

**ENTRY MODE AND PERFORMANCE IN A TRANSITIONAL ECONOMY:  
A FRAMEWORK FOR FOREIGN-INVESTED ENTERPRISES IN CHINA**

Howard Davies

Jin K. Han

Namwoon Kim

Jae H. Pae\*

\*Howard Davies is Professor of Management, Namwoon Kim is Associate Professor of Marketing, Jae H. Pae is Assistant Professor of Marketing, all at the Hong Kong Polytechnic University, Kowloon, Hong Kong. Jin K. Han is Associate Professor of Marketing at the Singapore Management University.

# **ENTRY MODE AND PERFORMANCE IN A TRANSITIONAL ECONOMY: A FRAMEWORK FOR FOREIGN-INVESTED ENTERPRISES IN CHINA**

## **Abstract**

A conceptual framework is developed, bringing together entry mode, the influence of state officials, and the adoption of a customer-driven orientation in order to explain the performance of foreign-invested firms in a transitional economy. The model is tested on a sample of firms in China across eight provinces and cities, spread across the relatively developed South Coast, the Central Belt formed by Shanghai and the Yangzi basin and the less-developed North and West. We find that the decision to enter through a joint venture reduces the customer focus of the enterprise. Contrary to expectation, however, we find no positive relationship between entry by joint venture and the degree of state influence exerted over the enterprise. It appears that wholly-owned foreign enterprises experience just as much involvement by government officials in their activities as do the joint ventures. However, greater customer focus fosters innovativeness, which in turn, leads to higher performance. Managerial implications are discussed for executives responsible deciding on the mode-of-entry: wholly-owned foreign enterprise (WOFE) or foreign equity joint venture (FEJV).

## **ENTRY MODE AND PERFORMANCE IN A TRANSITIONAL ECONOMY: A FRAMEWORK FOR FOREIGN-INVESTED ENTERPRISES IN CHINA**

### **Background**

As China makes significant strides in “marketizing” its planned economy (Perkins 1994; Jefferson and Rawski 1994) the global business community has been quick to stake its claim on the emerging market and wealth of resources represented by more than 1.2 billion people. By the end of 1998 there were 227,807 registered foreign-funded enterprises in the country, with a total investment valued at \$US774 billion, of which \$US313 billion was contributed by the foreign partners. That foreign contribution rose more than 50% in the preceding four years, from a base of \$US196 billion in 1994 (National Bureau of Statistics 1999, p.577). However, despite the optimism underlying that inflow, reports of dismal corporate performances by foreign-invested enterprises (FIEs) in China are becoming increasingly numerous. According to the State Taxation Administration only one third of foreign-invested enterprises made a profit in 1998 (McMahon 1999) and many major firms have found management difficult and returns elusive (Vanhonacker and Pan 1993; Lu, Child and Yan 1997). While A.T.Kearney (1999, p.1) found that “global companies are not considering quitting China” the reports of dampened enthusiasm underscore the need to better understand the antecedents of performance for foreign-invested firms in the world's largest transitional economy.

Research to date has provided a number of useful insights into the determinants of FIE performance in China, with most attention being paid to foreign equity joint ventures (FEJVs). Yan and Gray (1994, 1996) focussed on relationships between FEJV partners and found positive links between performance, control and the quality of the partners’ working relationship. Similarly, Ding (1996) found performance to have a positive relationship with control and a negative relationship with conflict. Luo (1997a) found that strategic and organizational traits of partners affect performance. Osland and Cavusgil (1996) used case studies of FEJVs to

suggest that performance is related to dominant control (for large JVs) and split control (for small JVs), disparities in parent size, preferential government policies and protected markets. Hu and Chen (1996) examined the performance of FEJVs and found that duration, total investment, the number of partners and the US as country of origin all had positive effects on the probability that a venture would be commended on an honor roll compiled by the China Association of Enterprises with Foreign Investment.

As these studies were confined to FEJVs they provided no evidence on the impact of entry mode on performance, which is a key issue for managers. However, Luo (1997b) examined FIEs in general and found that entry through joint venture was positively associated with performance when compared with the WOFE. That study also found that FIEs using business strategies based upon high intensity use of *guanxi* (networks of business connections) were more profitable than those with low intensity use of *guanxi*. Pan, Li and Tse (1999) found that foreign equity joint ventures (FEJVs) had significantly higher profitability than contractual joint ventures (CJVs) while wholly-owned foreign enterprises (WOFEs) did not, and added that early entry and longer lead times had positive effects on both profitability and market share. They also found inter-action effects between order and mode of entry, such that earlier entry enhanced the market share effect for both FEJVs and WOFEs. While Luo and Peng (1999) examined FIEs of different types, they omitted entry mode as a determinant of performance, focussing instead on the intensity and diversity of an “MNE sub-unit’s” experience. Both dimensions of experience were found to impact on organizational learning and hence performance, the effects were subject to diminishing returns over time, and the environment was found to interact with experience so that the latter’s effects are stronger in the presence of greater environmental dynamism, hostility and complexity.

While these studies of FIEs in China shed useful light on some determinants of performance in that setting, a number of observations are in order. First, the predictor variables which have been included are drawn from widely different

domains and yet represent only a small proportion of the plausible antecedents of performance as identified in the wider literature (Capon, Farley and Hoenig 1996). In joint venture studies most emphasis has been placed on partner characteristics and on issues internal to the management of the venture, notably control, conflict and timing. Although Osland and Cavusgil (1996) found that the characteristics of the business environment in China may determine also affect performance, none of the other studies made reference to such external factors, suggesting under-specification. Two of the three studies, which extended to different types of FIE (Pan, Li and Tse, 1999; Luo 1997b), used entry mode as a predictor variable but the other (Luo and Peng 1999) did not, despite its salience. Furthermore, the issues of timing and learning have been given much greater emphasis in the literature on FIE performance in China than in either the general literature on business performance or in studies of FIE and JV performance. Capon, Farley and Hoenig (1996), for instance, examined 428 studies on the determinants of business performance and identified more than 20,000 relationships tested without making any reference to the timing or learning effects, which have featured so strongly in the China literature. Datta et al (1998) identified just 15 studies in the joint venture literature, which examined venture outcomes and none of those referred to timing or learning as a determinant of performance.

This variation in the predictor variables from study to study, and the emphasis placed on factors which have not been central to the mainstream literature on performance, arises in some cases from the difficulty of collecting primary information in China (Shenkar 199?) and the consequently 'data-driven' nature of many studies. Pan Li and Tse (1999), for instance, used data on more than 14,000 firms, contained in a quasi-official listing of FIEs in China. As that listing contains very limited information (performance, mode of entry, date of entry, size of investment and sector), and as it would be impracticable to add variables to such a large set of observations, analysts using it are forced to seek predictor variables from within that domain and are hence drawn to timing effects. Luo (1997a ) also drew on serendipitous data, provided in a Chinese provincial directory, which directed the

analysis towards the performance effect of partner size, length of experience, and ‘absorptive capacity’ (measured by data provided on technical and professional employment). The hypotheses examined in these studies are carefully linked to the prior literature and they address important issues. However, their selection involves a substantial element of ‘convenience’, whereby the broad body of theory is scanned for hypotheses that link the variables for which data happens to be on hand.

This rather idiosyncratic nature of the studies to date leaves at least three major issues unexplored. The first of these concerns the extent to which the performance of foreign enterprises in a “marketizing” transitional economy like China is determined by the adoption of business orientations and philosophies which have been found to be important in market economies. Evidence from the United States, Japan, Europe and Hong Kong suggests that having a “customer focus” and/or being “innovative” has a significantly positive effect on performance (Narver and Slater 1990; Capon, Farley and Hoenig 1996; Deshpande et al 1997; Han, Kim, and Srivastava 1998; Chan and Ellis 1998). Certainly, the Chinese authorities opened their economy in the late 1970s on the presumption that the adoption of business practices found to be effective in the West would have an equally positive effect in China. However, the impact of these business orientations on FIE performance in China has not been explored, which is a significant gap in the literature. A first aim of the current study therefore is to examine their role, set in an explicit model linking performance with its antecedents.

A second issue which has not been directly addressed in the literature on the FIE in China concerns the role of state influence in the determination of performance and the channels through which that influence operates. Despite the twenty year history of the "open door" policy all enterprises in China, whether they be domestic firms, foreign equity joint-ventures (FEJV), or wholly-owned foreign enterprises (WOFE) are still subject to the ubiquitous influence of the state. That influence can reasonably be ignored in analyses of performance that are set in mature market-economy environments. However, if performance in the transitional economy setting

is to be understood state influence needs to take its place amongst the antecedents and paths to organizational performance which are taken into account..

At one level, the involvement of government officials in FIE decision-making may simply be seen as unnecessary bureaucratic interference, anticipated to have a direct negative effect on performance by distracting FIE managers from the central task of competing in the marketplace. On the other hand (Xin and Pearce 1996) officials provide a measure of protection for FIE property rights, a source of resources and a route to the many permissions and licenses which are still required in China, which might yield a positive direct link between state influence and performance.

State influence may also affect performance indirectly, through its impact on other variables in the model. A second aim of this study therefore is to introduce it into the model, in order to test a number of hypotheses concerning both direct and indirect effects upon performance.

In summary, the current state of the literature on FIE performance in China offers the opportunity to open up a new approach by developing and testing an explicit model which brings together the impact of entry mode, state influence, customer focus and innovativeness . This study presents such a conceptual framework and tests a series of hypotheses using a unique and recent data-set.

### **Conceptual Framework and Hypotheses**

The search for the antecedents of business performance in developed market economies has recently been directed back towards the central roles of “marketing” and “innovation”, identified more than forty years ago by Drucker (1954) as the only meaningful functions of the business enterprise. In the marketing literature a stream of studies has examined the links between “market orientation” and performance, testing for both a direct relationship (Narver and Slater 1990; Ruekert 1992) and a moderating role (Day and Wensley 1988; Diamantopoulos and Hart 1993; Greenley 1985; Jaworski and Kohli 1993; Slater and Narver 1994). In the innovation literature,

a quite separate stream of work points to a robust and direct relationship between innovativeness and business performance (Damanpour and Evan 1984; Damanpour, Szabat and Evan 1989; Khan and Manopichetwattana 1989; Zahra, de Belardino and Boxx 1988).

As these research areas have proceeded in isolation from each other, most of the studies to date have treated market orientation and innovation as separate and unrelated routes to superior performance. Recently, however, it has been shown that they work together to influence performance, with innovation acting as a mediating variable (Han, Kim and Srivastava 1998). Market orientation has a positive impact on firms' innovativeness, which in turn has a positive effect on performance. This study develops this line of inquiry in two directions. The first is to extend the setting into a transitional economy where relationships with the state need to be taken into account. The second is to examine both the direct and indirect impact of the entry mode decision on FIE performance.

Most of the studies to date on innovation and market orientation as antecedents of business performance have been set in developed market economies. In that context (outside the regulated sectors) the influence of the state can reasonably be ignored as a determining, mediating or moderating factor with respect to individual firm performance. However, that presumption cannot be carried over into the analysis of firms operating in transitional economies where the role of the authorities may be central. In such economies the influence of the state may affect FIE performance, and itself be affected, through a number of channels. First, state influence may have a direct impact on performance, as noted above. Second, it may have an indirect influence on performance through its impact on innovativeness. Thirdly, state influence on an individual FIE may itself be determined in part by the parent

company's choice between an FEJV and a WOFE. The conceptual framework for this paper sets out a 'nomological network' linking the key constructs in order to derive and test a series of hypotheses.

FIGURE 1 GOES AROUND HERE

#### The Direct Impact of Entry Mode on Performance

Figure 1 shows the conceptual framework that forms the basis for this study. The starting point for the analysis lies in the mode of entry decision, where a dichotomous distinction is drawn between the wholly-owned foreign enterprise (WOFE) and a joint venture (FEJV). Despite the large number of studies that have been carried out on the entry mode decision, relatively few have examined its consequences for performance (Pan, Li and Tse 1999; Woodcock Beamish and Makino 1994; Osland and Cavusgil 1996). There may be a direct effect, as indicated, but the direction of that effect is problematical, especially in the Chinese setting.

Faced with a choice between the FEJV and the WOFE, executives find conflicting signals from experience to date and from the academic literature. On the one hand, FEJVs account for the bulk of foreign investment in China, both in terms of the number of enterprises and the total value of investment (Osland and Cavusgil 1996; Pan 1996; Ministry of Foreign Trade and Economic Co-operation 1998). While that preponderance is partly due to Chinese government restrictions on entry through the wholly-owned route some observers have argued that appropriately structured FEJVs can reduce uncertainty and costs, while enhancing revenues (Beamish and Banks 1987). From that point of view the FEJV, and the shared control it involves, provides the higher-performing option which can most effectively integrate local and

foreign knowledge and capabilities in order to yield superior returns (Child and Faulkner 1998). At the same time, other observers point out that the balance of new investment in China has been shifting towards the WOFE so that in 1998, for the first time, newly contracted investment in WOFEs exceeded that in FEJVs (Ministry...Almanac).

A stream of literature on the joint venture in general has pointed to the conflicts and transactional difficulties which are inherent when two or more firms attempt to take decisions and manage resources jointly and research focusing on China in particular has found very significant dissatisfaction amongst foreign managers in FEJVs, especially since 1989 (Beamish 1993; Pan, Vanhonacker and Pitts 1995). Hence, Vanhonacker (1997) recommends that WOFE is the route to higher performance in China. WOFEs provide for greater control; they avoid the 'ex ante' costs of partner identification, negotiation and contracting; and they also eliminate the 'ex post' risk of losing key assets through 'leakage' to the partner, who may also win the 'race to learn' (Hamel 1990). They also avoid the costs of integrating the assets pooled by the partners (Madhok 1997).

On the other hand, the FEJV provides a measure of political protection to the business operation, which is still necessary in China for non-state enterprises (Xin and Pearce 1996). It may also give better access to networks of personal connections (Davies, Leung, Luk and Wong 1995) and a means by which resources may be accessed in a setting where markets remain significantly under-developed (EAAU, 1997). The balance of advantage between those opposing effects is difficult to identify, shifting with local and central government policy, hence no hypothesis is offered here in respect of the direction of the effect.

While the choice of entry mode may have a direct effect on performance it is also hypothesized to have an indirect effect through its influence on innovativeness, which is mediated by the extent of a firm's "customer focus" and the degree of "state influence" to which it is subject. Each of these is considered in turn.

### The Impact of Entry Mode on "Customer Focus" and "State Influence"

One of the most fruitful approaches to the strategy/environment relationship is the resource dependence approach (Aldrich 1976; Pfeffer and Salancik 1978) which sees organizations as dependent for survival, growth and success on resources which must be acquired from the environment. Organizations attempt to meet their objectives by adopting "organizational strategies" (Child 1972, 1997) designed to acquire resources from the environments in which they find themselves.

A key implication of the resource dependence approach is that the strategies adopted depend on the channels through which resources may be acquired. However, the nature of these channels varies widely with the institutional setting. For firms operating in a competitive market economy, resources are acquired by implementing strategies and policies that meet customer needs, thereby generating the necessary cash flow, profits and infusions of capital. In a transitional society like China the institutional setting (Scott 1987) varies with the position of the firm in the process of reform. Some firms do operate in highly "marketized" settings in which case the channels through which resources are acquired are similar to those in market economies.

On the other hand, firms still operating in a command-economy setting face relatively soft budget constraints, administrative allocation of funds and materials, limited autonomy and administered prices for inputs and outputs. For them the pattern

of resource dependence, and the identity of the salient actors, is very different from that facing a firm in a market economy. In their circumstances, the route to acquiring resources lies not through inter-actions with customers, competitors and suppliers, but rather through the development of good personal relationships with officials in supervising Ministries and other regulatory agencies. In such firms, therefore, it may be hypothesized that little attention is devoted to business strategies as understood in market economies. Instead, the focus will be firmly on the development of good relationships with regulators and others that provide resources directly (Shenkar 1991).

In a transitional economy, therefore, there are two separate routes through which resource dependence may be ameliorated. The first is by developing a strong “customer focus” and the second is by involving state officials in the company’s operations, described here as “state influence”. For domestic enterprises the most appropriate route is largely determined for them by their industrial and institutional setting. Small collective or private firms in light industry have limited access to the organs of the state, and need to focus on their customers’ needs if they are to perform well. Large state-owned firms in heavy industry have a much closer relationship with state officials and less autonomy in their business decisions (Davies and Walters 1999) rendering state influence a more accessible route to resources.

Foreign-invested enterprises (FIEs) entering a transitional economy are less constrained in their choice of strategy than many domestic enterprises and they have the opportunity to pursue either, or both, of these routes to the reduction of resource dependence. “Customer focus” and “state influence” may therefore be conceptualized as orthogonal dimensions in their strategic space. However, the choice of entry mode

may have a key impact on the extent to which the FIE pursues each of these strategies.

The choice between a WOFE and a JV will impact on the degree of customer focus shown by the business in a number of ways. In the case of the JV, the need to share management and control, and to co-ordinate activities with indigenous Chinese enterprises, is hypothesized to lead to a less well-developed customer focus, for a number of reasons. First, JVs require a functioning local partner and such Chinese partners have little experience in meeting customer needs, as their organizational antecedents lie in the shortage economy (Kornai 1990) where demand for all products exceeded supply. JVs therefore have a difficulty in re-orienting their local managers and workers towards the concept of meeting customer needs. Secondly, JVs are usually required to hire a significant proportion of their workers and managers from amongst the employees of the partner company (Warner 1993; Bjorkman and Lu 1997; Von Glinow and Teagarden 1988). As the employees thereby allocated are not necessarily the most able and forward-looking, and as in some cases their function is to monitor and report on the JVs operations to the Chinese authorities, they are unlikely to make a significant contribution to the development of a customer focus and they may hamper it significantly. Hence the first hypothesis:

H1: there is a negative relationship between the choice of FEJV as the mode of entry and the degree of customer focus adopted by the FIE.

“State influence” is defined here as the extent to which the firm is dependent upon government officials for its decision-making. To some extent such influence is unavoidable for any type of foreign-invested enterprise in China. However, it may be

exerted at two different points in the entry process and it impacts in different ways at those points. First, before entry takes place, all FIEs, whether WOFE or FEJV, require a plethora of permissions and licenses before they can commence operations. Certain types of activity are forbidden to foreign investors, in many others only JVs are allowed and even where foreign firms have a free choice between WOFE and JV they must meet, or promise to meet, a whole range of conditions. At this stage in the process the WOFE is more restricted in its freedom of action than the JV, essentially because the Chinese government continues to be concerned about the prospect of wholly-foreign controlled organizations operating in sensitive sectors inside the country. In that sense, state influence is more significant for WOFEs than JVs in the 'ex ante' business decision-making which takes place in the pre-entry phase.

A foreign firm's ability to determine the domain of the business, and its geographical location, is more tightly circumscribed for a WOFE than for a JV in the pre-entry phase of the operation. However, in the post-entry phase the situation is reversed. Having once determined the domain of the business, the WOFE has significantly more freedom to take its own decisions within that domain, being less subject to state influence. The primary reason for that reversal is that JVs require the involvement of a local enterprise while WOFEs do not. In China, the boundaries between enterprises and between enterprises and the state are very much more blurred than in developed industrial economies (Peng and Heath 1996). State enterprises still account for 30% of the economy's industrial output (State Statistical Bureau 1997) and such firms remain subject to control by the Ministries and the object of arbitrary intervention by officials.

Similarly, the property rights and control of the collective enterprises which account for a further 39% of output are vested in township and local governments,

who use them as instruments of local economic development (Nee 1992). Even in the case of private enterprises, the state is heavily involved as recent surveys have shown (SCMP, 11 Feb 1999). Such firms have more autonomy than most in respect of hiring staff, paying bonuses and deciding where to market their products (Davies and Walters 1999). However, their sensitive status as private enterprises in a socialist state leads to fears that policy may change and that there is more business risk. As a result, they are vulnerable to predatory officials seeking rents and are required to spend a considerable amount of time and effort negotiating with such officials for their place in the economy (Nee 1992).

When a foreign firm enters China through an FE JV with a local enterprise, whatever its ownership type, it therefore becomes inextricably involved with the state in the course of its day-to-day decision-making. A firm, which enters through a WOFE, may be more restricted at the pre-entry stage but by avoiding the involvement of a local partner it cuts off many of the channels through which government officials may involve themselves in decision-making. Hence:

H2: there is a positive relationship between the choice of JV as a mode of entry and the extent of state influence over company decisions

### Innovativeness, Customer Focus and State Influence

The development of a customer focus and the active involvement of the state in decision-making are conceptualized here as two different, orthogonal rather than mutually exclusive, means by which an FIE in China may seek to reduce its resource dependence and hence enhance its performance. The extent to which a firm adopts either strategy may have a direct effect on performance, as indicated by the paths in

Figure 1. However, a key argument here is that innovativeness acts as a mediating variable so that customer focus and state influence both affect performance through their influence on innovativeness, as found by Han, Kim and Srivastava (1998). It is important, therefore, to consider how the adoption of each strategy will affect the innovativeness of a FIE.

With respect to the links between customer focus and innovativeness Pierce and Delbecq (1977) showed that commitment to meeting customer needs leads to increased boundary-spanning activity, while Deshpande, Farley and Webster (1993) found a positive correlation between customer orientation and innovativeness. In the Chinese environment customer needs are changing quickly as incomes rise rapidly and idiosyncratically Chinese requirements emerge. For instance, white goods maker Hai'er found that newly prosperous peasant farmers put washing machines to unexpected uses (washing the dirt from vegetables, for instance) which require amended product designs if the needs are to be met effectively (Liao 1998). Hence:

H3a: customer focus has a positive impact on innovativeness

State influence might affect innovativeness in either direction. On the one hand, it can be argued that higher levels of state influence introduce higher levels of bureaucratic oversight and monitoring procedures that are inhibitive of innovation. On the other hand, preliminary work for a related study has shown that in a large sample of Chinese firms of all types there is a positive relationship between willingness to take risk and dependence on officials. While that might seem counter-intuitive at first, discussions with Chinese scholars and managers suggests that it is a valid finding because a firm which involves the authorities in its decision-making has some

political protection if it takes risks and experiences failure. Having involved the state in their decision-making, managers can point to state support for, or at least acquiescence in, their actions. On the basis of that argument;

H3b: state influence over decision-making is positively related to innovativeness

#### Innovativeness, Performance and the Role of Technological Turbulence

The link between innovativeness and performance is perhaps the most firmly established finding in the literature on the managerially-controlled antecedents of firm performance (Capon, et al. 1992). Studies by Kimberly and Evanisko (1981), Ettlie and Bridges (1982), Damanpour and Evan (1984), and Damanpour, Szabat and Evan (1989) all point to the robustness of the relationship. Firms that are highly innovative perform better because they are more able to cope with the uncertainties generated by a changing environment. Hence:

H4: Innovativeness is directly related to performance

The argument also suggests that technological turbulence may impact on the variables in this model in a number of ways. Most obviously, it will have a direct effect on innovativeness as higher technological turbulence increases the return to the development of new products and processes. Hence:

H5. Innovativeness is positively related to technological turbulence

In addition to that direct effect it is anticipated that when technological turbulence is more marked the value of innovativeness as a means by which to meet customers needs will be higher. Hence:

H6a: technological turbulence moderates the impact of customer focus on innovativeness, such that greater turbulence leads customer focus to have a more positive effect on innovativeness

Similarly, it is to be anticipated that a higher level of technological turbulence will affect the relationship between state influence and innovativeness. However, when the level of turbulence is higher, having government officials more involved in a firm's decision-making is likely to have a less positive effect on innovativeness than when the environment is relatively stable. Given the key importance of coping with uncertainty and its consequences, an FIE operating in a stable and relatively predictable environment will be more willing to innovate as it secures the closer involvement of government officials, who can protect it against the consequences of mistakes. However, if the environment is highly turbulent, with a self-evidently higher risk of failure, government officials will themselves be more concerned about the consequences of their sanctioning innovative behavior that increases the level of risk. Hence:

H6b: technological turbulence moderates the impact of state influence on innovativeness, such that greater turbulence leads to a less positive effect on innovativeness

## The Research Design

### The Sample and Survey Method

Relatively few studies undertaken in China have involved the quantitative analysis of primary survey data from large samples and the preferred methodology commonly involves either analyzing the data serendipitously provided by lists of enterprises (Pan and Tse 1997; Tse, Pan and Au 1998; Hu and Chen 1993) or case study work. This is partly because probability sampling is made difficult in China by the lack of accurate and comprehensive sampling frames, and the likelihood of non-response in an environment where many managers regard data collection with suspicion (Mannion 1994; Shenkar 1994).

In order to overcome these problems, a starting point was found in a *guanxi* network (Davies et al 1995) of graduates from one of China's most prestigious universities. Those graduates are placed in senior positions across the country in a variety of government agencies, which have access to comprehensive listings of enterprises. Through this network assistance was sought from local branches of government agencies having an interest in the project for themselves and in a position to use their authority to request data from a representative sample of enterprises in their area. Principal collaborators were identified from amongst officials in each area. They held primary responsibility for data collection and were briefed to draw on their lists of manufacturing enterprises to provide a representative random sample of FIEs.

Responses were gathered from a total of eight provinces and cities, spread across the relatively developed South Coast, the Central Belt formed by Shanghai and the Yangzi basin and the less-developed North and West. Non-response bias was not an issue as the collaborators chosen were able to exercise authority in order to secure responses. There might be a danger of 'yea-saying' bias when respondents had been

instructed to co-operate, but the questionnaire items have no obvious 'value-loading', it was explained that the data was for statistical analysis only, and the responses show use of the full range of values for all items.

The survey method used the key respondent approach whereby a structured questionnaire was administered personally during interviews by survey workers with respondents who were either the general manager of the enterprise or not more than one level below them. While reliance on a single respondent is open to criticism, Glick et al. (1990) point out that using a single key respondent reduces the biases associated with different functions or hierarchical positions, gives access to more knowledgeable informants and increases statistical power by increasing the number of observations gathered for the same resources. In China, where 'power distance' is high, (Hofstede 1980) appearing to "check" one respondent's answers against another's is fraught with possibilities for misunderstanding and the generation of hostility towards the researcher.

The starting point for development of the survey instrument lay in generating a battery of items designed to measure the constructs which make up the conceptual framework. These were set in the format of 7-point scales, anchored on "very strongly disagree" (rated 1) and "very strongly agree" (rated 7) with a "neutral" mid-point. An English language version of the questionnaire was developed first and subjected to the procedures recommended by Bhalla and Lin (1987) in order to secure conceptual equivalence. Each statement was translated into Chinese and then back-translated twice by translators working independently. The researchers and translators discussed any conflicts and confusions until agreement was reached. As both of the original translators were native Cantonese speakers further consultation took place with two native Mandarin speakers (one from Shanghai and one from Beijing) in order to

ensure that the resulting survey form would be easily comprehended by managers in other parts of China.

The questionnaire was originally produced in the two different Chinese character sets, the simplified one which is standard throughout China and the complex one which is used only in the South. However, discussion with Chinese academics having extensive survey experience suggested that use of the complex character set was unnecessary and that was confirmed by initial pilot interviews in the South. The instrument was then pre-tested for content and face validity in exploratory field work with 34 Chinese managers from six different cities in China, and some modifications were subsequently made, primarily involving simplification of the Chinese wording. The data was then collected between November 1996 and June 1997 from 149 equity joint ventures and 76 wholly-owned foreign enterprises.

#### Measures and Construct Validity

Face validity and content validity for the individual questionnaire items were assured through the process of piloting and discussion with experts (DeVellis 1990). Table 1 shows the items used for each of the five constructs in the model.

-----  
Table 1 goes around here  
-----

Construct reliability was estimated by calculating the Cronbach alpha coefficient for each of the constructs as shown in Table 1. While only two of them met the conservative benchmark set by Nunnally (1978) the less demanding figure of .60 suggested by Robinson et al. (1991) was met by all of the constructs.

In so far as “customer focus” and “state influence” might be interpreted as reverse-coded versions of each other it is important to test them for discriminant validity. Examination of the correlation co-efficient between them showed it to be negative and significantly different from zero but far short of 1.0. A formal test of discriminant validity was also carried out (Anderson 1987) by placing a confidence interval of two standard errors around the estimated correlation. As that interval did not include 1.0 the pair of constructs passed the test and discriminant validity is demonstrated.

The Model Specification

- (1) CUSTFOC =  $\beta_1 + \beta_2$ ENTRYMODE
- (2) STATEINF =  $\beta_3 + \beta_4$ ENTRYMODE
- (3) INNOV =  $\beta_5 + \beta_6$ CUSTFOC +  $\beta_7$ STATEINF +  $\beta_8$ TECHTURB  
+  $\beta_9$ (TECHTURB x CUSTFOC)  
+  $\beta_{10}$ (TECHTURB x STATEINF)
- (4) PERF =  $\beta_{11} + \beta_{12}$ ENTRYMODE +  $\beta_{13}$ INNOV  
+  $\beta_{14}$ STATEINF +  $\beta_{15}$  CUSTFOC

Where:

CUSTFOC = Customer Focus                      STATEINF = State Influence  
INNOV = Innovativeness                      PERF = Performance  
ENTRYMODE = Mode of Entry (JV = 1, Wholly-Owned = 0)  
TECHTURB = Technological Turbulence (Above/Below the Mean = 1/0)

Model Estimation

The system of equations representing the model was estimated using a three-stage least squares (3SLS) analysis (Judge et al. 1985). For the technological turbulence variable, the main effect was included as well as the interaction effect, in

order to test H5. In order to incorporate the Chow test for the interaction effect, a dummy variable approach was used (Kennedy 1989) by classifying technological turbulence into “high/low” categories, using the mean as the dividing point (Slater and Narver 1994).

## Results

H1 and H2 deal with the direct impact of the mode of entry on the degree of customer focus adopted by the foreign-invested enterprise (FIE) and the extent of state influence over company decisions. As the Table shows, entering through a joint venture has a significantly negative impact on the degree of customer focus adopted by the enterprise ( $\beta_2 = -2.31; p < 0.05$ ) and H1 is supported. However, there is no significant link between entering through a joint venture and the degree of state influence over the enterprise and H2 is not supported, though not refuted. H3a, H3b, and H5 concern equation (3) and the hypothesized direct links between the innovativeness of the enterprise, the degree of customer focus, the degree of state influence and technological turbulence. H6a and H6b are represented in the same equation by the coefficients on the interaction effect of technological turbulence between customer focus, state influence and innovativeness. As the results show, all of the coefficients are significant with one exception.

-----  
Table 2 Goes Around Here  
-----

H3a, H3b, and H5 are empirically supported as customer focus, the degree of state influence and technological turbulence all have positive effects on

innovativeness ( $\beta_6 = 0.29; p < 0.01$ ,  $\beta_7 = 0.16; p < 0.05$ ,  $\beta_8 = 2.05; p < 0.01$ ). The estimates for the interaction effects show mixed results. Customer focus does not inter-act significantly with technological turbulence in determining innovativeness and hence H6a is not supported. However, H6b is supported as the interaction of state influence and technological turbulence does have a significantly negative sign ( $\beta_{10} = -0.38; p < .01$ ) showing that when technological turbulence is high state influence has a less positive/more negative influence on innovativeness. Finally, the impact of innovativeness on performance (H4) proves to be robust as the corresponding coefficient ( $\beta_{13} = 0.72; p < 0.01$ ), while entry mode, customer focus and state influence have no significant direct effects on performance.

### **Discussion**

The aim of this study has been to examine the role played by entry mode, customer focus and state influence in determining the innovativeness and performance of foreign-invested enterprises in China. It has first been found, as anticipated, that the decision to enter through a joint venture reduces the customer focus of the enterprise. As the management of a joint venture needs to spend significant time and resources managing the governance problems which arise, and as they also need to work with Chinese managers from JV partner firms who have little past experience of a customer orientation, less effort is devoted to the development of a customer focus. That reduced customer focus has no significant direct effect on performance, but it does curtail innovativeness, which in turn has a very significant impact on performance.

Contrary to expectation, the results showed no positive relationship between entry by joint venture and the degree of state influence exerted over the enterprise. It

appears that wholly-owned foreign enterprises experience just as much involvement by government officials in their activities as do the joint ventures. The most apparent explanation for that finding lies in the fact that markets remain significantly underdeveloped in China, so that access to resources and customers still requires engagement with officials, even for WOFEs. Hence those officials are just as involved in decision-making in WOFEs as they are in FEJVs.

The results on the determinants of innovativeness are particularly interesting, as there have been no previous studies on that variable in a developing transitional economy and none have examined the role played by state influence in its determination in any setting. The result presented here have supported H5, showing that innovativeness is significantly positively related to the degree of technological turbulence. They also support H6a and H6b, which predict a positive relationship with both customer focus and the degree of state influence.

However, the latter result requires qualification in the light of the strongly negative coefficient that was predicted and found for the moderating effect of technological turbulence on the link between state influence and innovativeness. If technological turbulence is low ( $TECHTURB = 0$  in the model estimated) the estimated co-efficient of STATEINF on INNOV is  $+0.18$  and an increased degree of state influence increases the innovativeness of a foreign-invested enterprise. Therefore, if the environment is one in which technology is changing only slowly, an enterprise which involves state officials more closely in its decision-making will be more innovative. The explanation proffered is that a higher level of official involvement provides a greater degree of political ‘insurance’ when the environment is relatively stable. However, if technological turbulence is high ( $TECHTURB = 1$ ) the co-efficient of STATEINF on INNOV is  $(+0.18 - 0.37 = -0.19)$  and the direction of the

effect is reversed. When technological turbulence is high, firms having a high level of involvement by state officials are less willing to innovate. That result would be explained if in turbulent conditions officials' nervousness about the risks involved in being innovative lead them to counsel caution and to refuse to provide support in the event of failure. In that case, when the environment is technologically turbulent, involving officials in decision-making to a greater extent would lead to less innovativeness.

Finally, the results provide replication and further support for Han, Kim and Srivastava's finding that innovativeness is a mediating variable in the determination of enterprise performance. Mode of entry, customer focus and state influence has no statistically significant direct impact on performance. However, entry mode has a significant effect on customer focus and both customer focus and state influence have a significant positive effect on innovativeness, which in turn determines performance.

The managerial implication of these results is that executives responsible for the choice between WOFEs and FEJVs need to recognize a number of issues. First, the choice of a WOFE as the form of entry mode will be associated with a better-developed customer focus, which will follow through into greater innovativeness and hence greater performance. However, it will not have a significant impact on the degree of state influence in decision-making. While that degree of influence will be lower in foreign-invested enterprises than in purely Chinese firms (Davies and Walters 1999) it is not lower in WOFEs than in JVs.

The degree of technological turbulence in the environment will have a positive impact on innovativeness, as has been found in advanced market economies, and innovativeness will also be affected positively by the extent of customer focus. Given that positive impact and its consequent link to performance, managers should

encourage the development of customer focus, as they would in market economies. State influence, however, has a more complex effect. If the environment is perceived as being relatively stable, it would be most appropriate to encourage the involvement of state officials in decision-making, because that has a positive impact on innovativeness and hence performance. The mechanism suggested here is that greater involvement of officials will provide greater political insurance in this situation. However, if the environment is turbulent, greater involvement of officials leads to less innovativeness and hence has an indirectly negative impact on performance. The lesson for performance would appear to be that managers should encourage the involvement of officials when operating in stable environments but discourage it in the face of turbulence.

## REFERENCES

- A.T.Kearney (1997) *Global Companies in China: A White Paper on the Changing Landscape*, Chicago; A.T.Kearney
- Aldrich, H.E. (1976), "Resource Dependence and Inter-Organizational Relations," *Administration and Society*, 7, 419-454.
- Anderson, James C.(1987) "An Approach for Confirmatory Measurement and Structural Equation Modelling of Organizational Properties", *Management Science*, 33(4), 525-541
- Bhalla, G. and L. Lin (1987), "Cross-Cultural Marketing Research: A Discussion of Equivalence Issues and Management Strategies," *Psychology and Marketing*, 4, 275-285.
- Bjorkman, Ingmar and Yuan Lu (1997) "Human Resource Management Practices in Foreign Investment Enterprises in China" in *Advances in Chinese Industrial Studies*, 5,
- Capon, Noel, John U. Farley and Scott Hoenig (1996) *Towards An Integrative Explanation of Corporate Financial Performance*, Amsterdam, Kluwer Press
- Capon, Noel, John Farley, Donald R. Lehmann, and James M. Hulbert (1992), "Profiles of Product Innovators Among Large U.S. Manufacturers," *Management Science*, 38 (February), 157-169.
- Child, John (1972), "Organizational Structure, Environment and Performance: The Role of Strategic Choice," *Sociology*, 6, 1-22.
- \_\_\_\_\_ (1997), "Strategic Choice in the Analysis of Action, Structure, Organizations and Environment: Retrospect and Prospect," *Organization Studies*, 18, 43-76.
- Child, John and David Faulkner (1998), *Strategies of Co-operation*, New York: Oxford University Press
- Damanpour, Fariborz and William M. Evan (1984), "Organizational Innovation and Performance: The Problem of 'Organizational Lag'," *Administrative Science Quarterly*, 29 (September), 392-409.
- \_\_\_\_\_, Kathryn A. Szabat, and William M. Evan (1989), "The Relationship Between Types of Innovation and Organizational Performance," *Journal of Management Studies*, 26 (November), 587-601.
- Davies, Howard, Thomas Leung, Sheriff Luk, and Yui-Hing Wong (1995), "The Benefits of Guanxi," *Industrial Marketing Management*, 24 (June), 207-214.
- Davies, Howard and Peter Walters (1999), "Measuring the Move to Market: An Empirical Analysis of Chinese Enterprise," *Keynote Paper, Tenth Annual Conference of the Chinese Economic Association*, London, March 28-29.

Day, George S. and Robin Wensley (1988), "Assessing Advantage: A Framework for Diagnosing Competitive Superiority," *Journal of Marketing*, 52, (April), 1-20.

Deshpande, Rohit, John U. Farley, and Frederick E. Webster, Jr. (1993), "Corporate Culture, Customer Orientation and Innovativeness in Japanese Firms: A Quadrant Analysis," *Journal of Marketing*, 57 (January), 23-37.

DeVellis, R. (1991), *Scale Development: Theory and Applications*, Newbury Park CA: Sage.

Diamantopoulos, A. and S. Hart (1993), "Linking Market Orientation and Company Performance: Preliminary Work on Kohli and Jaworski's Framework," *Journal of Strategic Marketing*, 1, 93-122.

Drucker, Peter F. (1954), *The Practice of Management*, New York: Harper and Row.

East Asia Analytical Unit (EAAU) (1997), *China Embraces the Market: Achievements, Constraints and Opportunities*, Department of Foreign Affairs and Trade, Commonwealth of Australia.

Glick, W. H., G. P. Huber, C. C. Miller, D. H. Doty, and K. Sutcliffe (1990), "Studying Changes on Organizational Design and Effectiveness: Retrospective Event Histories and Periodic Assessments," *Organization Science*, 1, 293-312.

Greenley, Gordon E. (1995), "Market Orientation and Company Performance: Empirical Evidence from UK Companies," *British Journal of Management*, 6 (March), 1-13.

Hamel, Gary (1990), "Competition for Competence and Inter-Partner Learning Within International Strategic Alliances," *Strategic Management Journal*, 12 (Summer), 83-103.

Han, Jin K., Namwoon Kim and Rajendra Srivastava (1998), "Market Orientation and Organizational Performance: Is Innovation a Missing Link?" *Journal of Marketing*, 62 (October), 30-45.

Hofstede, G. (1980), *Culture's Consequences: International Differences in Work-Related Values*, Beverley Hills, CA: Sage.

Hu, Michael Y. and Haiyang Chen (1993), "Foreign Ownership in Chinese Joint Ventures: A Transaction Cost Analysis," *Journal of Business Research*, 26 (February), 149-160.

Jaworski, Bernard J. and Ajay K. Kohli (1993) "Market Orientation: Antecedents and Consequences," *Journal of Marketing*, 57 (July), 53-70.

Jefferson, Gary H. and Thomas Rawski (1994) "Enterprise Reform in Chinese Industry" *Journal of Economic Perspectives* 8, 47-70

Judge, George G., W. E. Griffiths, R. Carter Hill, Helmut Lukepohl, and Tsoung-Chao Lee (1985), *The Theory and Practice of Econometrics*, 2<sup>nd</sup> ed., New York: John Wiley and Sons.

Kennedy, Peter (1989), *A Guide to Econometrics*, 2<sup>nd</sup> ed., Cambridge, MA: MIT Press.

Khan, Arshad M. and V. Manopichetwattana (1989), "Innovative and Noninnovative Small Firms: Types and Characteristics," *Management Science*, 35 (May), 597-606.

Kornai, J. (1990), *The Road to a Free Economy*, New York: Norton.

Liao, Darlene M. (1998) "Outfitting Chinese Households" *China Business Review* 25 (6), Nov/Dec, 32-34

Lu, Yuan, John Child and Yanni Yan (1997) "Adventuring in New Terrain: Managing International Joint Ventures in China" *Advances in Chinese Industrial Studies*

Luo, Yadong (1997a) "Partner Selection and Venturing Success: The Case of Joint Ventures with Firms in the People's Republic of China" *Organization Science*, Vol.8, No.6 November-December, 648-662

Luo, Yadong (1997b) "Guanxi and Performance of Foreign-invested Enterprises in China: An Empirical Enquiry" *Management International Review* Vol.37, No1.51-70

Madhok, Anoop (1997), "Cost, Value and Foreign Market Entry Mode: The Transaction and the Firm," *Strategic Management Journal*, 18(1), 36-61.

Mannion, M. (1994), "Survey Research in the Study of Contemporary China: Learning from Local Samples," *The China Quarterly*, 741-765.

McMahon, William (1999) "Foreign Profits Down in China, But FDI Still Needed" *ChinaOnline News*, [www.chinaonline.com](http://www.chinaonline.com) October 10.

Narver, John C. and Stanley F. Slater (1990), "The Effect of a Market Orientation on Business Profitability," *Journal of Marketing*, 54 (October), 20-35.

National Bureau of Statistics (1997,1999) *China Statistical Yearbook*, Beijing ,China Statistics Press.

Nee, Victor (1992) "Organizational Dynamics of Market Transition: Hybrid Forms, Property Rights and Mixed Economy in China" *Administrative Science Quarterly*, 37,1-27.

Osland, Gregory E. and S. Tamer Cavusgil (1996), "Performance Issues in US-China Joint Ventures," *California Management Review*, 38(2), 106-30.

Pan, Yigang, Shaomin, Li and David Tse (1999), "The Impact of Order and Mode of Market Entry on Profitability and Market Share," *Journal of International Business Studies*, 30(1), 81-104.

- \_\_\_\_\_ and David Tse (1996), "Co-operative Strategies of Foreign Firms in an Overseas Country," *Journal of International Business Studies*, 27(5), 929-946.
- Peng, M.W. and P. S. Heath (1996), "The Growth of the Firm in Planned Economies in Transition: Institutions, Organizations and Strategic Choice," *Academy of Management Review*, 21, 492-528.
- Perkins, Dwight (1994), "Completing China's Move to the Market", *Journal of Economic Perspectives*, 8(2) Spring, 23-46
- Pfeffer J. and G. R. Salancik (1978), *The External Control of Organizations: A Resource Dependence Perspective*, New York: Harper and Row.
- Pierce, J. L. and A. L. Delbecq (1977), "Organizational Structures, Individual Attitudes and Innovation," *Academy of Management Review*, 2 (January), 26-37.
- Robinson, J. P., P. R. Shaver, and L. S. Wrightsman (1991), "Criteria for Scale Selection and Evaluation," in *Measures of Personality and Social Psychological Attitudes*, J. P. Robinson, P. R. Shaver, and L. S. Wrightsman, eds., San Diego: Academic Press, pp. 1-15.
- Ruekert, Robert W. (1992), "Developing a Marketing Orientation: An Organizational Strategy Perspective," *International Journal of Marketing*, 9 (August), 225-45.
- Scott, W. R. (1987), *Organisations: Rational, Natural and Open Systems*, 2<sup>nd</sup> edition, Englewood Cliffs, NJ: Prentice Hall.
- Shenkar, O. (1991), *Organisation and Management in China, 1979-1990*, New York: Sharpe.
- \_\_\_\_\_ (1994), "The PRC: Raising the Bamboo Screen Through International Management Research," *International Studies of Management and Organization*, 24, 9-34.
- Slater, Stanley F. and John C. Narver (1994), "Does Competitive Environment Moderate the Market Orientation – Performance Relationship," *Journal of Marketing*, 58 (January), 46-55.
- South China Morning Post, February 11, 1999.
- Tse, David, Y. Pan, and K. Au (1997), "How MNCs Choose Entry Modes and Form Alliances: The China Experience," *Journal of International Business Studies*, 28(4), 779 –805.
- Vanhonacker, Wilfried. (1997), "Entering China: An Unconventional Approach," *Harvard Business Review*, (March/April), 130-140.

Vanhonacker, Wilfried and Yigang Pan (1993) "The Impact of Country of Origin, Business Scope and Location on International JV Operations in China" Working Paper, INSEAD, Fontainebleau, France

Von Glinow, M. and M. Teagarden (1988) "The Transfer of Human Resource Management Technology in Sino-US Co-operative Ventures: Problems and Solutions" *Human Resource Management*, 27, 210-29

Warner, Malcolm (1993) "Human Resource Management 'with Chinese characteristics'" *International Journal of Human Resource Management*, 4, 45-65

Woodcock, C., Patrick, Paul W. Beamish, and Shige Makino (1994), "Ownership-Based Entry Mode Strategies and International Performance," *Journal of International Business Studies*, 25(2), 253-273.

Xin, K. and J. Pearce (1996), "Guanxi: Connections as Substitutes for Formal Institutional Support," *Academy of Management Journal*, 39 (December), 1641-1658.

Zahra, Shaker A., Sephanie de Belardino, and W. Randy Boxx (1988), "Organizational Innovation: Its Correlates and its Implications for Financial Performance," *International Journal of Management*, 5 (June), 133-142.

**Table 1**  
**Constructs, Items and Reliabilities**

<p><b>Customer Focus</b> (Cronbach Alpha = .66) (7-point scales on importance)</p> <ul style="list-style-type: none"> <li>• Uniqueness of your products</li> <li>• Targeting clearly identified groups of customers</li> <li>• Marketing products suitable for sale at high prices</li> </ul> <p>Making products for specific groups of customers</p> <p><b>State Influence</b> (Cronbach Alpha = .77) (7-point scales on agree/disagree)</p> <ul style="list-style-type: none"> <li>• We hire our production workers without the help of government(RC)</li> <li>• We set the prices of our products without intervention from government (RC)</li> <li>• We hire technical staff and supervisors without the help of government officials (RC)</li> <li>• Officials of the local government play an important role in our decision-making.</li> <li>• Officials of provincial or central government play an important role in our decision-making</li> </ul> <p><b>Technological Turbulence</b> (Cronbach Alpha = .75) (7-point scales on agree/disagree)</p> <ul style="list-style-type: none"> <li>• Technological change provides good opportunities for profit in this industry</li> <li>• In this industry, a firm which uses old technology loses many of its customers</li> <li>• The technology in this industry is changing rapidly</li> <li>• In this industry, a large number of new products have been made possible through technological breakthroughs</li> </ul>	<p><b>Innovativeness</b> (Cronbach Alpha = .83) (7-point scales on agree/disagree)</p> <ul style="list-style-type: none"> <li>• We seek a reputation for being the first in the industry to introduce new technologies</li> <li>• Our technology development effort allows us to enter new markets before our competitors</li> <li>• We try to introduce products which are “new to the world”</li> <li>• Our production process uses technology which is more advanced than our competitors</li> <li>• We spend more money on developing new products than our competitors</li> <li>• We spend more money on up-grading our equipment and machinery than our competitors</li> </ul> <p><b>Performance</b> (Cronbach Alpha = .84) (7-point scales on “Very Poor” to “Excellent”)</p> <ul style="list-style-type: none"> <li>• Total Sales</li> <li>• Market Share</li> <li>• Total Profit</li> </ul>
---	--

**Table 2. 3SLS Model Estimation**

Dependent Variable	ENTRYMODE	CUSTFOC	STATEINF	TECHTURB	CUSTFOC TECHTUR Interactor
CUSTFOC	-2.29*				
STATEINF	n.s.				
INNOV		.29**	.16*	2.05**	n.s.
PERF	n.s.				

\*\*  $p < .01$   
 \*  $p < .05$   
 n.s.  $p > .05$

ENTRYMODE = Mode of Entry (Joint-Venture = 1, Wholly Owned Foreign Enterprise = 0)  
 CUSTFOC = Customer Focus  
 STATEINF = State Influence  
 TECHTURB = Technological Turbulence  
 INNOV = Innovativeness  
 PERF = Performance

**Figure 1**  
**Hypothesized China Market Entry Mode – Performance Framework**

