will reduce the ownership restriction on foreign firms in this sector.

In the meantime, laws and regulations in China may provide advantages for MNEs. For instance, Volkswagen was among the first of the automobile MNEs that entered the Chinese market. Its joint venture with Chinese partners helped it gain great advantages in China compared to other competitors (Tao, 2006). The Shanghai government set up an office for the joint venture of Volkswagen in 1987 to help it build up the plant and enter the market. As such, Volkswagen wisely adapted to the local laws and regulations; this helped the company gain strong local government support, legitimacy and first mover advantages and hence retain a leading position in the Chinese automobile market (Frynas, Mellahi, & Pigman, 2006). Among all the joint ventures established by Volkswagen in China in 2000, two of them had over 53 per cent of the market share and essentially dominated the market and the other six shared 44 per cent, while 20 domestic car makers shared the remaining three per cent of the market (Gao, 2002). Other global leaders such as Ford and BMW were outside the market altogether. Moreover, the new foreign investment law reinforces incentives in certain economic development zones and regions according to the following two articles of that law (*Foreign Investment Law of the People's Republic of China*, 2019):

> Article 13: As needed, the State is to establish special economic zones or implement experimental policy measures on foreign investment in certain areas to promote foreign investment and expand the scope of opening-up.
>
> Article 14: Based on the needs of national economic and social development, the State encourages and guides foreign investors to invest in certain industries, fields, or regions. Foreign investors or foreign-invested enterprises may enjoy preferential

treatment in accordance with the provisions of laws, administrative regulations, or the State Council.

A country might have both constraints and incentives for foreign investments. In the *Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises (issued in 1991)*, some provisions have outlined tax deductions for foreign firms in different circumstances. Table 3.3 summarises articles in the income tax law where foreign firms are able to enjoy greater benefits than local firms by lawful methods. These are direct evidence that MNEs are inherently privileged by their foreign identity.

Table 3.3: China, Income Tax Law Articles related to Foreign Investments

Article 7	The income tax on enterprises with foreign investment established in Special Economic Zones, foreign enterprises which have establishments or places in Special Economic Zones engaged in production or business operations and on enterprises with foreign investment of a production nature in Economic and Technological Development Zones, shall be levied at the reduced rate of fifteen percent.
	The income tax on enterprises with foreign investment of a production nature established in coastal economic open zones or in the old urban districts of cities where the Special Economic Zones or the Economic and Technological Development Zones are located, shall be levied at the reduced rate of twenty-four percent.
	The income tax on enterprises with foreign investment in coastal economic open zones, in the old urban districts of cities where the Special Economic Zones or the Economic and Technological Development Zones are located or in other regions defined by the State Council, within the scope of energy, communications, harbour, wharf or other projects encouraged by the State, may be levied at the reduced rate of fifteen percent. The specific measures shall be drawn up by the State Council.
Article 8	Any enterprise with foreign investment of a production nature scheduled to operate for a period of not less than ten years shall, from the year it begins to make a profit, be exempted from income tax in the first and second years and allowed a fifty percent reduction in the third to fifth years (called *liang-jian san-mian-ban*). However, the exemption from or reduction of income tax on enterprises with foreign investment engaged in the exploitation of resources such as petroleum, natural gas, rare metals and precious metals shall be regulated separately by the State Council. Enterprises with foreign investment

	which have actually operated for a period of less than ten years shall repay the amount of income tax exempted or reduced already.
	The relevant regulations, promulgated by the State Council before the entry into force of this Law, which provide preferential treatment of exemption from or reduction of income tax on enterprises engaged in energy, communications, harbour, wharf and other major projects of a production nature for a period longer than that specified in the preceding paragraph, or which provide preferential treatment of exemption from or reduction of income tax on enterprises engaged in major projects of a non-production nature, shall remain applicable after this Law enters into force.
	Any enterprise with foreign investment which is engaged in agriculture, forestry or animal husbandry and any other enterprise with foreign investment which is established in remote underdeveloped areas may, upon approval by the competent department for tax affairs under the State Council of an application filed by the enterprise, be allowed a fifteen to thirty percent reduction of the amount of income tax payable for a period of another ten years following the expiration of the period for tax exemption or reduction as provided for in the preceding two paragraphs.
Article 9	The exemption from or reduction of local income tax on any enterprise with foreign investment which operates in an industry or undertakes a project encouraged by the State shall, in accordance with the actual situation, be at the discretion of the people's government of the relevant province, autonomous region or municipality directly under the Central Government.
Article 10	Any foreign investor of an enterprise with foreign investment which reinvests its share of profit obtained from the enterprise directly into that enterprise by increasing its registered capital, or uses the profit as capital investment to establish other enterprises with foreign investment to operate for a period of not less than five years shall, upon approval by the tax authorities of an application filed by the investor, be refunded forty percent of the income tax already paid on the reinvested amount. Where regulations of the State Council provide otherwise in respect of preferential treatment, such provisions shall apply. If the investor withdraws its reinvestment before the expiration of a period of five years, it shall repay the refunded tax.
Article 11	Losses incurred in a tax year by any enterprise with foreign investment and by an establishment or a place set up in China by a foreign enterprise to engage in production or business operations may be made up by the income of the following tax year. Should the income of the following tax year be insufficient to make up for the said losses, the balance may be made up by its income of the further subsequent year and so on, over a period not exceeding five years.

Based on Article 9 of the *Income Tax Law* related to foreign investments, local and provincial governments are able to provide exemptions or reductions of local income tax on any foreign investment of a project encouraged by all levels of government. Therefore, different regions in China have had various policies over the past four decades. China has a large number of provinces, autonomous regions and state-level municipalities. Each of them has its own policies to attract FDI which are permitted as long as these policies are in line with the national regulations, which often may be in the form of guidelines. To stimulate the local economy, government officials are required and encouraged to attract foreign MNEs (see Table 3.2, *Provisions on Guiding Direction of Foreign Investment*). For instance, they may provide enormous tax reductions not only for foreign firms but also for their foreign employees (i.e., income tax deductions for expatriates) and discounted land offers for building industrial plants or other projects.

However, benefits offered by local governments normally last for only a period of time. Economic development has pushed industry transformation and guided new foreign investment. For instance, the use of the '*liang-mian san-jian-ban*' policy (100 per cent income tax exemption in the first two years of the operation and then 50 per cent in the following three years; see first paragraph of Article 8 in the income tax law) has been abolished in many industries or more developed locations over the years since the early 2000s. Nevertheless, the same industry (e.g., labour-intensive industry) can be restricted in one region but encouraged in another (most probably a less developed area). Municipalities such as Shanghai no longer encourage labour-intensive industries, so they no longer provide preferential policies. On the other hand, less developed places such as Gansu Province in the North-Western region still provide a range of beneficial offers to foreign MNEs working in labour-intensive industries. In addition, the State Council of the People's Republic of China in 2008 issued a two-year total tax exemption and three-year 50 per cent exemption policy in Shanghai to attract high-tech enterprises. The major changes to these institutional beneficial policies are that they are only provided in less developed industries and regions or in high-tech industries. Beneficial policies will be reduced when some industries have become developed. The most recent decision of the National People's Congress to revise relevant laws and regulations has demonstrated that many more developed regions have become less favourable to foreign firms, as they no longer provide as many benefits as before to some foreign investment. In addition, the MOC has also released a report (MOC, 2017) outlining a policy for new institutions to be built up to provide for foreign-capital enterprises. The pilot free trade zone will be expanded from Shanghai, Guangdong, Tianjin and Fujian to include Liaoning, Zhejiang, Henan, Hubei, Chongqing, Sichuan and Shanxi.

In summary, regulations, laws and policies of host countries relevant to foreign MNEs represent the regulative source of foreignness. These linked laws, policies and regulations distinguish foreign firms from local firms based on their foreignness. It is obvious that foreignness has been employed by the central and local governments in China as a criterion to formulate and implement policies. FDI policies and regulations create restrictions or benefits for MNEs in terms of the ownership structure (e.g., wholly owned or international JVs), nature of investment (equity or non-equity), type of industry (labour-, capital- or technology-intensive industries) and location (well developed areas along the east coast or less developed areas in the middle to western regions in China) and lead to positive or negative regulative discrimination against MNEs.

3.3.2 The Normative Source of Foreignness

Although foreignness has primarily been defined by FDI laws and policies enforced by government, it is also possible that foreignness is shaped by local shared values, norms and patterned behaviours in a host country over time. The normative source of foreignness lies in the national interests and/or patriotism which provide a psychological foundation to legitimise regulations against foreign MNEs (Scott, 2013) and emphasise national interests and patriotism based on the foreign identity of MNEs. This kind of foreignness is often illustrated through patterned behaviours of competitors, suppliers, sales representatives, local partners and consumers. The related values and norms structure the social and economic behaviours of these economic agents towards foreign firms and support the persistence of the normative source of foreignness.

Indicators of the normative source of foreignness vary across different industries. They manifest themselves in patterned behaviours towards foreign business in each industry. These patterned behaviours are the responses of local actors towards MNEs. For instance, local competitors may become accustomed to the high quality of products from developed country MNEs and admit that these foreign products should enjoy a premium in the form of a higher price. Germany and Japan have built reputations in manufacturing high-quality products (Hong & Kang, 2006); local partners and suppliers are more likely to work with MNEs from these two countries.

Conversely, local markets may also perceive foreign products as low-quality due to the reputation of the home country of MNEs. For instance, EMNEs often have difficulty in gaining access to developed economies. Therefore, they tend to enter into a developed country market through mergers and acquisitions (Luo & Tung, 2007), which has given rise to evidence of a positive linear relationship between knowledge distance and equity participation and a curvilinear relationship between economic distance and equity participation (Gaffney, Karst, & Clampit, 2016). As such, EMNEs may also take a major share of equity in a firm from a developed country to gain an advantaged position.

Emerging markets have successfully attracted inward FDI in the past decades (UNCTAD, 2017). Most initial investments came from developed country MNEs, with new technologies and managerial skills that have often helped to improve product quality standards and appreciation of foreign firms' investment. The belief that foreign firms normally have better corporate structures and management systems has resulted in some favourable patterns of behaviour. For instance, in emerging economies such as China, local suppliers and buyers tend to prefer to work with foreign firms instead of local firms; many employees prefer to find a job in MNEs; some local firms are more willing to form partnership with foreign firms (Held & Bader, 2018). It is evident that working in an MNE means higher pay and more training opportunities for an employee, especially in the early stage of their careers. All these values, norms and patterned behaviours have enabled foreign firms to gain advantages in host countries, especially in developing economies such as China.

3.3.3 The Cultural-Cognitive Source of Foreignness

The cultural-cognitive source of foreignness refers to socially shared definitions, understanding and stereotypes of foreign firms and widespread taken-for-granted routines of how foreign firms should be treated (e.g., discriminatorily or beneficially) (Scott, 2013). It is the common beliefs regarding foreign firms and socially constructed assumptions through labelling and stereotyping that make them distinct from local firms. Foreign firms, mainly those from developed countries, have many characteristics that may be useful in contributing to the development of local economy. For instance, some foreign firms are good at developing talent, while some are keen to invest in research projects. The long history of foreign investments has provided various stereotypes and labels about foreign firms to construct the cognitive source of foreignness.

It appears that not all foreign firms continue to enjoy institutional advantages; some firms suffer institutional liabilities. For instance, when the British automobile maker LandRover (owned by a US firm, Ford) was acquired by Tata Group – an Indian company (Meyer, 2015), the sales of LandRover went down by 52 per cent. In this case, the cultural-cognitive sources of foreignness played a critical role affecting post-acquisition sales of LandRover.

The major indicator and carrier of cultural-cognitive foreignness involves the stereotypical responses (e.g. ethnocentrism) of local stakeholders regarding foreign firms based on their countries of origin. Hostile beliefs may result in MNEs suffering institutional liabilities; these beliefs refer to "consumers' strong feelings of dislike or even hatred towards a country due to its political, military, or economic behaviour" (Harmeling, Magnusson, & Singh, 2015, p. 678). Such a cognitive appraisal will most likely lead to negative emotional responses such as anger or fear. Harmeling et al. (2015) have empirically explored how hostile beliefs have effects on negative word of mouth, product avoidance and product quality judgement for historical reasons. These behaviours may not only affect a firm's performance, but also the organisational legitimacy of MNEs. Hong and Kang (2006) highlight that the local market may react negatively to products of MNEs if that market has animosity towards the MNEs' home country. For instance, China and Japan had a history of military conflict during World War II. These relationships were mediated by agonistic (i.e. anger) and retreat emotions (i.e. fear) (Harmeling et al., 2015); it is reported that such shared beliefs and emotions continue to affect the purchasing behaviour of Chinese consumers such as leading to avoidance in regard to Japanese products (Fong, Lee, & Du, 2015; Harmeling et al., 2015) These socially shared beliefs can be obstacles to the building up by MNEs of legitimacy in host countries (Scott, 2013). Another example is that because of the historical relationship between Germany and its neighbours, animosity towards Germany after World War II led to a set of stereotypes regarding German firms. Hence, German MNEs suffered liabilities in these neighbouring countries in the late 1950s and 1960s. This was similar to the case of Japanese investment in China.

A similar example or indicator of the cultural-cognitive source of foreignness is the country-of-origin (COO) effect. The country of origin affects perceptions of local stakeholders regarding foreign firms and their products/services. Scholars have studied the COO effect on consumer perceptions in relation to product evaluation (Bilkey & Nes, 1982; Johansson, Douglas, & Nonaka, 1985), information processing and knowledge activation (Hong & Wyer, 1989) and country image perceptions (Roth & Romeo, 1992). The COO effect has been widely recognised in terms of quality perceptions and purchase intentions. However, there remains a need for further empirical research to make clear the causes and consequences of the COO effect for both developed country MNEs and EMNEs (Moeller et al., 2013). While COO often emphasises negative impacts experienced by EMNEs, it may generate positive benefits (e.g. AOF) for developed country MNEs. Sharma (2011) compares the COO effect between consumers in developed and emerging markets and finds huge differences in consumer perceptions of product origins. Moeller et al. (2013) have examined the COO effect on the acceptance of MNEs in a host country and found that an MNE from a more developed economy is more likely to attract customers than an MNE from a less developed economy. The country of origin plays an important role in determining the potential of an MNE in a host country. Scott (2013) claims that these socially shared understandings, classifications and stereotypes can gain legitimacy easily because they can be seen as the way things should be. Therefore, local recognition and acceptance are critical for MNEs as they may lead to institutional advantages or help reduce institutional liabilities.

The cultural-cognitive dimension of foreignness also evolves over time. However, while the regulative source of foreignness is easy to identify through the observable rules and regulations and the normative source is reflected in patterned behaviours of stakeholders in host countries, the culture-cognitive pillar is much harder to identify. Nevertheless, the cognitive elements exist and can greatly affect the behaviours of all stakeholders in the host country.

Table 3.4 summarises the three pillars of foreignness based on the institutional analysis above.

Table 3.4: The Sources of Institution-Induced Foreignness

Institutional source	**Regulative**	**Normative**	**Cultural-Cognitive**
Basis of compliance	Expedience	Sovereignty and/or patriotism	Taken-for-grantedness Shared understanding
Basis of order	*Laws and regulations*	*Expectations from local competitors, suppliers and partners*	*Cultures and cognition*
Mechanisms	Coercive	Normative	Mimetic
Logic	Instrumentality	Appropriateness	Orthodoxy
Basis of legitimacy	*Legally approved, promulgated and amended*	*Mutually governed by industry stakeholders*	*Recognised* *Comprehension* *Culturally supported*

Indicators	*Laws, regulations and policies against foreign firms*	*Pattern behaviours against foreign firms*	*Shared logics and cultures of actions and behaviours*
Carriers			
Cultures	*Regulations of foreign investment*	*Appreciation or depreciation of foreign standards*	*Stereotype on foreign firms' home countries*
Structure	*Differential treatments to foreign firms*	*Hierarchical in management practices and technology development*	*Classification of foreign firms based on perceptions to home country*
Routine	*Policymaking routines for foreign firms*	*Learning from developed country MNEs*	*Country-of-origin effect*
Note: analysis used italic font.			
Source: adapted from Scott (2013, p. 60); Zhang (2016, p. 54)			

3.4 Conclusion

This chapter has adopted an institutional perspective to analyse the foreignness of MNEs. It has analysed foreignness based on Scott's (2013) integrated model of institutions and identified foreignness among the rules, values, norms and patterned behaviours in host countries concerning inward FDI and MNEs. Although the liabilities stream of research has claimed that MNEs face various liabilities when operating in host countries, few studies have examined these liabilities from an institutional perspective, which can deepen the understanding of foreignness. There is no comprehensive framework to discuss LOF caused by institutional factors. Similarly, little research has studied whether foreignness would result in an AOF to MNEs. Therefore, this chapter introduced Scott's (2013) integrated institutional model as the unified framework to analyse the foreignness of MNEs in terms of regulative, normative and cognitive dimensions. By doing so, this chapter has provided a framework for understanding how foreignness generates AOF and LOF for MNEs from an institutional perspective.

CHAPTER 4: ORGANISATIONAL STRATEGIES TO MANAGE FOREIGNNESS

4.1 Chapter Objectives

The previous chapter discussed the foreignness of MNEs from an institutional perspective. It has provided a comprehensive analytical framework of *institution-induced foreignness* and the mechanisms whereby it generates liabilities and advantages. This chapter identifies possible organisational responses to managing *institution-induced foreignness* by capturing the institutional advantages it generates and by offsetting and minimising institutional liabilities or transforming such liabilities into advantages. The chapter first introduces the strategies taken by organisations in response to institutional environments. Secondly, a theoretical framework for organisational responses is outlined. Then, to deepen understanding of SQ 3, raised in Section 2.4 (*What organisational strategies should multinational enterprises adopt to manage foreignness? Why?*) and some organisational strategies of MNEs in response to *institution-induced foreignness* are described. This structure aims to provide guidelines for MNEs to manage their foreignness in host countries.

4.2 Theoretical Background of Organisational Responses

Many theoretical concepts such as informal and formal cross-cultural institutional differences have deepened the understanding of LOF (Cantwell, Dunning, & Lundan, 2010; Denk et al., 2012; Orr & Scott, 2008). However, there are no systematic empirical studies of MNEs' response strategies towards foreignness. Most studies focus on foreignness that is created by both institutional and non-institutional effects. For instance, LOF has been tested in the context of developing countries that have a less developed institutional environment hosting foreign firms. The firms' ability to co-evolve with their environments and even to proactively influence their environments have been increasingly recognised in the literature (Denk et al., 2012). Luo et al. (2002) argue that MNEs may use a defensive strategy to reduce their dependence on and vulnerability to the local environment, or an offensive strategy to enhance their local adaptation and localisation. Jiang, Liu and Stening (2014) find that LOF may exist in China but is insignificant because of the compensations given by local governments to foreign firms in order to attract foreign investment. Moreover, the location-based advantages of local Chinese firms appear to be counterbalanced by the superior firm-specific and multinational advantages that foreign MNEs enjoy (Jiang et al., 2014). Furthermore, foreign MNEs can gain location-based resources in the later stage of their integration by acquiring local Chinese firms (Wei & Clegg, 2015). However, Acheampong and Dana (2015) claim that, even if firms increase their security expenditure, the effect of LOF still persists, particularly in emerging economies such as China and Ghana. Therefore, the question of how to deal with *institution-induced foreignness* is an underdeveloped field of research in the literature.

Institutional actors (e.g. MNEs) tend to respond to institutional environments differently. For example, experienced foreign investors have a better understanding of local institutional complexities which enables them to respond more effectively to environments and gain legitimacy more quickly than first-time entrants (Kostova & Zaheer, 1999; Tan & Meyer, 2011). MNEs need to carefully consider their strategies and levels of embeddedness in multiple institutional settings to retain benefits (Pinkse & Kolk, 2012). In addition, both insider and outsider identities can affect the response of institutional actors to local institutional environments. For instance, Thornberry et al. (2014) describe the critical role of insiders such as *bazaaries* and *ulama* in informal networks of the Iranian political institutional environment. Further, the transformation of an outsider into an insider is constrained by the complexity of institutions (Thornberry et al., 2014). However, the liability of outsidership not only refers to countries; it is also a firm-level phenomenon of a network within a country, or a wider region (Rugman & Verbeke, 2007). Therefore, the responses of institutional actors are highly dependent on the positions of actors and the situations of institutional environments and hence these factors need to be considered when discussing the organisational response of MNEs to institutions.

Prior research has emphasised the organisational response to institutional pressures and constraints over other institutional elements. Greenwood et al. (2011) argue that organisational responses to institutional constraints focus on the distribution of power which is influenced by the relationship between organisations and institutional fields. However, since the institutional environments include the field structure and different levels of institutions, the work of Greenwood et al. fails to show the feedback effects of organisational responses.

4.2.1 Organisational Responses that Focus on Organisational Strategies

The notion of strategic responses emerges from the growing literature that links institutional theory to organisational strategies (DiMaggio & Powell, 1991). Oliver (1991) conceptualises this notion and argues that organisations' responses to institutional pressures can be interest-seeking and active rather than invariably passive and conforming and this is dependent on the nature and context of institutional pressures. Oliver's work provides a deeper understanding of institutional complexity and how organisations actively handle the pressures of an institutional environment.

While the IB literature has focused on how the institutional environment constrains the choices of MNEs (Baum & Oliver, 1992), little attention was paid prior to the work of Oliver

(1991) to the response of organisations to institutional pressures. Oliver's model presented five types of strategies that MNEs may employ to address institutional pressures: *acquiescence, compromise, avoidance, defiance* and *manipulation*. The strategy of *acquiescence* implies that MNEs tend to obey institutional pressures; the *compromise* strategy is more active than *acquiescence*, but MNEs still comply with rules to some extent; the *avoidance* strategy suggests that MNEs tend to find a way to disguise their non-conformity. Any of these strategies may be adopted by MNEs towards *institution-induced foreignness*. *Manipulation* and *defiance* are two strategies through which MNEs have a strong influence on institutional constituents and processes and the sources of institutional pressures. However, these strategies are not applicable to foreignness since MNEs tend to engage and become involved with the development of institutions, not to impose power over regulators. The tactics of these strategies are identified in Table 4.1 and examples are given.

Table 4.1: Oliver's Strategic Responses to Institutional Processes

Strategies	Tactics	Examples
Acquiesce	*Habit*	Following invisible, taken-for-granted norms
	Imitate	Mimicking institutional models
	Comply	Obeying rules and accepting norms
Compromise	Balance	Balancing the expectations of multiple constituents
	Pacify	Placating and accommodating institutional elements
	Bargain	Negotiating with institutional stakeholders
Manipulate	*Co-op*	Importing influential constituents
	Influence	Shaping values and criteria
	Control	Dominating institutional constituents and processes
Avoid	Conceal	Disguising nonconformity
	Buffer	Loosening institutional attachments
	Escape	Changing goals, activities or domains

	Dismiss	Ignoring explicit norms and values
Defy	Challenge	Contesting rules and requirements
	Attack	Assaulting the sources of institutional pressures

Source: Oliver (1991, p. 152).

Etherington and Richardson (1994) argue that strategic responses can be viewed in terms of both the level of activity and the pattern of resistance. Thus, acquiescence is a passive strategy; compromise and manipulation are two active strategies that provide positive responses; while avoidance and defiance are two active strategies that provide negative responses. Building on Etherington and Richardson's (1994) study, Clemens and Douglas (2005) empirically test the framework and find general support for it. They group acquiescence, compromise and manipulation as three responses that try to work *with* the institutional pressures and avoidance and defiance as two responses that contest *against* the institutional pressures.

Some earlier scholars also provided empirical support for this theoretical framework (Goodstein, 1994; Ingram & Simons, 1995; Milliken, Martins, & Morgan, 1998) and confirmed the usefulness of this model in responding to institutional pressures. Other scholars have applied this framework to interactions with institutions. Pinkse and Kolk (2007) analysed the strategic responses of MNEs to the institutional pressure under an emissions trading scheme context in the European Union and argued that MNEs can strategically avoid pressures or use bargaining power to influence actors that enforce institutions (Child & Tsai, 2005). However, although these studies emphasise the validity of strategic responses, they do not pay attention to other institutional sources such as local norms and values other than the institutional pressures.

Given the complex and dynamic nature of institutional environments, organisations evolve dynamically within them and institutional changes with many variations occur within local institutional environments. Under such circumstances, it remains a concern whether a strategic response framework is useful for organisations in their responses to institutional changes and variations. Another critical factor missing in the literature is the impact of home country institutions/institutional environments on MNEs while they are operating in host countries. There is a lack of research into a strategic response framework for how home country institutions may affect the organisational responses of MNEs to host country institutional changes, although these home country institutions do influence the strategies an MNE is likely to adopt.

Kraatz and Block (2008) raise another important approach to strategic responses; they argue that the pluralistic legitimacy of organisations may enable them to employ multiple logics. Four types of responses are identified: first, organisations may resist institutional pressures; second, firms may try to balance institutional demands (Pratt & Foreman, 2000); third, organisations may build durable identities and increase their embeddedness within institutions; fourth, firms may also relate to various institutions in a form of decoupling (Binder, 2007). The fact that subsidiaries of MNEs may find different ways to respond to the institutional demands of their environments has been neglected in most empirical studies (Binder, 2007). The first two types of responses are similar to Oliver's framework and the third type is also applicable to responses to *institution-induced foreignness*. However, there is a lack of empirical research on this approach and the corresponding responses. Most prior studies have only examined a single response rather than empirically examining all or multiple responses (Kraatz & Block, 2008).

4.2.2 Organisational Responses to a Mixture of Institutions

Recent studies have examined organisational responses to a mixture of institutions. Organisational responses may put more focus on solving immediate issues through short-term strategies and tend to focus on long-term strategies in complex situations involving various institutions (McPherson & Sauder, 2013; Smets, Morris, & Greenwood, 2012). For example, some teams and groups in subsidiary branches of organisations are set up to examine types of strategies to deal with new policies, incentives and upcoming standards over a period of time. Organisations may need to engage with multiple institutions within complex institutional environments (Raaijmakers, Vermeulen, Meeus, & Zietsma, 2015), but few studies have examined how firms respond to multiple institutions and conflicts arising between them (Zilber, 2011).

It can be quite challenging for firms and organisations to adequately appreciate the complex nature of institutional environments and select appropriate strategies or form effective responses to them. Recently, researchers (Vermeulen, Zietsma, Greenwood, & Langley, 2014) have summarised different ways to examine organisational responses to the institutional environments (Battilana & Dorado, 2010; Jay, 2013; Kraatz & Block, 2008; Pache & Santos, 2010).

This thesis will examine different strategies adopted by organisations to manage institution-induced foreignness, drawing on prior approaches to studying organisational responses to institutional environments, including the cultural-cognitive aspects of institutional environments (Friedland, 2013) and reflections on how conflicting institutions interact on different levels of their environments (Hoffman, 2011). *Institution-induced foreignness* is treated in this study as resulting from the interactions of different institutions (Greenwood et al., 2011; Zaheer, 1995); no prior studies have focused on how organisations manage this multi-faceted phenomenon when operating abroad. Most studies have examined LOF from a resource-based perspective and have recently engaged with the institutional perspective. There is a growing interest in the importance of *institution-induced foreignness* faced by MNEs. Therefore, this thesis will use China as the sample host country location, since China has been the largest FDI recipient among emerging markets over the past decades and since 2014, it has become the largest recipient worldwide. The study will use a combination of approaches, mentioned in previous sections of this chapter, to explore how organisations respond to *institution-induced foreignness* when doing business in a foreign institutional environment. Rather than focus only on the institutional pressures, this thesis will explore how firms proactively transform their position from one that is disadvantaged to one that is more beneficial and even actively affect the complex nature of the institutions they engage with. Thus, this thesis focuses on organisational strategies to manage *institution-induced foreignness*.

4.3 MNEs in China

This study uses China as the sample host country for foreign MNEs because it is the second largest economy and the largest emerging market and has attracted the largest amount of FDI among all developing countries in the nearly three decades since the early 1990s. The institutional environment for foreign MNEs investing in China has changed dramatically over this period of time. Hence, the Chinese context presents an exemplary case for identifying the greatest possible number of indicators of the impact of the three pillars of the country's institutions on foreignness (i.e., *institution-induced foreignness*).

4.3.1 The Chinese Context

China has received vast attention and inward FDI since the early 1990s due to its large market potential, market-driven economic reform and unprecedented economic transformation (Brandt & Rawski, 2008; Nee, 1992). According to United Nations Conference on Trade and Development (UNCTAD, 2015), among the top ten foreign direct investment (FDI) recipients, five are developing countries and China has been the world's largest recipient since 2014. Given the increasing significance of emerging markets, it is critical for MNEs to understand the dynamic institutional environments of emerging markets.

Previous studies have often focused on institutional constraints in China (Child & Yuan, 1996; Li, Lam, & Qian, 2001). For instance, Child and Tsai (2005) claim that MNEs in the chemical industry have met institutional constraints, which are reflected in corporate environmental practices. However, there has been a lack of attention to benefits or advantages provided by institutions (i.e., *institutional advantage*) in China.

Distinct from the host country institutional constraints, Witt and Lewin (2007) argue that MNEs may conduct outward FDI as an escape response to home country institutional constraints. This organisational response can be adopted by both EMNEs and developed country MNEs. Developed country MNEs entered developing economies decades ago and China reached its highest economic growth in the years from the early 1990s to the mid-2010s. Developed country MNEs might wish to escape strict rules on environmental protection at home and take advantage of loopholes in this area in emerging economies. For instance, some socially irresponsible MNEs tend to escape environmental and stakeholder pressures in response to pollution issues (Surroca, Tribo, & Zahra, 2013), while EMNEs want to escape poor institutional systems at home (Marano et al., 2016).

The benefits provided by Chinese institutions are undoubtedly attractive to foreign MNEs and play important roles in the country's economic growth. Previous studies have sought to study those benefits from an economic or political perspective (Chen, Sun, & Wu, 2010; Weingast, 1995). However, these benefits could be based on the less developed institutional environment in China as well. A gap in the research conducted to date is the study of how foreign MNEs receive advantages provided to them by institutions in China.

Different levels of the Chinese government have provided various incentives to attract FDIs in the past four decades. Foreign investment in China has fluctuated over time. Local governments have provided preferential treatments such as free or low-rent land, taxation holidays and low-cost labour supply to attract investment. China's local institutions impose few constraints on MNEs. MNEs gain an *institutional advantage* except in highly regulated industries such as telecommunications, petroleum and railways since these industries are dominated by nationalised companies. In recent times, local institutions in China have pursued a higher standard of products and advanced technology. The reduced incentives provided to foreign MNEs have encouraged them to collaborate with local partners in the market. Although MNEs still maintain a leading position, they are no longer the only players in the market. As a result, most MNEs that have wanted to maintain their local market share and leading position have had to increase their investments against the competitive pressures.

As MNEs play a critical role in transferring capital and knowledge across national borders, they are able to affect stakeholders of both their home and host countries through their interactions with local institutions (Meyer, 2004). Existing studies have often been interested in entry strategies (Peng et al., 2008), subsidiary roles (Dellestrand & Kappen, 2012) and

MNE operations (Wang, Luo, Lu, Sun, & Maksimov, 2014). Fewer studies have examined the strategies of MNEs to gain advantages through their interactions with both the host country and their home country institutions (Regnér & Edman, 2014). It is critical for MNEs to choose the appropriate strategy to reduce their institutional liabilities and increase their institutional advantages and this study seeks to inform their choices.

4.3.2 MNE Organisational Strategies towards *Institution-Induced Foreignness*

As described in Section 4.2, the strategic response framework proposed by Oliver (1991) informs understandings of host country institutional pressures. Although Aharonson and Bort (2015) applied Oliver's (1991) model to corporate social action engagement, it is doubtful whether it can be applied in other situations. *Institution-induced foreignness* is complex and challenging because MNEs need to deal with both home and host country institutions. For instance, the entry to a host country could be a strategy to gain an institutional advantage through benefiting from local incentives or escaping from home country restrictions. The situations that MNEs face in both home and host country institutional spheres are often described in terms of institutional pluralism (Kraatz & Block, 2008). As both home and host country institutions have their demands, MNEs may adopt different strategies to these institutional demands in response to differing institutional pluralisms (Pache & Santos, 2010).

In the following framework (Table 4.2), organisational strategies and corresponding tactics to manage *institution-induced foreignness* are modified. The strategies in this modified model include *acquiescence*, *compromise*, *exploitation*, *avoidance* and *exploration*. As mentioned in Section 4.2.1, the *manipulation* and *defiance* strategies from Oliver's model are not applicable for MNEs (institutional actors), since the nature of *institution-induced foreignness* is constructed by institutional agents such as regulators, industrial players and stakeholders.

The *Exploration* strategy is added by the researcher to demonstrate the intention of MNEs to transform potential institutional liabilities into institutional advantages.

Table 4.2: Organisational Strategies towards Institution-Induced Foreignness

Strategies	Tactics	Examples
Acquiesce	*Habit*	Following other foreign firm models
	Imitate	Learning from local business models
	Comply	Obeying local regulatory rules and accepting norms
Compromise	Balance	Balancing expectations of multiple institutional demands
	Pacify	Increasing local embeddedness
	Bargain	Negotiating with institutional agents
Exploit	*Co-op*	Importing influential constituents (through joint ventures or local partners)
	Influence	Shaping local perceptions on foreign firms
	Control	Leading local industrial standards
Avoid	Decouple	Reducing foreign identities
	Buffer	Implicitly indicating foreign identities
	Escape	Exiting the host country
Explore	Dismiss	Ignoring unreasonable regulatory rules and immoral business norms
	Challenge	Contesting validity of rules for foreign firms
	Defend	Building durable foreign identities

Source: adapted from Oliver (1991) and Kraatz and Block (2008).

The *acquiescence* strategy is used when MNEs do not intentionally manage *institution-induced foreignness*. This is different from the other four strategies. Even though MNEs realise that there are LOFs and AOFs, they may not know how to manage foreignness or may not believe that foreignness can be managed. Thus, they tend to obey local regulatory rules and policies, follow what other firms did in the same host country, or imitate local firms' business models. In this way, MNEs do not seek to purposefully increase their *institutional advantage* or reduce their *institutional liability*.

The *compromise* strategy here is similar to that in Oliver's model. However, in addition to local institutional pressures, there is a need to balance the institutional demands of both home and host country institutions. This strategy reflects the approach to marginalising some institutional logics in the multiple institutional demands (Kraatz & Block, 2008). For instance, when operating in host countries, MNEs try to negotiate with local regulators and increase their local embeddedness. By doing so, MNEs try to minimise the institutional liabilities they may suffer and maintain institutional advantages they have obtained.

The *exploitation* strategy is a proactive choice for MNEs who have obtained institutional advantages in host countries. Normally, MNEs employing this strategy would have strong influence in their host countries and seek to exploit further advantages. This strategy reflects the approach to magnifying the institutional logic within institutional pluralism that leads to advantages for MNEs (Kraatz & Block, 2008). For example, this is applicable when an MNE is the only player in the local market who has more advanced technology in its superior products than those of the other suppliers. With support from local regulators and business partners, it may be able to set a superior product standard for the local market. This MNE would enjoy a great price premium in its products. Meanwhile, it would potentially shape local perceptions about this MNE and its home country. Therefore, MNEs may choose to explicitly demonstrate their foreign identities when undertaking this kind of strategy.

The *avoidance* strategy is a proactive choice for MNEs that have suffered substantial institutional disadvantages in host countries. These MNEs may be discriminated against because of their foreign identity or may experience restrictive compliance and regulation requirements from their home country institutions. In this case, MNEs may try to indirectly demonstrate their foreign identities to local stakeholders. They may even hide and reduce their foreign identity by localising all the staff in host country subsidiaries. In extreme cases, MNEs may exit the host country in response to a trade ban from either home or host country institutions.

The *exploration* strategy is a proactive strategy for MNEs that do not want to be restricted by institutional pluralism. MNEs make an effort not to follow some institutional demands by developing alternative approaches to escape from immoral business norms and practices or unreasonable regulatory rules and policies. MNEs may also build durable identities to defend themselves in conflicts (Kraatz & Block, 2008). In addition, they may challenge the validity of rules and norms to explore opportunities to transform liabilities into advantages.

Oliver's (1991) model illustrates five key institutional factors (see Section 4.2.1) that largely determine the institutional pressures that MNEs may suffer and affect an MNE's adoption of organisational responses to these pressures. By definition, *institution-induced foreignness* refers to the extent of institutional advantages and institutional liabilities experienced by MNEs. Therefore, the adoption of these five organisational strategies towards *institution-induced foreignness* depends on the type of institutional advantages and institutional liabilities experienced by MNEs.

4.4 Conclusion

This chapter has reviewed the organisational responses of MNEs to illustrate the potential strategies MNEs may be able to adopt to manage foreignness. It has sought to extend existing understanding of the relationship between MNEs and institutions by exploring how MNEs can proactively take organisational strategies towards *institution-induced foreignness*. The organisational response literature has emphasised the institutional pressures faced by MNEs but few studies have examined how they may enjoy institutional advantages. No studies have examined whether it is possible to transform institutional liabilities into institutional advantages. Therefore, China was selected as a research context and provided a platform for understanding how MNEs may adopt organisational strategies towards local institutions.

CHAPTER 5: RESEARCH METHODS

5.1 Chapter Objectives

This chapter provides details of the research design and the techniques used to collect and analyse data in this study. It first offers an overview of methodologies used in empirical studies related to institution-induced foreignness and MNE strategies towards foreignness and the rationale for using a qualitative approach. This is followed by a description of the procedure and the general rules used for data collection. The chapter then explains the process of coding and data analysis, as well as the reliability and validity issues.

5.2 Choice of Approach

Research approaches are plans and procedures used to span the steps from answering research questions or assumptions to the detailed process of data collection, analysis and interpretation (Creswell, 2014; Tharenou, Donohue, & Cooper, 2007). It is essential to ensure that the research approach underpins the research questions raised in previous chapters. Broadly, research approaches involve three parts: 1. **Worldviews** (Creswell, 2014), also known as ontology, epistemology and theoretical perspective (Crotty, 1998); **2. Research Paradigm** (Lincoln, Lynham, & Guba, 2011); **3. Research Designs** (Creswell, 2014). Others may name them methodology (Crotty, 1998), strategies of inquiry (Denzin & Lincoln, 2011); or research methods (Creswell, 2014; Crotty, 1998; Denzin & Lincoln, 2011).

5.2.1 Research Approach

Different research designs and methods follow different worldviews. Research approaches are generally qualitative and quantitative. Qualitative research is an approach for exploring and understanding social or human topics based on emerging phenomena and conducted in a natural setting (Creswell, 2014). The data analysis is often inductive and builds theories from particulars to general themes, whereby researchers make interpretations of the meaning of data (Creswell, 2014). Due to its exploratory nature, a qualitative research approach is useful when there is little understanding, or when existing theories do not fit a particular situation (Piekkari, Welch, & Paavilainen, 2009). Hence, theories are built in a systematic way to study phenomena, using extensive description and contextual analysis (Yin, 2014). For a qualitative approach, worldviews can be constructivist or social constructivist (also called interpretivist) and transformative. Corresponding qualitative designs can be narrative research, phenomenology, grounded theory, ethnography and case study (Creswell, 2013).

By contrast, quantitative research is defined as an inquiry for testing objective theories composed of variables and analysed using statistical procedures (Creswell, 2014). Qualitative research is often called an inductive approach, whereas quantitative research is a deductive one, where theories are deductively tested or verified rather than developed (Gill & Johnson, 2010). In a quantitative approach, a post-positivist worldview is applied. Corresponding quantitative designs can be experimental or non-experimental, such as a survey (Creswell, 2014).

In order to choose the most appropriate research approach from these broad genres, institutional studies in the IB field are reviewed and discussed to guide this thesis. The purpose of this thesis and the nature of the research question are analysed below to justify the research design.

5.2.2 Worldviews of Institutional Research

Institutional studies in management literature emerged from institutional theory in the field of economics (Meyer & Peng, 2016) and sociology disciplines (Scott, 2013). Over many decades, scholars have tried to gain understanding of the complex nature of institutions and the relationship between institutions and organisations. Organisational theorists have constructed many perspectives and logics to understand the complex nature of institutional environments, such as the three pillars of institutions (Scott, 2013), the institutional constraints on firms (Witt & Lewin, 2007), the co-evolution of institutions and MNEs (Cantwell et al., 2010) and the organisational responses to institutional complexity (Greenwood et al., 2011). Numerous empirical studies have been conducted to examine these perspectives. However, our understanding is still limited in appreciating the institutional environment, particularly as to how and when to apply multiple contesting, conflicting and competing institutional logics (Vermeulen et al., 2014).

In the field of institutional research, an early focus was on the institutional constraints on firms, followed by the co-evolution of institutions and MNEs and the increasing bargaining power of multinationals. Recent studies claim that MNEs also have impacts on institutional variation and change, especially in emerging markets (Meyer & Peng, 2016). However, most studies focus on a single institutional perspective, which is rather limited when multiple perspectives can be considered.

As the purpose of this thesis is to study how MNEs manage foreignness in host countries, the appropriate approach needs to be developed to address the research question. There is currently a limited understanding of institutional liabilities and advantages and how MNEs respond to them. In particular, this thesis expects to draw understandings of the internationalisation of MNEs from emerging markets such as China. It is exploratory in nature and responds to a need to examine the organisational responses of MNEs. In light of the discussion above, an exploratory worldview is adopted and a qualitative research approach is selected as the most appropriate.

5.2.3 Rationale for Utilising a Qualitative Approach

Yin (2014) suggests that the choice of research design depends not only on the nature of the research question, but also on the types of research questions. In this thesis, the research mainly focuses on "how" and "what" questions, which can be addressed by qualitative techniques. Given that the thesis will investigate perceptions of foreignness and strategies of MNEs to manage it, a multiple-case study is an appropriate method to answer the research question.

The researcher used in-depth interviews and documentation to collect qualitative data. The interviewees included expatriates, local executives and middle managers from 23 case study MNEs. To provide a comprehensive analysis, focused and non-focused MNEs were distinguished. The selection criterion required focused case study MNEs to have all roles, including expatriates, executives and middle managers, among interviewees for the case MNE. Eight MNEs became focused cases and the other 15 MNEs became non-focused case MNEs. The latter had at least one interviewee that was either an expatriate, a local executive or a middle manager. To avoid single-source bias, interviews were also conducted with government officials and senior representatives of the foreign chamber of commerce. Interviewees were selected by both the criterion and snowball technique to ensure reliability and validity of the data. Relevant firm documents such as foreignness management strategies were also collected and analysed.

5.3 Research Design

The researcher conducted three pilot case studies between January 2017 and March 2017 in Hong Kong. Subsidiaries of MNEs from Canada, Germany and the US were chosen because of accessibility, convenience and geographic proximity to the researcher (Yin, 2014). The three pilot cases involved interviews with a senior partner from a law firm, a senior executive of a multinational manufacturer and an executive of a bank. Each interview gave the researcher awareness of the clarity of terms and questions as perceived by interviewees and the applicability of the questions to the respondents. The interview questions were revised after each discussion and the revised questions were used for the following pilot cases. The use of pilot case studies helped the researcher to build insight into relevant issues and tailor interview questions to interviewees and interview contexts.

The field studies were conducted between April 2017 and June 2017 in Shanghai. The process and techniques of case selection and data collection are further elaborated in the following two subsections.

5.3.1 Case Selection

The underlying logic for selecting cases included accessibility and replication. Therefore, at least two cases were chosen under each subgroup, which was categorised by industries employed by this study (Yin, 2014). Two industries, the heavy machinery industry and the financial service industry, were selected.

A mixed sampling strategy was chosen to select case firms and interviewees, including maximum variation sampling, criterion sampling and snowball sampling (Patton, 2005). The maximum variation sampling strategy was used to identify shared identities that illustrate the foreignness experienced by MNEs in China. Criterion sampling was used because it is a technique that limits the cases to those exhibiting certain predetermined characteristics in order to ensure in-depth qualitative analysis. Case MNEs were chosen based on different countries of origin, entry modes, ownership, industry (mainly manufacturing and financial service industries), size (number of employees) and international experience (years having operated in China). For example, ownership was used as a selection criterion because MNEs with different ownership might experience different levels of foreignness. Case MNEs chosen based on these criteria enabled this study to test whether and how these contingency factors affect the mechanisms of foreignness and generate liabilities and advantages (SQ 2).

The snowball sampling strategy was used to pinpoint key informants who are knowledgeable and hence can provide further information and insights. The snowball strategy refers to a sampling technique where the existing informants are asked to recommend potential participants for the research (Patton, 2005).

Case studies were conducted in Shanghai, which is a major destination for MNEs from many countries. By selecting Shanghai as the field study destination, this study was able to utilise a maximum variation sampling strategy to choose case MNEs headquartered in different countries.

There are no rigid rules for sample size in qualitative research, as suggested by Patton (2005). The number of cases should reflect the number of replications the research needs or would like to have (Yin, 2014). As such, 23 case studies were conducted (see Table 5.1). This sample size was jointly determined by accessibility, firms' eligibility for the current study (having at least one establishment operating in China), the replication logic of case study design, the subtlety of country-of-origin effect (being manifest in various forms) and the existence of various moderating factors (e.g., industry and size).

Entrance to a research site has an important bearing on the validity of data subsequently collected (Patton, 2005). A researcher may confront many challenges in gaining access to cases and interviewees. For instance, convincing individuals to participate, building trust and credibility and persuading people to respond are three challenges in interviews (Creswell, 2013). The degree of difficulty involved varies according to the degree of resistance to the research (Patton, 2005). As many executives of MNEs in fact perceived, the focus of this study might be politically sensitive when discussing the regulatory sources of foreignness.

The researcher utilised four strategies to attain access. The first was the conventional method — cold calling, which enabled the researcher to recruit five organisations. Cold calling is a method for contacting organisations directly through their public contact profiles. The second strategy used a third party to establish contacts with the gatekeepers who manage the entry access into organisations (Tharenou et al., 2007). Data of eight organisations were obtained through this strategy. A third strategy adopted was to research potential case firms through personal networking. Five cases were accessed through the research project of this researcher's supervisor. The last strategy was the snowball technique, which recruited six case firms.

Table 5.1: Profile of Case Firms

Case firm	Industry	Home country	Entry mode	Year of FDI	Size
MNE1	Machinery	Korea	WOS/JV	1990s	Large
MNE2	Machinery/ Manufactory	US	JV->WOS	1980s	Medium

MNE3	Machinery	US	JV->WOS	1980s	Large
MNE4	Machinery	Finland	JV->WOS	1990s	Large
MNE5	Machinery	Germany	WOS/JV	1990s	Large
MNE6	Financial service	UK	WOS/JV	2000s	Large
MNE7	Financial service	US	WOS/JV	2000s	Large
MNE8	Financial service	Japan	WOS	2010s	Large
MNE9	Machinery	US	WOS/JV	1990s	Large
MNE10	Professional service	Canada	WOS	2010s	Small
MNE11	Machinery/ Manufactory	US	JV->WOS	1990s	Medium
MNE12	Professional service	US	WOS	2010s	Medium
MNE13	Professional service	US	WOS	1990s	Large
MNE14	Machinery	Japan	JV	1980s	Large
MNE15	Professional Service	Singapore	WOS	2010s	Medium
MNE16	Financial Service	Switzerland	WOS	2010s	Large
MNE17	Financial Service	France	WOS	2010s	Large
MNE18	Financial Service	Singapore	WOS	2010s	Large
MNE19	Professional Service	US	WOS	2000s	Large
MNE20	Luxury goods/ Manufactory	US	WOS/JV	2000s	Large
MNE21	Machinery/ Manufactory	Canada	JV	1990s	Small
MNE22	Financial Service	Australia	JV	2010s	Small
MNE23	Financial Service	Australia	JV	2010s	Small

Note: The case MNEs were coded in order to provide confidentiality.

Small: 201-1,000 employees; Medium: 1,001-10,000 employees; Large: 10,001+ employees

WOS: wholly owned subsidiary; JV: joint venture.

After establishing initial contacts with the gatekeepers, the researcher adopted three measures to obtain and maintain good access to case MNEs. First, a letter containing an explanatory statement and consent form was sent to gatekeepers following the protocol of the researcher's university. After access to a firm was granted, these documents were then sent by the researcher to the individuals who would be able to assist the data collection process. The letter explained to participants the nature of the project, the interview requirements and the protections participants would receive. The consent form was used to gain participants' approval. The explanatory statement and the consent form had two different purposes. One was to demonstrate the researcher's ethical standards and thus create an impression of trustworthiness. The other was to minimise possible resistance from participants which might be generated from misperceptions about the nature of the research or concerns about confidentiality and anonymity.

The second measure was to win participants' collaboration through reciprocity, or the formation of an exchange relationship, as gaining entry may be for the most part a matter of establishing trust (Patton, 2005). Connections with the participants that are built upon a high level of trust are essential for data collection. This is because, with a methodology that involves interviews, the depth of familiarity the researcher can attain with the participants is critical for the quantity and quality of the data to be collected. Mutual trust, respect and collaboration influence the emergence of an exchange relationship (Patton, 2005). Therefore, when approaching participants, the researcher tried to convince them of the importance of their participation and the useful feedback they could obtain from the research project. This strategy proved effective and useful when recruiting case MNEs concerned about the success and the survival of foreign firms in China.

Furthermore, prior to the field work, the researcher spent more than five months liaising with key informants. Both formal and informal conversations undertaken before the data collection contributed to the establishment of trust between interviewees and the researcher and the acquisition of valuable information by the researcher.

5.3.2 Data Collection

The most commonly used data collection methods in qualitative case study research are observations, interviews and documentation (Eisenhardt & Graebner, 2007). This study utilised all three methods as research instruments. Interview is the most frequently used method of qualitative data collection, as well as conversations between an interviewer and an interviewee. The focus is on the interviewee's insightful perceptions of a phenomenon. The greatest advantage of adopting interviews over other data collection methods is the ability to obtain rich data that involves internal and in-depth stories. Such an ability is based on the capability for interviewers to ask follow-up questions, for interviewees to elaborate on their feelings and opinions and for interviewers to utilise non-verbal cues or body language through observations as data (Fontana & Frey, 2005). In brief, interviews provided a powerful tool for the researcher to capture the richness of data necessary to understand the complex nature of institutional environments faced by MNEs.

There are three different types of interviews: structured, semi-structured and unstructured. Structured interviews consist of completely pre-set standardised questions (Tharenou et al., 2007). These interviews offer little flexibility as regards the way questions are asked or answered (Fontana & Frey, 2005). The questions in unstructured interviews are open-ended. Interviewees are allowed to take the lead in conversation, telling stories at their own pace and in their own way. A semi-structured interview lies between the above two. It is a guided, focused but also open-ended conversation (Tharenou et al., 2007). A semi-structured interview allows interviewers to ask all participants the same questions, but also provides flexibility to interviewers to pursue and respond to emerging opportunities in relation to critical matters. As such, the semi-structured interview best suited the needs of this study (to obtain rich data about foreignness while exploring emerging mechanisms) and hence was used as the primary data collection tool in this study.

The funnel technique was adopted during the interview: open-ended questions were asked initially, followed by specific questions to allow interviewees to provide more information. In-depth interviews ranged from 45 minutes to 1.5 hours in duration. In most cases, this enabled the researcher to collect sufficient information from one key informant in the company.

In total, 56 interviews were conducted in 23 MNEs (see Table 5.2) and were recorded digitally along with notes taken by the researcher. The transcription of interviews was sent to interviewees for verification purposes. This process enhanced the credibility of data. Although some interviewees were Chinese, there were no problems in discussing the questions in English, as they already required and possessed professional English skills to work in these case MNEs. The profiles of interviewees are detailed in the Table 5.2.

Table 5.2: Case Firms and Interviewees

Case firm	Interviewee	Role	Age	Gender	Nationality	Type of Interview
MNE1	Interviewee1	Senior manager	40~50	Male	Korea	Face-to-face
	Interviewee2	Senior manager	40~50	Male	Korea	Face-to-face
	Interviewee3	Senior manager	40~50	Male	Korea	Face-to-face

	Interviewee4	Sales Supervisor	30-40	Male	China	Face-to-face
	Interviewee5	Financial Supervisor	30-40	Female	China	Face-to-face
MNE2	Interviewee6	General Manager, Marketing and Business Development	40-50	Male	China	Face-to-face
	Interviewee7	Market research Manager	30-40	Female	China	Face-to-face
	Interviewee8	General Manager, Finance	40-50	Male	China	Face-to-face
	Interviewee9	Senior HR manager/HR business partner	40-50	Female	China	Face-to-face
	Interviewee10	Sales Director	40-50	Male	China	Face-to-face
MNE3	Interviewee11	Senior financial manager	30-40	Female	China	Face-to-face
	Interviewee12	Executive Assistant	30-40	Female	China	Face-to-face
	Interviewee13	Senior financial planner	30-40	Female	Philippines	Face-to-face
	Interviewee14	Service manager	30-40	Male	China	Face-to-face
	Interviewee15	Strategic financial manager	40-50	Female	China	Face-to-face
	Interviewee16	Operations Director	40-50	Male	Singapore	Face-to-face
	Interviewee17	Law Director	30-40	Male	China	Face-to-face
MNE4	Interviewee18	Vice President, Business Control	40-50	Male	China	Face-to-face
	Interviewee19	Senior Manager, Finance	30-40	Female	China	Face-to-face
	Interviewee20	Vice President, Supply Chain	40-50	Male	Malaysia	Face-to-face
	Interviewee21	Head of Marketing	40-50	Female	China	Face-to-face
	Interviewee22	Head of Sales Development	40-50	Male	China	Face-to-face

MNE5	Interviewee23	Senior Public Relations Manager	30-40	Female	China	Face-to-face
	Interviewee24	Executive directive/Regional president - Asia Pacific	40-50	Male	Germany	Face-to-face
	Interviewee25	Global head of innovation	40-50	Female	China	Face-to-face
	Interviewee26	Head of engineering (Engineering Director)	40-50	Male	China	Face-to-face
	Interviewee27	Senior Manager, Business Development and Strategic Marketing	30-40	Male	China	Face-to-face
MNE6	Interviewee28	Compliance Manager	40-50	Male	Australia	Face-to-face
	Interviewee29	Assistant Corporate Sustainability Manager	30-40	Male	China	Face-to-face
	Interviewee30	Vice President, Commodities and Structured Trade Finance	30-40	Female	China	Face-to-face
	Interviewee31	Chief Digital Executive, Retail banking	30-40	Male	China	Telephone
	Interviewee32	Assistant HR manager	30-40	Female	China	Face-to-face
MNE7	Interviewee33	Senior Manager	30-40	Male	China	Face-to-face
	Interviewee34	Senior Partner	40-50	Female	Canada	Face-to-face
	Interviewee35	Senior Manager	30-40	Female	US	Face-to-face
	Interviewee36	Director	40-50	Male	China	Face-to-face
	Interviewee37	Senior Manager	30-40	Female	China	Face-to-face
MNE8	Interviewee38	Vice President, Executive Director	30-40	Female	China	Face-to-face

	Interviewee39	Representative, Executive Director	30-40	Male	Japan	Face-to-face
	Interviewee40	Chief Representative, Executive Director	40-50	Male	China	Face-to-face
MNE9	Interviewee41	Chief Law Officer	50+	Male	US	Face-to-face
MNE10	Interviewee42	Partner	30-40	Male	Canada	Face-to-face
MNE11	Interviewee43	Head of HR	40~50	Female	China	Face-to-face
MNE12	Interviewee44	Managing Director	40-50	Male	Australia	Face-to-face
MNE13	Interviewee45	Senior Financial manager	40-50	Female	China	Face-to-face
MNE14	Interviewee46	HR manager	40-50	Female	China	Face-to-face
	Interviewee47	General Manager	40-50	Male	China	Face-to-face
MNE15	Interviewee48	Regional Executive	50-60	Male	Singapore	Face-to-face
MNE16	Interviewee49	Senior Compliance Manager	30-40	Male	China	Face-to-face
MNE17	Interviewee50	General Manager, Senior Banker, Corporate Coverage	40-50	Male	China	Face-to-face
MNE18	Interviewee51	Executive Director, Head of HR China	40-50	Female	China	Face-to-face
MNE19	Interviewee52	Senior Financial Manager	40-50	Male	Australia	Face-to-face
MNE20	Interviewee53	Sales Director	30-40	Male	Singapore/Hong Kong	Face-to-face
MNE21	Interviewee54	Executive manager	50-60	Male	Canada/Taiwan	Face-to-face
MNE22	Interviewee55	General Manager	50-60	Male	Australia	Telephone
MNE23	Interviewee56	General Manager	30-40	Female	Australia	Face-to-face

The second data collection technique used was documentation. A systematic search for documents is important for any case study, as documents provide an unobtrusive source of information to supplement other forms of data collection (Yin, 2014). In addition, documentary information can offer different perspectives and verification of the same phenomenon and reduce the bias inherent in other methods (Tharenou et al., 2007). Therefore, for the purpose of triangulation and enhancing the researcher's understanding, every effort was made to collect all available documents relating to case MNEs. These documents included: annual reports; published books, newspapers, magazines, or journals; organisational policies; brochures, employee handbooks and newsletters; collective arguments; memoranda and internal reports; and official websites.

In conclusion, the data for this study were collected primarily through in-depth, semi-structured interviews including interview questions and observations, along with supplementary documentation. The qualitative data obtained for the thesis were rich and wide-ranging. The next section will explain the data analysis process.

5.4 Data Analysis

Data analysis is a process of drawing meaning from data, which represents one of the most difficult aspects of case studies (Yin, 2014). Thus, Yin (2014) strongly suggests case study researchers choose an analytic strategy to help them to analyse data effectively and efficiently and produce compelling conclusions. Therefore, this study used three analytic strategies, including theoretical orientations, cultivating case descriptions and inspecting conflicting explanations (Yin, 2014). The theoretical orientation strategy was drawn from the literature review in the previous chapters and shaped the data collection planning and helped focus attention on the relevant data. In addition, the developed propositions helped the researcher build a scheme for coding segments consisting of the most relevant categories. Secondly, this study used the strategy of developing brief case descriptions for most cases. Lastly, the researcher explored conflicting explanations from industry and host country sources in the data analysis.

Various approaches to the procedure of qualitative data analysis are suggested by different researchers across different qualitative research inquiries. For instance, Creswell (2013) proposes a seven-step procedure for case study data analysis and presentation. These steps are: 1) creating and organising files for data (from both interview notes and observations); 2) reading through text and making margin notes for initial codes; 3) describing the case and its contexts; 4) using categorical aggregation to establish themes or patterns; 5) using direct interpretation; 6) developing naturalistic generalisations; and 7) presenting an in-depth picture of the case using narrative, tables and figures. These seven steps were all followed in this study and provided a logical flow to the analysis of data. In addition, the qualitative data analysis included coding the data, clustering the codes into broader categories or themes and displaying and making comparisons using graphs, tables and charts (Creswell & Clark, 2011).

Guided by the selected general analytical strategies and the methodologists' suggestions about data analysis procedures, the processing of the data in this study followed five steps. The first was to create a case study database for each case. The database consisted of the researcher's case study notes, collected documents, interview transcripts and the researcher's tentative answers to the questions in the case study protocol based on the integration of available evidence (Yin, 2014). This step involved a range of activities: collating all information about a case from various sources, sorting out redundancies, fitting parts together and organising information for ready access according to the major subjects as outlined in the case study procedure (Patton, 2005).

The researcher then proceeded to manually code the data while going through transcripts and recordings. Interview questions were highlighted and the sections of text were categorised under different theme headings. This assisted the understanding and explanation of the MNEs' approach towards local institutional environments.

The third step was to present descriptions based on the research questions. The descriptions consisted of four parts (Yin, 2014): 1) description of the case organisation background; 2) explanation of organisational responses, organisational structures and strategies towards foreignness; 3) accounts of executives', middle managers' and expatriates' understanding, attitudes and beliefs about foreignness in China; 4) report of the rationale for firms' decisions made in regard to institutional advantages and liabilities and the perceived influential factors.

This descriptive framework was used to organise the data analysis for each case, incorporating data from different sources topically and grouping the categorised data. The framework was also used as a template to formulate the case study report for each individual case. In the report, all the findings from individual cases were presented, including convergent evidence in relation to the overall conclusions for research questions (Yin, 2014). The descriptions were sent to the key informants in each case organisation for factual verification and suggestions on the completion of the draft report for each case. This step was undertaken in order to confirm the content and interpretation of the data, thus enhancing the accuracy of the case study and the construct validity of the study. All case firms confirmed that the case study report faithfully reflected the situation in their firm and some of them provided further information which was subsequently incorporated into the final version of the case study report.

After the single-case analysis, the data analysis concluded with the cross-case synthesis (Yin, 2014). This was done to build up a general explanation that suited most case scenarios. Comparisons were made by identifying similarities and differences and verifying emerging patterns among individual cases. The cross-case conclusions about each research question were then drawn. At this stage, the generalisability of the research findings was also assessed against existing literature where possible (Eisenhardt, 1989).

Due to the large number of cases, the research findings are not reported on the basis of individual firms. Rather, the thesis synthesises the findings from all cases, illustrates them with examples drawn from individual cases and presents the findings in accordance with different research subjects. The findings will be presented in the chapters to follow. The organisation of the research findings allowed close comparisons between the cases, satisfied the literal replication logic and permitted the generalisation of patterns among similar types of cases (Yin, 2014).

5.5 Validity and Reliability of the Research

Validity and reliability are two important concerns in an unassailable research design, especially for qualitative methodologies (Tharenou et al., 2007). Yin (2014) claims that construct validity, internal validity, external validity and reliability are four commonly used tests to judge the quality of research designs. Construct validity refers to the use of correct operational measures for the concepts under study; internal validity is not relevant to exploratory studies like this one, as it emphasises the evaluation on a causal relationship; external validity defines the generalisability of the research findings; and reliability deals with the repeatability of the study (Yin, 2014).

In previous sections, a series of steps were described that enhanced the validity of the data and research findings in the study. To ensure the construct validity, data were gathered from multiple sources and key informants were asked to review the draft report of the relevant case firms (Yin, 2014). As for external validity, analytical generalisation was used to generalise a specific set of findings to build up a broader theory, which could be tested by replicating the findings in other cases (Yin, 2014). In this study, applying replication logic in over 23 cases increased external validity.

As Yin (2014) asserts that the goal of reliability is to reduce errors and biases in a study, interview and case study protocols were used to maintain consistencies between each case firm. To further ensure reliability, cross-comparisons between interviews were also conducted to ensure that the data correctly reflected participants' opinions. Furthermore, the researcher followed the guidelines for steps to conduct research and interpret findings; and the information collected was also sent to case firms to ensure the accuracy of the researcher's interpretation.

To further strengthen the validity and reliability of the research, the researcher carried out a number of cross-comparisons. For each interview, comparisons were made between recorded interviews and the field notes. The rationale for comparing field notes with transcribed interviews was that during interviews, body language could be an important non-verbal clue picked up through observations. Therefore, when analysing the data in this study, the field notes were used to compare interviewees' responses captured during interviews against their non-verbal communication recorded in the researcher's field notes, in order to detect inconsistencies. The clues for accurately evaluating interviewees' responses were looked for in the field notes. Secondly, data collected from in-depth interviews with local executives and middle managers were cross-checked with expatriates. The data from interviews were also compared within those documents.

5.6 Conclusion

This chapter started with a justification for choosing a qualitative research method and multiple case study research design. The chapter also outlined how the interviews and case studies were designed and how the data were collected, analysed and reported. The measures taken to enhance the validity and reliability of the research were also addressed. The following chapters will present the findings regarding the *institution-induced foreignness* of MNEs and their responses to managing it.

CHAPTER 6: INSTITUTIONAL LIABILITIES OF MNES IN CHINA

6.1 Chapter Objectives

Chapter 3 examined the *institution-induced foreignness* (i.e., the institutional liabilities and advantages) experienced by MNEs in host countries, utilising Scott's integrated model of institutions (2013). This chapter aims to identify and analyse the *institutional liability* suffered by MNEs in China. As a newly proposed concept, *institutional liability* has not been systematically examined, especially in the context of China, a typical emerging market. The research findings are discussed based on the three institutional pillars and the empirical evidence collected is presented to address SQ 1 and 2:

SQ 1: What does it mean for MNEs to be foreign in host countries?

SQ 2: How and when does foreignness generate liabilities?

This chapter presents an in-depth investigation of MNEs through an analysis of the empirical data gathered, offering in-depth insights in answer to the research questions. Analysis of the concept of *institutional liability* based on Scott's (2013) integrated model of institutions contributes to the literature of foreignness and institutional environments. This chapter examines the regulative, normative and cognitive dimensions of MNEs' institutional liabilities by reviewing the findings from semi-structured interviews and case studies.

6.2 The Regulative Pillar of Institutional Liability

Foreign firms have increasingly entered China since Chinese market-oriented reform commenced in the 1980s. As part of this process, the central government has enacted regulations in relation to foreign investment, but has also allowed local governments to work out policies to attract investors and foster the local economy. As a result, local governments such as the Shanghai municipal government are able to set their own rules based on the local situation, but following the guidelines of the central government. As discussed in Chapter 3, the regulative pillar of *institutional liability* mainly involves laws, regulations, policies, beliefs, attitudes and patterned practices that are unfavourable for foreign investment. Favourable institutional factors that constitute the institutional advantages will be discussed in the next chapter. As the case study MNEs are from the manufacturing and financial service industries with different ownership types, only the institutional liabilities of MNEs from these two industries with their various ownerships are discussed in this chapter.

6.2.1 Ownership Restriction

Among all indicators for the regulative source of institutional liabilities, the most transparent and influential indicator is the ownership restriction on foreign investment in China. The Chinese financial service industry is regulated by one bank and three commissions: the People's Bank of China, China Banking Regulatory Commission (CBRC), China Securities Regulatory Commission (CSRC) and China Insurance Regulatory Commission (CIRC). These regulators have gradually reformed the ownership restrictions for foreign financial firms during different operation periods, constituting a liability for foreign investment. One compliance manager (Interviewee 28) from a foreign bank (MNE6) commented:

> *In general, foreign banks in China have experienced different stages. From allowing us to set up representative offices only (pre-1995) to establishing subsidiaries without legal representative (1995) to running wholly owned foreign subsidiaries (2007); from transacting foreign currency business only (pre-2004) to allowing us to run local currency business with geographic and customer restrictions (2004-2006). Such restrictions were removed in 2007. Although foreign banks have been able to build up wholly-owned foreign subsidiaries in China since 2007, ownership restrictions still exist in the financial industry. For instance, if we want to innovate some financial products with insurance or funds in the local market, we need to co-operate with local*

firms, because all foreign insurance and mutual fund firms cannot be wholly foreign owned. In addition, wholly foreign owned banks cannot get an A stock licence. The ownership restrictions have certainly limited our capabilities.

Another interviewee (Interviewee 51) echoed this argument and confirmed the ownership restriction for a foreign financial service company. For example, the foreign share of a mutual fund joint venture cannot exceed 49 per cent. While foreign firms could set up a financial service joint venture in China, they have not been allowed to take majority ownership. They could only take 20 per cent of a securities joint venture. This complicates how foreign banks can market their financial products, as they must work with other firms to include insurance, funds and securities components. Due to this limitation, they often postpone the offering of products and services in China as they do not have full control over joint ventures. One informant (Interviewee 34) added the following comments which were supported by many others (Interviewees 33, 35, 36, 39 & 40):

While taxation subsidiaries of our firms are allowed to be wholly foreign owned, there are still ownership restrictions on foreign auditing firms in China. We cannot set up wholly foreign owned auditing subsidiaries at the moment. It may not be accurate to say what disadvantages these regulations have generated, but many inconveniences were caused, which has inevitably led to inefficiency or waste of time.

The so-called 'inconveniences' are actually obstacles limiting many foreign firms' expansion of their business in China. Foreign banks were not able to operate a commercial banking service until 2007. In addition, foreign securities firms are still not able to trade local shares and financial products such as derivatives and foreign auditing firms are still not allowed to audit local firms. A general manager (Interviewee 50) of a foreign bank noted:

Prior to 2007, foreign banks could only do business with foreign firms in China. For example, French banks would only work with French firms in China. From 2007, the Company Law enforces the corporation of banks to do business with other corporations (legal entities). This is different to financial regulations of the European Union, where foreign banks are much less restricted in doing business with local firms.

An executive director (Interviewee 40) of a security firm commented:

The ownership restrictions for us limit our capabilities for sure. However, now in 2017 we are able to do business in the Shanghai B-Share stock market, which means we are able to trade foreign currency over the market as we trade Chinese Yuan. We can also trade offshore business in China in the same way. Nevertheless, we are still very cautious about conducting business here, not to mention the foreign exchange risk we also have to bear.

A senior manager (Interviewee 35) claimed that:

We used to be unable to do any business with local firms here (in China). So, the business of our branch here is for foreign firms only. Nowadays we are able to audit for foreign firms when they need to conduct business such as mergers and acquisitions with other Chinese firms, but not for local firms. We are able to audit for both local and foreign firms in our home country. Therefore, we actually lose the auditing business for local firms and we do not know how long we should wait for further market openings. Aren't we disadvantaged by the ownership restriction?

Ownership restrictions also heavily affected case study MNEs from manufacturing industries. The most transparent case is that the ownership of foreign firms in the automobile industry in China could not exceed 50 per cent at the time when this fieldwork was conducted. Majority foreign ownership was prohibited not only in the automobile industry, but in most other manufacturing industries. Almost every manufacturing foreign firm chose to form a joint venture in China at the beginning of their entry two to three decades ago and ownership interests were equally shared by both local firms and foreign firms, as otherwise foreign firms were not able to enter the market.

However, the ownership restrictions on foreign firms have been modified over time. Among five manufacturing case study firms, MNE2 and MNE4 have transitioned from joint ventures to wholly foreign owned subsidiaries, while MNE1, MNE3 and MNE5 have some subsidiaries that are wholly foreign owned and some subsidiaries that are still joint ventures to date. The joint ventures of MNE1 and MNE5 are automobile related firms, while the joint venture of MNE3 is an electrical firm. A law director (Interviewee 17) of MNE3 claimed that:

> *In manufacturing industries, only the automobile industry is strictly restricted in that foreign shares cannot exceed 50 percent. Others like us are fine now. However, the real challenge for us is the transformation from joint ventures to wholly owned subsidiaries. For instance, we used to hold 50 percent of the electrical joint venture, now we are holding 70 percent. As an MNE, we certainly have the financial capabilities to acquire the rest of the shares, so we can achieve full control. You know one MNE can only have two joint ventures in the heavy machinery industry. It is our local partner who is not willing to sell their shares, because this joint venture can*

provide sustainable profits to them. As such, this side effect limits our potential to seek for new opportunities.

Therefore, the side effects of ownership restriction may also disadvantage the position of MNEs. Ownership restriction confines their access to the local market, limits their potential to market their products or expand their local business and even prevents them from gaining full control of local subsidiaries.

6.2.2 Capital Operation

In addition to the ownership restrictions on foreign MNEs, the regulation of capital operations from the home country of MNEs is another indicator of *institutional liability*. Despite local requirements for a foreign firm, such as a minimum amount of investment or capital, they also need to follow the regulations of their home country and the country where they have been listed on the stock market. For instance, US MNEs might be more constrained by their home country institutions than by host country institutions. A chief law officer (Interviewee 41) noted:

As the chief law officer of our subsidiary here in Shanghai, we need to be cautious about every move we make. Following local rules is the same for every player here in the market; however, what constrains us doing business here is that we are required to follow the guidelines of the US standards as well, even we are doing business overseas. There are too many things that local competitors can do which we cannot – a liability certainly exists. For example, rules here such as business law or company law are less restricted, so local firms can try new practices, e.g. loans and leveraged leases. No matter what kinds of new local regulations come in, local firms can make adjustments easily because they only do business here and do not need to follow other *countries' guidelines. Therefore, foreign firms are disadvantaged from the start of doing business here.*

Compared to more flexible local institutional environments, the home country's regulations on capital operations place additional constraints on well-established institutions among the case study MNEs. A senior partner (Interviewee 42) of a law firm echoed this perception:

> *Most of my clients are foreign firms; they have the same problem in China. The cost of following two sets of laws and rules (both home and host countries' institutional requirements) is not equal to one plus one. There is business you can do in both countries and business you cannot do in both countries. However, if some business is not allowed in your home country, you cannot do it here, while your local competitors can and make enormous profits over it. We call this situation 'dancing with chains. Imagine you are in a ball or a dance battle and you need to wear chains to dance, it makes you harder to follow your partners' moves in a ball and even harder to beat your rivals who don't have the same constraints.*

In addition to the business that local firms can do which foreign firms cannot do, supervision in the host country is much closer and the regulation is much stricter. As the most developed city in China, Shanghai has been well-known for its number of foreign firms. However, the number of regulators for foreign firms is different from that for local firms. A senior compliance manager (Interviewee 49) noted:

> *If you look at the number of regulations, rules and laws, it seems to be similar for both domestic and foreign firms. Nevertheless, the tricky part is the number and the rigour of regulators on foreign firms. For instance, there are three departments of CBRC that supervise foreign banks while only one department supervises local banks.*

> *Not to mention how easy they go on state-owned banks. The approval for issuing credit cards can be a good example. The banking industry claims to be fully opened since 2007 and we all eager to pursue our passion to claim more market shares. Yet, the credit card business of foreign banks did not get approval until Citi Bank became the first wholly foreign owned bank to issue credit cards independently in 2012; other financial institutions were far behind the process of breaking into the local market. However, the accumulated credit cards were 285 million in 2011 and local banks have been issued credit cards since 2003. So, how can we get market share with so many regulators not approving our products?*

Another compliance manager (Interviewee 28) echoed this perception, which also received support from others (Interviewees 29 and 31):

> *Compared with manufacturing firms, banks face a vast range of regulations that they need to deal with. In addition, foreign banks are easier to target. On the one hand, local regulators expect foreign banks not to make any 'mistakes' and fine them heavily if they are over the boundaries, while they have not expected local banks to comply. For example, CBRC hasn't fined Ping An Bank as much as us (foreign banks) even though Ping An has violated the rules. Regulators may treat local banks as strictly as us one day, but they have always expected us to behave better. On the other side, local banks, especially those big four banks, have at least 20,000 branches here in China. In terms of numbers, we are at different levels of exposure, but it makes us easier to target. Regulators may select this branch of a local bank to visit and the next branch for next time, but ours? Every time, during the supervision period, they come to pay a visit. Hence, we have a third-party risk management policy that restricts us from doing anything beyond basic business routines. Not only are*

business innovations non-existent here in Shanghai, we cannot even launch any innovative products from our headquarters, as they may not pass the risk assessment. Even if we want to open new branches, it is harder to get approval from CBRC (compared with local banks). To be honest, the regulations directly limit our business capabilities and put us into a disadvantaged position.

Apart from the different levels of regulations, foreign exchange restriction constitutes another disadvantage for foreign firms. Unlike the foreign currency risk of Chinese Yuan depreciation or home country currency appreciation, MNEs have to face the reality that they cannot exchange too much of their profits or send them back home. In addition to security risks such as money laundering businesses or firms transferring assets overseas and going bankrupt, there are two situations that MNEs need to handle. First, foreign firms may promise to invest most of their profit in local business development so they can transfer some profit out of the country. Second, the depreciation pressure of the local currency may enforce harder foreign currency purchasing. A corporate sustainability manager (Interviewee 29) claimed that:

Under the depreciation pressure of Chinese Yuan, there is a very high level of control on purchasing foreign currency. The problematic issue is not the official policy on how much you could buy, but how long you would wait to process the money. Every time you transfer five million Chinese Yuan, an investigation is conducted. Listed companies might face liquidation problems such as paying overseas debts or dividends, blocked trading and acquisition. It is a very serious concern for foreign firms since 2014.

A regional executive (Interviewee 48) of a global consulting firm confirmed the statement above and noted:

> *It is not very hard to get business done here, but it takes a very long time to receive payment. It has been very common to get payment in 180 days. There used to be one-month processing period for foreign exchange, now it's a three-to-six month processing period. Sometimes we joke about staff of the State Administration of Foreign Exchange living in the foreign banks, so bank staff have nowhere to sleep.*

Therefore, the regulations on capital operation limit the financial capabilities of foreign firms. Foreign firms are restricted by both home and host country regulations; they have to wear chains to get into a business battle. Foreign banks face more regulators than local ones do and it is much harder for them to expand their business range and launch new financial products. Even if foreign firms get business done, the supervision on foreign exchange makes them wait until the prolonged process period is over.

6.2.3 Business Operation

Another indicator of *institutional liability* is the regulation of the business operations of foreign firms. A most critical disadvantage of foreign firms is the lack of government support. This does not mean that the government does not support foreign firms to invest locally; quite the contrary, they have encouraged foreign firms to conduct business in China for decades. The disadvantage here is that that local legal enforcement authorities offer much more support to local firms than to foreign firms. For instance, a senior financial manager (Interviewee 52) argued that:

> *From the aspects of laws and regulations, wholly foreign owned firms were not allowed to do online advertising business ten years ago. Every profitable website*

must have an Internet Content Provider (ICP) license. The licensing approval was the biggest obstacle, since many different government departments were involved in the examination and they are not approachable for many foreign firms. For example, some requirements such as data servers of foreign firms had to be relocated in China and regulators must have access to data servers when required for an investigation. That's why Google had to leave the local search industry and advertising industry many years ago. Nowadays such a large MNE like Google has withdrawn from the Chinese market. It still has some branches in China, but it can only provide offshore advertising services. However, it is much easier for local companies to get access or approval.

A global head of innovation (Interviewee25) supported this argument:

There are still limitations for foreign firms in the Chinese market. Nowadays, electric vehicles are heavily supported by the Chinese government. However, the central government has its policy, the provincial governments also have their catalogue and there are different levels of local protectionism. On the national level, there are only subsidies for domestically made battery packs. There are also subsidies for all battery cells of all kinds of licences in Shanghai. For example, only full electric vehicles, plug-in electric vehicles and fuel cell electric vehicles are supported by government subsidies. Hybrid electric vehicles innovated by Japanese automakers are not supported because the local government does not want to use national funds on Japanese firms. If a foreign firm is not on the track of the Chinese strategic development plan, it is at a large disadvantage. In other words, foreign firms can only succeed by meeting the expectations of government policies.

Another case noted by a market research manager (Interviewee 7) is detailed below:

> *In the building material industry, the technological barriers to trade are not high. Products of foreign firms may have an advantage in terms of quality, but we are not allowed to install or construct products by ourselves. While local firms can directly install their products, we can only provide finished or end products to local distributors and ask them to sell the products. The extra layer of agents puts us into a disadvantaged position. Shanghai regulators did not want to develop manufacturing industries anymore in Shanghai (except high-tech or electric vehicles), so they undertook some measurements to force firms to move the factories to less developed regions. Guess who has been largely affected? Regulators could have tons of means, but firms have limited ways to deal with them. Lobbying government like in the US is not going to happen in Shanghai.*

A senior financial manager (Interviewee 45) also noted that:

> *We used to have factories in Beijing and we moved to Shanghai, now they are in another city of Jiangsu Province. It is officially stated by the local government that they prefer local firms, as they have serious concerns about foreign firms. Many foreign firms withdraw capital from China because it is much harder to conduct business here than ever. We had a higher industry standard of effluent treatment compared to local competitors, yet we were the first company to move the factory because we did not meet higher environment standards any more. However, our local competitor can maintain their factories at where they were.*

A financial supervisor (Interviewee 5) even claimed that:

The regulation on imported products is very tight. For example, if your products for the supermarkets are imported, even if there is only one tag missing in a group of products, as a foreign firm you would be fined. This procedure costs much more than people outside the business can even imagine. It was a large part of the operation costs for foreign supermarkets when entering the market. (Interviewee 8 echoed this)

The investigation of environmental issues can be a tricky part of regulation. All five case MNEs from the manufacturing industry have been forced either entirely or in part to close their factories in Shanghai and move to other cities. Although some firms mentioned that moving factories to other cities or even other countries was in their prospects, other firms admitted that they had to move under pressure from the local government, leading to relocations of personnel, factories and operation networks. On the other hand, many state-owned enterprises still maintained their factories in Shanghai. A head of sales development (Interviewee 22) noted that:

When we entered the Chinese market, there were no local competitors. The government asked us to work with local firms to form joint ventures. Eventually we bought the other shares of the joint venture, but more local competitors stood out in recent years. It does not matter how high your standard is, you just cannot meet the environmental requirements, so you have to move the factory to another place that is normally less developed with a bit lower standard for industrial production.

An operation manager (Interviewee 16) supported this statement:

Our factory moved from Shanghai to another southern city of China three years ago. For a heavy machinery industry, foreign firms from developed countries often have higher standards. However, the local government has set a low standard in order to *protect local firms, which is fine. The problem is that even though we have a higher standard with higher cost, the legal enforcement may conclude that we did not meet local requirements, so we have to move. We call this selective legal enforcement. The governmental officials select foreign firms upon which to enforce their powers. As local governments have maintained discretionary power, they may choose to enforce their powers when they think it is necessary.*

A sales supervisor (Interviewee 4) echoed the higher standard of environmental regulations on foreign firms:

All of our factories except the automobile parts assembly factory have moved out of Shanghai because of the enhanced environmental regulations. It is understood that the government wants to have a better environment, we all do. It is just that we are always targeted first. The cost of land usage may decrease because of moving to a place that is far away from the city, but the cost of everything else goes up. We had the disadvantage of higher costs in the first place and now our costs are even higher.

Thus, regulations on business operation have restricted the capabilities of foreign firms. Local firms are more supported by local governments while foreign firms are easier to target. For instance, subsidies are provided to local firms, which puts foreign firms at a disadvantage. All foreign manufactories face tougher environmental regulations and are compelled to relocate their factories from Shanghai to other places and eventually increase their operation costs.

6.2.4 Institutional Void

The institutional void has been a long-term issue for MNEs in China. The weak protection of intellectual property rights in China has been a critical indicator for institutional liabilities.

The institutional voids existed where local formal institutions were unable to provide regulations (Peng & Luo, 2000). In the Chinese market, the acceptance and the awareness of intellectual property was weak two to three decades ago. As such, MNEs were exposed to the institutional void (Schrammel, 2013). This was evidenced by the experience of MNE2 and MNE5 respectively. A general manager (Interviewee 6) claimed that:

> *We suffered from weak protection of intellectual property rights. I believe most manufacturing had a similar terrible experience two decades ago. There used to be a belief that foreign firms entered the local market to make profits out of the institutional void, but they had to bear the cost – some technologies were learnt (or copied) by local competitors.*

A CFO (Interviewee 8) supported his colleague's opinion:

> *There is no protection on intellectual property, or very few requirements on it. The cost of protection on intellectual property is very high.*

A global head of innovation (Interviewee 25) asserted that:

> *Technological innovations in the local market would be quickly learned by our competitors. The 'copycat' issue was indeed serious two decades ago. It is getting better now, but we have still experienced some intellectual property issues every now and then in the past few years.*

Therefore, the institutional void plays a critical role in constraining the capabilities of foreign firms. It limits the potential of foreign firms to produce new products and expand market share in the local market and restricts their investments into research and development of the local subsidiaries.

6.3 The Normative Pillar of Institutional Liability

MNEs may also suffer from the normative type of institutional liabilities. It is common for different industries to have different business norms, standards and patterned behaviours. Normative institutional liability can often be seen in the patterned behaviours of competitors, suppliers, sales representatives, local partners and consumers. Their related values and norms structure their social and economic behaviours towards foreign firms and support the persistence of normative foreignness.

Indicators of normative foreignness vary across different industries. They present as patterned behaviours towards foreign business in each industry. These patterned behaviours are the responses of local agents towards MNEs, which complement the regulations on MNEs. Case study MNEs in both the financial services industry and the manufacturing industry have experienced normative institutional liabilities.

6.3.1 Flexible Rule Compliance of Local Firms (Flexible Local Business Practices)

A critical indicator for *institutional liability* for case study MNEs is that local competitors are able to have flexible rule compliance in the local market, while MNEs are not. Flexibility here particularly refers to the ability to respond to new marketing means or e-commerce methods. In contrast, foreign firms lack flexibility and have slow responses to the local market. Their means and methods must follow the compliance requirements of both home and host countries. For instance, an executive director of a foreign bank argued:

> *The banking industry has been open to foreign banks since 2007. However, the market share of foreign banks has declined from more than 2% in 2007 to a little bit higher than 1% in 2017. Many critics claim that foreign banks do not know China*

and they do not localise well. I admit it. Nevertheless, a more critical factor is that foreign banks have more restricted compliance requirements; this is because they get treated differently. In the Chinese banking industry, local banks can proactively try any new financial products. They sometimes even touch the regulation bottom line; they can just do the new product first and gain some benefits from it. They may get fined by the law enforcement department, but that is less than the benefits. If they don't get fined, they are the first mover in the market even before the market gets regulated. (Interviewee 30)

Reporting back to headquarters in the home country largely slows down the decision-making process and hence causes MNEs to exercise inflexible rule compliance. Some interviewees from the banking industry reflected on this:

As foreign banks, we are regulated by the local market and our home country. For instance, we are targeted by local competitors and regulators here in China. They can respond quickly to every move we make, while we have a slow decision-making process, in that we have to wait for decisions from overseas headquarters. It is very hard to compete with local banks in terms of flexibility in meeting compliance requirements. (Interviewees 49, 50 & 51)

A vice president (Interviewee 18) on business control also noted:

The reactions from foreign firms to local markets are very slow. For example, one day our executive team had a meeting with headquarters back in Europe. They believed the data showed that the GDP growth of China in the first quarter has slowed down by one or two percent. However, we (the local executive team) believed it was wrong and that the market had in fact grown bigger. It took headquarters three months to *retract the budget reduction plan. Unfortunately, headquarters trust more in lagged data than in our perceptions.*

The inflexible rule compliance of MNEs has also created some barriers for their subsidiaries. A senior HR business partner (Interviewee 9) of a manufacturing firm noted:

> *To some extent, the high level of compliance requirements of foreign firms in China indicates barriers to subsidiary development. Foreign firms are much less flexible and hence their growing speed is not as rapid as that of local firms, which makes it difficult for them to overcome the barriers in the local market. It may be inappropriate to say that local firms can do illegal business, but they certainly have a much faster expansion speed in the early stage. (Interviewee 14 echoed this).*

The sales director of MNE2 (Interviewee 10) supported his colleague in regard to inflexible rule compliance by MNEs:

> *The biggest disadvantage of foreign firms is that they lack flexibility when handling local rules. It has been a common problem for all foreign firms. Different foreign firms may have different levels of localisation; however, most local staff are not able to make decisions. There is a lag on investments, strategies and responses within the local market. The inflexible rule compliance of foreign firms has also legally and morally affected their capabilities to conduct business abroad. (Interviewee 18 echoed this)*

In addition, the constraints of home country institutions are also reflected in this indicator. A head of marketing (Interviewee 21) even claimed that:

An indicator of our low flexibility can be found in our compensation system. Our salary package and commission are strictly based on headquarters' policy, such as performance-based bonus and end-of-year bonus, which used to be very attractive to local staff. However, nowadays they are outdated. All of these incentives can be transferred to monetary compensation, but this is not possible in foreign firms because we have a code of principles; that is why more local staff now prefer working in local firms.

In summary, foreign firms tend to lack flexibility to react to the market. New marketing means or e-commerce methods cannot be updated in time. Compared to the flexible rule compliance of local firms, the case study MNEs suffered institutional liabilities.

6.3.2 Hierarchical Support of Local Government

Another indicator is that local government gives hierarchical support to different firms. Local government or regulators have tended to prioritise issues regarding state-owned enterprises (SOEs) in the last decade. With the focus on SOEs, private firms find it much harder to survive. This state of affairs is not like that of three decades ago, when the local regulators tried to lure foreign firms to the local market. A general manager (Interviewee 6) argued:

The Chinese market phenomenon is that state-owned enterprises (SOEs) grow bigger and bigger. 'Guo jin min tui' - *the state advances, the private enterprises retreat; this is the mainstream in the last decade. It is not an official policy, but it is a very common phrase now and it sums up which way the wind is blowing. The national government has constantly raised the funds or directly increased the capital of SOEs. Therefore, the underlying pattern of behaviour of the whole industry indicates the* *priority of support from regulators — SOEs rank first, private local firms rank second, foreign firms rank last.*

The level of governmental support is reflected in many aspects of governmental activity. For instance, government procurement can restrict the proportion of foreign firms' participation. A market research manager (Interviewee 7) mentioned that:

> *Government procurement is an identical behaviour in industry norms. When local firms were not competitive enough, they [the government firms] did purchase from us. Now they buy products of local firms. For example, Beijing asked for products from a Chinese original brand manufacturer. Therefore, the public bidding at different levels of local government might not specify that the bidders should be local firms, but the winner would be local firms, or at least they would account for 50% of government purchasing.* (Interviewee 8, 10 echoed this)

In summary, local firms have received more support from local governments which has caused an institutional liability for case study MNEs.

6.3.3 SOEs Become Leading Actors in the Local Institutional Environment

As foreign firms are no longer industry standard designators, they lose the advantage of a leading position in some industries. At the same time, they are disadvantaged, as they are required to follow the rules set by SOEs. This change is critical, because SOEs are institutional actors and are supported by institutional agents — local regulators. A CFO (Interviewee 8) of a foreign firm claimed that:

> *Before 2010 every product used should be new or innovative for the Chinese market, so foreign firms could get great payback because they set up the standards, took the*

first mover advantage and controlled the direction of technological advancement. Now it is different. Except for monopolised industry, SOEs become the designators for many manufactory industries. Foreign firms are very passive about local standards. For instance, if standard B costs three times more than standard A due to its quality or uniqueness, we are normally able to meet standard B, while local firms can only meet standard A. However, if we build a production line only to meet standard A as required by the local government, it is very costly and makes research and development more expensive as well, since they cannot distribute it onto the premiums. (Interviewee 17 echoed this)

The local standards caused a burden to case study MNEs when they did match their existing standards and product lines. A law director (Interviewee 17) commented:

Nowadays foreign firms must follow local standards. Many advanced foreign standards must get approval from Beijing (i.e. the central government). Based on the national principle that 'China must have its own standards'; the technological advantages of foreign firms are no longer advantages but extra costs.

The change of leading roles in the local market has gradually diminished the potential institutional advantages of case study MNEs and even caused institutional liabilities. It is not only about the cost, but also relates to pricing problems in both home and host countries. A vice president of supply chain (Interviewee 20) observed that:

A phenomenon of the local market is that SOEs are in the leading position now. This position allows them to have bigger discourse power in setting industry standards, pricing products and directing technology advancement. It becomes very critical. For instance, we have factories and manufacturing products in China. If we want to sell *part of the products to other countries, there is a term called international transfer pricing. If we priced the products so high that we did not earn much profit in China, we did not need to be taxed much. However, as SOEs took the leading role, we could not have a high price on our products, because otherwise we would be fined for tax evasion. It put us in a very disadvantaged position. (Interviewees 33 and 45 echoed this)*

As a result, case study MNEs have suffered institutional liabilities, since local SOEs become leading actors in the local institutional environment.

6.3.4 *Guanxi*

Guanxi can also be a critical indicator for *institutional liability* faced by case study MNEs in China. It is a way of doing business by cultivating networks and relationships in the Chinese market and also in the overseas markets when doing business with Chinese firms. Many case study MNEs rely on local agents to distribute their products and maintain networks. In the long term, their capabilities are restricted by their local agents and their *guanxi* with these agents. A sales director (Interviewee 10) argued:

> *One pattern of behaviour of foreign firms is that sales rely on local agents or distributors. It may be the result of regulations or lack of local connections, but it inevitably leads to overreliance on local agents or distributors. Normally if a group of distributors reached more than 30% sales of total sales, they would have the capability to affect product premiums.*

In addition to distribution and sales networks, case study MNEs have also required *guanxi* for other purposes such as public relations. It takes time to build trust and many foreigners are not accustomed to this approach. Hence, they rely on locals such as agents or brokers to build *guanxi* for them. A law director (Interviewee 17) added:

> *Foreign firms rely on local agents not only for sales networks, but also for public relations. For instance, we have hired brokers only to work on* guanxi *for us. The costs of hiring local brokers are very high, but we have to hire them because we cannot take the risk of losing networks.*

Guanxi can be hard to build with local partners. However, many case study MNEs had acquired their local partner's share and their joint ventures became wholly owned subsidiaries. They needed to foster *guanxi* on their own and this was a significant challenge for them. A strategic financial manager (Interviewee 15) explained that:

> *Our biggest disadvantage is that we did not comply with local* guanxi. *We used to ask our joint venture partner to deal with all these networks issues; now we have acquired the rest of the shares and become a wholly foreign owned subsidiary, things have become difficult. Of course, we want to have good networks and* guanxi *with local partners; but we are not permitted by our headquarters to send gifts because we have a no-gift policy, while these behaviours are very common in maintaining networks in China. (Interviewees 12, 14, 16 echoed this)*

In addition, the inconsistent tenure of executives of foreign subsidiaries in China can make it even harder to maintain *guanxi*, since *guanxi* requires interpersonal relationships. These executives are often expatriates and they may only stay in China for a limited period ranging from three months to two years. An executive assistant (Interviewee 12) noted:

> *Foreign firms usually have different corporate structures compared to local firms. They used to have limited trust in putting local staff onto an executive level for*

> *different reasons. Therefore, during seven years of working in this subsidiary, our general manager has been changed four times. It may sound like a basic routine for a US firm – rotation while maintaining consistency. However, it did not work well, since business networks require to be supported by personal* guanxi *in China. Headquarters has appointed five foreign executives for this subsidiary in seven years. It's been really hard for local business partners and government officials to remember who you are and hence hard to build strong* guanxi. (Interviewee 13 echoed this)

Furthermore, the host country government may restrict the number of foreigners working in the host country. For instance, the Chinese government has restricted the number of foreign expatriates and has made long-term working visas harder to obtain than was the case two decades ago. A senior manager (Interviewee 35) added:

> *It is very hard to keep expatriates working for a long time in China. Many work issues or personal issues become obstacles for their stay. Visas are getting harder to get; income taxes and labour contracts are new problems, as the local government prefers local labour contracts to foreign contractors assigned to work in China for three to six months. I have worked three years in China and stayed the longest among our foreign colleagues. Even so, a new position is waiting for me in North America and I am going to leave China in two months due to my visa's expiry.*

Therefore, the lack of *guanxi* means that foreign firms have experienced institutional liabilities resulting from the normative elements of institutional environments.

6.4 The Cultural-Cognitive Pillar of Institutional Liability

In addition to the regulative and normative sources of institutional liabilities, MNEs also receive different treatment because of cultural-cognitive aspects of the Chinese mainland institutional environment. The cultural-cognitive pillar refers to common beliefs regarding foreign firms and assumptions that are socially constructed by labelling and stereotyping, which sets MNEs apart from local firms. The shared understandings of local stakeholders about foreign investors vary from time to time. The indicators may result from a short-term issue such as a political phenomenon or a long-term stereotyping such as country-of-origin effects and may also be consequences of changes in market conditions.

6.4.1 Nationalism

The stereotypical responses to foreign investors and products can have a strong influence on the business operations of foreign firms in host countries. These effects may not be reflected in the official diplomatic channels, but are reflected in aspects of consumer behaviour. For instance, MNE1 has experienced institutional liabilities due to nationalism. A senior manager (Interviewee 1) explained:

> *The Terminal High Altitude Area Defence (THAAD) issue in Korea has resulted in a series of problems to us. As a Korean corporation, we suffered a lot of pressure on this issue. The flash point earlier this year (2017) was a Korean corporation called LOTTE provided land for settling THAAD. Of course, the Chinese government did not officially punish the company in China, but as the fifth largest corporation in Korea, LOTTE has over 30 per cent sales achieved in China. The company experienced a boycott by Chinese consumers for quite a long time. When Chinese consumers boycott LOTTE, they may also think differently about buying other Korean-made stuff. Hence, our business was greatly affected by this issue.*

A belief that buying foreign products is not patriotic reflects the nationalism of local consumers and inevitably causes institutional liabilities to case study MNEs. Two senior managers (Interviewees 2 & 3) from MNE1 echoed the statement above and added:

> *In contrast to our business with consumer sections, our business-to-business sections are not highly affected. However, issues such as THAAD place us in a very awkward situation. We somehow lose a part of our bargaining power due to reasons that are out of our control. Consumers here in China would not consider buying our products although we have nothing to do with this issue. They would simply believe you are a Korean company so they should avoid buying your products to show their patriotism. All we can do is to stay low for this period of time.*

In addition to consumer nationalism, other business operations became harder because of nationalism. For instance, MNEs reported that business partners tended to be tougher to negotiate with and regulative investigators took longer to examine their practices. The sales supervisor and financial supervisor of MNE1 (Interviewees 4 & 5) claimed that:

> *The THAAD issue has affected us heavily. As our company produces products in South Korea, customs clearance usually takes one week. The THAAD issue changed this to two weeks on average. The influence is so strong that many clients do not want to purchase from us. Some small firms had concerns and did not work with us during that period of time. Price negotiations became harder (they cut the price down) and some factories in China were investigated for longer than usual. For instance, the Wuxi government treated all South Korean companies according to regulations — three months of assessment for approval purposes. It sounds fair enough, but it used to be one month for us. Regarding financial regulations, some policies were self-*

contradictory or controversial, so they were not officially settled and could not be justified. But now these policies were used against South Korean companies in every disadvantageous way.

In summary, the difficult experiences of case study MNE1 reported here indicate that nationalism can play a significant role in affecting foreign firms and hence result in institutional liabilities for them.

6.4.2 Country-of-Origin (COO) Effect

The COO effect is another indicator for foreign firms suffering from institutional liabilities. Like other indicators from the cultural-cognitive source, this effect brings liabilities for foreign firms even before their market entry. Most of them acquire these institutional liabilities because of their home country. A strategic financial manager (Interviewee 15) claimed that:

> *Business-to-business (B2B) and Business-to-consumer (B2C) sectors are completely different. The B2B sectors are not affected as much as B2C sectors by country-of-origin effect. During the THAAD issue period, all South Korean firms were affected by the country-of-origin effect. However, the heavy machinery industries were not affected as much as supermarkets. Because business partners of machinery industries would not give up their networks after years of collaborations, they somehow reduced their orders. While consumers chose not to buy anything from South Korean supermarkets due to the national negative attitude to THAAD; this led to a big drop in sales.*

The COO effect reflects the perceptions of local stakeholders about other countries. For instance, a senior public relations manager (Interviewee 23) claimed that:

> *A liability to foreign firms is the impression that technologies in some industries, such as auto components and parts, are oligopoly markets dominated by foreign firms. Local stakeholders believe that local firms are oppressed by foreign firms, so that their own technologies have not developed over the years. Even though we have many executives who are Chinese and the German government has maintained good relationships with the Chinese government, local stakeholders still treat us as oppressors to local competitors.*

This kind of perception may be expressed as xenophobia. Xenophobia denotes hostility towards foreign firms and products. An executive director (Interviewee 39) shared some experiences:

> *As a Japanese firm, we have to admit that we are disadvantaged here somehow in China. Local business partners and clients admire our quality of service; however, they do have negative emotions about Japanese firms to some extent. This is due to historical reasons and it is still very sensitive to discuss these reasons. We tend to avoid talking about it. Unfortunately, we know it is really hard to change the perceptions of local stakeholders.*

A more common attitude than xenophobia is ethnocentrism, which is expressed in the preference of local stakeholders for local firms and products. It differs from nationalism, because ethnocentrism emphasises the perceived superiority of the local firms and products over foreign firms and products in terms of quality, price and even service. A managing director (Interviewee 44) asserted that:

Nowadays many local stakeholders have more faith than ever in Chinese local products. They believe local firms are able to produce quality goods with reasonable price and great customer support. This was hard to imagine two decades ago when people here believed that foreign products were always better. This faith in local products has largely benefited local firms and put us (foreign firms) into a less advantaged position.

In summary, the COO effect has affected how local stakeholders perceive foreign firms. They may perceive some case study MNEs (e.g. Case study MNE1) as having inferior products and local competitors as having better quality products, or even refuse to buy from foreign firms from certain countries.

6.4.3 Misconceptions and Stereotypes

Some institutional liability may be rooted in misconceptions and stereotypes. These misconceptions and stereotypes can arise from both foreign firms and local stakeholders. For instance, expatriates from headquarters generally have less local knowledge than local staff and hence work on the basis of more stereotypical knowledge that may be outdated. The high failure rate of expatriates implies that foreign staff tend to underestimate the changes in the local market and are slow to respond to these changes. In case study MNE2, a general manager (Interviewee 6) stated:

Expatriates used to be the mainstream for hiring staff in subsidiaries of foreign firms. They came to China, had a stereotype of the Chinese business and thought China stayed in the past. Local firms used to look up to foreign firms, but now local markets are dominated by local firms. Many foreign firms failed in the long run because they have held a misconception of the Chinese market.

Moreover, some misconceptions of the local market have caused MNEs to incur very significant financial costs. The sales director (Interviewee 10) of MNE2 said:

> *It is safe to say this. My predecessor, who was an expatriate, had misconceptions of the local market and he did not perceive the dynamic changes over the past few years. Some unwise decisions were made and cost millions for nothing. This phenomenon happens every day in many foreign firms.*

In addition to the misconceptions and stereotypes held by foreign staff, local stakeholders, especially local talented prospective and current employees, may also hold misconceptions and stereotypes about foreign firms as well. For instance, local employees often have much higher expectations of MNEs compared to local firms due to reputed management practices of MNEs. However, the case study MNEs reported that they are no longer as popular with employees as three decades ago. An HR manager (Interviewee 43) explained:

> *There used to be many local people trying to work in foreign firms. Now it is completely different. Local talent no longer perceive foreign firms as a more attractive option than local firms now. Local firms can provide better salary packages, flexibility and innovative platforms. Local unlisted firms can even provide dividend bonuses as incentives which can never happen in foreign firms. As such, to some extent, the cost of hiring local staff is even higher than the same level of US staff. Foreign firms used to have absolute advantages in middle and above level managers and executives. Nowadays many managers and executives in local firms who used to work in foreign firms are as competitive as any other competitors in foreign firms.*

Some interviewees shared this perception. A managing director (Interviewee 44) confessed:

> *Local talent used to believe that foreign firms provided the best platforms for them to grow, such as training and career development practices. They found out their perceptions were wrong a few years later, so most of them left for local firms. The differences led to a huge increase of employee turnover – from 30% to more than 50% in foreign firms.*

An HR manager (Interviewee 32) commented that:

> *It is getting harder to recruit local talent because they believe local firms can provide better platforms and working there gives them better chances to be promoted. Under such circumstances, how to recruit more local talent to work for us becomes a big issue that needs to be solved.*

In summary, misconceptions and stereotypes have caused institutional liabilities to case study MNEs. They are reflected in factors affecting both foreign and local staff and talented potential employees.

6.5 Conclusion

The research findings have addressed two questions raised at the outset of this thesis. Foreign firms have suffered from institutional liabilities. These liabilities are generated through different indicators. The indicators are summarised in Table 6.1.

Table 6.1: Indicators for Institutional Liabilities

Institutional source	Regulative	Normative	Cultural-cognitive
Indicators	Ownership restrictions	Flexible rule compliance of local firms	Nationalism
	Capital operation	Hierarchical support of the local government	Country-of-origin effects
	Business operation	SOEs become leading actors in the local institutional environment	Misconceptions and stereotypes
	Institutional void	*Guanxi*	

CHAPTER 7: INSTITUTIONAL ADVANTAGES OF MNES IN CHINA

7.1 Chapter Objectives

Chapter 3 identified and examined the *institution-induced foreignness* of MNEs in China utilising Scott's (2013) integrated model of institutions. This chapter aims to examine the *institutional advantages* experienced by MNEs in China. As a newly proposed concept, *institutional advantage* has not yet been systematically and empirically examined. The research findings are discussed based on the three institutional pillars and empirical evidence collected is presented to address the following research SQs:

SQ 1: What does it mean for MNEs to be foreign in host countries?

SQ 2: How and when does foreignness generate advantages?

The examination of institutional advantages experienced by MNEs was based on semi-structured interviews of employees. It will be presented in terms of the regulative, normative and cognitive pillars.

7.2 The Regulative Pillar of Institutional Advantages

The central government in China has provided various incentives to attract foreign investment since the early 1980s. As a result, MNEs in China have enjoyed some government incentives which have not been offered to domestic firms. The major incentives include reductions of and exemptions from taxation, land concessions and benefits derived from regional institutions that constitute the regulative dimension. The following subsections will discuss some relevant indicators drawn from the findings.

7.2.1 Taxation Reductions and Exemptions

Among all indicators for the regulative dimension of institutional AOF, tax reductions and exemptions are the most critical indicator to attract foreign firms to conduct business in

China. For instance, before the late 2000s, a popular policy was the '2 + 3 **years tax holiday'** ('*liang mian san jian ban)*', which means that once a firm starts to earn profits, they are exempt from the first **two years** of tax and for the following **three years**, they obtain a **50 per cent** tax reduction. Additionally, in the economic and technological development zones of Shanghai, manufacturing firms that operated for more than ten years could enjoy a similar policy whereby corporate income tax was exempted for the first two years in which they made a profit and in the following three years, their tax would be reduced by half. For newly established foreign firms with investments of USD 10 million or more that have operated for more than 15 years, or high-tech firms with investments of USD 5 million, corporate income tax has been exempted for a two-year tax holiday when making profits. These MNEs have also obtained a reduction of one half in their tax for the following three years and a subsidy of 12.5 per cent of the tax paid to the local government. During the sixth to tenth years in which they made a profit, they have also obtained a subsidy amounting to 6.25 per cent of the tax paid. Most interviewees confirmed this policy. A law director (Interviewee 17) from MNE3 explained that:

> *There have been many different regulations and policies to attract foreign firms to invest in Shanghai. Prior to 2008, a* '2 + 3 **years tax holiday'** *policy was adopted. It meant that all foreign companies were granted a two-year tax holiday when making profits and half-tax reductions for the following three years. It was an attractive advantage and domestic firms jealously called it a super-national treatment, which offered foreign firms enormous incentives and made the treatment of foreign firms much better than that of local firms. (Interviewees 13, 15 and 16 echoed this)*

There were also prior to 2008 different taxation rates for local and foreign firms and these two rates were merged into one single rate that has applied to all firms since 2008. However, the merger of taxation rates for local and foreign firms did not mean an end to the tax reductions and exemptions provided to foreign firms. For example, with the abolition of the '2+3 years tax holiday' policy for all foreign firms, the Shanghai municipal government issued a new policy designed for high-tech foreign firms, operative during the 2010s. During the first two years of business operation for high-tech manufacturing firms, 6.25 per cent of the value-added tax has been paid back by the economic and technological development zone. From the third year, 3.75 per cent of the value-added tax received from foreign firms has been paid back until foreign firms recoup their initial investments.

In summary, the main incentive for case study MNEs is taxation reduction and exemption. This incentive has provided a long-term reduction in costs and allowed potential profits which have helped case study MNEs to survive in China. Although some taxation policies have been abolished or modified, they are still regarded as an important means to attract different types of FDI based on the needs of the host country.

7.2.2 Land Concessions

Land concessions are another important indicator for the regulation of institutional advantages. Almost all manufacturing firms require land on which to build up their plants; even foreign firms in the financial service industry require land for their office buildings. Under the land concession policy, economic and technological development zones are authorised to price their lands for foreign firms flexibly. For instance, in Shanghai, manufacturing firms with investments of over CNY 10 million (Chinese renminbi) are eligible to apply for short-term land usage. The standard price is CNY 600 per acre each year for the first five years and CNY 1,000 per acre per year for the following ten years. Foreign firms with investments in infrastructure developments are entitled to operate their business under the service area and have priority to enjoy discounts on land prices. As a market research manager (Interviewee 7) from MNE2 explained:

> *There used to be many business-friendly policies only enjoyed by foreign firms in order to attract investment. Land and property incentives were most likely provided by local governments. For instance, local governments were entitled to provide everything foreign firms needed in the economic and technological development zone. To attract foreign firms, many plants were authorised to be built in a very effective manner, which meant local governments most likely provided foreign firms with the license for business operation and the lowest price to obtain lands for commercial purposes.*

Land concessions were also very direct incentives provided to case study MNEs. These concessions improved the efficiency of their market entry and saved costs, giving them an institutional advantage. An assistant corporate sustainability manager (Interviewee 29) from MNE6 supported this argument:

> *Local governments made our entry into China easier after the accession of China to the WTO. For example, the licence for foreign banks has become much easier to obtain than before the accession. New branch openings are also speeding up due to land concessions. As a foreign bank, we have more opportunities to do business with foreign firms in China.*

In addition to concession fees for obtaining lands, the selection of factory/plant site might also benefit from support. A global head of innovation (Interviewee 25) from MNE5 related their experience in factory site selection:

> *As the national government has strongly supported the development of auto parts*

manufacturing enterprises in the Chinese market, there has been great support in factory site selection, business office selection and business expansion at a national level. There are also collaborations with local universities to create a labour pool and work on technology development.

7.2.3 Regional Incentives

The central government's development strategies in China have aimed to attract FDI. Initially every separate foreign investment was welcomed and subsequently only high tech-based FDI that was needed by more developed regions. More developed coastal regions such as Guangdong, Jiangsu and Zhejiang provinces have attracted much more foreign investment than less developed regions and hence these provincial governments have reduced their support to some forms of foreign investment that have become less important to the area. Since 2008, not every foreign firm has been able to enjoy super-preferential policies. Only government-supported industries in these regions can still benefit from these policies. Therefore, less developed regions have provided more attractive policies to attract some foreign firms that no longer enjoy benefits in coastal regions. This is in line with the strategy of the central government to help less developed regions. As an executive director (Interviewee 24) of MNE6 argued:

Local governments are very effective when you have a good connection with them or you have things they want. Although there are a lot of policies at the country level that favour domestic firms, many province-level policies are very attractive to us. A lot of benefits are nowadays provided through provincial governments other than Shanghai. For instance, if they (government officials) promise a five-year plan, they will stick to it. When they say they can offer you this, they have very high credibility. Imagine if the Chinese system is not effective, how can they manage a fast growth rate for more than

20 years? In our case, the local government has provided us with tax reduction, preferential plant and equipment and even labour. When we planned to move a factory from Shanghai to other places, many governments from various provinces in China offered different beneficial policies in order to get us move the factory there. The support was incredible and we expanded dramatically within five years.

Apart from the factory in Shanghai, case study MNE6 has collaborated with other provincial governments and has built factories in those provinces. A colleague (interviewee 26) supported this observation:

The super-preferential tax policies are well known. In the auto parts industry these policies still exist, as the local government supports the development of this industry. However, the advantage of these policies for foreign firms has decreased over time. Ten years ago, the local government did not collect any tax from foreign firms. Even though the amount of FDI is huge now, the national government would only select some of them to support, compared to supporting all of them in the past, such as in the 1980s and 1990s.

As mentioned above, the central government has almost entirely removed the super-preferential tax rate for the years since 2008. However, this does not mean that foreign firms no longer have institutional advantages in terms of the regulative dimension. Quite the contrary; it has only changed the direction of support. For instance, the super-preferential tax policies used to be focused on economically open areas of coastal regions, or economic and technological development zones. Nowadays, the benefits have been transferred to high-tech development zones, export-oriented foreign firms and reinvestment tax reduction policies. High-tech foreign firms are entitled to a reduction of 15 per cent in the total amount of their corporate income tax and benefits from all policies for reduction and exemption of other taxation. A senior manager (Interviewee 33) of case MNE7 asserted that:

> *Now not every foreign firm can have advantages in regulations and policies. Before 2010, almost all of them could enjoy huge advantages in many areas and now some may still have such advantages while some don't. It makes people feel like local firms are getting stronger and bigger and they now enjoy more advantages than foreign firms. This view is actually incorrect, because many foreign firms still enjoy more beneficial policies than local firms. High-tech foreign firms still enjoy super-preferential tax reduction policies, which are even higher than in the old days.*

Export-oriented foreign firms can also benefit; if their total export amount accounts for more than 70 per cent of the total sales of the financial year, they can enjoy reduction in their corporate income tax by one-half. If they pay corporate income tax based on the 15 per cent rate, they need pay only at a rate of 10 per cent. Advanced-technology enterprises can extend to three years the one-half corporate income tax reduction. As a director (Interviewee 36) from MNE7 explained:

> *The corporate income tax has changed over time. Before the late 2000s, foreign firms had a different corporate income tax rate which benefited them. Now both foreign and local firms share the same rate. However, foreign firms in government supported industries or less developed regions still benefit from taxation incentives. Export-oriented or advanced-technology MNEs enjoy even more benefits than ever. This is due to the transition of the Chinese economy. (Interviewee 27 echoed this)*

The reinvestment policy for tax reduction is for foreign investors who reinvest the profit from the local market locally. If their current business operation period exceeds five years and they intend to reinvest for another five-year period, they are entitled to recoup 40 per cent of their paid corporate income tax. There is a trend that indicates foreign firms no longer enjoy as many advantages as they used to have, but most of them still benefit from being foreign in China. A senior financial manager (Interviewee 45) observed that:

> *If you go back to ten years ago, you could get the taxation reduction for whatever business you did in China as long as you were a foreign firm. Nowadays you need to prove to the government that what you do is environment-friendly and sustainable to local development. In addition, such local development has to fit the need of the country. We do have a 15 per cent taxation reduction for our high-tech business here in Shanghai. However, we need to prove that we are capable of helping the development of the local high-tech industry. A series of examinations, auditing and research is done by third-party institutes every year to make sure we are on track. I'll say we still enjoy some advantages, but not as much as before.*

In short, regional incentives offered by less developed regions (inner provinces of China) have created some institutional advantages which have diminished in the more developed regions (coastal regions of China) in recent years. This reflects the strategy of the Chinese central government to transfer more FDI projects into the inner provinces and attract more high-tech FDI programs in coastal regions.

7.3 The Normative Pillar of Institutional Advantages

Foreign firms may also gain institutional advantages from the normative source. These institutional advantages may be generated through the influence of foreign firms in the setting of local policies and industry standards and also through their patterned management practices; in addition, foreign products tend to enjoy a higher price premium. This has been evident in the Chinese local market for many years.

It is very common that different industries have different business norms, standards and patterned behaviours which supplement formal regulations and policies. Case study MNEs in both the financial services industry and the manufacturing sector have gained institutional advantages, as detailed below.

7.3.1 Local Industrial Preference for Foreign Products

The local industry has preferred foreign products since the economic reforms in the 1980s. The industrial preference for foreign products conferred higher price premiums and hence brought enormous benefits. It was a normative belief in the local manufacturing sector that foreign products were superior to local products, especially in the first couple of decades of China's economic reform. The preference of local partners has leveraged the price premium of foreign products. A general manager in marketing and business development (Interviewee 6) supported this perception:

> *Our reputation in quality standards makes us more trustworthy than most domestic firms in the Chinese market. Although it is difficult to beat local firms and take most of the market share with our prices, especially in the mid-to-low end product section, we still maintain advantages in the high-end production section. Both local clients and partners are more willing to do business with us when they want premium products.*

Over three decades of economic reform has changed the preferences in the local market. With the booming of the Chinese manufacturing sector, foreign firms have faced strong competition from local firms, especially in the business-to-consumer (B2C) sector. Case study MNEs need to directly face consumers in the B2C sector, whereas in the business-to-business (B2B) sector, they only need to deal with industry partners such as suppliers. A general manager in finance (Interviewee 8) of case study MNE2 claimed that:

> *The advantage of foreign firms still comes from the local preference for details of our products, services and technologies. Local firms may provide cheaper products, but there are many other aspects to catch up. Therefore, local business partners in the B2B sector have even more belief in foreign products.*

The perception of suppliers and purchasers in the industry has impacted the decision-making processes of business partners. For instance, it has become a patterned business behaviour to buy from foreign firms when industry players have high-quality requirements on materials, parts, components and machines. A sales supervisor (Interviewee 4) of MNE1 gave an example for a product development business:

> *Local suppliers and buyers have a common practice of coming to us if products need better quality control, or they would go to local firms for products with higher cost pressure. Perhaps the power of the machine looks the same, but there are major differences in quality control, performance and stability. This is a belief held about foreign products in our industry.*

Foreign firms have not maintained their advantages in the B2C sector; however they have maintained their advantages in the B2B sector in many industries. Although local firms have brought down their prices dramatically over the past three decades, industry players would still prefer foreign products. A sales director (Interviewee 10) of MNE2 claimed that:

> *From a dynamic perspective, the products of foreign firms are more popular in my*

industry, even this trend is declining as local manufacturers have consistently improved their products. The prolonged prosperity of the Chinese economy means that an increasing number of clients are willing to pay more for better quality and services. In addition, many U.S. firms in China become our business partners, because they believe we have higher quality control as a US firm.

In addition to foreign products, the local market prefers services provided by foreign banks over local banks, even though foreign banks often charge higher fees. A chief digital executive in the retail banking sector (Interviewee 31) from case MNE6 commented that:

The initial launch of foreign banks in China was restricted in many ways and has caused huge operation costs. Due to limited business capabilities, we could only provide limited services. Compared to local banks, we charged much higher transaction and service fees. However, many local clients approached us and tended to put more trust in us than in local banks.

Interviewees 4, 10 and 22 echoed this observation and stated that even though government purchases sometimes required that 30 or 40 per cent of products should be made by Chinese local firms, foreign firms were still favoured over local firms for the remaining proportion of transactions because of their foreign identities.

7.3.2 Influence on Local Policies and Industry Standards

The influence of foreign firms on local policies and industry standards can bring substantial benefits, such as local preferences for foreign firms. Foreign firms used to lead the local manufacturing sector and set industrial standards. This situation has changed and now foreign firms tend to suggest industry standards. Interviewees 25 and 26 said that they were able to make some suggestions or give advice to the industry association about new technology developments because of their advanced technology. A senior manager in business development and strategic marketing (Interviewee 27) from MNE5 noted:

> *We certainly have much more advanced technologies across different areas of our industry. Some people think that a new standard, associated with our advice, may bring us a lot of advantages. That is kind of true. However, a more important point is that we are capable of building up relationships with industry partners and government officials to develop local markets based on our mature management practices and consistent innovation.*

However, this advantage in setting standards is declining as SOEs become major players. A law director (Interviewee 17) from MNE3 added:

> *If we have better standards, we could suggest them to the industry association in a bid to make all new standards ours. By doing so, of course, we could gain a huge advantage. However, that is unrealistic now. Neither your competitors nor industry partners would allow your company standards to be the whole industry standard. To be honest, we can only suggest some new technology standards for a period of time. We no longer lead the local industry standards as we did before and it is too risky for us to take the leading position because of the political risks. Yet in a way, we still maintain some advantages in indirectly affecting the standards.*

In summary, the prolonged influence of foreign firms on local policies and industrial standards has explicitly and implicitly generated institutional advantages for foreign firms. Although some institutional advantages have declined to some extent, they still exist in the Chinese local market and persistently affect local regulators and industrial players.

7.3.3 Being Able to Escape from Local Norms and Practices

Many foreign firms tend to have different management practices from those of local firms. Some foreign firms may choose to comply with local dominant practices to increase their local legitimacy, where others can escape from local dominant norms and business practices by using their customary management practices. In China, some case study MNEs adopted the latter to escape from *guanxi*, bribery (by using a no-gift policy) and other immoral business practices (such as corrupt rebates). The ability to escape from local norms and practices is one normative institutional advantage for some case study MNEs in China.

For instance, the no-gift policy in many case study MNEs strictly limited the exchange of gifts between employees and clients. Although this policy did not comply with the dominant business norm — *guanxi* — in the local market, it was effective in avoiding bribery and gave an institutional advantage to those case study MNEs. A compliance manager (Interviewee 28) from case study MNE6 asserted that:

> *It is a big deal for foreign firms in the financial service industry to insist on the no-gift policy.* Guanxi *is very important for us to do business in China, we are aware of that. However, we cannot risk exchanging gifts which may to lead to bribery. As a matter of fact, many local clients or business partners would more likely appreciate this policy, since it seemed to be more reasonable for a foreign firm to be different.*

This was similar to the situations of many other case study MNEs. However, case study MNE1 had made some adjustments to limit the value of gifts to be below a certain specified value in RMB (Chinese Yuan). A senior manager (interviewee 3) claimed that:

> *We are also from an Asian country and we understand that it is important to exchange gifts in order to keep business relationships as well as interpersonal relationships close in China. However, we have to be very cautious in China because of political and operational risks. Therefore, our gift policy is to set a limit on the value of gifts, which cannot exceed 200 RMB on any occasion.*

Rebates can be quite common in marketing, when firms want to promote sales and offer rebates to distributors and sales agents. However, in the manufacturing sector, payment of a large amount of money can be considered to be corruption, though it may only represent a 1 or 2 per cent rebate. In addition, many SOEs were at one time significant players in the manufacturing sector in China and some senior SOE employees might ask for rebates when they were responsible for purchasing. A head of sales development (Interviewee 22) shared his experience:

> *We experienced such a situation when an SOE senior manager asked for high rebates. He asked us to transfer three percent of the rebates to his own account and another three percent to another account (could be an account of another person in charge from the SOE). We refused to do so, since our corporate policy restricted such practices and it is immoral and illegal. As a result, we did not get the purchasing order. To be honest, we lost many orders from local clients due to our policies compared to local firms… well… I believe it is worthy to do so and we do not wish to be exposed to any immoral management practices.*

In summary, being able to escape from local norms and practices is a normative institutional advantage to case study MNEs. By ignoring local dominant business practices and adopting their own practices, case study MNEs have been able to steer clear of local dominant norms, potential bribery risks and other immoral practices.

7.4 The Cultural-Cognitive Pillar of Institutional Advantages

The cultural-cognitive source of institutional advantages enjoyed by foreign firms has been very apparent in the Chinese context. The indicator of cultural-cognitive institutional advantages may present as a kind of belief or trust in foreigners, a self-identity recognition of employees, or a stereotyping of foreign firms in regard to country-of-origin effects and their reputations.

7.4.1 Belief and Trust in Foreigners

There was in the past a belief in the Chinese market that everything foreign was better. The common perceptions were that foreign products were better; foreign firms paid employees much more; foreign practices were more effective; and foreign technologies were more advanced. Such beliefs were particularly common two decades ago. For instance, a global head of innovation (Interviewee 25) of MNE5 stated that:

> *The local market used to believe that foreign products were better in every aspect. Local product innovations were just learning from foreign firms and we had this name 'copycat' for local firms. Although it is no longer true in China, there is still a belief in the automobile industry that foreign products are better. If the budget is sufficient, most clients would prefer to buy foreign products.*

It was in the past a shared understanding that foreigners could do better, such as in product quality. Now things have changed because local firms have improved their product quality, but the local market still values foreign products and enables them to retain a higher price premium compared to local products. A market research manager (Interviewee 7) of MNE2 claimed that:

> *The recognition of brand name, product quality and customer service still give us an advantage because the clients believe there is a guarantee in reputation. It is weird to say this, because the Chinese manufacturing sector has grown so strong. Thirty years ago, few local firms could produce good products with modern functions. Now they produce almost everything. However, high-end clients still purchase from foreign firms and have continued to do so even though the local manufacturers are so strong.*

A senior public relations manager (Interviewee 23) of MNE5 emphasised that:

> *A great reputation in the industry in both local and international markets has granted us a great advantage. As we have not had any negative news in the past, the Chinese media is also going easy with us; public relations are not as hard as for MNEs from some countries. As we consistently invest largely in technology development, many leading technologies have also granted us the advantage of suggesting new standards in the local market.*

The local market has put more trust in foreign products and their standards. The perception of the superiority of foreign products has been prevalent for thirty years. It is hard to eliminate the perception, even if it is biased; this allows foreign firms to gain an institutional advantage from being foreign. A service manager (Interviewee 14) of MNE3 argued that:

> *The biggest advantage for foreign firms is that the brand image and reputation supports a higher price premium. Both business partners and consumers have trusted foreign products for a long time. For instance, our clients are willing to trust our products and services to be better and it is common for better products to be pricey.*

As a result, they pay the price premium.

This kind of trust is a result of a long-term relationship between foreign firms and the local market and its customers. It is difficult to diminish this trust in a short time. The shared trust of the local market in foreign products is likely to persist for a long time. A sales supervisor (Interviewee 4) of MNE1 confirmed this:

> *Maybe the local market does not blindly trust foreign products as much as before in my industry (auto industry), but we subconsciously trust foreign products more than local products in many aspects. After a long-term contract, most clients would pursue continuing business partnerships if nothing goes wrong with us. Very few people would take the risk of going for some newly emerged local competitor when they have worked with us, realised our capability and constantly trusted us. Therefore, many clients would rather pay a few more percentages to work with us because of their trust. (Interviewee 5 echoed this)*

Similar to the manufacturing sector, foreign banks were seen as more trustworthy by high-end clients. Although foreign banks were required to follow more restricted local regulations and rules than local banks, many high-end clients would still prefer foreign banks. A compliance manager (Interviewee 28) of MNE6 stated that:

> *To be honest, it is easier to get business deal sometimes just because you are a foreigner. Some clients do not have faith in local banks and they are afraid of accounts being frozen by state-owned banks. Foreign banks used to have a much better reputation for keeping clients' information and offering better products and service. Often local businesses want to take a loan from foreign banks as they want their assets to be professionally managed, which has certainly produced a big*

advantage to us. (Interviewee 31 echoed this)

Even though localisation levels are high nowadays in MNE subsidiaries, foreignness remains as long as the ownership and corporate culture remains foreign. A senior partner (Interviewee 34) of MNE7 argued that:

> *Many people in foreign firms claim that the localisation level gets higher and the foreignness seems to get lower or diminish. This is partially true, but as long as the capital is from overseas countries, the foreignness can never get diminished. As such, some local clients believe we are better because of our foreign identity. (Interviewee 35 echoed this)*

In summary, belief and trust in foreigners has produced a perception of their value in the local Chinese market. This perception has brought huge institutional advantages to case study MNEs from the time at which they entered the local market. It is also the foundation for other indicators, such as the organisational attractiveness of case study MNEs.

7.4.2 Organisational Attractiveness

The remuneration of employees has been a critical factor for case study MNEs in attracting local talented staff. Foreign firms generally have offered higher remuneration, including salary packages, leave, insurance, health care and social security, compared to payments from local firms. A general manager in marketing and business development (Interviewee 6) of MNE2 claimed that:

> *There used to be absolute advantages in the remuneration of employees in foreign firms compared to local firms. Three decades ago, the salary package of a graduate working in a foreign firm in Shanghai was ten or twenty times more than his peers in*

a local firm. Although the allocation of university graduates was abolished later on, most people still wanted to get jobs in international joint ventures when they graduated. Now the difference is not as much as before, but the higher salary package offered by many foreign firms is still a major reason for people to seek jobs in a foreign firm. For entry-to-mid level staff, the package for working in a foreign firm is way better (than with a local firm).

Foreign firms were no doubt the most attractive option in the job market 20 years ago. Nowadays they are still the first or second option for graduates. Many graduates might prefer SOEs to foreign firms, but most graduates would not consider local private firms if they received the offer from a foreign firm, all other things being equal. A senior HR partner (Interviewee 9) of MNE2 commented:

Local employees are more willing to work in foreign firms because working in foreign firms stands for a successful career. This is a result of thirty years of higher payments offered by many foreign firms in Shanghai. Even nowadays, some local firms are able to provide higher salary packages than foreign firms; foreign firms seem to retain their attractiveness to the local job seekers. Many local employees gain a sense of accomplishment in working in foreign firms, to demonstrate that they are better than others.

In addition to high remuneration and a sense of accomplishment, the self-recognition of local employees has been another attractive aspect of working for a foreign firm, as a senior publication manager (Interviewee 23) noted:

Twenty to thirty years ago, working in a foreign firm represented a better or more decent job for local employees. Eight out of ten job seekers would prefer to work in a *foreign firm because it also represented being a part of an international company, which gave them more opportunities to advance their career. (Interviewee 31 echoed this)*

Moreover, local talented prospective employees believe that working in foreign firms gives a chance to obtain different experiences in their career. Even if it could be difficult to obtain promotion in foreign firms, they would have more opportunities when leaving a foreign company than when leaving a local firm. An operations director (Interviewee 16) of MNE3 stated:

> *Local talent are more willing to work here, as foreign firms like us may provide them with more advanced technical knowledge. They are driven by the perception that foreign firms represent a secure future and opportunities. As we are big firms, it can be hard to get promoted to the senior level, but we surely provide opportunities for them to develop their capabilities. Working in foreign firms enables local employees to have more diverse exit opportunities compared to working in local firms. Local staff with working experience in a foreign firm normally have more choices of positions, including overseas assignments, than other locals without this kind of experience.*

In addition to the beliefs about salary packages, accomplishment, recognition and career development, there has also been a perception that foreign firms have more transparent systems. An assistant HR manager (Interviewee 32) of MNE6 claimed that:

> *Foreign firms still attract more talent in the banking industry. It is a belief that foreign banks are more transparent while local banks are much more* guanxi *based. There is a common understanding that if you have strong* guanxi *with the regulators, go to work*

for local banks. Most local banks are state-owned and working in local banks you need to follow the local bank culture and practices such as relying on guanxi*, otherwise it is difficult for you to survive. I am just saying it is more transparent in our bank.*

This transparency may also be reflected in shared understandings of staff, who are aware of the purposes of their work and what to expect during their work. Case study MNEs were very clear about their missions and visions compared to local firms and leaders of case MNEs were more willing to share their objectives with staff. An executive assistant (Interviewee 12) of MNE3 stated:

In the past, local firms only had two objectives: learning from foreign firms and getting rid of them. However, talent still want to work in foreign firms even now because some local firms provide better salary packages. I believe foreign firms are more attractive to talent because they appreciate the corporate culture.

A vice president in the supply chain (Interviewee 20) of MNE4 supported this argument:

The corporate culture of our firm has also given us an advantage in attracting talent that appreciate the workplace atmosphere. Many local staff work here because they feel respected by their supervisors as the power distance between them and their supervisors is significantly lower than that in local firms. A good workplace atmosphere is also a kind of incentive to us. Our employee retention rate is also better than our local competitors. (Interviewee 21 echoed this)

In summary, the organisational attractiveness of case study MNEs has given them an institutional advantage in attracting local talented staff in terms of offering good salary packages and benefits, more opportunities in developing professional capabilities and career, more transparent systems and an attractive corporate culture.

7.4.3 Country-of-Origin (COO) Effect

The COO effect is another indicator for institutional advantages for foreign firms, especially those from developed countries. Like other indicators from the cultural-cognitive source, this effect brings advantages to foreign firms even before their market entry. Most case study MNEs enjoyed this institutional advantage because of their home country. For instance, a senior manager in finance (Interviewee 19) argued that:

> *The home country reputation has given our company some advantages. As a European MNE, the reliability of providing consistent services can be a big advantage. For instance, many local firms do not fulfil commitments as the market becomes bigger and price goes higher, but European MNEs will fulfil the current order with the original price even if they increase the price for next order. This is a common perception of how the local market thinks of our firm. (Interviewee 22 echoed this)*

If an MNE's home country is a developed country such as Germany, local stakeholders tend to believe its products are better than local competitors. Developed country MNEs appeared to be more popular to consumers. The COO effect tended to work on consumers rather than suppliers or other industrial players. A senior public relations manager (Interviewee 23) argued:

> *The perception of German brands and products has been accumulated over years in the Chinese market. It is a common belief that German-made products are good. Our business is very favoured by local institutional environments. Corporate capabilities*

in guaranteeing reputations and continuous technology development are certainly the main reasons that have led to our current position. As a German company, we benefit from the local belief that German products are better. In addition, local partners, government officials and consumers tend to trust us more because of this invisible effect.

The COO effect has resulted in a huge institutional advantage for case study MNEs from developed countries. Although local consumers no longer prefer all foreign products, they still appreciate the home country of products and firms in the B2C sector. A senior manager in business development and strategic marketing (Interviewee 27) of MNE5 observed that:

As a senior manager in local business development, I can assure you that the local market has a positive recognition of German products. Most consumers and business clients believe that German products have good reliability. It is an inherent advantage for the whole German manufactory industry, which brings the recognition of German brands.

In addition to the manufacturing sector, two senior managers (Interviewees 35 & 37) working in the financial service industry agreed with the perception of local consumers and claimed that:

In our industry, it is definitely the truth that our clients prefer foreign MNEs. They tend to believe a foreign bank from UK like us can provide a better guarantee in reputation. High net worth individuals in China (who have high value of wealth and are able to make a large amount of investments) *are very well informed and they know who did well in the past. It is a word-of-mouth business and your home country image in the host country can be critical.*

In brief, the COO effect has not only created institutional liabilities for case study MNEs but has also brought various institutional advantages for case MNEs. Local consumers and stakeholders no longer blindly prefer foreign products, but they still appreciate foreign products that are made by a developed country MNE. This has not been identified in the literature and is a reflection of the non-financial advantages enjoyed by foreign firms.

7.5 Conclusion

The research findings in this chapter have addressed the research questions regarding whether, why and how foreign firms can obtain institutional advantages. The empirical evidence clearly indicates that case study MNEs in China have enjoyed institutional advantages through different indicators that affect their *institution-induced foreignness*. MNEs experience institutional advantages in China in terms of regulative, normative and cognitive pillars through different mechanisms that generate institutional advantages. These mechanisms are summarised in Table 7.1.

Table 7.1: Indicators for Institutional Advantages

Institutional source	Regulative	Normative	Cultural-cognitive
Indicators	Taxation reductions and exemptions	Local industrial preference for foreign products	Belief and trust in foreigners
	Land concessions	Influence on local policies and industry standards	Organisational attractiveness
	Regional incentives	Being able to escape from local norms and practices	Country-of-origin effect

CHAPTER 8: ORGANISATIONAL STRATEGIES TOWARDS INSTITUTION-INDUCED FOREIGNNESS

8.1 Chapter Objectives

This chapter presents findings on case study MNEs' organisational strategies towards *institution-induced foreignness* in China. The field study provided a solid base for SQ 3 (i.e., *What organisational strategies should multinational enterprises adopt to manage foreignness? Why?)*. As discussed in Chapter 4, the intentions of MNEs in adopting organisational strategies could be classified as the reduction of institutional liabilities, the enhancement of institutional advantages and the transformation of liabilities into advantages. Therefore, the organisational strategies adopted by case study MNEs may range from *acquiescence* to *compromise*, *exploitation*, *avoidance* and *exploration*.

The following three sections will discuss how case study MNEs use organisational strategies to reduce institutional liabilities and increase institutional advantages in China in response to regulative, normative and cultural-cognitive sources of *institution-induced foreignness*.

8.2 Organisational Strategies Responding to the Regulative Source

8.2.1 Organisational Strategies in Response to the Regulative Institutional Liability

Case study MNEs have faced regulative institutional liabilities, including ownership restrictions, regulations on capital and business operations and an institutional void. The researcher has noted *acquiescence*, *avoidance* and *compromise* strategies to reduce such liabilities and also a strategy of *exploration* to transform liabilities into advantages.

Acquiescence

In order to reduce the regulative institutional liability, case study MNEs have undertaken several measures. The field study findings revealed that these MNEs tended to comply with local regulatory policies, rules and legislation without challenging their effectiveness. For example, some interviewees (Interviewee 2, Interviewee 16 and Interviewee 26) told the researcher that ownership restriction was still a large obstacle for case MNE1, MNE3 and MNE5. However, case study MNEs were required to cope with the ownership restriction, even though the liability of forming partnership with local firms outweighed any potential benefits. A law director (Interviewee 16) of MNE3 pointed out that:

> *We certainly want to wholly own our subsidiaries here (in China) rather than form joint ventures with local partners. The (local) government wanted us to train more local talent for our local partners, which were mostly SOEs. The initial consideration for the ownership restriction was to protect local firms, grow local talent/management staff and stimulate local developments. However, it makes much less sense these days. Three decades of joint ventures with local partners have grown many talent and our local competitors have learnt everything (such as management practices) from us. The benefit of forming joint ventures with local partners has also diminished over time for us and we still have to follow regulatory policies even though we do not want to keep these joint ventures.*

These findings fit the *acquiescence* strategy as noted in Section 4.3.2, which indicates that MNEs accept institutional demands without active measures to change/influence institutions. They have become accustomed to rules and norms and choose to follow and accept them. It was evident in the field study that MNEs choose to use compliance tactics by obeying local regulatory rules and accepting norms. Given that most case MNEs entered the Chinese market more than a decade ago, two other tactics — habit and imitation — were less evident in the findings.

In industries where ownership restrictions have diminished, most case study MNEs attempted to convert their joint ventures into wholly owned subsidiaries. However, MNE5 continued to build up new joint ventures with local partners to reduce the regulative institutional liability. Collaborations with local partners tend to reduce their potential regulative institutional liability. A chief law officer (Interviewee 41) stated this argument:

> *There are much less differences in terms of staff and technology between foreign and local firms in the local manufacturing sector, yet there are more restrictions for foreign firms. We (foreign firms) do not have much choice but to follow the rules set by local regulators to reduce liabilities (as foreign firms) as long as we want to stay in the local market, even we are getting fewer advantages in competing compared to a few years back.*

Avoidance

Building factories elsewhere was the fundamental response of case MNEs to freeing themselves from the restrictions in Shanghai as it became more expensive, restricted and unfavourable. Case study MNE5 was the first MNE studied that realised that conditions for plants had become unfavourable in Shanghai and hence collaborated with other provincial regulators to build plants and factories elsewhere. However, not all case study MNEs reacted to the circumstance in the same way. Some moved their plants to Bangladesh and Vietnam as a response. This response partly followed the *avoidance* strategy. Although case MNEs did not completely exit the host country, they used the tactic of escape to move their factories elsewhere. An operation director of MNE3 (Interviewee 16) noted:

We tried our best to localise ourselves. We hired local staff in our subsidiaries and reduced the number of expatriates. We set up local technology development centres and staff training centres. However, with the strong support of local government for SOEs, we can hardly compete with them now. Therefore, we moved some factories to other developing countries.

Compromise

With the intention of dealing with restrictions on capital operations of foreign firms, case study MNEs tend to compromise by reinvesting part of their profits into the domestic market. Due to the restrictions on exchanging amounts of CNY 5 million or more imposed in 2015, MNE4 subsequently had liquidation problems. Its strategies involved four steps. First, they exchanged foreign currency in their joint venture subsidiaries and asked the counterparts to carry out the task, as they would meet fewer obstacles from local regulators. Second, the amount of foreign exchange was limited to a much smaller value in order to speed up the transaction process. Third, their reinvestments became dominated by domestic business operations to reduce the possibility that foreign cash 'could flow in but could not flow out'. Fourth, case MNEs were able to export the products and finalise their business in overseas countries where liquidation risks could be reduced.

MNE7 and MNE8 faced a similar situation in capital restrictions. Two compliance managers (Interviewee 28 and Interviewee 49) shared a strategy with the researcher that many MNEs adopted in the financial service industry:

The Chinese financial service industry was announced 'opened' to foreign banks in 2007. However, we could not open more branches in more places due to many regulatory obstacles. Our strategy was to cautiously expand our footprints in China.

It took us five years to set up branches in the first province where we entered the market and another five years in Shanghai and other large cities (mainly the capital cities of coastal provinces). We tried to build trust within the local market. You may or may not know that back in 1997 when the local government took Hong Kong back under control, many foreign banks were terrified and exited Hong Kong. It made it harder for us (foreign banks) to rebuild belief and trust within the mainland market due to this history. It (i.e., the exit) was certainly difficult for us to recover our image and reputation. Therefore, even though we know that some regulations were not very reasonable, such as local regulators not allowing foreign banks to issue credit cards until 2017 because local banks were not capable of competing with us in 2007, we still obeyed those regulations and tried to impress local regulators and even helped some local banks to develop their credit cards.

A head of HR (Interviewee 43) provided another approach to the strategy above:

Our bank had a very simple strategy (to reduce the liability of foreignness). We hired local staff to create jobs and provided training for them to impress local regulators. We built and maintained a good guanxi *with local regulators; that was the main reason why we expanded faster than other foreign banks. We tried to build local legitimacy and made explicit localisation of staff to the market. Apart from the executives in the market, we wanted to demonstrate that everything was local to reduce our liability.*

These findings fit the *compromise* strategy and also reflect its tactics, as noted in Section 4.3.2. MNE7, MNE8 and other MNEs in the financial service industry tended to balance the local institutional demand and their own demand for expansion in the local market. They also tried to pursue pacification through increasing their local embeddedness by hiring local staff. Furthermore, these MNEs attempted to build local legitimacy through negotiating with local regulators.

Exploration

Many case study MNEs suffered an institutional void such as weak protection of IP rights and compromised with the situation. The first eight large case MNEs did not try to transform this liability into an advantage, perhaps because of their size and because it was too risky or not necessary for them to undertake this kind of strategy.

However, case study MNE22 and MNE23 both tried to make a leadership move to transform their liability in the institutional void to an advantage. They were two financial leasing firms, which were restricted to entering the local market as wholly owned subsidiaries. As the regulation was incomplete in terms of financial leasing, a local licence could not be obtained by foreign firms and was also very hard to obtain and maintain for local firms. The experienced case studies, MNE22 and MNE23, arrived and provided resources, protocols, staff and effectively everything needed to promote their service and existence in China. Meanwhile, they were able to share local resources by building a 'joint venture' (only to obtain a licence). This differed from the Sino-foreign joint ventures of a few decades ago in the nature of its business. Case MNE22 and MNE23 did not require many staff or factories, as the financial service could be provided by expatriates. They could keep a small number of expatriates and local staff to issue financial leases. The general manager (Interviewee 55) of MNE22 noted:

> *We noticed that the local financial leasing market was still in early development stages compared to the market in Australia. It was not a big market, however the need*

for financial leasing was urgent for local businesses. Apparently local firms had not fulfilled the demand in the local market. Therefore, we jumped in. The strategy was to build a joint venture with a local partner who had the licence and we were responsible for business operations including cash inflows and outflows. Since we were more experienced than local competitors, our strategy created an advantage for us in breaking into the market and we were able to take a critical share of the market.

This finding echoed the challenge tactic of the *exploration* strategy, which enabled MNEs to contest the validity of rules in obtaining the licence. The general manager (Interviewee 56) of MNE23 further emphasised the importance of *guanxi* in building the joint venture with the company's local partner:

It was critical to find the right person to introduce us to the local partner. We were lucky to build up some guanxi *with some Chinese firms in Australia and one of these firms introduced us to the Chinese market. As foreign firms were not allowed to obtain licences, only eight local firms gained the full licence. Later on, when we entered the market through the joint venture, a dozen joint ventures turned up. Our joint venture was not as restricted as the eight wholly local owned firms due to the fact that local regulators always wanted foreign investment to flow in the local market for their local businesses. The* guanxi *of our local partner was also strong otherwise it would be impossible to get the licence. As such, our strategy worked and we also benefited from the first mover advantage we created.*

In summary, fieldwork findings have demonstrated that MNEs have adopted acquiescence, compromise, avoidance and exploration strategies towards regulative institutional liabilities.

However, the *exploration* strategy adopted by MNE22 and MNE23 was not commonly adopted in other case study MNEs.

8.2.2 Organisational Strategies towards the Regulative Institutional Advantage

Case study MNEs have also obtained regulative institutional advantages in terms of tax reduction and exemptions, land concessions and regional incentives. The *exploitation* strategy was undertaken by case study MNEs to capitalise on their institutional advantages in China.

Exploitation

Case study MNEs adopted a very straightforward strategy to obtain the regulative *institutional advantage*, by moving their factories towards other regions that provided incentives. This strategy allowed the MNEs to gain benefits from regional institutions and even gave them the ability to affect regulators in other regions. However, it was impossible in Shanghai for MNEs to affect local policies and legislations, because the local regulator held a very dominant position and there were too many MNEs in Shanghai.

Case study MNE5 tried to build up new factories in other provinces, as some provinces other than coastal regions have much more desire to attract foreign firms. These provincial governments are also able to provide tax reductions and land concessions which are no longer provided in Shanghai. Although MNE5 could no longer maintain advantages in Shanghai, it could still benefit from its six factories in other provinces.

Case MNE2 even closed their factories in Shanghai in order to leverage the advantage provided by other provincial governments. It was not a requirement of the Shanghai regulator for MNE2 to close the factory, but it became costly for case MNE2 to maintain its factory there. Ever since the firm began to make a profit, the taxation had become unfavourable in Shanghai. Therefore, MNE2 undertook the strategy of maintaining its head office in Shanghai while looking for provinces and cities that could provide beneficial policies. In a sense, it leveraged regional benefits from other cities in China.

Case MNE3 also did something similar. Its original factory had operated in Shanghai for almost 30 years but no longer met the regulatory requirement, so it had been moved out of the city. Thus, the firm was going to build another new plant specifically for high-tech products to profit from the institutional advantage provided by the Shanghai government. In other words, case study MNEs had undertaken strategies to leverage *institutional advantage* from every possible regulator within the country. Even though they understood that these advantages would diminish over time, they made every attempt to obtain benefits while they could.

These empirical findings have demonstrated that case MNEs used the *exploitation* strategy (as noted in Section 4.3.2) to proactively leverage their roles as institutional actors to further influence the direction of institutional demands from host country institutions. However, the *exploitation* strategy was more evident in the actions of many case study MNEs in the period thirty years ago. MNE2, MNE3, MNE4 and MNE5 had adopted this strategy in response to institutional demands in Shanghai that prompted them to move their factories in order to exploit advantages in other regions. The rise of local firms allowed both local regulators and competitors to have greater bargaining power when regulating foreign firms. Meanwhile, many case MNEs did not maintain as strong an influence on the market as they had thirty years ago. In summary, fieldwork findings have demonstrated that MNEs have adopted an *exploitation* strategy towards changes in regulative institutional advantages.

8.3 Organisational Strategies Responding to the Normative Source

8.3.1 Organisational Strategies in Response to the Normative Institutional Liability

Case study MNEs have faced various normative institutional liabilities. Local firms enjoy more flexible rule compliance, while local governments prioritise support to local SOEs and transform local SOEs into leading actors in the local institutional environment. Furthermore, case study MNEs tend to lack local *guanxi* compared to local firms. Therefore, case study MNEs have adopted *compromise* and *avoidance* strategies to manage normative institutional liability.

Compromise

The most notable organisational strategy of case MNEs towards the lack of flexibility and consistency problems has been staff localisation in their domestic subsidiaries. Most case study MNEs localised staff up to the executive level. Case study MNE2 even appointed local employees as general managers in the Chinese subsidiary and only employed one parent country national as a compliance manager to ensure that the local subsidiary could meet compliance requirements. This move greatly improved the subsidiary's autonomy and provided a solid base for increasing the conformity of executives. Local employees were aware that they were able to obtain higher positions in a foreign firm, unlike three decades ago, when there was always a ceiling to restrict them from reaching the executive level. In this way, MNE2 has increased their local embeddedness to reduce normative institutional liabilities. The general manager in marketing and business development (Interviewee 6) of MNE2 commented that:

> *Our company has localised most staff in China. I was appointed three years ago as the general manager of the subsidiary. A few local colleagues were promoted to the*

executive position following my appointment. It was not possible to hire local executives a decade ago in our subsidiary, not to mention localising most executives. I believe the company attempts to use our local knowledge to improve our subsidiary's autonomy.

Other case study MNEs have localised their staff to differing degrees: MNE1 and MNE3 still maintain the staff structure wherein only parent country nationals are able to take executive positions; MNE4, MNE5, MNE6 and MNE8 had no limitations on host country nationals and third-country nationals. Remarkably, MNE7 has undertaken a strategy that provided programs for talented employees to work in other countries (not limited to the home country), so they were exposed to international experience. Then these skilled staff were re-assigned in China as middle managers and executives, given they had acquired international experience from other countries and they had fewer cultural barriers in China. A senior manager (Interviewee 37) shared some of her experience:

I was assigned to New York office for six years and then two years in Boston Office. Working in these places enabled my capabilities to deal with US clients. I am now fully responsible for all US related cases in our Shanghai Office. A few colleagues have experienced similar assignments in Canada, UK, Germany and Brazil.

Similarly, case study MNEs have used strategies to deal with over-reliance on the *guanxi* of local agents by developing their own local networks. Although the cost of business operations in the local market has risen steadily over the past three decades, case MNEs have had no choice but to build their own networks. For instance, MNE2 had to recruit even more local staff to expand its local networks as it wanted to reduce over-reliance on local agents. A sales director (Interviewee 10) noted:

> *We have realised that the over-reliance on* guanxi *of our distributors has constrained our capabilities in building our networks. We have let our agents and distributors know that we would like to be directly exposed to the market. In a way, we still use their networks. However, we have expanded direct sales from us and built our own sales centres in most cities around China.*

Avoidance

Unlike the situation of three decades ago in regard to normative institutional liabilities where case study MNEs might have been able to proactively pursue strategies, it has become inevitable that local firms will receive greater support from local regulators and SOEs will stay in leading positions in the local market. Only two kinds of responses were found in the case studies to this situation: they compromised with local competitors or exited the local market. Most case MNEs compromised; only a small number of MNEs moved their factory to another country; some MNEs took their business to overseas markets; only MNE21 exited the market. The company adopted the *avoidance* strategy to escape from this host country. The executive manager (Interviewee 54) of MNE21 argued that:

> *Local regulators' strong support for local SOEs made it impossible for us to make a profit. Being a foreign firm in China no longer provides us with any advantages. It was a tough decision to make, but we had to exit the market.*

Fulfilling institutional demands of both home and host country can be very challenging. The no-gift policy was used quite often by case MNEs to escape local potential bribery and other immoral practices; however, the cost was sacrificing the development of local *guanxi.* Many case MNEs tend to use the *avoidance* strategy to prevent potential risks. They tend to partner with local firms to implicitly diminish their foreign identities so as to reduce normative institutional liabilities. A managing director (Interviewee 44) of MNE12 claimed that:

> *We continued to partner with local firms while taking business deals from local firms. We do not want to label us as a foreign firm. Therefore, we often ask our local business partners to deal with local firms and allow them to share some revenues out of it.*

In summary, the field study has demonstrated that case study MNEs adopted *compromise* and *avoidance* strategies in reducing normative institutional liabilities.

8.3.2 Organisational Strategies towards the Normative Institutional Advantage

Case study MNEs have obtained normative institutional advantages in local industrial preferences and their influence on local policies and industry standards. They are also able to escape from local dominant norms and immoral business practices. The *exploitation* and *compromise* strategies were used by case study MNEs to extend their normative institutional advantages.

Exploitation

MNEs have made efforts to maintain their normative *institutional advantage.* For example, case MNEs in the local machinery industry previously influenced local regulators to set industrial standards. This was because case MNEs were stronger in bargaining power than local competitors and sometimes they have been the only firms who could produce certain machines. This has brought case MNEs huge institutional advantages in the industry.

Most foreign firms targeted the high-end market after their entry into China. Although things have changed over three decades, due to the fact that local product quality has improved significantly, most foreign firms which have survived in the Chinese market have maintained high-end market positions. A strategic financial manager (Interviewee 15) of case MNE3 claimed that:

> *Foreign manufacturing firms normally aim at high-end markets and try to gain higher price premiums. Although foreign firms seem to have higher costs, the higher price of their products allows them to offset those costs. There is a consensus in this industry that foreign firms have better quality control and technological support. As such, a higher price premium seems to be reasonable for the market.*

The consistent innovations of foreign firms help them keep a high-quality product standard and a high price premium. Some case study MNEs were able to influence local industrial standards and also technology development. These MNEs enjoyed huge benefits (i.e., institutional advantages) when entering the local market. A senior financial manager (Interviewee 45) claimed that:

> *We had much fewer liabilities thirty years ago. However, we experienced huge advantages in setting up the Chinese subsidiary and entering the Chinese market back then. Although we were in the manufacturing sector, we were a high-tech enterprise that only focused on high-tech products and research and development. Therefore, we did not experience many restrictions like other foreign firms. As a matter of fact, we were able to ask for more incentives from the local government back then. We helped set up the manufacturing standard of the local industry. In addition, the company built quite a few talent development centres which trained 20 to 30 percent of local executives in today's local market. I know it is hard to imagine, right? Our strategy*

was to influence local stakeholders to not only benefit the company but also the local market.

This confirmed the proposition of Sethi and Judge (2009) that MNEs may be able to change institutions. Some case study MNEs strive to produce premium products and build up price premiums to keep local competitors away. For instance, MNE2 and MNE4, as leaders in both their heavy machinery sectors, only do business with large enterprises and provide extremely strong after-sales services. They tend to ignore small business orders and keep their products at a high price premium. In a way, they have successfully built barriers to local competitors through this patterned practice. The local market has acknowledged that MNE2 and MNE4 only provide high-end products. A vice-president in the supply chain (Interviewee 20) of MNE4 claimed that:

> *We have a well-known procedure to examine product quality. Not only are our buyers aware of that, our local suppliers know even better than our buyers. We've returned a tremendous amount of lower quality components parts to our local suppliers because they did not meet the assembly standard.*

Nowadays, with the rise of local competitors, MNEs no longer have such a strong influence on industrial standards. To maintain their advantage, MNE5 has used responses such as only suggesting the acceptable upper limit of any industrial standard without giving any suggestions/barriers to the lower limit. A head of engineering (Interviewee 26) stated that:

> *We do not want to fully demonstrate our influence and strong bargaining power in the local market even though we are global leaders. Setting barriers to the lower limit of industrial standards can harm our local* guanxi *if local competitors cannot meet those limits.*

This strategy was to keep the products of MNE5 within the standard without costing too much to adjust or lower its product standard to meet local needs. Although it had even better products, they would not be released in the market until the local competitors can meet the lower limit of the standard. In addition, MNE5 did not put barriers up for local competitors (in the lower limit), so local competitors could still produce local products to stay in the industry. Furthermore, this strategy was compatible with the local regulators' purposes – to grow local firms in the industry. As such, case MNE5 successfully reinforced their products as high-end premium products.

Case study MNEs also attempted to offer better staff development programs for employees to maintain their normative institutional advantages. This enhanced a positive perception of employees in case study MNEs. A senior financial planner (Interviewee 13) of MNE3 claimed that:

> *I believe the talent development program is much better in foreign firms than in local firms. Local firms may provide better flexibility for employees, but they only need you to get things done, not develop your own capabilities. I am not saying foreign standards are better, but in a way, the global standard provides better training to talent. This is a continuing strategy that our firm has adopted to attract talent.*

Foreign firms transferred many patterned risk prevention management practices between home country to host country. They tried to meet compliance requirements of both. Risk management has been much more heavily emphasised in foreign firms than in local firms. An HR business partner (Interviewee 9) of MNE2 claimed that:

> *The management practices of foreign firms are still more sound and robust. This is an*

advantage that local firms can hardly compete with. Local private firms would do anything for growth and are sometimes not fully compliant with local rules and regulations, while we maintain reasonable operation plans, transparent financial statements and restricted compliance requirements.

Furthermore, strict compliance with regulations and rules is critical for foreign firms to build up trust with local regulators and other business partners. A senior manager (Interviewee 33) of MNE7 claimed that:

> *From my point of view, it is an advantage for us to keep more strict requirements for compliance. The track record of long-term good tax payment compliance makes foreign firms more reliable to both local firms and governments. Those non-durable, low-technological advantages of SOEs would diminish over time. Unless the economy goes into downturn or recession, the control and supervision of both local and foreign firms would be increasingly harder. Those so-called 'grey areas' would be additional costs in the future. Our compliance requirements may cause us some additional costs as liabilities, but also some advantages. For instance, we have very low political risks, as bribery is prevented. (Interviewee 14 echoed this)*

A senior manager in business development and strategic marketing (Interviewee 27) of MNE5 supported this argument:

> *A systematic and healthy corporate governance gives the employee autonomy, because staff are aware of their duties and responsibilities, rewards and consequences. From a firm level, European firms often focus on the benefits in the long term. Compared to local firms that focus on short-term benefits, the credibility and reliability of European firms are much better in our industry. Therefore, we*

transferred our corporate governance structure to the local market to maintain our high credibility and reliability.

Compromise

Case study MNEs in the financial service industry tended to adopt a *compromise* strategy towards normative institutional advantages. For instance, foreign banks made many attempts to expand their business operations, although these MNEs were not entitled to large institutional advantages in the local market given the various restrictions imposed on them. These MNEs aim to bargain with other industrial players. They eventually found their position as the bridge for local firms to expand overseas. A chief digital executive in the retail banking sector (Interviewee31) from MNE6 argued that:

> *Foreign banks have overcome liabilities through providing high quality service at a more reasonable price. We try to take advantage of how local business partners perceive us. Yes, we still have to follow local* guanxi*, but it does not mean we cannot expand our offshore business in the local market.*

Compared to local firms, conducting business across national borders allows foreign firms to maintain a wider overseas network. Most local firms have only begun their internationalisation since 2008 or later. In contrast, case study MNEs were quite competitive in their overseas business networks. A vice-president in commodities and structured trade finance (Interviewee 30) of MNE6 told the researcher that:

> *Foreign banks have absolute advantages in international networks compared to Chinese banks. Foreign banks have created huge advantages since the People's Bank of China tried to internationalise local currency — Chinese Yuan. Local banks only have networks in Hong Kong and small overseas branches such as Bank of China in*

many developed countries while we (foreign banks) have way bigger and more stable network across borders. We helped local firms initial their entry into many other countries, it was a win-win situation.

An assistant corporate sustainability manager (Interviewee 29) supported the colleague above and argued that:

> *Local clients with needs in offshore business would come to foreign banks rather than local banks. They basically put in trust on overseas channels and connections of foreign banks. We capitalised the overseas network to build up* guanxi *with local firms, which helped our expansion back in the Chinese local market. The ultimate goal was to reduce the liability in local* guanxi *and transfer our advantage back into the local market.*

It was very clear that case study MNEs tried to attract local clients to work in offshore businesses. A senior manager (Interviewee 33) of MNE7 argued:

> *In professional service areas of financial industries such as taxation, wealth or asset management and insurance, foreign firms actually hold a complete advantage over local firms. There was an old saying: 'in a joint venture in China, listen to the local part if it is in the manufacturing sector, listen to the foreign part if it is a service industry'. I do not totally agree with the former part, but I do agree with the latter part. Most foreign hotels are doing great in China because their executive team and management practices are supported by their home country headquarters. The local financial service industry is young and gradually opening to the global market. It is highly regulated and local firms are still learning. In other words, foreign firms are much more competitive compared to local ones. For our firm, the strategic focus has*

> *always been offshore business. We want to demonstrate our expertise in this area to our local clients and also build* guanxi *with them.*

In summary, the field study has demonstrated that case MNEs adopted *exploitation* and *compromise* strategies to increase their normative institutional advantages.

8.4 Organisational Strategies Responding to the Cultural-Cognitive Source

8.4.1 Organisational Strategies in Response to the Cultural-Cognitive Institutional Liability

The cultural-cognitive institutional liabilities are subtle and more implicit than others. The existence of nationalism, xenophobia and other misconceptions and stereotypes have had negative effects on the perceptions of local stakeholders about foreign firms. Moreover, the COO effect has had a negative spillover on some case study MNEs. Therefore, case study MNEs have adopted *avoidance* and *compromise* strategies to manage the cultural-cognitive institutional liability.

Avoidance

Compared to adopting organisational strategies to shape patterned behaviours of industrial partners, it has been much harder to change the common perceptions of local stakeholders. When a political issue like THAAD developed, for instance, nationalism was potentially harmful to case study MNE1, which had no choice but to pause its business for a few months, which imposed a very significant financial cost on the organisation. Concerns have arisen for case study MNEs about political risks within the host country because local stakeholders could be sensitive to political issues, leading to changes in institutions. A senior manager (Interviewee 3) of MNE1 commented that:

We did not have any other choice than to be honest. We kept a low profile at the time and also paused many business operations and marketing activities. We did not even participate in a product exhibition roadshow in China.

Compromise

In addition, the COO effect played a critical role that led MNE1 to compromise. German MNEs have been in an advantageous position in the Chinese auto industry for years, but MNE1, a Korean company, needed to cut its price premium when it confronted MNE5, a German company selling auto parts. Even though the THAAD issue had much less influence on B2B business, the same effect caused MNE1 to once again cut the price premium of its products. Case study MNEs tend to face a similar situation regarding the misconceptions and stereotypes of local stakeholders. To reduce cultural-cognitive liabilities, case study MNEs have tended to increase their local embeddedness. For instance, a regional executive (Interviewee 48) of MNE15 told the researcher:

If the home country of your firm does not have a more developed economy, you have to do a lot to change the way local stakeholders perceive your firm. Increasing local presence is just a starting point. We worked with local universities and ran campus recruiting. We formed joint ventures even though we did not have to. We tried to follow local rules and build up local guanxi. *Every attempt was to build the trust and belief of our stakeholders.*

In summary, the field study has demonstrated that case MNEs adopted *avoidance* and *compromise* strategies in reducing cultural-cognitive institutional liabilities.

8.4.2 Organisational Strategies towards the Cultural-Cognitive Institutional Advantage

Cultural-cognitive institutional advantages have been identified within the perceptions and beliefs of local stakeholders towards foreign firms. Case study MNEs have gained advantages in terms of the belief and trust of local stakeholders and through their organisational attractiveness to potential employees. The COO effect has also had a positive spillover effect on developed country MNEs. The *exploitation* and *compromise* strategies were adopted by case study MNEs to expand their influence in affecting the perceptions of local stakeholders.

Exploitation

Case study MNEs have tried to expand their influence to exploit their cultural-cognitive *institutional advantage*. They aim to maintain their reputational management practices to strengthen the perception that foreign firms are better. They previously provided higher remuneration and more career development opportunities for employees. In recent years, case study MNEs have focused more on emphasising that their corporate culture and corporate social responsibility are better than those of local competitors. An executive director of MNE5 emphasised that:

> *There is a part of our advantage that builds upon the belief and trust of local stakeholders in German products. We want to keep and enhance that perception. Our efforts in forming joint ventures across various regions also helped us enhance that perception of every stakeholder in other regions.*

Maintaining a good reputation is critical for the success of foreign firms. Unlike local firms with various local connections or even support from the government, a bad reputation would ‘kill’ a foreign firm’s local business development. Case study MNEs have focused on keeping an above-average reputation in the local market. A vice-president (Interviewee 38) of MNE8 argued that:

> *We have our reputations worldwide in the wealth management area. If we are not able to keep a good reputation, nobody would bring business back to us. Our clients come to us mainly because they believe we are better at overseas investments compared to local firms. In addition, it is not only about the performance, but also the security of money. (Interviewees 39 & 40 echoed this)*

For instance, two decades ago MNE1 paid salaries to employees at manager and executive levels ten to twenty times higher than salaries paid by local competitors to staff at comparable levels. Nowadays, salary packages at executive level may not exhibit such a significant difference. MNE1 is keen to provide entry-to-mid level staff with better salary packages (one to two times greater). As local firms grow much faster now than three decades ago in the Chinese market, the efforts made by case MNEs in attracting talented staff no longer stop at remuneration. MNE3, MNE4 and MNE5 have tried to provide more career paths for employees. MNEs have been able to attract a greater number of talented staff when employees have had better exit opportunities when they have left these MNEs. An operations director (Interviewee16) claimed that:

> *Our firm wants to illustrate the diversified career opportunities to our employees and that they could enjoy more choices once joining us. We would like to develop their capabilities and design a career path that best fits them.*

Case study MNEs have also obtained advantages from their corporate culture. The findings support the argument that MNEs may escape from local dominant norms (Mallon & Fainshmidt, 2017). When corporate culture demonstrates the norms and values of a firm, staff are aware of the nature and purpose of the organisation they are working for. Case study MNEs are often very clear about their missions and visions. Compared to local firms, leaders in case study MNEs have been more willing to share their objectives with staff. The corporate culture of case MNEs has provided an alternative option for employees who do not find local dominant norms and business practices agreeable. A senior partner (Interviewee 34) asserted that:

> *We only recruit people who value our corporate culture. This shared value could help us shape the perception of employees about our firm.*

8.5 Conclusion

This chapter has sought to empirically demonstrate how case study MNEs have selected and adopted relevant organisational strategies to deal with institutional liabilities and advantages. The field study findings revealed various organisational strategies adopted by case MNEs towards regulative, normative and cognitive sources of institutional advantages and liabilities. These strategies have also demonstrated several patterns based on the extent of institutional liabilities and advantages faced by case MNEs. In particular, the field study found evidence to support the strategies identified in Chapter 4. Various strategies employed by case MNEs have clearly indicated the ability of MNEs to learn through their experience and then adapt themselves to fulfil institutional demands from local institutions. They have not only complied with the local rules but also tried to influence the local institutions to increase their advantages in doing business locally and overseas.

CHAPTER 9: DISCUSSION AND CONCLUSION

9.1 Chapter Objectives

This chapter achieves three objectives as follows. First, the empirical research findings are discussed in relation to the research questions. Secondly, the implications of the study for researchers, MNEs, governments and industrial associations are considered. Thirdly, the contributions are identified and implications for research, policy and practice are highlighted; the limitations of the thesis are identified and future research directions are suggested.

9.2 Discussion Corresponding to Research Questions

The overall RQ of this study is to identify *how MNEs manage foreignness in host countries*. To address this inquiry, the thesis has examined the following three SQs:

SQ 1: What does it mean for MNEs to be foreign in host countries?

SQ 2: How and when does foreignness generate liabilities or advantages?

SQ 3: What organisational strategies should multinational enterprises adopt to manage foreignness? Why?

9.2.1 What Does It Mean for MNEs to Be Foreign in Host Countries?

Going beyond the parameters of previous research, the thesis sets out a theoretical basis for the study of *institution-induced foreignness* and explores the role of foreignness in shaping the relationship between local regulators, competitors, stakeholders and MNEs. Differing from other studies on foreignness, this thesis examines *institution-induced foreignness* not only in terms of regulatory rules and policies, but also in regard to norms, values, perceptions and patterned management practices. This is achieved through in-depth analysis of regulative, normative and cognitive sources of *institutional liability* and *institutional advantage*. The notions of *institution-induced foreignness*, *institutional liability* and *institutional advantage* are used to answer SQ 1. This study thus advances our understanding of institutional liabilities and advantages and the ways that local institutions affect MNEs.

9.2.2 How and When Does Foreignness Generate Liabilities or Advantages?

Through the institutional analysis, indicators are explored in terms of the sources of institutional liabilities and advantages in Chapter 6 and Chapter 7 respectively. The qualitative data collected from 56 interviews in 23 case study MNEs provide rich empirical information to address SQ 2.

Case study MNEs have experienced *institutional liability* in the dimensions of industry, home country and capabilities, to different extents according to their circumstances. A most influential indicator is the restriction of ownership of FDIs in China, which confines MNEs' access to the local market, limits full control over local subsidiaries and joint ventures and restricts their opportunities to expand. Another indicator is the regulation of capital operation of MNEs by both their home and host countries. This limits the financial capabilities of MNEs, especially their cash flow. In addition, the regulation of business operations means that MNEs are disadvantaged by local governments limiting their support compared to that given to local firms. MNEs have faced tougher environmental regulations and been forced to relocate factories to other places, while local firms have been under much weaker supervision from local regulators. Moreover, MNEs have experienced an institutional void due to limited protection of intellectual property rights in the Chinese market.

In addition to the regulative source of *institutional liability*, there are some normative indicators as well. For example, local competitors have flexibility in their compliance with local regulations while MNEs do not. This is reinforced by hierarchical support from local government, which prioritises local SOEs. Furthermore, MNEs have lost their leading position in the local market, while local SOEs are becoming leading actors in the local institutional environment due to the support they receive from local regulators. Another critical indicator is *guanxi*; MNEs tend to lack the support of this network of interpersonal relationships when doing business in China and with Chinese firms.

The indicators of the cultural-cognitive source are essentially the perceptions and beliefs of local stakeholders. Some local stakeholders, influenced by nationalism, hold a preference for local firms, products and services over foreign ones. This perception may extend to the belief that buying foreign products is not patriotic. Another indicator is the perception of local stakeholders about the COO of foreign firms or products. This may be expressed as xenophobia — local consumers should boycott foreign firms; or ethnocentrism — local products are superior. In the long term, these perceptions of the local stakeholders may evolve as misconceptions and stereotypes held towards foreign firms and can be hard to shift. Collectively, they are a further source of the *institutional liability* suffered by MNEs in the local market.

Case study MNEs have also enjoyed *institutional advantage* in China. Tax reduction and exemption are strong incentives provided to MNEs by local government regulations. These incentives have enabled MNEs to obtain an institutional advantage by reducing costs and gaining greater profit. MNEs may also be able to improve their efficiency through land concessions which reduce the costs of market entry. Moreover, some less developed regions are able to provide more incentives to attract FDI, which enables MNEs to gain advantages by operating their business in those regions.

The normative indicators of *institutional advantage* for the case study MNEs are found in the patterned norms of local business. The local industrial players prefer foreign products, which leads to a higher price premium and creates an institutional advantage for MNEs. Local suppliers and buyers appreciate foreign products and this enables the firms to price them at levels higher than local goods. Furthermore, MNEs with a strong influence on local policies and industrial standards have both explicitly and implicitly generated institutional advantages for themselves. As MNEs have established their own pattern of business activities from their home country, they may choose to keep to it to escape from local dominant norms and prevent potential risks such as bribery or other immoral business practices.

Case study MNEs have gained a strong *institutional advantage* from the cultural-cognitive source. The belief in the Chinese market that everything foreign is better has created an invisible advantage to MNEs. It implicitly affects the decision-making process of local stakeholders when comparing foreign firms, products, practices and technologies to local ones. The local market has put trust in MNEs and their products and standards. Moreover, MNEs tend to be more attractive to local talented employees in terms of remuneration, career development opportunities, transparent systems and corporate culture. The COO effect creates a further institutional advantage for MNEs. Local stakeholders hold a stereotypical understanding that a developed country as home country gives developed country MNEs high standards in products and services.

In summary, the empirical findings in Chapters 6 and 7 have explained how and when foreignness generates liabilities and advantages for case study MNEs.

9.2.3 What Organisational Strategies Should Multinational Enterprises Adopt to Manage Foreignness? Why?

SQ 3 was answered in Chapter 8 by the empirical findings regarding the organisational strategies adopted by case study MNEs. As discussed, many case study MNEs deploy different strategies over time, according to the extent of institutional liabilities they suffer and institutional advantages they obtain. The organisational strategies are categorised in terms of the sources of advantages and liabilities. In confronting the regulative source of *institution-induced foreignness*, case study MNEs tend to use *acquiescence*, *avoidance* and *compromise* strategies to reduce liabilities; they transform liabilities into advantages through an *exploration* strategy and adopt an *exploitative* strategy to increase advantages. Case study MNEs tend to use *avoidant* and *compromise* strategies for liabilities and *exploitative* strategies to maximise the advantages of normative and cultural-cognitive sources. Further, a *compromise* strategy is used by case study MNEs to increase the cultural-cognitive source of advantages.

9.3 Contributions and Implications

9.3.1 Contributions and Implications for Research

This thesis theoretically and practically contributes to the literature in several ways. First, it conceptualises the foreignness of MNEs in a new way by providing a unique investigation of MNEs' experience of institutional liabilities and advantages in host countries. By focusing on *institution-induced foreignness*, the thesis has addressed three gaps in the existing literature: absence of a unified framework of what foreignness means to MNEs; a lack of studies on how foreignness generates liabilities and advantages for MNEs; and an absence of empirical research on how MNEs manage foreignness in the host country.

The thesis identifies and analyses the concept of *institution-induced foreignness*, which has not previously been examined systematically from an institutional perspective (answering the first gap). This study has theoretical importance and practical relevance in IB research. The identification and in-depth analysis of *institution-induced foreignness* can advance our knowledge of the foreignness experience of MNEs and deepen our understanding of the business operations of MNEs in host countries. Therefore, this conceptual development makes it possible for researchers to treat *institutional liability* and *institutional advantage* as variables and examine the relationships between MNEs, home and host institutional environments, managerial practices, organisational strategies and organisational legitimacy. Further, the application by the thesis of Scott's integrated model of institutions contributes to the literature of neoinstitutionalism and institutional analysis.

The second key theoretical contribution of the thesis is that it integrates several disciplinary areas — neoinstitutionalism, international business and strategic management — in one study. In doing so it combines both the process and variance approaches in a single study and avoids the tendency to treat the institutional environment as one variable without regard to its three pillars, the regulative, normative and cultural-cognitive forces. *Institution-induced foreignness* is examined in this thesis from the perspective of these pillars. This analysis further confirms the applicability of institutional theory in international business management research (DiMaggio & Powell, 1991). As such, it advances the application of the cultural-cognitive pillar into IB institutional analysis; the IB literature has tended to overlook the cultural-cognitive dimension; for example, Wu and Salomon (2017); Xu, Pan and Beamish (2004).

The third theoretical contribution of this thesis is that it adds to the limited research on the organisational responses of MNEs to host country institutions. Henisz and Swarninathan (2008) claim that little is known about how MNEs respond to the institutions of a host country, how their responses differ from domestic firms and what factors influence MNEs' strategies towards specific institutional characteristics. There are few studies on the relationship between the institutional characteristics and organisational behaviour of MNEs. Therefore, this thesis empirically enriches our understanding of institutional theory in IB studies by providing data that indicates that *institution-induced foreignness* can be managed. It highlights the organisational strategies of MNEs in response to institutional liabilities and advantages, which contributes to studies of the intersection of institutions and international business (Henisz & Swarninathan, 2008). The effects of MNEs' responses to these liabilities and advantages appear in subtle and implicit ways, such as transferring managerial practices, replicating home practices and/or even escaping from the home country institutions. This finding significantly highlights the need for more empirical data to examine the effectiveness of strategies to manage foreignness.

This thesis sheds light on how MNEs tend to proactively manage *institution-induced foreignness* to achieve a better outcome. The findings respond to the suggestion of Henisz and Swarninathan (2008, p. 539) that "firms' responses to (unexpected) variation in the institutional environment of an investment capture a significant share of senior managers' time and are a key determinant of success and failure". The findings demonstrate that MNEs' responses are subject to their experiences in both home and host country institutional environments. This correlates with the suggestion of Henisz and Swarninathan (2008, p. 539) that:

firms' responses and their performance implications to a given institutional construct will vary according to multiple criteria including aspects of a firm's prior experience in its home country institutional environment as well as those of other countries in which it has operated.

The thesis thus contributes to closing the gap in the literature on how MNEs proactively respond to local institutions.

Information on the institutional advantages of foreignness is particularly lacking in the existing literature. The rich empirical data presented in Chapters 6 and 7 provide valuable information as to MNEs' views about institutional liabilities and advantages they have experienced. The empirical evidence about institutional advantages presented in this study may therefore serve as a basis for future studies which aim to respond to the call for a positive scholarship of foreignness studies in the IB research field (Stahl et al., 2016).

This thesis advances understanding of the advantages of foreignness (AOF). The customary research focus on LOF in IB does not mean that AOF is not available to MNEs in host countries. It is evident that foreignness deserves increased attention from scholars who are interested in AOF. The study demonstrates that AOF is not limited to firm-specific advantages, but can also be gained from the institutional environments of MNEs' home and host countries. More importantly, this thesis has broadened the understanding of the AOF concept by emphasising the potential *institutional advantage* of being foreign in host countries and empirically demonstrating the link between the *institution-induced advantage of foreignness* and organisational strategies. The empirical evidence indicates that developed country MNEs may enjoy inherent institutional advantages in China through having a developed home country, in addition to responding to conditions in the host country by taking strategic actions to create an institutional advantage (Regnér & Edman, 2014). Future studies should pay greater attention to detecting the links between the observed behaviour of MNEs and the host country institutions.

Foreignness is also influenced by a series of factors that impact at national, industry and firm levels in addition to institutional factors. Amongst these factors, this study finds that the effect of foreignness not only evolves over time in the host country but also varies at different stages of local economic development. For instance, many case study MNEs that largely benefited from incentives three decades ago in the manufacturing sector no longer enjoyed these incentives at the time of the study. This finding indicates that it is advisable for future studies to attempt a longitudinal research design. A longitudinal research design will enrich understanding of the dynamics of foreignness by examining the effectiveness of management practices during the development of the host country economy. Research findings that investigate how case study MNEs undertake strategies and implement their planned responses to host county institutions would potentially generate rich context-specific analyses. Such an analysis is greatly needed in studies on institutions and international business (Henisz & Swarninathan, 2008; Jackson & Deeg, 2008).

This study finds that foreignness also works through the mindset of host country stakeholders in terms of their biased perception, which can lead either to an ignorant belief that developed country MNEs are better than local firms, or to nationalistic support for local firms regardless of the quality and price of their products. This finding underscores the necessity for the conceptualisation of foreignness to go beyond the conventional focus on observable liabilities by paying attention to normative and cultural-cognitive sources. It is important for future research to explore the foreignness of MNEs in terms of the perceptive cognitions of stakeholders and their influence on organisational outcomes.

9.3.2 Implications for Governments and Policy-makers

The findings of this study have several implications for host country governments and policy-makers. First, the local regulator can adjust its policies to influence foreign MNEs. This study demonstrates that the local government tends to develop the industries it most desires and hence provides incentives to attract MNEs. In such a case, institutional advantage is more evident to MNEs than institutional liability. Eventually, institutional liability becomes more apparent when the local regulator moves attention to other industries and the initial institutional advantage diminishes over time. This process becomes apparent when local regulators try to attract foreign investment; however it did not necessarily apply to every MNE in this study. Regulators may have different incentives in different situations and are often heavily influenced by the central government development strategies, such as an emphasis on economic development at one stage and then on environmental protection at a later stage.

Secondly, home country institutions may obstruct or intervene in MNEs' behaviour in host countries. This study demonstrates that home country institutions, such as regulators, industrial associations and unions, may have a strong influence on the business operations of MNEs in host countries. Therefore, the local institutional actors may need to consider the responses and practices of home country institutional actors when attracting MNEs from other countries.

9.3.3 Implications for MNEs

The findings of this study have important implications for MNEs. MNEs operating in host countries should be aware that home country management practices need to provide reliable, well-researched guides to managing foreignness in the situations that may arise in the host country. In addition, MNEs need to be well informed about host country institutions, since they can greatly affect business performance. Thus, MNEs should thoroughly investigate host country institutions when entering the market, not just be attracted by the incentives provided by local regulators.

China as a host country has undergone marked changes in the institutional environment over the past three decades; this may either cause more problems or give more advantages to foreign firms. MNE needs to be well informed about the current political and economic conditions of the host country. The empirical evidence indicates that foreign firms do better if they keep their well-developed managerial practices when operating overseas to prevent potential risks.

It is important for MNEs to deal with institutional exceptions such as institutional void. That is, they should anticipate that, when making sense of and responding to foreignness issues in host countries, their past experiences, assumptions and normative practices may be invalid or may even be an obstacle. In addition, while MNEs need to adapt to local institutions (Orr & Scott, 2008), they need to consider how they can reduce institutional liability while not losing the possibility of gaining institutional advantages. MNEs may offset institutional liability by relying on local staff, forming a joint venture with a local partner, or even replicating the practices of successful firms operating in the same host country.

Apart from the contributions discussed, this study is significant to EMNEs, whose movements are affected by rapidly increased levels of foreign investment from emerging economies, the distance between the institutional environment at home and abroad, the effects of being a late comer and developed country MNEs' first mover advantages. The study has useful findings from which EMNEs may adopt organisational strategies to respond to host country institutional environments.

9.4 Limitations of the Research and Suggestions for Future Research

Although this study makes significant contributions to our understanding of MNEs managing foreignness in host countries, the research has several limitations that indicate areas for future study. First, this is not a longitudinal study. A more ideal situation would be a longitudinal design that allows the researcher to interview expatriate managers who worked in the same overseas subsidiary at different time periods, in order to track the changes in host country institutions and MNEs' responses to host country institutions. As the foreignness experienced by MNEs may change over time, organisational strategies of the same MNEs during different time periods could be usefully compared.

The second limitation relates to the case selection. Due to data access, most case study MNEs were from developed countries except for one MNE from South Korea. Therefore, the case selection failed to recruit a number of EMNEs operating in these industries to pair up developed country MNEs and EMNEs so as to compare them in terms of foreignness and their corresponding strategies. These limitations restrict the comprehensiveness and depth of the analysis of factors influencing institution-induced foreignness. Developed country MNEs are normally believed to have more resources to manage LOF and obtain AOF than EMNEs.

Therefore, an area for future study may be to compare EMNEs with developed country MNEs under the same circumstances.

Future research may also choose a number of MNEs from different home countries in the same industry within the same host country. This would allow a more effective comparison of identified institutional advantages and liabilities by excluding the COO effect. Another suggestion is that future research can adopt a survey-based quantitative research design or a mixed methods approach, conducting surveys on a larger number of MNEs with diversified organisational characteristics to test hypotheses. Moreover, a quantitative research design could consolidate some findings of this study and enhance the generalisability of research findings.

Due to the time limit and budgetary constraints on this doctoral research project, the views of host country government officials were not collected. However, local regulators have significant influence on the institution-induced foreignness experienced by MNEs. Future research should interview local regulators to understand their views and attitudes towards foreign MNEs.

This study did not examine the relationships between different liabilities such as how liabilities of origin, multinationality, emergingness and outsidership related to each other. Future studies can explore the differences, so as to obtain a better understanding of the sources and mechanisms of these liabilities and organisational strategies to deal with them.

Finally, this study identifies some under-investigated research areas and topics. These include, but are not limited to, institution-induced foreignness, institutional liability, institutional advantage; organisational strategies of MNEs to manage institution-induced foreignness; and MNEs' ability to influence host country institutions. Therefore, future studies may find it worthwhile to further explore institution-induced foreignness and MNEs' strategies and practices.

9.5 Conclusion

This final chapter has discussed the empirical findings in relation to the research questions and their implications for the conceptual framework proposed in early chapters. The study has aimed to clarify how MNEs can manage their foreignness in host countries; in Chapters 6 and 7, analysis of the data revealed that institutional advantages and liabilities may be generated through different regulatory policies, rules and laws, *guanxi* in local business networks and the belief and trust of local stakeholders. In Chapter 8, the findings of the research suggested that *institution-induced foreignness* can be managed through various organisational strategies.

This study has implications for researchers, policy-makers and MNEs. It has contributed to the literature and development of theory in the field and identified limitations of the study and areas for future research. The suggestions proposed for MNEs in this study are valuable for MNEs which lack international experience when entering host country markets and especially emerging markets, where it may be found that the institutional environment of the host country is quite different from that of the MNEs' home countries.

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APPENDIX A: EXPLANATORY STATEMENTS

EXPLANATORY STATEMENT

Project: How to manage foreignness of MNEs in China

Chief Investigator's name

Professor Cherrie Jiuhua ZHU
Department of Management
Phone: +61 3 990 55465
email: Cherrie.Zhu@monash.edu

Student's name Yifan ZHONG
Phone : +61 3 99059250
email: yifan.zhong@monash.edu

You are invited to take part in this study. Please read this Explanatory Statement in full before deciding whether or not to participate in this research. If you would like further information regarding any aspect of this project, you are encouraged to contact the researchers via the phone numbers or email addresses listed above.

What does the research involve?

This research project aims to examine liabilities and advantages of foreign multinational enterprises (MNEs) in China and explore the strategic responses of these MNEs to manage foreignness in China. This research project will include survey questionnaires and interviews. You will be asked to either fill in a survey questionnaire or conduct an interview with the research team. The survey questionnaires will take no more than 30 minutes to complete. The interviews will take no more than one hour.

Why were you chosen for this research?

You are chosen for this research because you fit the criteria that you are employed by a foreign company in China and you have accepted the invitation distributed from the company by the research team.

Consenting to participate in the project and withdrawing from the research

The consent process involves presenting explanatory statement, signing and returning the consent form. The participant reserves the right to withdraw from further participation at any stage, along with any implications of withdrawal. If you have submitted an anonymous questionnaire, it will not be possible to withdraw data once they have submitted the responses. It is also your right to choose not to participate.

Possible benefits and risks to participants

Possible benefits to participants are given in the report that may help participants and the community to have a better understanding of issues related to managing foreignness of MNEs in China. No foreseen risks beyond normal life experience.

Confidentiality

All participants will be coded by case firms to ensure confidentiality and anonymity of the data. By publishing or reporting the data, identifiable information will be coded where no one beyond the research team can be able to identify. This research is a doctorate student research project that is conducted by the Department of Management at Monash University. The data remain the intellectual property of Monash University and is strictly confidential.

Storage of data

The information provided by each person will remain **strictly confidential** as only the aggregated results will be presented. Only members of the research team will have access to the data. Upon completion of the project the data will be stored securely for five years and then destroyed as prescribed by the university regulations.

Results

The results of this study will be presented in academic papers and a report will be made available to your organisation. You will be able to access the report from your organisation.

Complaints

Should you have any concerns or complaints about the conduct of the project, you are welcome to contact the Executive Officer, Monash University Human Research Ethics (MUHREC):

Executive Officer
Monash University Human Research Ethics Committee
(MUHREC)
Room 111, Chancellery Building E,
24 Sports Walk, Clayton Campus
Research Office
Monash University VIC 3800

Tel: +61 3 9905 2052 Email: muhrec@monash.edu Fax:
+61 3 9905 3831

Thank you,

Professor Cherrie Jiuhua Zhu

APPENDIX B: CONSENT FORM

Project: How to manage foreignness of MNEs in China

Chief Investigator: Professor Cherrie Jiuhua Zhu

I have been asked to take part in the Monash University research project specified above. I have read and understood the Explanatory Statement and I hereby consent to participate in this project.

I consent to the following:	Yes	No
I agree to be interviewed by the researcher	☐	☐
I agree to fill in a survey questionnaire for this research	☐	☐
I agree to allow the interview to be audio-taped	☐	☐

- **I understand that my participation is voluntary, that I can choose not to participate in part or all of the project and that I can withdraw at any stage of the project without being penalised or disadvantaged in any way.**
- **I understand that any data that the researcher extracts from my interview is for use in reports or published findings will not, under any circumstances, contain names or identifying characteristics.**
- **I also understand that data from the interview will be kept in a secure storage and accessible to the research team. I also understand that the data will be destroyed after a 5 year period.**

Name of Participant ______________

Participant Signature Date _________

APPENDIX C: INTERVIEW QUESTIONS

1. How long have you worked in foreign firms in China?
2. How long have you worked in your current firm? What’s your position in the firm?
3. Is your firm an international joint venture or a wholly owned subsidiary of a foreign company?
4. How many foreign employees (including PCNs and TCNs) (or what proportion) does your firm have in China? How many employees did your company have in 2017?
5. Have your firm enjoyed income tax benefits in China? If so, how?
6. Compared with your counterparts in the same industry, is your firm performing below, or at or above the average level? (Only perceptions are fine)
7. Where is the location of your firm in China?
8. How long has the firm operated in China?
9. Do you think the location of your firm has affected your benefits/liabilities in China? If so, how?
10. Do you think being a foreign firm has brought your firm any liabilities or advantages? If so, how
11. Do you think it is necessary to manage the foreign identity of your firm? Why?
12. Have you taken any steps to manage the foreign identity of your firm? If so, how? If not, why?
13. What is your firm’s specific advantages? Technology, service, innovation, corporate governance, etc.
14. Do you perceive that local suppliers, buyers and partners are more willing to do business with your firm instead of other local firms?
15. Do you think that local talent are more willing to work in your firm instead of other local firms?
16. Do you perceive any effects of your firm caused by product avoidance in China?

APPENDIX D: ETHICAL APPROVAL

Monash University Human Research Ethics Committee

Approval Certificate

This is to certify that the project below was considered by the Monash University Human Research Ethics Committee. The Committee was satisfied that the proposal meets the requirements of the *National Statement on Ethical Conduct in Human Research* and has granted approval.

Project Number:	1551
Project Title:	How to manage foreignness of MNEs in China
Chief Investigator:	Professor Jiuhua Zhu
Expiry Date:	29/03/2022

Terms of approval - failure to comply with the terms below is in breach of your approval and the *Australian Code for the Responsible Conduct of Research*.

1. The Chief Investigator is responsible for ensuring that permission letters are obtained, if relevant, before any data collection can occur at the specified organisation.
2. Approval is only valid whilst your hold a position at Monash University.
3. It is responsibility of the Chief Investigator to ensure that all investigators are aware of the terms of approval and to ensure the project is conducted as approved by MUHREC.
4. You should notify MUHREC immediately of any serious or unexpected adverse effects on participants or unforeseen events affecting the ethical acceptability of the project.
5. The Explanatory Statement must be on Monash letterhead and the Monash University complaints clause must include your project number.
6. Amendments to approved projects including changes to personnel must not commence without written approval from MHUREC.
7. Annual Report - continued approval of this project is dependent on the submission of an Annual Report.
8. Final Report - should be provided at the conclusion of the project. MUHREC should be notified if the project is discontinued before the expected completion date.
9. Monitoring - project may be subject to an audit or any other form of monitoring by MUHREC at any time.
10. Retention and storage of data - The Chief Investigator is responsible for the storage and retention of the original data pertaining to the project for a minimum period of five years.

Thank you for your assistance.

Professor Nip Thomson

Chair, MUHREC

CC: Dr Mingqiong Mike Zhang, Mr Yifan Zhong

List of approved documents:

Document Type	File Name	Date	Version
Consent Form	consent-form	09/12/2016	1
Explanatory Statement	EXPLANATORY STATEMENT	09/12/2016	1
Explanatory Statement	EXPLANATORY STATEMENT (1)	09/12/2016	2
Questionnaires / Surveys	Questionnaire v3 20170325	25/03/2017	1