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# Navigating in the Institutional Jungle of China

An Investigation of Competitive Advantages Through the  
Management of Institutional Contexts

by

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# ABSTRACT

**Title:** Navigating in the Institutional Jungle of China - An Investigation of Competitive Advantages Through the Management of Institutional Contexts

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**Keywords:** Institutions, Capabilities, Strategy, Transitional economy, Competitive advantage

**Purpose:** The purpose is to explore the institutional forces in a transitional regulated economy. Furthermore, the study seeks to gather information about firms' perception of these forces and the way by which these firms seek to handle them and use them to build competitive advantages.

**Methodology:** The study is of qualitative character with an instrumental case study design and a mix of deductive and inductive research approaches. The main data used in the study is collected from in-depth interviews with representatives from three different actors in the dairy market. Beyond the interviews, secondary data is used for additional perspectives and clarification.

**Theoretical perspectives:** The study is based on institutional theory and its institutional-based view. This is combined with the resource-based view and industrial organization economics for the creation of a theoretical framework that maps the creation of competitive advantages through management of institutions.

**Empirical foundation:** China as a transitional regulated economy and its dairy industry is the studied setting. This context was found to be suitable due to the prominent institutional environment and instability.

**Conclusions:** We conclude that there is relevance for firms in the recognition of the institutions in the investigated context. There are certain capabilities and strategies that are useful and lead to development of competitive advantages through better management of the institutional context.

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# 1 INTRODUCTION

## 1.1 Theoretical Introduction

There have been two eminent perspectives when analyzing firm competitiveness within strategic management; one internal and one external (Hoskisson, Hitt, Wan & Yiu, 1999). Firstly, the internal perspective, contemplating firms' strengths and weaknesses, identifies specific combinations of resources that render competitiveness, i.e. resource-based view (RBV) (Barney, 1991). Secondly, the external perspective focusing on industry structures and competitive positioning within the industry, i.e. industrial organizational economics (IOE) (Porter, 1980).

In 1999, Hoskisson et al. emphasized that the competitive landscape of firms is highly affected by varying rules, technological development, globalization and differences in cultures and countries. Thus, these factors added a layer of complexity to the theoretical research approach. To manoeuvre this entanglement, a multi-theoretical approach in which theories of competitiveness are complemented and integrated with institutional theory is advocated (Hoskisson et al., 1999; Hoskisson, Eden, Lau & Wright, 2000; Peng, 2002).

Furthermore, Whittington (2012) especially questions the applicability and explanatory power of the historical view of firm competitiveness in transitional economies. For example, competitive advantages, especially in state-controlled markets such as China, Russia and Brazil, could be considered to be state-based rather than market-based. In compliance, Peng (2002) mentions that a lot of researchers (primarily investigating western countries) has overlooked the relationship between institutions, organizations and strategy.

Thus, what is implied is that solely analyzing a transitional economy through the IOE and RBV lens would vitally neglect one critical aspect. As Meyer, Estrin, Kumar Bhaumik and Peng phrased it:

*“a new generation of research suggest that institutions are much more than background conditions, and that ‘institutions’ directly determine what arrows a firm has in its quiver as it struggles to formulate and implement strategy, and to create competitive advantage.”* (2009, p. 61).



This theoretical integration was initiated by Oliver (1997) when she introduced the concept of *institutional capital* which is defined as the context around a firm's resources that enhance the optimal use of resource capital. In her 1997 article, Oliver takes an internal view and considers the value of institutional capital as a firm's ability to build internal institutions that increase decision-making efficiency. In other words, the creation of guiding principles for decision-makers to follow when they are affected by internal and external influences. However, in the same article Oliver calls for a more external view of institutional capital and implies that a source of firm variation and heterogeneity can be created through firms' ability to handle the external institutional context, such as regulations or social expectations. This external view of the theoretical combination of institutional theory and resource-based view was later phrased as the institutional-based view by Peng (2002). This perspective advocates how institutions interact with organizations and can affect their strategic choices (Peng, 2008).

This interaction has been partly explored by Marquis and Raynard (2015) in their attempt of developing generic institutional strategies for emerging markets. What is far less explored is the mapping of capabilities that serves this purpose. Oliver and Holzinger (2008) provided strategies and dynamic capabilities for firms to use when managing the political environment. While their contribution is useful, it is not adapted to the peculiar circumstances of transitional regulated economies. Neither does it consider capabilities to handle the less formal institutions such as social expectations.

To conclude, we will perform this study to map the capabilities and strategies that firms use to manage not only its political and legal environment, but also its social environment in a transitional regulated economy to create a competitive advantage.

## **1.2 Empirical Introduction**

The main emerging countries in the world have for some time been considered to be Brazil, Russia, India, China, and South Africa, also known as the BRICS countries (BRICS, 2017). Within this grouping of states, China has by many been considered the most eminent player with an increasing production and big impact on the world economy (Zhao, 2015; Rapoza, 2017). Currently, China is the world's second largest economy behind the U.S. and has seen tremendous growth and development over several years (The World Bank, 2018). This development has resulted in alterations in several parts of the Chinese society. The disposable

income has increased, urbanization trends are apparent, the technological development has flourished, and the general living standard has improved. One major result of these developments has been the substantial enlargement of the Chinese middle class. Tsang (2014) mentions that the growing middle class of China should rather be called a “new” middle class due to the shift from being tightly connected to traditional living patterns to a wider acknowledgement of both domestic and foreign trends. Moreover, the enlarging middle class in urban areas is seen as the main driver of consumption in China especially regarding the appreciation of new social and consumer trends (Tsang, 2014; Boston Consulting Group, 2015). However, this positive and expeditious economic development is, perhaps inevitably, entailed by some negative aspects as well. These negative aspects include for example increased inequality, a difficult-to-manage urbanization, and unsustainable environmental consequences (The World Bank, 2018).

A sector of the Chinese market that has had an interesting advancement, in tune with the overall economy, since the end of the last century has been the dairy industry. From the early 1990s the industry has been developing at a high pace, just as the Chinese economy, with increased demand and domestic supply (Fuller, Huang, Ma & Rozelle, 2005; Sharma & Rou, 2014; Gooch, Hoskin & Law, 2017). Some even term the development of the dairy market as ‘the Chinese dairy boom’ (Sharma & Rou, 2014). Considering per capita consumption, China consumes very little dairy products compared to the world average. The consumption is at a little more than 25 kilograms per person and year in average, with more consumption in urban areas and less (to none) in rural areas. The consumption, however, is expected to keep increasing henceforth (Jia, Luan, Huang, Li & Rozelle, 2014; DBS Group, 2017; Sharma & Rou, 2014) and due to the large number of Chinese consumers, the total volume of the market has a substantial impact in the world (Gooch et al., 2017).

The development of the dairy industry is a result of several developments in various business-environmental aspects (Sharma & Rou, 2014). Economical changes, demographic and social changes, political changes, technological changes have all influenced the current evolution. Also, the fluctuating industry dynamics are interesting with a few very large, mainly domestic, actors, governmental involvement, increased regulations, uneven power distribution in the value-chain, and varying consumption trends. The simultaneous development of the Chinese economy makes the dairy industry a suitable object to study when trying to answer the scholarly call for an application of the institutional strategic lenses in transitional economies (e.g. Whittington, 2012; Hoskisson et al., 2000; Peng 2002).

### **1.3 Aim and Objectives**

To conclude, this study has the objective to provide understanding and explain firms' interactions with institutional forces in transitional regulated economies, with China and its dairy industry as a focal case. The aim will be to develop the theory on firm competitiveness by concertizing and operationalizing it through identifying strategies and capabilities that are used to manage institutional forces. This will be done by utilizing an institutional perspective on traditional strategic management theories consisting of the resource-based view and industrial organization economics.

### **1.4 Research Question**

*How can firms create a competitive advantage in a transitional regulated economy by being able to affect, understand and adapt to its institutional context?*

### **1.5 Research Purpose**

The purpose of this study is divided in two. Firstly, the aim is to explore the institutional forces in a transitional regulated economy, in this case the Chinese economy and its dairy market. Secondly, it will seek to gather information about firms' perception of these forces and the way by which these firms seek to handle them and use them to build competitive advantages. Concludingly the purpose will be to provide theoretical implications for researchers regarding the connection between competitive advantages and institutional contexts, and practical implications for firms operating in transitional regulated economies regarding the efficient handling of institutional forces.

### **1.6 Research Limitations**

There are several transitional economies in the world and these economies will have both similarities and differences. While this study will aim to provide as generalizable conclusions as possible, it has to be acknowledged that every economy has its own peculiar circumstances and context. This study will be limited to the transitional economy of China and, hence, be performed and framed with regards to the Chinese context. The conclusions drawn from this study should therefore be carefully applied if used in other economies than the Chinese. To

simplify this transferability as much as possible, a comprehensive description of the methods used and the context will be provided.

Furthermore, the Chinese dairy market contains a wide range of actors from all over the world, operating to varying extent geographically in China. Thus, there are many possible ways to go about to investigate the industry and its institutions. Strategic management research on transitional economies has historically made a distinction between domestic and foreign firms' strategic approach. To keep in line with prior research and be able to extend on it, we have chosen to focus on foreign firms acting in the Chinese market. This consideration was mainly driven by two reasons. First of all, institutions vary across countries, hence, we argue that foreign firms in the Chinese dairy market will to a larger extent be able to provide a nuanced view of (potential) differences between other markets' and the Chinese market's institutions. Finally, the time-frame of the study was a period of ten weeks. Thus, it was necessary to rather limit the scope of the study to instead be able to perform a deeper and more thorough study of the view of foreign firms. Within a longer study it would be interesting to be able to compare the views and strategic considerations of domestic and foreign firms.

## **1.7 Outline of The Thesis**

This paper will be outlined in the following way. First, relevant literature within industry organization economics, resource-based view and institutional theory will be reviewed and then summarized in section 2.5. Second, a description of the methodological choices made during the research process is presented and discussed. Third, the Chinese economy and its dairy market is described and combined with insights retrieved about firms' activities to handle the institutional context. Finally, we provide a description of what capabilities and strategies firms develop in a transitional economy and offer theoretical and practical implications of our findings.

## 2 LITERATURE REVIEW

### 2.1 Introduction

This literature review aims to summarize the existing research on firm competitiveness, in the context of transitional regulated economies. Traditional theories within strategic management, including industrial organization economics (IOE) and resource-based view (RBV), will be elaborated on and combined with institutional theory (IT). The peculiar business environment of transitional economies composes important strategic contexts for firms, domestic as well as foreign. Therefore, to enhance the understanding of the theoretical and analytical context of this study, the review will firstly introduce the attributes and former research on transitional economies. This section will be succeeded by the theoretical perspectives of IOE, RBV and IT. Lastly, the theories will be summarized together in section 2.6 to form a base for the understanding, mapping and explanation of the competitive landscape in the Chinese dairy industry.

### 2.2 Transitional Economies

Transitional economies and emerging markets have come to play an increasingly apparent role in the internationalization of various industries. The phenomena of transitional economies has been more and more addressed in management research, especially in the 21st century (Hoskisson, Wright, Filatotchev & Peng, 2013). These markets are often characterized by a transition from planned economy to market economy, economic liberalization, urbanization, rising middle class and initially less competition (Hardaker, 2017). The economy also becomes more integrated in the global economy (Khanna et al., 2005; Marquis & Raynard, 2015). Another factor that is distinctive for the development of an emerging market is the co-evolvement of the economic and social aspects of the market and the nation, which enable firms to affect both these developments (Marquis & Raynard, 2015). Transitional economies constitute an environment in which political and regulative instability is apparent as well as a deficient infrastructure (Hoskisson et al., 2013). The factor markets, such as labor or production input, are harder to map and evaluate (Khanna et al., 2005; Zhong, Chen, Kong & Tracy, 2014). Marquis and Raynard (2015) provided a useful framework to display the central differences between transitional economies, developed markets and developing markets and can be seen in Table 2.1.

DEVELOPED MARKETS	TRANSITIONAL ECONOMIES	DEVELOPING MARKETS
<b>Economic conditions</b>		
<ul style="list-style-type: none"> <li>• Developed capital markets with moderate to high levels of liquidity</li> <li>• “Meaningful” regulatory bodies</li> <li>• High levels of per capita income</li> <li>• Dominance of industrial and service sector</li> <li>• Minimal trade barriers</li> <li>• Low GDP growth rates</li> </ul>	<ul style="list-style-type: none"> <li>• Low GDP growth rates</li> <li>• Marginally developed capital markets with low levels of market liquidity</li> <li>• Low levels of per capita income and high income inequality</li> <li>• Rapid economic growth and development</li> <li>• Volatility in financial capital inflows</li> <li>• High levels of inflation</li> <li>• Modernization of infrastructure</li> <li>• Dominance of manufacturing and labor-intensive industries</li> <li>• Decreasing trade barriers</li> <li>• High GDP growth rates</li> </ul>	<ul style="list-style-type: none"> <li>• Poorly developed capital markets with low levels of market liquidity</li> <li>• Low levels of per capita income and high level of poverty</li> <li>• Stagnant productivity</li> <li>• Stifling bureaucracy hinders entrepreneurship, trade, and investment</li> <li>• High dependence on agriculture</li> <li>• Moderate to high trade barriers</li> <li>• Unfavorable balance of trade</li> <li>• Low GDP growth rate</li> </ul>
<b>Political, legal, socio-cultural and technological conditions</b>		
<ul style="list-style-type: none"> <li>• Formal regulatory infrastructure in place (e.g. market regulation, corporate governance, transparency and accounting standards)</li> <li>• Moderate to high standard of living</li> <li>• Moderate to high Human Development Index (HDI) levels (education, literacy, and health)</li> <li>• Advanced technological and commercial infrastructure</li> <li>• High degree of political freedom</li> <li>• Little government intervention in business</li> </ul>	<ul style="list-style-type: none"> <li>• Non-transparent political and regulatory environment</li> <li>• Improving standard of living</li> <li>• Young population and expanding working population</li> <li>• Moderate to high Human Development Index (HDI)</li> <li>• Increasing urbanization</li> <li>• Burgeoning middle class</li> <li>• Growing demand for consumer goods</li> <li>• Prevalence of state-owned firms</li> <li>• Low to moderate degree of political freedom</li> <li>• Moderate to high levels of government intervention in business</li> </ul>	<ul style="list-style-type: none"> <li>• Absence of specialized intermediaries and regulatory systems</li> <li>• Low standard of living</li> <li>• Low Human Development Index (HDI) levels</li> <li>• Poor education system and high illiteracy</li> <li>• High unemployment</li> <li>• Lack of adequate health care</li> <li>• Low degree of political freedom</li> <li>• Moderate to high risk of social unrest and war</li> <li>• Constraining government policies hinder economic develop and</li> </ul>

Table 2.1: Characteristics of developed, transitional, and developing countries (adapted from Marquis & Raynard, 2015)

Transitional economies are usually characterized by environmental turbulence, e.g. inconsistent regulations and fragmented markets which force organizations, MNCs in particular, to learn and adapt to new contexts (Luo & Peng, 1999). Hence, a market and exogenous orientation in these economies is inevitable to embrace in order to survive and prosper (Singh, 2003). Concludingly, with regards to the circumstances in transitional economies, firms need to consider both its internal abilities and resources as well as its environment. Within traditional strategic management theory there has been two eminent perspectives for these considerations; industrial organization economics (IOE) and the resource-based view (RBV).

## **2.3 Traditional Views in Strategic Management Theory**

IOE and RBV have been widely adopted due to their applicability in various business environments. For the focal study, these theories will provide explanation of the competitive environment of the market. However, as stated in the introduction, they are not considered to regard the important institutional environment in a transitional economy. Hence, in this section, the usefulness of these two perspectives will be described and then concluded with their limitations for the aim of this study.

### **2.3.1 Industrial Organizational Economics**

Industrial organizational economics (IOE) is a theoretical area that has been approached by many scholars through different angles. In its simplest description, it could be described as an attempt to explain firms' profits within an industry based on the structural dimensions of the specific industry (Porter, 1981; Conner, 1991; Kahn, 1983). The Bain IOE-paradigm was amongst the first and is built upon the notion that the industry structure (the context, e.g. number of sellers and buyers or entry barriers, in which competition occurs) affects firm conduct (i.e. their strategy through pricing, quality, advertising etc.) which conclusively determines performance (Porter, 1981; Conner, 1991). The Bain paradigm assumes that size equals power, and with power meaning the ability to carry out monopolistic behavior that increase performance (Porter, 1981; Conner, 1991). The Neoclassical theory of IOE instead assumes a perfect market in which firm size, prices, and costs are controlled by capitalist-market forces (Conner, 1991). Few markets, however, could be labeled perfect, especially when using several points of reference when distinguishing the context in which the strategy

of a firm is conducted (Porter, 1981). Thus, the Bain paradigm is considered more suitable in transitional economies.

The industry structure in the Bain paradigm has been elaborated and clarified by Porter in 1979 with his publication of the influential five forces. The forces that determine the industry structure are internal rivalry, threat of entry, buyer power, supplier power and threat of substitutes (Porter, 2008). Subsequently, these forces determine the way in which firms can position themselves and finally what profitability level that is possible to achieve in the industry (Teece, Pisano & Shuen, 1997). Thus, the goal through this perspective is to protect the firm as much as possible from these competitive forces, which then will increase the possibility of higher profits (Teece, 1984).

While IOE is useful for explaining the competitive landscape in an industry and the industry-level profitability, it is not extensive enough to, on its own, explain the competitiveness in transitional economies (Hoskisson et al., 2000; Peng, Wang & Jiang, 2008; Bresser & Millonig, 2003). Teece (1997) states that putting too much emphasis on industry forces can lead to under-investments in internal competencies and capabilities, and therefore possibly lead to damage in long-term competitiveness of the firm. In addition, “while IO[E] is useful for determining the likely average profitability of an industry, in its traditional form it clearly is not very useful for sorting out the different performances of different companies” (Porter, 1981, p. 612). The reason for this limitation lies in the notion mentioned above, that markets seldom are perfect. This means that firms’ access to resources will vary, and so will its abilities to compete efficiently. In this sense the RBV perspective aims to solve the inability of the IOE to explain why firms within an industry vary in performance (Barney, 1991).

### **2.3.2 Resource-Based View**

The difference in profits on an intra-industry level is larger than the difference between industries, which implies that firm-specific aspects are important to consider (Rumelt, 1991). The focus on the internal organization and its resources is argued to be a good complement to the traditional strategy research of IOE. To unravel the varying intra-industry performances, the resource-based view (RBV) in which the composition and use of resources is seen to determine competitiveness, is a suitable theoretical perspective (Barney, 1991; Collis, 1991; Teece et al., 1997; Eisenhardt & Martin, 2000; Amit & Schoemaker, 1993)



RBV takes an internal view of the firm, advocating that firms are idiosyncratic in their combination of strategically relevant resources. It is assumed that resources are not perfectly mobile, implying that firm heterogeneity can be long lasting. Over time organizations can develop different tangible (e.g. physical assets) and intangible assets (e.g. tacit learning and routines) that makes them unique. (Barney, 1991; Collis, 1991). To determine whether these resources can facilitate firm competitiveness, Barney (1991) suggest using four criteria, called the VRIS-criteria. First, they should be *valuable*, i.e. they contribute to price raises or cost reductions. Second, resources should be *rare*, meaning that other firms do not possess them to a great extent. Third, they should be *imperfectly imitable*, implying that they are not easy to acquire. Last, resources should *not be substitutable*, referring to the non-availability of strategically equivalent resources. For a strategy to be a source of sustained competitive advantage all four criteria need to be fulfilled. Nevertheless, a strategy can still yield a competitive advantage if it fulfills the first criterion of it being valuable, but it would not make up a *sustainable* competitive advantage. It would instead imply that the strategy is not currently performed by any other firm but could after all be copied over less extensive time (Barney, 1991).

Collis (1991) gathered various views of the construct of competitive advantage and claimed that the three vital constituents of RBV include core competencies, administrative heritage, and organizational capabilities. These are resources by which a firm can create a (sustainable) competitive advantage.

*Core competencies* are defined as “(...) the vector of the irreversible assets along which the firm is uniquely advantaged” (Collis, 1991. p. 51). It reflects both tangible and intangible assets that are determinants of a firm’s strategic position. Thus, it is abilities or competencies that are necessary and fundamental to the competitive advantage of the firm. It should represent the foundation for value-creating strategies that are conducted by the organization (Eisenhardt & Martin, 2000). A core competence can provide potential access to different markets by being applicable for creation of various products and services. The competence should significantly contribute to perceived customer benefits of the end product and it should not be easily imitated by competitors of the firm (Prahalad & Hamel, 1990).

*Administrative heritage* is a construct of two parts; the cultural and physical heritage. Firstly, a firm's cultural heritage, such as leadership style and symbolic actions, set the context for the strategic decision-making. Secondly, the physical heritage such as office facilities or communications systems frame the organization's decision-making (Collis, 1991). Furthermore, already made investments can create a path dependency and therefore affect new investment decisions. Barney (1991) argues that historical conditions, causal ambiguity, and social complexity, in turn, lead to resources becoming imperfectly imitable, which is one of the criteria to obtain a sustainable competitive advantage. Administrative heritage addresses the same complexity and idiosyncratic display of firms, implying that the historical development and the social context within the firm affects the organization's competitiveness.

*Organizational capabilities* have been discussed through varying perspectives by several scholars. Collis (1991, p. 52) refers to it as "the managerial capability to continually improve and upgrade firm efficiency and effectiveness - the 'production of new production function'". However, other scholars present an extended description of Collis and divide capabilities into being either operational (ordinary) or dynamic (see Winter, 2000; 2003; Teece et al., 1997; Eisenhardt & Martin, 2000). An operational capability is defined as the ability to make a living in the present and refers to activities performed by known techniques on a more or less day-to-day basis. A dynamic capability is the capacity to alter how the company makes its living. Hence, dynamic capabilities enable adaptation and change of operational capabilities in line with the shifts of the environment and industry (Eisenhardt & Martin, 2000; Teece et al., 1997; Helfat & Peteraf, 2003). With this categorization Collis' (1991) description would arguably fall under the dynamic category.

Capabilities are viewed by several scholars as an important dimension of firm idiosyncrasy that enable competitive advantage (Helfat & Winter, 2011; Collis, 1991; Eisenhardt & Martin, 2000), and they can be seen as general internal resources in line with the reasoning of Barney (1991). Due to other scholars' view and its importance for this study, it is necessary to provide a more thorough description of what capabilities are.

#### Breaking Down Capabilities

Several scholars discuss the construct of competitive advantage through firms' capabilities (e.g. Collis, 1991; Felin, Foss, Heimeriks & Madsen, 2012; Eisenhardt & Martin, 2000;

Teece et al., 1997). A capability refers to a firm's ability to perform a specific activity in a reliable or at least satisfactory way. It should enable output that is apparently beneficial for the prosperity of the firm (Winter, 2000). The purpose of the capability should be intended and specific, and the activity should be viable to conduct repeatedly. Hence, the behavior shall reflect pattern, practice and routines that imply no ad hoc handling. For an activity to be classified as a capability it needs to be significant for the firm, otherwise it would be regarded as a general routine with less strategic importance (Winter, 2000; 2003).

As implied in the previous paragraph, organizational capabilities can include a wide variety of firm abilities and routines, hence, different interpretations and conceptualizations has been made. Felin et al. (2012) portray what they call 'microfoundations' of capabilities. These are what underlies capabilities. Put differently, microfoundations are what capabilities consist of. Three components of microfoundations are identified, consisting of *individuals*, *social processes* and *structure*. These components co-exist in capabilities and are interrelated, however, their combination and importance vary. Individuals can substantially affect behavior, development and performance of firms. Individuals' heterogeneity in their characteristics, abilities, choices and cognition is displayed as an important aspect of firms and are considered to create, develop and alter capabilities. However, individuals need to be supported by processes of interaction and structure. A process is defined as a sequence of interrelated events, however it can be more or less rigid. Some processes require strict adherence to beforehand decided events. Other allow for more flexibility and situational adaptation, which is somewhat contradicting to the definition of Winter (2003) where repeatability is advocated. To use and develop capabilities firms need structures in place that enable processing of information, sharing and development of knowledge, coordination, and integration. Several aspects of structure are highlighted. One is the structure of the decision-making process, which can be governed by both informal heuristics and formal rules. Another is the organizational design (structure). The continuum between horizontal and bureaucratic organizations is, to a varying extent, but still related to the continuum of rigidity and flexibility of processes (Felin et al., 2012). The structure component is therefore similar the administrative heritage aspect presented by Collis (1991).

As mentioned above, a common way to address organizational capabilities is to separate operational (ordinary) and dynamic capabilities. Teece (2012) emphasizes in his article "Dynamic capabilities: Routines versus Entrepreneurial Action" that ordinary capabilities are

more rooted in routinization, than dynamic capabilities. It is explained that individual managers' strategic acts, that does not derive from routine-based behaviour, can likewise be a basis for capabilities of dynamic character. Teece (2012) therefore also criticised the definition of Winter (2003) where he makes a distinction between dynamic capabilities and more flexible ad hoc problem solving. It is instead argued that "it is often extremely difficult, if not impossible, to routinize change beyond recognizing shared principles that should be adhered to in order to deal with it" (Teece, 2012, p. 1397). Nevertheless, Helfat and Winter (2011) argue that the line that separates the two categories (i.e. operational and dynamic) is blurry. First, firms' surroundings and circumstances are always changing to some extent. To determine the intersection of how much change that distinguishes an operational capability from a dynamic is likely to be irrelevant and different cases will presumably provide different answers. Second, there is a presupposition that for a capability to be dynamic it needs to support a radical change in how a company makes its living. Capabilities that support the current operations in non-radical and incremental change can still possess vital dynamic elements. Third, some capabilities have dual purposes and are used for both operational and dynamic causes. A good example is capabilities in relation to sales, distribution and marketing that provide market access, which can promote and facilitate both existing and new products (Helfat & Winter, 2011).

To summarize, Dynamic capabilities are not limited to radical change and swift environmental alteration. Capabilities do often (but not always) serve both operational and dynamic purposes to some degree. In addition, capabilities and its microfoundations can vary in rigidity and routinization.

The theme of capabilities is heavily studied within management. There is consensus regarding the potential to create competitive advantage through leveraging capabilities and they can therefore be considered resources in themselves in line with the reasoning of Barney (1991). However, as implied above there are different interpretations and operationalization of its meaning. Even though the theoretical area is lightly elaborated, some authors have attempted to consider and operationalize capabilities in the context of transitional economies.

## Capabilities and Transitional Economies

Luo and Peng (1999) discuss learning capabilities as a considerable source of competitive advantage in transitional countries. A firm can thus, affect its competitiveness through active participation and established processes for accumulating experiences and obtaining knowledge (Luo & Peng, 1999). When an economy is transitioning from a plan economy to a market economy, the situation enables market exchanges which foster resource dependencies. This in turn require business relationships to obtain input to reach the desired performance (Smirnova, Naudé, Henneberg, Mouzas & Kouchtch, 2011). State owned enterprises (SOEs) often compete and/or collaborate with MNCs, due to their occasional shortage in for instance, technological, managerial, and financial resources. This generally render strategic alliances and networks to obtain the necessary capabilities to compete (Peng, 2001). Relational capabilities, which can be defined as a firm's abilities and activities that foster collaborative business relationships, is therefore necessary in this context (Smirnova et al., 2011).

### **2.3.3 Concluding Traditional Strategic Management**

The perspective of RBV is on an intra-firm level. Thus, emphasis is put on the efficient use of resource advantages rather than the exploitation of possibilities to create market imperfections, such as monopoly rents (Barney, 1991). However, it is not reasonable to not take those market imperfections into consideration, especially in a transitional economy where a lot of different factors affect the way in which companies can compete (Peng, 2001; Peng 2002; Hoskisson, 2000; Luo & Peng, 1999). Indeed, IOE considers market imperfections and some institutional forces in the form of governmental influences on industry structure (see Porter, 2008). However, it is necessary to take guidance from theories that are rather considering competitive possibilities based on institutional circumstances around the firm. The criticism that has been directed towards the IOE and RBV perspectives is the two's lack of attention to these institutional forces in the environment. Hence, the critique implies that the RBV and IOE theories are better suited and created for an analysis of stable and market-based competitive circumstances (Bresser & Millonig, 2003), which is not reasonable to assume in a transitional economy (Peng et al., 2008).

Organizations can develop strategies, routines and procedures to better meet the needs of environmental changes, but RBV does not consider how the exploitation is made. Even though, RBV is an insightful theory for studying competitiveness in the context of

transitional economies (Hoskisson et al., 2000), it is argued by Peng (2001; 2008) to be more fruitful when used in conjunction with institutional theories for it to clarify and resolve institutional intricacies. This challenge has been attempted to be mitigated through the combination of RBV and IT. This view, originating from Oliver (1997), implies that the firm can be better or worse at managing its internal and external institutional context. Also, it is acknowledged that the firm can form the external environment to fit its resources, rather than only forming the internal resources to fit the external environment. This theoretical integration has been named the institutional-based view (Peng, 2002).

## **2.4 Business Strategy Through the Institutional Lens**

The business strategy perspective of institutional theory (IT) contributes with a broader view than firm resources and industry positioning as sources of competitive advantage (Hoskisson, 2000; Peng et al., 2008). As mentioned earlier, both RBV and IOE have received criticism, due to their insensitivity of informal and formal institutional forces that exist both internally and externally in relation to the organization and provide the context for the competition. Instead, these theories generally view institutions as “background” conditions, since they are mostly applied in western contexts, where more stable and market-based conditions can be assumed (Peng et al., 2008). Therefore, in the empirical context of a regulated transitional economy it is suitable to accompany the IOE and RBV perspectives with IT (Meyer et al., 2009) to take note of these institutional forces that are embedded in the market and the surrounding context of the operations (Peng, 2002).

According to the reasoning of Oliver (1997), a firm can choose to create or alter resources and capabilities that enhance its capacity to affect and manage the institutional context in its favor, in order to create a competitive advantage. This is in line with the reasoning of Meyer et al. (2009) that resources and institutions are not just complementary, they are interdependent. What this would imply is that the competitiveness of a firm’s operations in a transitional economy is the result of an interaction between both its resources and institutions (Peng et al., 2008; Meyer et al., 2009).

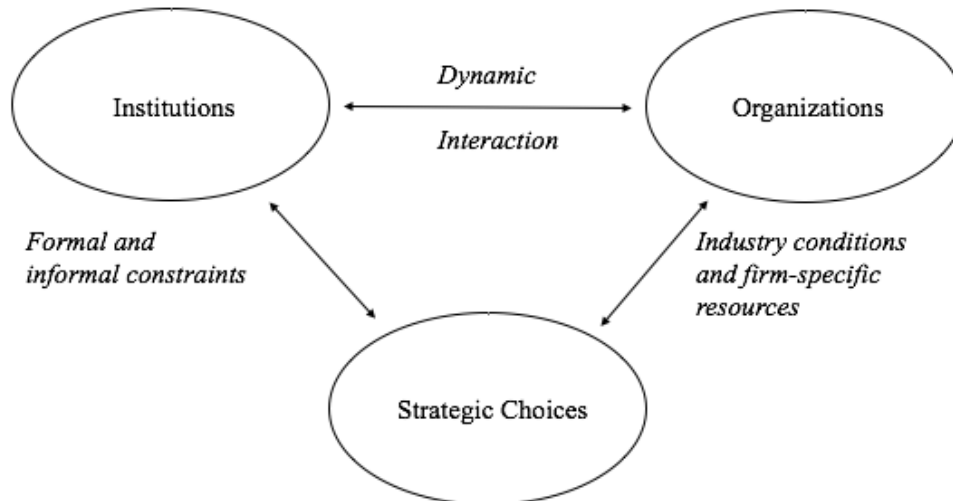


Figure 2.1 *Institutional-Based View* (adopted from Peng, 2002).

### 2.4.1 Defining Institutions

The definition of an institution is varying between scholars. Bresser and Millonig (2003) point out the absence of a suitable definition, whilst Peng (2008, p. 921) refer to North (1990) and describes it as “the humanly devised constraints that structure human interaction” and concludes that institutions govern societal transactions within politics, society and law. Brammer, Gregory and Matten (2012, p. 9) provides a more thorough description and define an institution as follows:

*“By the word ‘institution’, we usually have in mind certain ‘typifications’ where under certain conditions X, a particular type of actor Y is expected to do Z. A particular way of doing things can be considered institutionalized to the extent that deviant action has a reasonable expectation of ‘enforcement’ in the sense of facing social sanctions or loss of legitimacy.”*

The economic upside and the competitive impact of acknowledging the institutional context around an organization is referred to as the institutional-based view of the firm. With this view, institutions constitute the context around the firm’s resources that either enhance or limit the optimal use of those valuable resources (Oliver, 1997). As a theoretical concept for competitive advantage, the institutional view emerged in the late 1990s when Oliver (1997) combined the institutional view with the resource-based. Several scholars (e.g. Bresser &

Millonig, 2003; Peng, 2002; Peng, Sun & Pinkham, 2009) have extended on Oliver's work and incorporated it even further into the business strategy theory. As mentioned above, RBV considers the way in which an organization can build a sustainable competitive advantage through its way of utilizing internal resources and capabilities within the firm. However, according to Oliver (1997) this view is limited to some extent due to its non-consideration of the informal constraints (i.e. socio-cultural environment) and formal constraints (i.e. the regulative and political environment) that limit decisions of resource selection and utilization. Oliver considers that institutions exist and exert pressure on firms' decision-makers both internally and externally in relation to the firm. An internal institution can be the corporate culture that guides decision-making by implying what is correct as well as incorrect behavior. External institutions are, for example, government regulations or societal norms that state what behavior is legitimate (Oliver, 1997). As an important note, the intra-firm perspective on institutional context falls outside of the scope of this study and we will thus focus on the institutions in the firm-external environment.

Bresser and Millonig (2003) define the firm-external institutional context as the socially legitimated behavior that can influence the organization by either regulative, normative or cognitive pressures. Hence, three kinds of external pressures are acknowledged, including *regulative*, *normative* and *cognitive* pressures. These pressures were originally presented by Scott (1995). To understand the meaning of these pressures, a further description is useful.

#### **2.4.2 The Three Institutional Pressures**

The three pressures are generally used by many authors of institutional theory literature within the business strategy area (see Oliver, 1997; Bresser & Millonig, 2003; Peng, 2002; Huang & Cao, 2016; Peng et al., 2009; Wu, Daniel, Hinton & Quintas, 2013). They originated from DiMaggio and Powell's (1983) three mechanisms for isomorphic change (Scott, 2008) and their individual effect on firms is not always clear-cut since they can affect the same behavior from different angles simultaneously (Delmas & Toffel, 2004).

While Scott's three pressures will mainly be used in this study, an understanding of DiMaggio and Powell's three mechanisms is suitable for an overall comprehension of the theoretical area. DiMaggio and Powell mean that organizations are constantly part of an isomorphic process, i.e. a process in which organizations and individuals adapt to norms,



expectations and rules in their environment. This process results in firms conforming to a limited number of institutionalized structures and practices. The three suggested mechanisms by DiMaggio and Powell are coercive, mimetic, and normative mechanisms.

The *coercive mechanism* is expressed through formal and informal pressures from other organizations, government, and other stakeholders that the focal organization is dependent upon. The kind of pressures fitting in this categorization are relatively wide and include any kind of pressure ranging from regulations to cultural expectations. The common denominator between these pressures, however, is that they are associated with some form of sanction if they are to be violated. The *mimetic mechanism* is rather driven by perceived uncertainty than coercive pressures. In simple terms, this mechanism drives organizations to copy each other's processes to manage ambiguous and uncertain challenges. By copying an organization with successful operations, there is less *perceived* risk of falling victim of an ill-fitted response to a problem or market challenge. DiMaggio and Powell's *normative mechanism* is described as emerging from professionalization, which the authors define as "the collective struggle of members of an occupation to define the conditions and methods of their work, to control the 'production of producers', and to establish a cognitive base and legitimation for their occupational autonomy" (1983, p. 152). Hence, it is a mechanism that makes individuals within a certain type of profession to share the same values, norms, and mindset.

The coercive mechanism is most similar to Scott's (1995) regulative pressure, though it seems as if Scott is leaning more towards formal pressures, such as regulations, than informal ones in his definition. Scott's (1995) normative pressure is instead what constitutes the informal pressures of compliance in his model. The normative pressure is the moral obligation to accept and conform with the prevailing norms and values in the country, market or organization (Bresser & Millonig, 2003). The cognitive pressure, on the other hand, is rather operating on a subconscious level and is the foundation of the belief system. There seems to be a conception within institutional theory that it is difficult to make a clear operative distinction between these normative and cognitive pressures, since one of them does not necessarily exclude the other (Huang & Cao, 2016). Scott (2008, p.429) does not provide much guidance in this issue when describing cognitive frameworks as providing "the infrastructure on which not only beliefs, but *norms* (italics added) and rules rest". Bresser and Millonig (2003) express a clearer distinction by defining the cognitive element as "the ways in which individuals perceive and interpret reality, a reality that is always a social

construction” (p. 227). The normative element, on the other hand, is defined as “norms and values that define the types of behaviors that are considered desirable, appropriate, and correct” (Bresser & Millonig, 2003, p. 227). Through this stance, normative pressures and mimetic mechanisms are institutions in the form of a consciously created tunnel vision through which companies only consider alternatives, structures and processes that are generally applied in the industry. Put simply, firms do not consider every possible alternative in their strategic decision making, since certain actions will be considered inappropriate by the surrounding stakeholders. In contrast, the cognitive elements would instead represent the unintentional disregard of other solutions, structures or processes than those that are (subjectively) taken for granted. To clarify, the cognitive pressures affect the way in which the firm and its various stakeholders perceive and evaluate their reality.

The underlying mechanisms that constitute institutional pressures have now been established. However, they are not, as mentioned above, clear in what form they affect the firm operatively. North (1990) used a more operationalized categorization of these pressures by dividing them into being either formal or informal. This partition has been adopted by several other scholars (see Peng, 2002; Peng et al., 2008; Puffer & McCarthy, 2011; Marquis & Raynard, 2015). Formal refers to the political and regulatory environment and economic contracts. Informal constraints include socially sanctioned norms of behavior, which are planted in ideology and culture (North, 1990).

### **2.4.3 Institutional Capital - Applying the resource perspective**

Up until now, we have not described institutional contexts in a light that shows how they can become a resource of the firm, which will now be elaborated on.

Organizations that resist institutional pressures are exposing themselves to legal, economic, and social sanctions that can impose a threat to both their profits and their future existence (Bresser & Millonig, 2003). A firm’s ability to handle these various advantageous or disadvantageous institutional contexts is realized in the form of *institutional capital*, which is considered a resource in itself that has the possibility to create a sustainable competitive advantage for a firm (Oliver, 1997).

More specifically, by the definition of institutions mentioned before, the institutional capital is dependent upon the firm's handling of the context around its resources. The level of the firm's access to this capital will subsequently enhance (or limit) the optimal use of those valuable resources (Oliver, 1997; Bresser & Millonig, 2003; Huang & Cao, 2016). As noted above, this study will adopt the view of institutions and institutional capital by considering how well the firm handles the firm-external, not firm-internal, context around its resources. Hence, what will be regarded is for example the handling of government regulations. What will not be regarded is how the firm creates internal institutions through its culture or similar techniques to exert institutional pressure on its decision-makers. By this logic, the value of the institutional capital is decided by, firstly, how well the firm affects and handles the institutional pressures to fit its strategic objective and, secondly, how well the contingent environment suits and is adopted by the organization (Bresser & Millonig, 2003). In the first view, the perspective is on the firm since it considers how the firm itself acts with regards to its external environment. The second view is on an external level in which the institutional environment creates a comparative institutional advantage for specific firms.

#### **2.4.4 Institutional Strategies in Transitional Economies**

Ability to handle institutional pressures can, as mentioned above, be derived from either intra-firm activities or external circumstances. However, what is not addressed are the actual strategies that firms can use to affect this ability. Research has been able to investigate the strategic activities by which firms can enhance their competitiveness by superior handling of institutional contexts (e.g. Oliver, 1991; Khanna et al., 2005; Brammer et al., 2012; Marquis & Raynard, 2015). Marquis and Raynard (2015, p. 291) conceptualize institutional strategies which is defined as “the comprehensive set of plans and actions directed at leveraging and shaping socio-political and cultural institutions to obtain or retain competitive advantage”. Three institutional strategies are found generically suited for emerging markets, where China among others countries is mentioned. They include *relational strategies*, *infrastructure-building strategies* and *socio-cultural bridging strategies*. Relational strategies address how firms interact with important stakeholder, through effective management of those relationships. This can render competitiveness as well as stability and less uncertainty of the firm's resource exchanges (Marquis & Raynard, 2015). In transitional markets this is inevitably tied to political conditions and the level of development of the market and regulatory infrastructure. In a context where government involvement is common and

contractual enforcement is low, relational strategies become vital for a firm's ability to first, secure resources and second, to receive support and legitimacy from critical external stakeholders (Hoskisson et al., 2013; Marquis & Raynard, 2015). Infrastructure-building strategies are performed when organizations assist in developing key commercial, technological or physical infrastructures that is missing or is underdeveloped, to gain competitive advantage. Socio-cultural bridging strategies refer to firm's strategizing that attends to shape or adapt to socio-cultural or demographic characteristics of the competitive environment. Organizations, if powerful enough, can affect and alter the context around it, and their products can be valued enough to force changes in the local market. However, it is also advocated that local conditions are important to consider and appreciate for foreign firms operating in a transitional economy (Marquis & Raynard, 2015).

Lastly, Oliver and Holzinger (2008) presented an institutional perspective in the form of political strategies where a firm can be comply or influence. The purpose is to maximize the economic return from the political environment, through various activities and capabilities. It is stated that firms that engage in political strategies are more likely to strengthen their competitive advantage. In addition, the authors advocate a dynamic capability perspective on the management of political circumstances due to it becoming more fast-changing and complex. However, Oliver and Holzinger's (2008) research is not conducted in the setting of a transitional economy, yet it has some similarities in the presentation of a dynamic institutional context.

## 2.5 Theoretical Summary and Firm Institutional Capabilities

The competitive landscape in transitional economies differs from a market-based, since it is characterized by instabilities and environmental turbulence. In this context, the limitations of the traditional theories of strategic management, IOE and RBV, have been presented. The added institutional focus mitigates some of traditional theories' weaknesses when analyzing transitional economies according to several authors (see Hoskisson et al., 2000; Peng et al., 2008; Bresser & Millonig, 2003). IOE emphasizes a firm external view where industry structure and firm positioning are the two central points. The structure determines what potential strategies that can be conducted and the intention is to obtain a competitive positioning in the market. Even though, for instance, governmental involvement is recognized in this theory, the institutional perspective provides a much more extensive foundation for analyzing both formal and informal institutional constraints that is embedded in the context of an organization that is operating in a transitional regulated economy. Thus, the institutional perspective is seen as the primary external view of the firm, since the study aims at explaining how firms handle their external environment in an economy characterized by institutional forces. Even though a transitional regulated economy is characterized by more evident institutional constraints than a developed market, it is necessary to acknowledge that important market- and industry forces will not always be existing in the form of an institution. Hence, IOE serves an analytical purpose, yet, it is a rather secondary external view in this thesis.

The resource-based view (RBV) contributes with an endogenous perspective, that emphasizes how competitiveness renders from the combination and alternation of firm-specific resources and capabilities. It has been established that a firm can be better or worse at managing its external institutional context. The value of this ability is regarded as *institutional capital* and can exist as a resource for the firm. The level of institutional capital is in the theory described to depend on the firm's *ability to handle* the institutional context. Generic *institutional strategies* have been conceptualized by Marquis and Raynard (2015) as the comprehensive set of plans and actions by which a firm can strategize to enhance the handling of institutional contexts and thus, gain competitive advantage. However, our aim is to investigate one step further and see whether not only institutional strategies can be found empirically, but also capabilities that facilitate more efficient management of the institutional context. These

capabilities are operationalized in this thesis as *firm institutional capabilities*<sup>1</sup> and refer to individuals' or collectives' activities within a firm that are more or less routinized and serves the purpose of facilitating the firm's survival and prosperity within a specific institutional context, in our case China and the country's dairy industry. In line with the possibly more flexible and less routinized view of (dynamic) capabilities presented by Felin et al. (2012) and Teece (2012), we anticipate that capabilities serving the purpose of managing institutional contexts are unlikely to display strict routines and adherence. Instead, they should be more likely to occur in a more flexible and process-like manner. This would be especially true for transitional economies that has shown to be more volatile than both developed and developing economies (see Marquis & Raynard, 2015).

To conclude, the institutional perspective complements RBV by indicating what internal capabilities that are required for a firm to operate and navigate efficiently and successfully around the institutions in the environment and their pressures (i.e regulative, normative and cognitive). However, in line with North (1990) and Peng (2002) we argue that the more simplistic view of institutional pressures, where it is divided in formal and informal constraints, will be beneficial for the contextual application. Table 2.2 displays the definitions of six phenomena that are central for this study. These definitions are derived from the presented theories and will be the theoretical base for the analysis of the empirical data. Figure 2.2 displays the relationship and interaction between these concepts.

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<sup>1</sup> *Firm institutional capabilities* should not be interpreted as institutional capabilities, which refers to the capabilities of institutions (see Mathews, 1998). It is instead firms' internal routines and processes that interact with institutions.

<b>Formal institutional pressures:</b>	<i>Regulations or expected behaviour from formal authorities that are entitled to sanction misbehavior</i>
<b>Formal institutional capital:</b>	<i>A firm's ability to affect, understand and adapt to formal institutional pressures to obtain or retain competitive advantage</i>
<b>Formal firm institutional capabilities:</b>	<i>Individuals' or collectives' activities within a firm, that are more or less routinized, which serves the purpose to affect, understand and adapt to formal institutional pressures</i>
<b>Institutional strategies</b>	<i>The comprehensive set of plans and actions directed at affecting, understanding and adapting to formal and informal institutions</i>
<b>Informal institutional pressures:</b>	<i>Not regulated but norm-based expectations from non-authoritative stakeholders on firm. behavior that, if not fulfilled, will lead to social sanctions</i>
<b>Informal institutional capital:</b>	<i>A firm's ability to affect, understand and adapt to informal institutional pressures to obtain or retain competitive advantage</i>
<b>Informal firm institutional capabilities:</b>	<i>Individuals' or collectives' activities within a firm, that are more or less routinized, which serves the purpose to affect, understand and adapt to informal institutional pressures</i>

Table 2.2 Theoretical concepts. Formal and informal institutional pressures are adopted and revised from North (1990). Formal and informal institutional capital is adopted and revised from Bresser & Millonig (2003). Institutional Strategies is adopted and revised from Marquis & Raynard (2015).

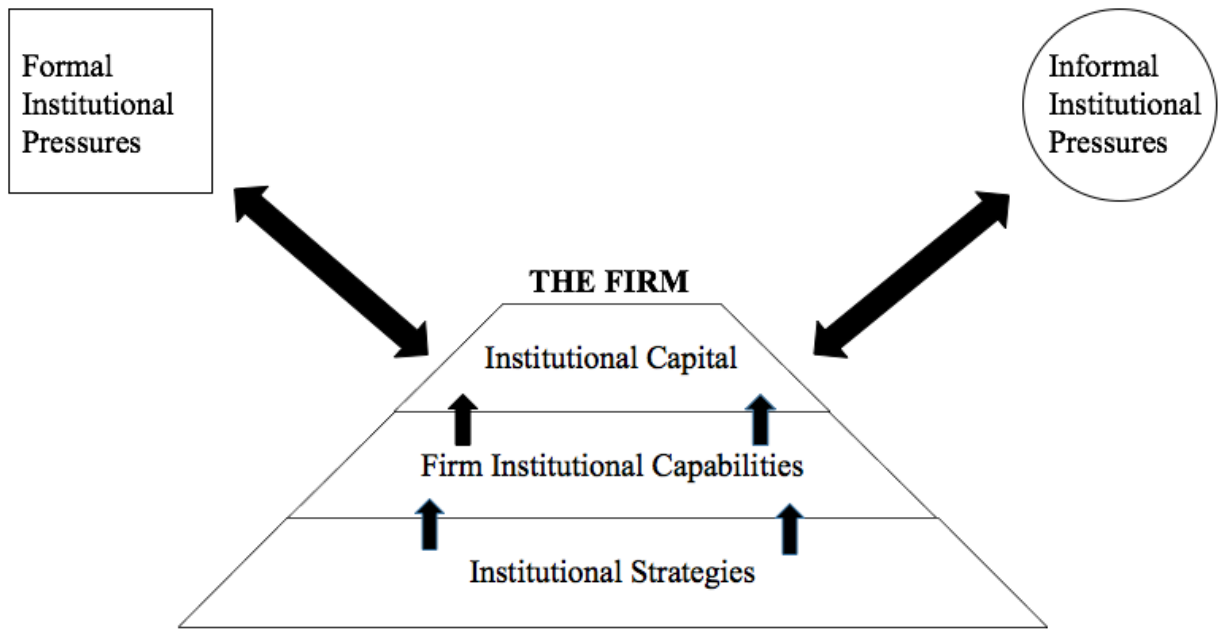


Figure 2.2 The institutional context and the creation of institutional capital, through capabilities and strategies.



## 3 METHODOLOGY

### 3.1 Research Approach

The field of strategic management is subject to a large variety of research approaches. However, in the quantitative-qualitative controversy, the latter is the dominant direction (Hoskisson et al., 1999). This is not a surprise due to the subject's close connection and dependency on ever-changing social contexts that can be hard to measure in a quantitative approach (Bryman & Bell, 2015). This led to the result of studies being dependent on both formal and informal variables. For example, institutional theory is dependent upon both cognitive forces and regulatory forces. Hence, due to the exploratory aim of this study combined with interpretive and both socially and societally complex characteristics, a qualitative research approach was chosen. Similar to the exploratory aim of this study, Wu et al. (2013) investigated institutional forces affecting supply chain practices in China and also used a qualitative approach to perform an initial investigation of their subject of interest.

Regarding the theoretical approach of this study, it was performed in an iterative manner by adopting both deductive and inductive approaches. Initially, the study was framed by a review of theory within strategic management in transitional economies. As the data was gathered, the theoretical frame was revised and adapted to the insights that were found interesting. The process was therefore mainly of inductive kind but was kept structured by also adopting the deductive approach. The main strength with using an iterative approach, is the ability continuously theorize the gathered data in the perspective of prior research, but also from the data itself. This enables both confirmation of existing theory as well as the establishment of new theory (Bryman & Bell, 2015).

### 3.2 Research Design

Empirical research within the theory of RBV and competitive advantages is challenging, due to the often tacit characteristics of resources or combination of resources that constitutes the sustained competitive advantage. To investigate the competitiveness in an industry and individual actors it is useful to choose a research design that enables the study and comparison of several individual actors. This view is advocated by Hoskisson et al. (1999) and Collis (1991) who say that RBV research is dependent on rich information about firms'

idiosyncrasies. Accordingly they suggest the case study design as an appropriate research design. Hence, the case study was considered a suitable design to lessen the difficulty in getting sufficiently deep insights into individual firms.

The case study design is one of the most used research designs in business research due to its ability to acknowledge the complexity and specific nature of a specific case (Bryman & Bell, 2015). Stake (1995, cited in Bryman & Bell, 2015) describes three kinds of case studies for a researcher to consider. They are either intrinsic case studies, instrumental case studies or multiple case studies. The intrinsic case study does not aim to investigate generic questions, which makes it unsuitable for this study. The instrumental and multiple case studies are both focusing on responding to questions of more generic character, which made them interesting to consider. The instrumental case study design uses a specific case as a mean to get understanding of a more general question. The multiple case study design aims to investigate several cases that collectively will answer a broader question.

As mentioned above, the goal is to investigate competitiveness through institution management in a transitional regulated economy. In this study, the dairy industry can be regarded as an instrumental and specific case that tries to explain the general characteristics of the transitional Chinese economy. In the next step, to be able to provide a thorough view of the Chinese dairy industry, a multiple case study design would have been especially useful. However, we did not manage to get access to comparable cases for this study. Instead representatives from two dairies and one supplier were interviewed. Hence, we rather gathered a multifaceted view of the industry and the Chinese economy. This was found to be useful as well for the study. While the cases are not operatively similar, their unification around the dairy industry facilitated reflection of the similarities and differences of the different cases as well, which is important (Bryman & Bell, 2015). Since we were able to access individuals that had experience of different geographical areas (mainly Europe and China), we used this opportunity to take inspiration for the data gathering from a cross-cultural design (i.e. a comparison of management systems and local business customs in various countries (Bryman & Bell, 2015)). However, the focus is still to investigate and draw conclusions only about the Chinese economy and its dairy industry a focal case. Thus, this consideration was more of a guiding principle than a design of the study.

One could also argue that a cross-sectional design, i.e. a study of several cases with the goal of being able to quantify data connected to specific variables to discover patterns, could have been useful for the apparent study. However, in this study the context (and its tacit constituents) of the specific cases would provide useful and important insights. In the cross-sectional design the specific contexts are not regarded as important (Bryman & Bell, 2015), which makes it less useful. In addition, if time was not limited for this thesis, a longitudinal study would also be insightful. It would be especially useful when establishing how firms' different interactions with institutions are displayed at various points in time and at different levels of development in the economy.

Nevertheless, to conclude we state that the case study design will be used for this study, with the dairy industry as an instrumental case.

### **3.3 Data Collection Method**

For this study, both primary and secondary data have been used to respond to the research question. Primary data is of course of highest methodological value since the raw-data can be analyzed and structured by the researcher. However, secondary data also has several advantages, which will be explained below (Easterby-Smith, Thorpe & Jackson, 2015; Bryman & Bell, 2015; Lundahl & Skärvad, 2016). First, a description of the secondary data will be provided, followed by a further description of the primary data collection.

#### *Secondary Data*

Secondary data is a useful tool if applied correctly. It can first of all save time and effort and, secondly, provide high-quality data that can be a suitable complement for the primary data. Thirdly, it can provide historical information and perspectives that it would not be able to retrieve through primary data (Easterby-Smith et al., 2015). The challenge with using secondary data is that it originally was not collected with the intent of answering the research question of this study. Hence, it can to some extent be maladapted which require the researcher to interpret the data with extra care (Easterby-Smith et al., 2015; Bryman & Bell, 2015). By the same reasoning, the use of secondary data is positive since the material can be even more exhaustively analyzed and used in another setting for which it has not been used before (Bryman & Bell, 2015).

For our study, the historical view will be particularly important and numerical figures about consumption and prices from consultancy reports will be especially useful. Furthermore, various publications from governments and market consultancy firms will be suitable sources of secondary data (Easterby-Smith et al., 2015). However, these must of course be carefully scrutinized before use. The source and the quality of the content was therefore considered before adopted as a secondary source in the empirical section (Bryman & Bell, 2015). For example, the origin of the data used in the consultancy reports were considered. They were also cross-checked by not relying on only report.

### Primary Data

The process of collecting primary data in a qualitative study provides various methodological choices but conducting interviews is probably the most frequently used method (Bryman & Bell, 2015). Since the aim of the study is to understand both tacit and explicit dimensions of the dairy market and its competitive development, in-depth interviews were considered to be suitable. Due to the exploratory and inductive approach of the study, interviews were not of structured kind, i.e. they were not focusing on specific questions that were to be answered (Bryman & Bell, 2015). Instead, both unstructured and semi-structured interviews were conducted and used as sources for primary data. The usefulness of unstructured and semi-structured interviews was that the conversation could lead into areas that the interviewee was putting emphasis on in his or her answers (Easterby-Smith et al., 2015). As a result, unthought of topics could be put in the light by interviewees that could then be further investigated in the current and succeeding interviews (Bryman & Bell, 2015). This was an important methodological choice during the interviews to apply the inductive approach in the iterative process.

For the unstructured interviews, a few questions were prepared beforehand to initiate the topic. However, the interviews then evolved into conversation-like discussions that took the direction in which the interviewee was responding. The following interviews were semi-structured and these were based on a topic guide (see Appendix A) that was prepared in line with topics discussed in the unstructured interviews and the theoretical framework in section 2.5. Easterby-Smith et al. (2015) mention that a topic guide should be created in a way that will rather form the interview into a meaningful conversation than an activity to extract data. The topic guide was used for mainly three reasons. Firstly, it was used to make sure that we covered the relevant areas so that comparison would be possible between the answers of the

different interviewees. This would in the end increase the reliability of the answers (Easterby-Smith et al., 2015; Bryman & Bell, 2015). Secondly, the topic guide was formed to ensure that formalities were performed, such as asking for consent to record the interview, presenting ourselves and the study and conclusively ask for referrals for other interviewees (Easterby-Smith et al., 2015; Bryman & Bell, 2015; Skärvad & Lundahl, 2016). Thirdly, it was used as a supply of probes, which helped us as interviewers to get more exhaustive answers. Probes are useful techniques to make the interviewee develop and elaborate their answer even more whilst making sure that the interviewer does not affect their answer (Easterby-Smith et al., 2015). Furthermore, the topic guide was formed without too many theoretical and technical words (Easterby-Smith et al., 2015; Bryman & Bell, 2015). Instead, theoretical jargon was avoided by using general words used in business and the market. By conducting the interviews without too many theoretical words, the interviewee will feel more secure and has a higher probability of giving a clear and explicit answer (Easterby-Smith et al., 2015; Bryman & Bell, 2015).

### Sampling Strategy

When sampling interviewees, the researcher has several alternatives with more or less positive and negative consequences. Easterby-Smith et al. (2015) consider a multitude of techniques by which the researcher can find his or her interviewees. For this study a mixture of convenience, purposive and snowball-sampling was used, meaning that the interviewees were chosen on the one hand by their accessibility and on the other hand in a more strategic manner by following certain criteria (Easterby-Smith et al., 2015; Bryman & Bell, 2015). Although criteria were used, there were limitations connected to the access, which made the sampling process somewhat snowball-like. As mentioned above, interviewees were asked for other potential persons that could be of interest for the study.

To find interviewees, different tactics were used. First of all, contacts with a company were established and used as an initial base for the continuing sampling. The contacts retrieved via this connection can be seen as sampled via convenience since it provided a simple way of accessing initial interviewees. Secondly, interviewees were located via a LinkedIn search. This was found suitable due to the availability of extensive search filters that simplified the process of locating interviewees that fulfilled the criteria, which will be elaborated on below. This can be regarded as a purposive sampling since the interviewees were completely unknown beforehand, but still not randomly included in the study due to the search filters

used for locating them. The value of a random sampling would not have been great due to a quite small number of suitable companies to include in the study (Hardaker, 2017).

To be relevant as an interviewee, the individual needed to fulfill three criteria. Firstly, the person should be working within the Chinese dairy industry and should have been doing so for at least a few years. The company should originate from outside of China and fulfill the criteria of being a foreign actor. The goal was to access individuals with as long experience as possible, but individuals with less experience tend to be younger and could therefore bring a more unaffected view of the industry, which could also be interesting and necessary. Secondly, the individual should be working in a market role or strategy role since these individuals have frequent interactions with various stakeholders and need to analyze it to perform well in their roles. Thirdly, the targeted interviewees should have a managerial role or director role, which increased their credibility since they are the ones who control the resources and conduct of the firms. Lundahl and Skärvad (2016) mention direct stakeholders (transl. *direkta intressenter*), i.e. actors within the specific market, as suitable interviewees but with some limitations. When using direct stakeholders, the interviewer needs to ascertain that more views are regarded to make sure that one interviewee's perception does not obscure the overall reality. To mitigate this risk, a wide search for interviewees was performed, to get as many views as possible. Due to the risk for trade secrets being distributed, we have also chosen to keep all interviewees and their company-belonging confidential. This was expressively appreciated by several interviewees and we therefore regard this effort as contributory to the study rather than a risk for the interviewee to express false information.

#### Conduction of Interviews

Most of the interviewees were based in China and due to the distance, most of the interviews were performed via telephone calls using internet-based software. Telephone interviews are associated with both positive and negative consequences. Starting with the positive side, it simplifies the recruitment of interviewees since the effort for them decreases regarding the need to either host the researchers or travel to the researchers' location (Easterby-Smith et al., 2015). Furthermore, they decrease costs associated with travels to the location of the interview (Bryman & Bell, 2015), which in this case would be relatively substantial. Hence, the value lost from not being able to interact with the interviewee face-to-face was not considered higher than the cost of travelling. However, to weigh up the value of the lost methodological credibility from (mainly) conducting telephone interviews, we instead

focused on conducting more interviews since a lot of time was saved from the non-travelling. The negative part about conducting telephone interviews is the inability to read the interviewees' body language and facial expressions, that can have explanatory value as well (Easterby-Smith et al., 2015; Bryman & Bell, 2015). Furthermore, it is a higher risk of the interviewee to not engage fully into the conversation which might lead to less elaborate answers (Bryman & Bell, 2015). As an attempt to mitigate these negative consequences, we were clear with the interviewees that the conversation would be just like a normal face-to-face interview, and that it would take around 60 minutes (if they had the time). Furthermore, the interviewees were asked to give their consent of having their interviews recorded. Recording was done in all interviews except two. By recording the interviews, it was possible to re-listen the interviews to interpret in what ways the interviewees expressed themselves and, thus, make a more thorough analysis of the data through transcriptions (Bryman & Bell, 2015).

<b>Individual (Position)</b>	<b>Kind of firm</b>	<b>Current area (Experience from)</b>	<b>Unstructured/S emi-structured</b>	<b>Length of interview</b>
Portfolio Manager	Supplier (of dairy industry)	China (China)	Unstructured	60 min
Business Manager, Dairy	Supplier (of dairy industry)	Europe (Europe)	Unstructured	60 min
Business Development Manager, Dairy Category	Supplier (of dairy industry)	Europe (Europe)	Unstructured	20 min
Global Commercial Director	Supplier (of dairy industry)	China (Globally)	Semi-structured	60 min & 30 min

Marketing and Category Director	Supplier (of dairy industry)	China (China)	Semi-structured	60 min
China B2B Manager	Dairy A	China (Europe)	Semi-structured	60 min
Business Development Manager A	Dairy A	China (Europe)	Semi-structured	40 min
Business Development Manager B	Dairy A	China (Europe)	Semi-structured	50 min
Director	Dairy B	China (Europe)	Semi-structured	40 min

Table 3.1: *List of interviewees*

### 3.4 Data Analysis

A template analysis approach, which lies in between the content analysis and ground analysis (Easterby-Smith et al., 2015), has been used for the study. The influences from content analysis refers to our partially predetermined categorizations, which was spun out of theory, when the interviews and documents were reviewed. However, these predetermined codes were revised to some extent and new codes derived out of the empirical material, which is more similar to grounded analysis where categorization and concepts derive from data. First, all the interview recordings were transcribed in order to simplify and increase quality of the data analysis in the following steps. Second, an open coding of the transcriptions was conducted, where long statements and complex descriptions was color-coded and simplified into more manageable pieces of descriptive information. An example of a first level coding was if the statement concerned the regulative and political environment of the firm. It could also be codes that regarded comments that explained the industry structure or societal and cultural norms and preferences. Third, a more focused coding was performed. Here, the already highlighted more descriptive statements from the first coding was compared, further broken down and categorized, with more consideration to the theory to simplify the analysis.



A second level coding was, for instance, if the statement could help explain and evaluate the existence of institutional capital or define activities that firms performed to build this capital. This process was, as stated before, initially of deductive character and was built on predetermined theoretical areas. However, as the analysis proceeded new concepts and perspectives developed which represents the inductive approach in the research design. Last, insightful and explanatory quotes was chosen to accompany the empirical section. The data analysis was an iterative process of conducting and analyzing interviews while simultaneously reviewing secondary data.

### **3.5 Validity and Reliability**

Within qualitative research it has been discussed whether validity and reliability can even be considered as it is in quantitative research. Nevertheless, a reflection of these criteria is useful also for qualitative researchers since it ensures that the usefulness and applicability of the research is thought of (Bryman & Bell, 2015). Authors define validity and reliability in connection to qualitative research in various ways that are more or less connected to the definition of the criteria within quantitative research. In its general definition validity is, as generally known, the extent to which the study has measured and provided results that are accurately representing what it was intended to investigate (Easterby-Smith et al., 2015). Reliability, on the other hand, is evaluated by the extent to which the measurements are accurate and trustworthy (Bryman & Bell, 2015). Qualitative research is mainly connected to the ontology of relativism and nominalism which considers that there is no one truth, or that the truth does not even exist. The reality and the truth is rather, in more philosophical terms, a social construction by which humans try to understand their existence (Easterby-Smith et al., 2015). Due to the dependability on social contexts and interpretation by the researchers, qualitative research is harder to evaluate with the above mentioned definitions of validity and reliability. Guba and Lincoln (1994, cited in Bryman & Bell, 2015) instead provided a useful re-categorization of validity and reliability into the terms of credibility, transferability, dependability, and confirmability (see Table 3.2).

<b>Criteria of Guba and Lincoln (1994)</b>	<b>Compare to</b>	<b>Definition</b>
Credibility	Internal validity	How well the researcher has conducted the research in line with existing rules. Furthermore, the researcher should have ensured his or her interpretation with the people that are affected by the study.
Transferability	External validity	This criterion is based upon the researcher's ability to conduct thick descriptions of the context he or she is investigating. Only by a thorough description of the prevailing context can other persons consider whether or not the results can be used in other contexts as well.
Dependability	Reliability	To increase the study's dependability, the researcher should ensure that a clear description is made of the methodological choices and problematization. This will enhance the possibility of others to redo the study. It is also suitable to let other individuals "audit" the work in the process of writing.
Confirmability	Objectivity	The researcher should to the utmost extent make sure that he or she has not affected the results with his or her personal views. Since qualitative research by definition cannot be unbiased, the researcher must show he or she has acted in good faith.

Table 3.2 Definitions of validity and reliability (Based on Guba & Lincoln, 1994, cited in Bryman & Bell, 2015)

### **3.5.1 Credibility (Internal validity)**

Credibility is a central and important aspect of a study. As has been mentioned before, a qualitative study provides possibilities of several explanations of the social context that is studied. As a result, the aim of any researcher should be to provide results that have been

established by a thorough and righteous research process. By performing the study with a well-planned process, it will be more reasonable for others to assign higher credibility to the explanation of the social context that the researchers provide (Bryman & Bell, 2015).

In the context of this study, it was important to do a thorough planning of the research process and its sequential steps. Firstly, we reviewed secondary data about the Chinese economy and the dairy industry to make sure that we had a sufficient initial understanding of the context that we were aiming to investigate. To not obscure our analytical view and to not make the data collection biased, we made sure to also confirm more vital contextual insights with the interviewees. Furthermore, it was suitable to have the initial insights since the contextual reasoning that interviewees discussed did not need to be thoroughly explained. An example of this would be the Chinese guanxi phenomena that some interviewees discussed. (This will be elaborated on in the empirical section). Secondly, the topic guide provided suitable assistance to make sure that interview questions were formulated in a manner that would not be leading or not in line with the aim of the study. The unstructured interviews were naturally not as linear and comparable as the semi-structured interviews, but this was not the intention. Thirdly, the interviewees were given the possibility to review their individual transcripts and our paper to make sure that we had not misinterpreted their statement. This is something that Bryman and Bell (2015) call respondent validation.

### **3.5.2 Transferability (External validity)**

Since a qualitative study in general aims to focus on deep investigations rather than providing width, it has focus on specific and unique contexts that limits the generalizability of the results. To overcome this issue as much as possible, it is important for a researcher to provide a thorough and “thick” descriptions of the social reality that is being studied. By providing a description that is thorough, it will be possible for others to judge whether the results will be transferable to another context or not.

Firstly, a thorough description of the Chinese context and the dairy industry is provided in the empirical section. This description is mainly based on secondary data but has been aided with primary data from the interviews. Secondly, we have been generous with quotes from the interviews in the empirical section. This makes it possible for the readers to also make their own interpretations of what is said by the interviewee. Furthermore, our aim was to receive

views from more than one firm, which at least will limit the risk of the results being attributable only to the specific firm we gained access to. However, the transferability of our study could have been improved if our interviewees would not have asked for confidentiality. This limited our ability to make thorough descriptions of the specific firms' context that of course can have important aspects to consider for anyone interested in transferring our insights to another research setting. If we are to take the bitter with the sweet, we would argue that the confidentiality allowed the interviewees to make deeper descriptions and more thorough explanations.

### **3.5.3 Dependability (Reliability)**

The dependability of the study is reliant on the description that the researcher provides about choices made in the various steps of the research process (Bryman & Bell, 2015). We have aimed to make a thorough method section in the thesis and have also been open to feedback and reviews by fellow students and professors. Furthermore, we have taken inspiration from former studies by well-cited scholars to form the method of our study, which we believe strengthen the dependability of our study.

### **3.5.4 Confirmability (Objectivity)**

To stay objective is an important objective for any researcher, and in a qualitative it is a trying effort due to reasons explained earlier. To stay as objective as possible, we have cross-checked unclear statements with interviewees in retrospect. Furthermore, we have to the utmost extent performed interviews together, which allowed us to clarify and put in various perspectives in the conversation with the interviewees. Lastly, we aimed to either confirm or challenge the (interesting) views presented by one interviewee in the succeeding interviews, to make sure that we were not pursuing and analyzing information that were not generally viewed as right.

## **3.6 Chapter Summary**

This study will use a qualitative approach to investigate the research question. The combination of the research and theory was initially done deductively but was succeedingly and mainly performed in an inductive manner. The study was designed as a case study with multiple industry actors being investigated. To investigate the firms, ten interviews with varying length were performed with managers and directors. Furthermore, secondary data

was used for information gathering about the general aspects of the industry. The validity and reliability have been evaluated with alternative terminology using credibility, transferability, dependability and confirmability.

## 4 EMPIRICAL SECTION

### 4.1 The Development of China's Economy

During the last decades of the 20th century, China started opening up its market and de-collectivized several parts of it. The country also opened up for foreign investments and fueled the urbanization which led to an increase in export. This development concludingly led to China entering the World Trade Organization (WTO) (Hirst, 2015). China's entering into the WTO agreement in 2001 pressured the country to deregulate several markets, but also led to more entries and investments from foreign companies (Hardaker, 2017). Furthermore, the disposable income per capita has been rising in a steady pace historically and is still rising even today (Reuters, 2017; Tradingeconomics; n.d.). The Communist Party has had a lot of power over the economy (Khanna et al., 2005) and, as the Global Commercial Director at the Supplier mentioned, the government creates and changes regulations often and meticulously.

The dairy market has also seen high growth during the recent decades. A description of the development of the dairy market will be provided below after a brief description of the case companies. This will be followed with the views from the interviews in this study.

### 4.2 Case Companies

#### 4.2.1 Case Company Description: Dairy A

This dairy originates from Europe and is a large player in its home market. Dairy A is operating in China and is doing this through a joint venture with a Chinese dairy company.

#### 4.2.2 Case Company Description: Dairy B

Dairy B is a smaller European company operating in China. It sells its products by exporting them from its home country and sells them via distributors.

#### 4.2.3 Case Company Description: Supplier of Dairy Industry

The Supplier is operating in China among other markets, and supply one of the core inputs to dairies. The supplier is engaged in developing the markets they operate in.

## **4.3 Chinese Dairy Industry**

### **4.3.1 Dairy Consumption**

The economic growth, the incremental transition towards a market economy, and the accelerated urbanization have been shown to alter food consumption and preferences in China (Wang, Parson & Zhang, 2010; Dai & Wang, 2014). One of the most eminent changes is the shift from grains to animal products, such as meat and dairy. As mentioned before, premiumization and health trends have also increased which has led to consumers paying more attention to products' nutritional value, rather than price. This has fueled the development of premium products with higher unit prices within dairy (Euromonitor [A], 2017; Euromonitor [B], 2017).

Wang et. al. (2010) identify four factors that highly facilitated the brisk development of the dairy industry. First, the 1978 economic reform that allowed households to own land that previously was collectively owned. This rendered a freed-up market for agricultural products which, in combination with increasing income and elevated demand for animal products, made it profitable to begin raising cows for milk. Second, the Chinese government has since late 1970s made several efforts and reforms to improve the living standards in urban areas. This has led to active attempts in trying to increase the supply of dairy products. One example is the promotion of milk consumption in schools (Wang et al., 2010). Another example is the statement by the former Premier Wen Jiabao in 2006 in which he mentioned that the government had an aim to successfully provide a steady and sufficient milk supply to its citizens each day (Rohrer, 2007). Third, several other players such as international organizations, foreign governments and international dairy companies have provided financial and technical aid that have bolstered the Chinese dairy industry. Fourth, the development is a result of the growing middle-class in China which has had a steady growth in income and have incrementally developed a preference for dairy products (Wang et al., 2010). According to Wang and Zhang (2004) these preferences have partly been driven by the expansion of western food through western restaurant chains and food retailers.

As a result, the country's dairy consumption has been very expansive. In 1980, the consumption of milk was reported at 1,36 million tons. Almost three decades later, in 2008, this number had developed to a noticeable 37,86 million tons (see figure 4.1). Within a similar timeframe, Dai and Wang (2014) mention that the total profits in the dairy processing industry grew by 105 times between 1987 and 2010.

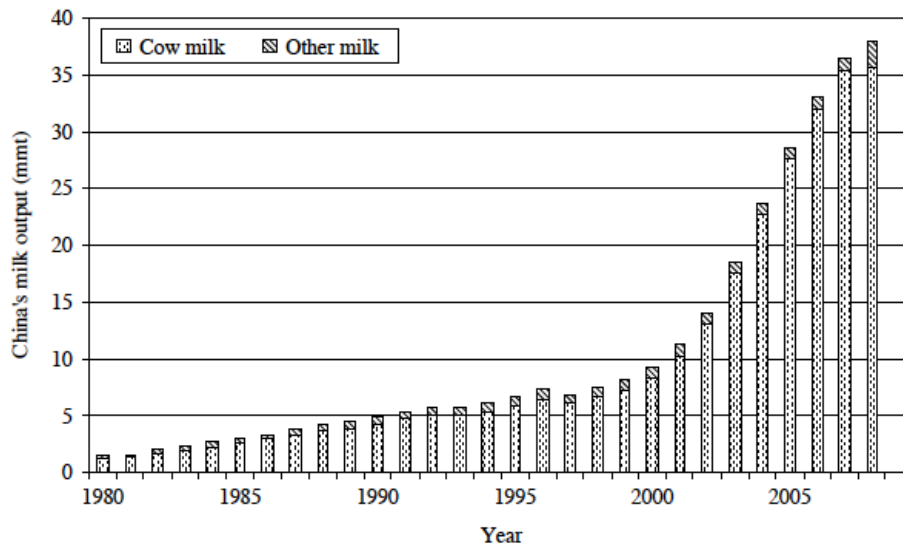


Figure 4.1 Chinese Milk Consumption 1980-2008 (Wang et al., 2010).

### 4.3.2 The Dairy Value-Chain

The first step in the value-chain is the farmers' production of raw milk. This initial part is very fragmented, where the largest party holds only 1,6 % market share in 2016 and most farms have 50-99 heads (number of cattle). However, the estimation is that the number of farms with less than 100 heads will decrease whilst farms with more than 1000 heads will increase in the coming years. A more consolidated farming is, thus, to be expected (DBS Group, 2017).

The next step of the value-chain is the dairy processing which is far less fragmented. When reviewing the dairy and processing companies, the five biggest incumbent firms possess 46 percent of the market share in 2017. Within the yogurt and sour milk segments, the five biggest firms have an even larger market share at 68 percent. In addition, nine of the ten largest in the industry are domestic companies (Euromonitor [A], 2017; Euromonitor [B], 2017). The relatively consolidated dairy market has high bargaining power against farmers since many farmers often have only one or a few potential buyers. The consumers have more choices, but they are also in a weaker position. This is displayed in the increased price gap



between raw milk and several processed milk products (e.g. milk powder, fresh milk) implying that consumer prices have been rising quicker than the price of production (Dai & Wang, 2014).

### **4.3.3 Scarce Supply**

The main challenge associated with the dairy boom is to secure the industry's continued ability to provide enough milk for the increasing demand. What the firms are struggling with mainly is the scarce access to raw-material and an underdeveloped and inefficient supply-chain. The industry has grown rapidly, making it hard to compare to the way in which dairy markets look in Europe where the development has been fine-tuned for over a 100 year, according to the Marketing and Category Director at the Supplier. Firstly, the Chinese cattle is not producing as much milk as cattle in more developed markets such as New Zealand or the US. The production rate per head is 50 percent less than the New Zealand or US cows. Furthermore, the feed is not as qualitative as in other countries (Sharma & Rou, 2014). The Marketing and Category Director at the Supplier states that this has resulted in that milk products imported from Europe have been on an equal price level as Chinese milk regardless of logistical costs. The Chinese government has been aiming to mitigate these challenges with various strategies, with consolidation and extended regulations of the supply-chain as two main parts of the solution (Gooch et al., 2017).

### **4.3.4 Scandals**

The evolution of the dairy market has brought some negative aspects that has shaped and is shaping the whole food industry. In 2008, a major scandal arose when it was discovered that raw milk had been adulterated with melamine, a substance used in plastic production. The underlying reason for this adulteration was to fool machines that measured the quality of the milk product, enabling milk suppliers to produce more "milk" at a lower cost. Unfortunately, this led to deaths of at least five infants and over 60 000 being hospitalized (Sharma & Rou, 2014). This scandal increased domestic demand for improved food quality and safety control. However, it is a challenge regarding how China can develop its dairy supply chain to be able to answer to the increased milk supply whilst withholding (and improving) safety and quality of the product (Qiping & Murphy, 2017).

The melamine scandal led to a widespread distrust in Chinese dairy products amongst Chinese citizens, with an increase of imported dairy products such as infant formula, as a result. As a result to the public demand, issues of quality and safety have received substantial attention in the dairy supply-chain, especially upstream in the chain. This is much due to the historical lack of control and assurance in this area (Ding, Fu, Zheng & Yan, 2018). Hence, to parry the development of decreased demand for domestic milk products, the government strived to create a dairy value chain that was easier to monitor to avoid future dairy-connected scandals. This was to be achieved by promoting scaled dairies with more modern and standardized procedures. The outcome came to be the establishment of “cow hotels” in which farmers moved together with their cattle to facilities where they could have access to better equipment and the government could have better possibilities of control and scrutiny (Mo, Huang, Jia, Luan, Rozelle & Swinnen, 2012). This has affected the landscape of small-scale farmers and the ways in which they can operate. Regulation has been increased which has also brought more economies of scale amongst the upstream parts of the dairy value chain (Jia, Luan & Huang, 2014).

#### **4.3.5 Consolidated Supply Chain**

Another result of the scarce supply has been the consolidation of the value-chain, especially the dairy firms’ vertical integration of the farming process (Sharma & Rou, 2014). The Chinese government has stake in many of the largest domestic firms, the largest of them being Mengniu. After the melamine scandal in 2008 it used ownership and regulations to control quality and supply according to several interviewees. The strategy that has been executed has been to invest in building very large farms containing from 1,000 heads up to more than 10,000 heads. Furthermore, they have invested in modern technology and imported cattle from countries with more efficient cattle (e.g. New Zealand). Hence, the government and the larger actors have been aiming to develop a modern and sufficient domestic supply-chain. This has led to a few national and very powerful dairies that have much control of the supply-chain (Sharma & Rou, 2014).

### 4.3.6 Competition

The Chinese dairy market has experienced high levels of growth and has thus attracted several actors, which have rendered fierce competition according to the Global Commercial Manager at the Supplier. Another interviewee made a figurative example:

*“For me it is the champions league or the world cup, because you have European brands, South American brands, Korean brands, Japanese Brands, local Chinese brands. It is basically a huge mix and everybody want to play in China. I would say it is very complex. It is very complex just because the market is so big and it can take in so many players. In Scandinavia you have Arla, in Southern Europe you have Danone or Lactalis. So these players have all been around for a long time, but in China the market is so big, but at the same time it is so young. It is pretty crazy when you think about it. The consumption rate of milk, of dairy products, it is nothing, literally nothing, and you already have all the biggest brands, the biggest brands of the world already competing.” - B2B Manager, Dairy A*

The foreign firms are not allowed to set up their own production in China. Only domestic firms are allowed to process dairy products in China and, thus, foreign firms can only access production by partnering with a Chinese dairy through a joint venture.

Improved image of domestic dairies

The 2008 melamine scandal hit the domestic firms hard in China. The trust in the domestic supply was at a record low and the demand for imported dairy products increased (Sharma & Rou, 2014). What has been clear in several of the interviews is that the reputation of the domestic firms now has been recovered which has strengthened the market position of the large domestic firms.

*“I think they [domestic dairies] are getting stronger and stronger. There was a melamine crisis, and after that the standards have improved rapidly and the government has given them some subsidies [...]. So, I would say in the medium to long term I would actually say that domestic brands will actually have a larger foothold.” - B2B manager, Dairy A*

### 4.3.7 Regulations and Formal Authorities

The Chinese dairy industry has been struck by scandals, where the melamine scandal in 2008 is distinguishing itself with regards to its effect on the regulative environment. Post this scandal the government was fond of securing the safety and quality of the products as well as restoring the reputation of the domestic Chinese dairies (Sharma & Rou, 2014). This was witnessed by both the B2B Manager at Dairy A and the Marketing and Category Director at the Supplier. Due to this, a lot of new regulations have been introduced that involve different aspects of the production, e.g. what ingredients that are allowed, raw milk character (e.g. protein and bacteria levels) and the processing procedure. What they all have in common is the purpose of increasing and securing quality. The extensive regulation can be displayed in this statement from one interviewee.

*“You could say that for our business the regulatory environment is very important. We are active in, for example, in the infant formula industry which is very heavily regulated. All of our products are imported and to be imported it needs to have the GB standard. So, what we do is try to navigate, and try to understand the different requirements and standards and then we try to fit our products into that” - Business Development Manager A, Dairy A*

GB standards are the Chinese national standards that concern human health, personal property and safety. All products and services, domestic or imported, need to be tested and comply with these standards (China National Standards, n.d). Business Development Manager A at Dairy A mention that when the Chinese authorities approve new products, they look at the rest of the world. If a firm has the GRAS certification, which stands for ‘Generally Recognized As Safe’ and is issued by the US FDA (U.S Food & Drug Administration, n.d), or an approval from the European Food Safety Authority (EFSA) the chance of approval is generally increased. Therefore, her firm tends to register China-targeted products for those certifications even though they will not be sold in the U.S. or Europe.

The same interviewee mentioned that setting standards is one of the ways in which firms in the industry can affect the regulative environment. It is mentioned that when setting new standards, the Chinese regulators review existing products to obtain a reference point. If their attention is directed at a specific firm’s product, and this product has an established reputation including the above-mentioned certifications, it could potentially be used to frame

the new industry standard. The Business Development Manager A from Dairy A proceeds with stating that this, in turn, can provide a first-mover advantage for the firm. However, for a firm to direct the regulators attention to itself, it needs established relationships and contacts. This requires an established network with of course regulators directly, but also influential and legitimate people such as university professors and specialists in the field that is recognized. Beyond good relationships, the interviewee points to the importance of well-performed documentation when interacting with the government:

*“I think the documentation is very important. The more information you have about your products and the more professional that information is, that shields you a little bit. Because if you get challenged you can argue your case a lot stronger, so I think that are things companies could do. So, before you start doing anything you want to be a company that is very well documented and well established”*

Occasionally, intended or unintended sanctions can be issued due to political reasons. One of the interviewees describes an interaction with the formal authorities in this manner:

*“I have attended events where they invite the industry because they present a new regulation and allow you to ask questions. What happens there is that they will never give you a clear answer on the questions. Every time somebody asks a question they will give a very wishy-washy answer, which is also part of the regulation. It should be very clear and it is actually not. A lot of the time the authority will only decide once they have a breach that is a breach. At the same time, there is a lot of grey zones and as a company you have to make a decision where you say ‘ok, it’s not a clear yes but not a clear no so we will take the risk and just do it’. Then it can work out either way”. – Business Development Manager A, Dairy A*

As mentioned, the political agenda of the authorities becomes evident in many regards. China is displayed as politically sensitive and volatile with, for instance, national disputes that heavily affect the general business environment. The B2B Manager at Dairy A mentions that his firm has close contact with its home consulate in China and are actively trying to portray its home country in a positive light. He continues with explaining the dispute that rose due to the Norwegian Nobel prize committee awarding Liu Xiaobo the peace prize. Xiaobo was a critic of the Chinese government and was a democracy campaigner. Due to this, the Chinese

government gave the Norwegian salmon industry the cold shoulder and stopped the import. Therefore, he believes it is important to foster the political relationships between the Chinese government and foreign (home) governments. In line with the unpredictable political environment, two other interviewees explain similar experiences.

*“Regulations is a major topic. It can change very quickly here, one day after the other. It sometimes changes to political reasons. It is a competitive instrument, a competition instrument to keep players out of the market, if you do something wrong with the labelling they can use that against you and block you for two years. So, these thing, regulations, is definitely a key thing here in China so that you comply. You always need to know what is going on”. - Business Development Manager B, Dairy A*

*“In China things move very very quickly. You always have to be on top of what is happening. It can be on the regulation side and politically. Now we had a case where it was some political tensions between China and South Korea and our South Korean customers really suffered hard. It’s a big market, so even small things can have a very big impact (...) So its just kind of a high-risk environment that you are navigating in” – Business Development Manager A, Dairy A*

The mentioned dispute concerns a disagreement between the South Korean and Chinese governments regarding the installation of a U.S. military defense system on South Korean soil (Taylor, 2017).

Another similar perspective is also presented by the Global Commercial Director of the Supplier. The interviewee stated that the publication of regulations is good, and that it is possible to easily stay updated. The difficult part is, however, how it is going to be implemented. Even though a new regulation is a fact, its applicability might differ in different regions and cities due to the respective regional authority, which once again adds complexity.

Furthermore, several of the interviewees in this study mention the authorities’ occasional favoritism of domestic companies. One of the reasons for this is inevitably that many of the domestic dairies are partially state-owned, such as Mengniu, the second largest dairy in China. The state-owned enterprises each have a representative from the governmental party, who is above the CEO, which is described as giving a clear advantage in navigating in the

regulative environment. The Business Development Manager A at Dairy A explicitly states that “regulation is used in a strategic way to limit the success of international companies”. It is then further explained that domestic companies get a preferential position and that international companies are required to prove that it and its products will benefit the Chinese society. First then it is likelier to get viewed in a more favorable light. The same interviewee concludes with “if they [Chinese authorities] feel that you're just interested in making a profit there is a political layer to consider. Overall, domestic players are at an advantage when it comes to regulation”.

Several of the interviewees express firms can receive favorable or unfavorable treatment from authorities, depending on how positive the relationship is between the two. However, firms can to some extent affect their position in the eyes of the regulators. This is done by proving that the company is contributing to the Chinese society in several ways. As one interviewee phrased it:

*“If you have stronger relationships with the government and authorities, they trust you. If you put in a lot of investments and show that you are here for the long-term, and not just here as an exporter. You are actually helping the local GDP, and so forth (...) These things really do matter” – B2B Manager, Dairy A*

Both the Business Development Manager A and the Business Development Manager B from Dairy A elaborate on that the attending meetings held by government, regulative associations and industry associations is shown to be both informative and influential. As mentioned in conjunction to the setting of standards these conferences provide an opportunity for the company to lobby its agenda as well as staying updated on the latest changes, according to. This is also confirmed by the Global Commercial Director at the Supplier.

#### **4.3.8 Customs, Norms and Preferences**

The impact of Guanxi

When considering the informal part of the Chinese society, an acknowledgement of the norms and customs connected to *Guanxi* is inevitable. The Chinese custom of *guanxi* has become a wide-known phenomenon around the world and relates to the possession of a wide network of reciprocal relationships with other people. Overall, *guanxi* builds upon mutual

trust and an exchange of assistance and benefits on several layers of society, including business (Chen, Chen & Huang, 2013). In its simplest form it can be regarded plainly as relations or good connections (Xin & Pearce, 1996; Tsang, 1998). In emerging markets, phenomenon such as the guanxi is useful both as a replacement of formal institutional structures (Xin & Pearce, 1996) as well as a way to access non-public information or relations with officials (Lee, Tang, Yip & Sharma, 2018). According to Chen et al's (2013) meta-analysis of guanxi research, there are two polarizing voices amongst scholars about guanxi and its current importance. On the one side, one group of scholars indicate the decreasing importance of guanxi in the Chinese society due to improved formal institutional structures and the emergence of market institutions. These scholars refer to the lesser use of guanxi in more market-based economic areas such as Hong-Kong compared to mainland China. On the other side, some scholars argue that guanxi is deeply rooted in Chinese culture and will therefore make a print in the development of Chinese capitalism.

All interviewees declared the need to build relationships in the Chinese market for several reasons. Firstly, the Business Development Manager A at Dairy A mentioned it as a useful tool to get access to industry-specific information and updates. For example, the firm is then more likely to receive gossip-like information about for example financial troubles amongst potential customers. Secondly, relationships with the government are used to make sure that the government has a positive view on the firm, according to the B2B Manager at Dairy A. Thirdly, it is a way to get access to the market and the stakeholders with whom the firm is dependent upon to succeed, such as consumers, customers, distributors and suppliers. In this sense, firms can use relationships to get their customers' and suppliers' views on forecasts regarding consumption patterns, trends or other developments in the market. Furthermore, several of the interviewees mentioned an overall reluctance towards planning too rigidly in the Chinese society. Instead, the Chinese are rather agile and can adapt quickly from one day to another. This puts pressure on the firms to quickly and efficiently receive and act upon information from their customers or suppliers that could be important to plan operations on a daily basis, which a majority of the interviewees mentioned. Guanxi was explicitly mentioned and the need for relationships was emphasized to efficiently operate and solve problems in the market:

*“You really need to invest the time to build up relationships trust. If you don't have that, you will face a lot of resistance. [...] They have the Guanxi, that I'm sure you've heard about. I*



*think that is a really true thing and I think it's important to do things that is not so common in The West to keep up the relations. In China our sales people regularly meet with the customers even though there might not be anything to discuss. It's just a way to keep the relationship going. While in Europe there needs to be a purpose for the meeting. So, I think it determines the way you are set up. We have all Chinese local employees which is a big competitive advantage. Because (...) they've grown up here, they've studied here, so they know the standard way on how to run a business here.” - Business Development Manager A, Dairy A*

#### Informal standards

Especially for a foreign company operating in a transitional economy, openness on both the political and social fronts is important (Khanna et al., 2005). The B2B Manager of Dairy A states that the Chinese people are generally open to new things and are interested in trying new products. In the dairy market the development and growth are high, and when combining this with the Chinese consumers' expectations on being offered innovative products it is a source of high competitive pressure on the dairy firms. This view is also shared by the Global Commercial Manager at the Supplier. The rise of the middle class is associated with increased interests in western food that several consumers might never have tried before. An example is pizza which, when it was introduced, presented opportunities for dairies delivering the cheese for the pizzas to set perceptible standards for the attributes of the cheese:

*“For the Chinese consumers, when they first tasted pizza, one of the first mozzarella cheeses were Fonterra's cheese. For them, they taught the Chinese consumers that 'stretch' is very important. In all the adds and commercials they showed how stretch was super important. This placed their products [first], and showed that their products were good at it. In our case, in Europe, no one cares about the stretch. It's about the mouth feel. It's about cheese being cheese and if it stretches it looks kind of fake. But Fonterra were the first ones there, they had the first-mover advantage over all of us. They educated the consumers on what cheese should look like.” - B2B Manager, Dairy A*

The Business Development Manager B at Dairy A takes a similar standpoint, where he states that while there are opportunities for firms to educate the consumers about the dairy products, they still need to adapt products to the Chinese's taste. Not seldom is it just small alterations that make the difference between a product succeeding or failing. To handle this, foreign

firms tend to use locals within product development, since the finishing touches that make the difference are hard to realize for someone originating from Europe or other western areas.

The same interviewee further implies that regarding innovation and product development, speed is an important factor. Therefore, dairies in China employ teams of local chefs to a much larger extent than what is common in Europe. By doing so, the dairies can more efficiently develop new products and variants that can be launched. Furthermore, the Chinese people are relatively open to new tastes and they are expecting new flavors and products on a regular basis. As a result, they are also used to products not being 100 percent fine-tuned when they are launched. This view of the rapidly moving market is expressed by a majority of the interviewees. A minimum viable product mentality is, hence, more successful in the Chinese dairy market than it would be in the European market.

*“One can 't wait for a product to be perfect. If you have an established brand in Europe you want to be really sure that it works before you go live or public. I think that here in China you need to accept a product that is maybe [fulfilling] 80% of the requirements that you wanted, like minimum viable product-thinking, because you need to be fast. Also, consumers here are used to things not being perfect. So, they have a higher acceptance for less perfection, compared to European consumers” - Business Development Manager B, Dairy A*

Similarly, the B2B Manager at Dairy A thinks that firms need to be agile and stay aware of their surrounding environment since the next hugely successful product innovation could come from anywhere.

## Trends

As mentioned before, the Chinese middle class is enlarging which is entailed with urbanization and several alterations to the way in which people consume and what they consume (Tsang, 2014). In this development, actors in the dairy industry have experienced, firstly, that the digitalization has made consumers more aware about facts about nutrients and what kind of marketing statements that are true or exaggerated, according to the Global Commercial Director at the Supplier. Secondly, as a result of both the digitalization, increased living standard and the historical dairy scandals, the average Chinese consumer is becoming more and more wary about food quality and food safety. Lastly, they have become

more interested in healthy (local) food which is also an important trend within the Chinese society (Euromonitor [A], 2017). This is also confirmed by two of the interviewees at the Supplier.

Hence, the aim of many dairies, foreign and domestic ones, is to improve both their own brand's and dairy products' legitimacy. Premiumization is in this sense a development that the dairies has been picking up during the later years to achieve the perception of dairy products as safe, qualitative and nutritious. As of now, the image has improved which is indicated by both the industry growth (DBS Group, 2017) and the view of the interviewees. One of the interviewees, the Marketing and Category Director at the Supplier, described that his company is continuously attempting to further improve the image of dairy products by educating consumers about the nutrients. Furthermore, another interviewee from Dairy A concluded that the domestic dairies are the ones facing the fiercest competition. Therefore, they spend more money on marketing coverage and simultaneously try to improve their image and legitimacy by using key opinion leaders and celebrity endorsers.

*“They must survive, they must win in China. You can see the marketing spendings, it is insane. For every product line they would have celebrity spokesperson. In China, celebrity endorsement is really important. It is true that people would buy a certain product just because a celebrity endorsed it. Seriously, I don't understand it, but it is just how the market is. (...) For example, I have a colleague, she is 35. She would buy certain products just because it is her favorite singer endorsing the product.” - B2B Manager, Dairy A*

#### **4.3.9 Strategic Alliances**

The often occurring and necessary relationships in China are sometimes of more formal character and can be referred to as strategic alliances. These collaborations are evident between many different actors in the industry. First, it is common among the international dairies to form a Joint Venture (JV) with domestic actors. The Business Development Manager B from Dairy A explained that the company's choice to partner up with a domestic actor was a strategic choice and not a legal obligation. If a foreign company in the Chinese dairy industry wants to execute production, they are obligated to have a local JV partner, and solely import and export can be done single-handed. Dairy A does the latter and chooses to have a partner, due to a few reasons that is presented. One is that they get access to an

extensive and strong distribution network. Another is that it provides assistance in navigating in the regulative but also the societal and cultural environment. In addition, it is also presented by the same interviewee that partnering up with a domestic firm can help in the quest for favorable treatment from formal authorities. What the domestic firms get in exchange is production expertise and knowledge about product quality.

*” That is the big story about China isn’t it? You get market access and they get know-how” - Business Development Manager B, Dairy A*

However, some skepticism towards these JVs has also been raised, which relates to the future development of the industry.

*“My personal perception is that some of the partnerships are also used to control the foreign competition. How promising is the distribution network? We have access to distribution network from the Chinese companies, but the sales people of the Chinese companies don’t put a lot of effort in selling our products, because they think that they can sell their own product. Therefore, I sometimes have the feeling that it is hard to come to a win-win situation with them where they also have your interest. Somehow, they, on long-term, see the imported category as a competitor. They are telling their consumers that they should start buying local Chinese products. In Long-term, that is my personal opinion, you can see that the Chinese companies are learning, building their own position in the home market, because it is a huge market. Building a strong base and a nice brand. Once they have done that and they think they have the strong position they will start to move outside and become competitors even on a global scale. I don’t know what happens with Chinese partnerships when they suddenly start to compete outside of China. I foresee more, within the next years, more of the partnerships dissolving and coming into competition. At that point the Chinese companies will already have a strong position.” - Business Development Manager B, Dairy A*

The second form of strategic alliance is performed by the dairies that do not have a JV with a domestic firm. In this case they instead need cooperation with local distributors that in turn have relationships with end-customers, and in this way assist the firms in reaching the market. This is favorable for dairies that just want to export and do not want to invest in extensive operations within China. This is, however, not an option for domestic dairies since they, in contrast to international actors, rely mainly, to not say solely, on the Chinese market.

For them, interactions with the consumers through marketing and advertising is a necessity. The third form of strategic partnership is presented by the interviewee representing the B2B department of Dairy A (i.e. the B2B-segment of the industry, where typical end-customers are restaurant chains). In this segment, but also generally in the industry, partnerships with end-customers, as well as distributors, is advocated to secure prosperity. The last type of strategic alliance, presented by the Marketing and Category Director at the Supplier, is the alliance between locally producing dairies (primarily domestic) and the producers of raw milk. i.e. farms. It is also common that the domestic dairies own their own farms. Nevertheless, both ownership and alliances with farms serves the purpose of securing product quality and raw material price, according to the Global Commercial Director and the Marketing, Category and Portfolio Manager at the Supplier.

## 5 ANALYSIS & DISCUSSION

The aim of this study is to investigate how foreign firms operating in transitional regulated economies create institutional capital through performed strategies and the utilization of capabilities to increase their competitiveness among various institutional forces in the external environment. It is fair to state that the competitive environment in a transitional regulated economy has several layers of complexity. Our theoretical summary indicates that there are two types of external institutional forces, informal and formal ones, that affect firms' ability to operate efficiently and compete successfully in the market. In the environment, these forces exert pressure on firms that, if ignored, limits their operational ability. In a transitional regulated economy, we will argue from our research that a source of competitive advantage lies in a firm's capabilities that lead to it either affecting, understanding and/or adapting to these institutional pressures.

### 5.1 Formal Institutions

The data gathering in this study, consisting of both interviews and secondary data, displayed an eminent regulative environment and influential authorities in the form of national government, regional governments and various prominent associations. This section aims to portray and analyze this environment and describe what activities firms in the dairy industry conduct to manage this context.

In the formal institutional context, a firm will be exposed to various pressures from formal authorities, which is evident also in the Chinese dairy industry. The regulative context is frequently being altered and changes are quickly implemented. Furthermore, the authorities do not treat all actors equally because of various reasons including political disputes, value-contribution expectations, or heritage. Therefore, the formal pressures in the Chinese dairy market are seen by the foreign actors to constitute a source of unstable circumstances. Regarding the competition, the foreign firms are of the view that their domestic counterparts have an initial greater level of formal institutional capital than its foreign counterparts. Due to this instability, foreign firms seem to assign an even higher grade of importance to the strategies and capabilities that make them able to affect, understand or adapt to changes of regulations or authorities' expectations on their behavior.

### **5.1.1 Navigating In The Formal Context and Contributing to China Prosperity**

There have been several indications that domestic firms have higher initial levels of formal institutional capital due to several reasons. Firstly, they have more established relationships and proximity to the government through ownership or history. Secondly, the government is interested in developing its domestic dairy market (and overall society) and will, thus, favor the domestic firms' development. These circumstances leave foreign firms at a competitive disadvantage regarding formal institutional capital, in line with the reasoning of Bresser and Millonig (2003).

#### **Joint Ventures**

An initial attempt by foreign firms to mitigate this issue is the establishment of a joint venture (JV) with a domestic firm. A JV strategy is undertaken by Dairy A and this has shown to provide assistance in the handling of several formal institutional pressures. Hence, it has been a building block of Dairy A's formal institutional capital.

Firstly, the Chinese regulative environment is complex, unclear regarding its application, and fast-changing. In this context, the JV is expressed by Dairy A to be a useful resource. It simplifies the firm's navigation around legal constraints through easier access to governmental insights which clarify complex regulative circumstances that the government and other authorities control. A second formal institutional pressure that is exerted by the Chinese authorities is their expectation that firms' operations should benefit the overall wealth and prosperity of the country. Here, local investments and production is viewed as a prime example, since the firm then contributes with local jobs that improve the Chinese GDP among other things. However, not all foreign firms are allowed to produce, most often due to legal reasons. How the foreign firms mitigate this disadvantage in formal institutional capital is, once again, through JVs and strategic alliances with domestic firms. Through these alliances, the domestic dairies have ownership of the production, but foreign firms are allowed to produce in them. In exchange foreign firms contribute with production expertise and product quality knowledge, which is seen as a favorable contribution to the Chinese society.

Arguably, a JV can for a foreign firm strengthen the formal institutional capital, since this alliance is shown to simplify and enable more efficient handling of its formal institutional context. Using Oliver's (1997) definition of institutional capital as being the context around the firm's resources, it can be concluded that a JV constitutes one part of the surrounding context that supports the handling of institutional pressures and enables the optimal use of value-creating resources. We would even argue that the JV in itself can fulfill some of Barney's (1991) VRIS-criteria. Firstly, it is valuable due to the access to formal institutional information, it is hard to imitate since firms often have exclusivity agreements, and difficult to substitute since JVs are to a large extent the only way for firms to access production in China. Thus, the JV could be regarded as a structure or resource that contributes in the creation of a competitive advantage.

Furthermore, while JVs have proven to be a useful strategic choice for foreign firms, they will not mitigate all institutional pressures to manage in the surrounding environment (Marquis & Raynard, 2015). Coherently, the firms in the dairy industry seek to perform various strategies to obtain formal institutional capital, despite the capital derived from the JV structure. Although Dairy A is operating through a JV, the interviewees still presented the institutional context as being clearly challenging to navigate in. This indicates that foreign firms should develop further institutional strategies and underlying formal firm institutional capabilities that in turn lead to increased ability to handle the formal institutional contexts and its pressures, i.e. formal institutional capital. A central strategy amongst firms in the dairy industry in this aspect is the establishment of valuable relationships.

#### Institutional relational strategies

Marquis and Raynard (2015) state that institutional strategies that aim to improve firms' relationships with useful actors in the market are important in transitional economies. In the cases of this study it is clear that firms believe that relationship-building is important to improve performance in the market. Several of the interviewees pointed out the need for established networks and relationships in relation to formal authorities. The interviewees imply that relationships are a critical aspect in China. Relationships are utilized to successfully operate and navigate around formal forces in the environment, mainly because of two reasons. Firstly, it is important to enable understanding of the applicability of new regulations and its implications. Secondly, it is useful to get as much influence on the



regulatory development as possible. Suitable relationships that were discussed amongst the dairies are, naturally, those directly with authorities, but also people with influence and credibility in the eyes of these authorities.

To foster and maintain efficient business relationships a firm needs to possess relational capabilities (Smirnova et al., 2011). In the context of this study, this can then be referred to as activities that is performed by the firm in a process-like manner that enables the firm to foster relationships that influence authorities and position itself in a favorable light. Why this capability is important is the fast-changing (and unstable) formal institutional environment that can be affected by many factors ranging from intra-industry incidents to political disputes between the Chinese government and a foreign government. An example that is displayed in interviews is that foreign dairies, Dairy A in particular, regularly attend events and meetings held by formal authorities (e.g. regulatory bodies and regional governments) in order to gather information but also maintain and foster the relationship with these authorities. Activities of this kind are performed regularly by individuals in the firm and serves the purpose of both gathering information, but also affecting the institutional context. Therefore, it can be considered a formal firm institutional capability that can facilitate a firm's ability to handle its formal institutional environment. In other words, it can be considered to generate formal institutional capital.

Furthermore, why this is a vital aspect to consider for a firm could, for example, be an incident like the South Korean dispute (see p. 47 for description) that one interviewee mentioned. In this aspect, a foreign firm can have more or less formal institutional capital depending on the relationship between the home government and the Chinese government. To enhance this formal institutional capital, some firms engage in activities that foster relationships directly with the Chinese government, with its own home country government, and with other government-influential individuals. These activities can therefore be considered to increase the firm's ability to affect, understand and efficiently adapt to formal pressures in its environment. However, these activities have not displayed themselves in process-like manners and can therefore not be considered as capabilities. Nevertheless, they could still yield formal institutional capital in line with the reasoning above.

## Product launches

Another strategically important process that was considered vital for firms was the process of launching new products in the Chinese market. For a new product to receive approval for distribution in the Chinese dairy market it is advantageous for it to have a history in other countries, and the associated certifications (e.g. GRAS and EFSA approval). This can be viewed as expected firm behavior rendering from formal authorities and is thus considered a formal institutional pressure. To successfully compete and continually introduce new products, firms need to first understand and then affect or adapt to this circumstance. Their ability to do this can then be regarded as formal firm institutional capital. As one of the interviewees explained, it is necessary to have procedures in place so that new products are quickly and successfully registered in EU and US, even though they will not be sold there. These procedures, that serve the purpose of handling this institutional context can then be considered formal firm institutional capabilities.

Another way for the firms to be evaluated in a positive light by formal authorities, mentioned by Business Development Manager A at Dairy A, is to have a thorough and highly professional documentation of its operations and product development. At a first glance, documentation could be regarded as a day-to-day routine with low strategic importance. However, in the context where a firm aims to launch a new product and set new standards for products and quality levels, it becomes a vital capability. When there is a new standard to be set the regulators review existing products for reference. A firm that is able to set the new standards will get a first-mover advantage that can lead to competitive advantage. However, for the authorities to favor and review a certain firm's product it is necessary and important to have thorough and credible documentation to enable the chance of even being considered. In the next step, established relationships with influential people is important for the firm to increase the ability to affect the standard-setting process. These people would include government officials, university professors and other competent individuals within the dairy industry. If these relationships are obtained it can be seen as formal institutional capital, and the more or less routine-based activities performed to establish those relationships, can yet again be seen as formal firm institutional capabilities.

## **5.2 Informal Institutions**

In the informal institutional context, it is generally considered that the pressures that exist is a response to non-existing formal pressures (Peng, 2002). In the context of the Chinese dairy industry, this alleged relationship between the existence of informal pressures to the non-existence of formal pressures is varying in its strength. In some circumstances, the presence of informal pressures can more clearly be attributed to the lack of formal pressures. However, in other circumstances this tie is less clear. As will be evident in the exposition below, Marquis and Raynard's (2015) view on informal pressures is more in line with the Chinese reality and, hence, more suitable. The two scholars contemplate pressures that are both coming from the lack of formal pressures and exist in the socio-cultural context.

### **5.2.1 Relationships**

In the section above regarding formal institutional pressures, relationships are shown to be a central tool to enhance the ability to handle the formal institutional context of the firm. In China, the phenomena of *guanxi* is a central aspect not only for the interaction with authorities, but for the whole country. Within both business and social life it is an important aspect and it is expected that relationships are fostered, and that mutual trust is developed and cared for. Since firm is expected to view the relationship as something more than an exchange of goods and payments, the custom of *guanxi* can be regarded as an informal institutional pressure that firms need to consider to compete in China. An important clarification should be made here regarding the usage of relationships in formal institutional contexts versus informal institutional contexts. In the formal institutional context, the pressure is that you need to follow regulation and fulfill the expectations of the authorities. The relationship is a tool to handle this pressure. In the informal institutional context, however, the pressure is coming from the societal custom and expectation that relationships should be established, valued and maintained. Hence, the informal institutional capital would be the ability of the firm to create those relationships that it needs to operate efficiently in the market, not just those that yield information from or possibility to affect authorities.

All interviewees held the importance of wide networks and reciprocal relationships high when considering factors affecting their efficiency and performance. We locate four aspects where relationships are especially useful for firms in informal circumstances. Firstly, they are a source of credibility that will facilitate easier access to important actors in the environment.

In China, relationships are utilized for this purpose to a much larger extent than many western countries, according to several of our interviewees. Secondly, informal relationships are an important source to get vital information about (in)formal changes; what one interviewee referred to as industry gossip. Thirdly, they are useful to receive insights from several actors including consumers, customers, suppliers and distributors. Insights in this sense were especially connected to planning and forecasts. This information could be important due to the fast-paced environment and less rigid planning (compared to e.g. Europe). Many interviewees emphasized this distinct speed of change in the Chinese economy, for example that one customer (B2B) could substantially change the volume of its order from one day to another. Hence, they underlined the vast importance of having good relationships that enabled fast communication with suppliers and customers etcetera. Lastly, it is important to make sure that the firm has particularly good relationships with actors that it is dependent upon. For example, if the firm uses distributors it is important to keep a good relationship to make sure that the distributor works efficiently with selling the firm's products.

To conclude, the effort to nurture and deepen relationships on an individual level is important in China and the dairy market. Therefore, the relational capabilities, in line with the reasoning of Smirnova et al. (2011), have high relevance in the informal aspect of institutional pressures that conceptualize firms' activities that aim to foster and develop relationships built on trust and reciprocity. These capabilities can thus be considered informal firm institutional capabilities.

### **5.2.2 Melamine Scandal**

The melamine scandal in 2008 has implications for the development of several quality reassuring regulations. However, it also affected the general perception of dairy products and brands. Several of the interviewees, and with secondary data, highlighted that the customer perception of the domestic brands was highly affected negatively in the aftermath of the crisis. Since the formal authorities could not prevent this scandal from occurring an informal institution was formed. This informal institution was the customer's demand for assurances of quality and legitimacy from the producers. At this point foreign firms had an advantage, since their legitimacy and credibility were not affected in the same way due to their unrelatedness to this scandal. Several years of governmental support, extensive advertising and attempted premiumization have assisted domestic dairies in regaining trust and

legitimacy in the eyes of the Chinese population, however, it has increased but not been fully restored. In this light, domestic firms are at a disadvantageous level of informal institutional capital, where foreign firms are perceived to better meet the need of quality assurance and legitimacy.

### **5.2.3 Institutional Socio-Cultural Bridging Strategies**

Marquis and Raynard (2015) argue that an institutional socio-cultural bridging strategy can bring social and cultural understandings of the company and its focal markets closer by either affecting the market or adapting to it. A challenging aspect in the Chinese dairy market where domestic firms are more advantageous is in the understanding of the consumer preferences that are embedded in culture. This is especially difficult for European and American dairies which culturally, both in general and in food, are further distanced from China than for instance Korean or Japanese competitors. Several of the interviewees explain how the Chinese preferred taste of products is hard to understand as a non-Chinese. In addition, it is explained that the Chinese people are more entrepreneurial and want to try new things regularly, much more so than, for instance, Europeans. Informal institutional capital in this aspect would then be the firm's ability to affect, understand or adopt to the culture's preferences and norms. Informal institutional firm capabilities in this would thus be in line with the reasoning of Luo and Peng (1999) where they discuss learning capabilities, as the established processes for accumulating experiences and obtaining knowledge. To obtain knowledge and experiences Dairy A mentioned two specific activities. First, local employees are hired to tap into the perception of the market. Second, chef consultants are regularly utilized to develop recipes and experiment with the use of products. The first activity provides a structure that directly gives the company informal institutional capital in the form of the Chinese employees cognition and human capital. The second activity could however be seen as an informal firm institutional capability, since it is done in a process-like manner with the purpose of getting better understanding of the Chinese food culture, taste and preferences, which then leads to informal institutional capital. However, the competitive advantage that renders from the first activity and the second capability is presumably limited due to non-rarity and the fairly easy imitation of both. Nevertheless, it can still be valuable.

### **5.3 Chapter Summary**

By considering the theoretical framework derived from the theory (see Figure 2.2) we investigated the formal and informal pressures in the institutional context. Succeedingly, it was analyzed how firms proactively and reactively manage these pressures to build institutional capital. The proactive and reactive activities were analyzed and considered whether they were either comprehensive strategies or more specific capabilities. Activities that were considered were those that the firms leverage to receive legitimacy and act efficiently around the institutions.

## 6 CONCLUSION

### 6.1 Research Aims and Objectives

The objective of this study was to provide understanding and explain firms' interactions with institutional forces in transitional regulated economies, focusing on China and its dairy industry. Furthermore, the aim was to expand the theory on firm competitiveness by identifying how firms leverage strategies and capabilities that are used to manage institutional forces. This was done by considering institutional aspects including institutional capital, institutional strategies and institutional capabilities through the view of traditional strategic management theories consisting of the resource-based view and industrial organization economics.

#### 6.1.1 Competitive Advantage Through Institutional Capital

In line with prior research this study strengthens the notion that a market-based approach to firm competitiveness in transitional regulated economies is insufficient, due to its neglect of the institutional background affecting firms' strategic ability to operate. The inequality that follows by the instability in the institutional context of a transitional regulated economy will turn the institutional capital into an idiosyncratic aspect in the composition of resources for firms. Thus, the varying institutional context comprises a complex set of pressures that firms will not be able to handle relatively equal. This study has also, in line with prior research, shown that institutional capital can be a source of competitive advantage in the studied context. Our study also presents the usefulness of dividing the concept of institutional capital and its constituents into formal and informal institutional capital. A clear example of this is the difference in how relationships are considered to create institutional capital in the view of formal and informal contexts.

In addition, it is advocated that the development of institutional capital is vital for foreign firms operating in a transitional regulated market, due to their often disadvantageous position in comparison to domestic firms. Hence, it is of essence that foreign actors consider more than market and industry forces and strategize and leverage capabilities to manage institutional forces. The generic institutional strategies of Marquis and Raynard (2015) was found useful in the explanation of comprehensive plans and actions. A further

operationalization of what constitutes a capability that purposively handles institutional context is rather absent in prior research. Our study has attempted to further fill this gap.

### **6.1.2 Firm Institutional Capabilities**

A strict capability perspective, where solid routinization is advocated (Winter, 2003) is seen as a less fruitful approach in transitional regulated economies since the institutional context of the Chinese dairy industry is shown to be unstable and fast-changing. Thus, one could argue that capabilities that serve the purpose of handling this context needs to be dynamic, or at least have dynamic influences that is in line with the reasoning of Helfat and Winter's (2011) dual-purpose capabilities. Felin et al. (2012) further argue that the interrelation between the underlying factors of capabilities (i.e. individuals, processes and structures) can vary in how they interact with each other and how rigid the supporting processes and structures are. In addition, Teece (2012) states that dynamic capabilities cannot be routinized extensively and can derive from both single individuals and collectives within a firm. We conclude, based on this prior research and our findings of volatile institutional contexts, that firm institutional capabilities are not characterized by particularly rigid processes and strict adherence. From the insights of this study firm institutional capabilities should instead be viewed as individuals' or collectives' activities performed in a process-like manner with the purpose to manage institutional pressures, where events are interrelated, yet more flexible and less rigid.

## **6.2 Practical implications**

What we tried to accomplish with this study was to break down the institutional theory by reviewing what capabilities and strategies that firms use to compete more efficiently in transitional regulated economies. From our research, we have found that it is necessary for firms operating in those markets to first, realize and map the institutional context. This is true especially for foreign firms. Secondly, we suggest that that firms should aim to strategically handle and affect these institutions by considering what various proactive or reactive activities to pursue. Thirdly, formal institutions in transitional economies display elements of instability. As a result, there is an opportunity for firms to affect the continual development of competitive constraints in its favor through a credible conduct combined with relationships with influential individuals. Lastly, it should be noted that informal institutional pressures are not necessarily existing as a response to insufficient formal institutional pressures, which is



generally regarded. Instead, they could exist disguised as market preferences, but are more deeply rooted in culture. Hence, they are also harder to express and frame clearly. They are also difficult to affect with traditional marketing techniques.

### **6.3 Future Research**

As with all studies, there are limitations that can be overcome and further investigated by other researchers in the future. Regarding this study, it would have been more optimal to have more firms participating and more interviews with each firm. Furthermore, the design of the study can most often be of a different kind that entails other pros and cons. Our suggestions for future research would be, firstly, that a similar study as this one but performed in a longitudinal design could bring useful insights to how the institutional capabilities and the institutional context is handled from the directors' drawing board to execution. Secondly, it would also be necessary to investigate how firms leverage their institutional capabilities and strategies in the context of other transitional (regulated) economies. A cross-cultural design could in this aspect be useful. Lastly, a study in which the views of domestic firms and the formal authorities is also regarded could provide interesting confirmations and contrasts to the views of the foreign firms in this study. A study of that kind would enable firms to better understand the actual motives behind government pressures and informal pressures in the market and society.

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## 8 APPENDIX

### 8.1 Appendix A: Topic Guide for Interviews

#### Info

- Master thesis project Lund University
- Your company and your name will be kept strictly confidential
- This study will aim to gain understanding and explain the process of a firm's interaction with inevitable institutional forces in transitional regulated economies with China and its dairy industry as a focal case.
  - The goal will be to investigate whether a firm can build (sustainable) competitive advantages by being better at handling the institutional forces (rules, norms, expectations etc.) in its environment.

#### Intro

- 1) Allowance to record?
- 2) What is your current role?
  - a) For how long have you worked in this role?
  - b) What actors or stakeholders do you interact with in the market and environment?

#### General

- 1) Generally speaking, how does the way in which firms conduct business in China differ from other countries?
  - a) Different Considerations? Different market dynamics
- 2) Considering the dairy market, how does it differ?

#### Industry structure

- 1) What noticeable changes can you locate/spot in the industry structure of the dairy market in the last 10-15 years?
- 2) What would you say drives the dairy market forward (driving these changes) in terms of how the industry is structured?
- 3) How does the power distribution amongst the rivaling firms look in the market?

#### Strategic resources and considerations

- 1) What parameters do you use to analyze and evaluate your business development process?

- a) If you must simplify, what factors is currently and have historically affected the direction of your business development?
- 2) What processes and activities do you have to gather information, measure and comply with these parameters?
  - a) If they do, how do domestic and foreign firms differ between in this sense?
- 3) What would you say drives the dairy market forward (driving e.g. changes in product offering) in terms of products being offered?
- 4) How does the domestic companies and foreign companies in the industry differ from each other?
  - a) Why do you think they differ in this manner?
- 5) What activities and processes within a firm do you see as vital for future survival, success and prosperity in the market?

### **Handling of formal and informal rules, norms and expectations**

- 1) How have formal regulative pressures, such as government regulations, industry associations or trade associations affected the market and your company?
  - a) What routines and processes do you have in order to gather information and comply with these pressures? Differences domestic and foreign?
- 2) Is there any informal (or less formal) pressures that have affected the market, such as cultural typicalities and societal preferences?
  - a) What routines and processes do you have in order to gather information and comply with these pressures? Differences domestic and foreign?
- 3) If you were to compare formal and less formal forces, in what ways do you think they affect the market and to what extent?
  - a) How is the focus distributed between these two in your operations?