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To what extent do informal institutions
influence the business strategy of developed
multinational enterprises in China?

by

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Abstract

This paper aims to answer the following research question:

“To what degree do informal institutions influence the business strategy of developed multinational enterprises in China?”

By using the comparison of existing literature and two primary interviews from strategic professionals, we were able to discover the most important factors for DMNEs to consider when entering China. The Uppsala Model turned out to be very relevant to the Chinese system, because of the significance of trust as a market power. At the forefront of business strategy should be the knowledge-building process; the volatility of the Chinese market means that it is mandatory for DMNEs to be able to predict and accommodate shifts in local conditions or institutional standards. Hence, success in China is a long-term, incremental process if done without merging with a Chinese firm. By scrutinising the informal institutions in China, DMNEs can develop a very capable mix in their strategy that can help them reduce risk, promote their image into the market, protect them from exploitation, maximize efficiency and minimise cost. If DMNEs get a good grasp on how particular informal institutions in China affect specific elements in their business strategy, a capable and flexible business setting may emerge in their favour.

Keywords - Informal Institution, International Business Strategy, Developed Multinational Enterprise (DMNE), Emerging Multinational Enterprise (EMNE), Foreign Direct Investment (FDI), China

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1 Introduction

1.1 Background

Historically, entry into China has been a daunting yet necessary experience for developed multinational enterprises (DMNEs). DMNEs are multinational firms that are birthed from developed economies; they share the common traits of having ownership, locational and internalisation advantages within their respective markets (Dunning, 2001). This paper aims to analyse the important factors DMNEs must consider in their business strategy in order to overcome psychic distance and liability of foreignness, with a particular focus on the effects of informal institutions on strategy. When we refer to informal institutions, we are referring to the North (1997) definition of “socially shared rules, usually unwritten, that are created, communicated, and enforced outside of officially sanctioned channels”. Some examples of this are the formality of communication channels, the expected morality of business decisions and the interrelation between language and business. Informal institutions vary across cultures, and hence might not be consistent across an entire country. To account for the differing cultures of Chinese regions, this paper is focusing on the business practices in Beijing, Shanghai and Guangzhou. These are the major economic zones in China (Asia Link Business, 2019) and are where foreign firms are most likely to do business.

As the third largest consumer market in the world, behind the USA and the EU, China is an ever increasingly more important location for any global strategy and success or failure there can be the making or breaking of a multinational firm. Since it is still an emerging market due to its low GDP per capita, the market operates differently to the large developed consumer markets that make up the majority of most DMNEs’ market share. This difference is what makes China worth researching; relative to its projected size, we believe that China is understudied from a developed multinational’s perspective. Research about informal institutions takes the form of a descriptive analysis in most cases, with very little research

focused on how they affect Western companies and their entry strategy. This descriptive analysis is very useful for making deductions about its influence on strategy.

The most pertinent example of failure in China due to not recognising informal institutions is eBay in 2004. In the reigns of a German manager and an American CTO, eBay consistently were outclassed by a small, now huge, local firm known as Taobao (Wang, 2010). Every element of Taobao's business strategy was based on a thorough understanding of the local market, whereas eBay's decisions were based on what had been successful in developed markets. In just two years eBay were forced out of the market due to low market share. Jack Ma, Alibaba's (Taobao's parent company) founder, famously described the competition with the following metaphor: "eBay may be a shark in the ocean, but I am a crocodile in the Yangtze River. If we fight in the ocean, we lose—but if we fight in the river, we win" (Ma, cited in Erisman, 2015). This is just one of many examples of successful western companies being stunned by the differing institutional structure between China and the West. This paper will use the eBay case and various other primary and secondary examples to further analyse the effects of China's informal institutional framework on developed firms.

1.2 Aim and Objectives

This paper's investigation is focused around the following research question:

"To what extent do informal institutions influence the business strategy of developed multinational enterprises in China?"

We aim to investigate the role of informal institutions in China, in terms of how they affect the international business strategy of developed multinational enterprises that engage in inward foreign direct investment (FDI). More importantly, it seeks to assess how companies should be adjusting strategy in order to improve both short-term and long-term performance in the Chinese market. We will use primary data in the form of interviews with professionals,

and secondary data in the form of historical examples to form our arguments. These arguments will then be analysed using internationalisation theory and business strategy theory to allow them to be useful to a wider audience. The combination of deductive (primary data) and inductive (secondary data) reasoning should allow us to test our conclusions on both historical and current examples.

1.3 Research Purpose

This paper reveals the link between informal institutions and business strategy from a new perspective. The originality of the paper is that it will provide a more explicit view on informal institutions by looking at their relevance to the market and their importance to DMNEs. We aim to explain why DMNEs should be concerned about informalities and suggest strategic adjustments to overcome them. Despite this paper being directly focused on Chinese institutions, we hope that it will stress the importance of taking informal institutions into consideration when deciding on entry strategy in all emerging markets.

The goal of this paper is for it to make a meaningful contribution to emerging market entry strategy. We hope that it will be a useful reference to business strategists when considering how to go about entering the Chinese market, and also to other researchers looking into similar themes. We also would like for this paper to be helpful to existing DMNEs who are already operating in China; ideally this paper will highlight some advantageous strategic changes that they could make.

1.4 Delimitations

Given the length of this paper, it is important to narrow down the research question to allow for a sufficient and meaningful contribution. Hence, we decided to remove the majority of the formal institution and emerging market multinational analysis that could be useful to understanding the bigger picture regarding the Chinese market. The other major delimitation is the inability to analyse regional differences to the fullest because this would require a much

longer research paper. Instead we decided to focus on the major economic zones of China (Beijing, Shanghai, Guangzhou) due to their similarities in informal institutions and their attractiveness to DMNE FDI.

1.5 Outline of the Thesis

Following this introduction there is a literature and theory review which highlights the scholarly foundations on which this paper is written. It allows the reader to familiarise themselves with the current economical and institutional structure of China and how that has affected DMNEs up until now. The theory in this section is used later on in section 4, where we use our data from interviews with businessmen that have experience in China from a DMNEs perspective to analyse the current and future implications of informal institutions. The methodology in section 3 explains the purpose of this paper: why it is useful research, how we conducted our research, and the limitations of the research. Here you will find our data collection methods and sampling techniques. Finally, in section 5 we discuss the results of our analysis and the differences between existing theory on informal institutions and the suggestions from our data. This concluding section suggests further research based on our findings and some future implications for DMNEs looking to enter China and DMNEs who are already established in China.

2 Literature/Theoretical Review

2.1 Informal and formal institutions and their relevance to business strategy

In order to understand the setting of competition between industries, researchers have been focusing on firm strategy in international business. By scrutinizing the different aspects of IB strategy, researchers can pick up new reference points that can help interpret the findings differently. Moreover, it is common that the primary standpoint that specialists make determinations from, essentially originates from regions that are assumed to have a moderately stable institutional structure (e.g U.S) (Peng, Wang & Jiang, 2008). The significance of the different idiosyncrasies between areas with regards to pragmatic research findings has to be taken under consideration. Apart from their natural differences such as, political forecast, geographical attributes and factor endowments, different regions in the world have diverse approach methods towards organizing competition (Peng, Wang & Jiang, 2008). The principles that nations need to depend upon so as to direct business endeavours, have considerable distinctions from place to place. Institutional formation effectively associates with these sets of rules and principals that subsequently influence business strategy. The profound importance of institutions has been progressively developing through social science research in the previous decades, and has indicated a new way to think about business strategy (Peng, Wang & Jiang, 2008) (Kapodistrias, 2020).

In order to get a better understanding of how institutions influence business strategy and the “rules of the game” (North, 1990), the definition of an institution must be examined. According to North, institutions are formally defined as “the humanly devised constraints that structure human interaction”. Building on this concept, it is apparent that institutions can be broadly classified as formal and informal (Peng, Wang & Jiang, 2008) . The extensive influence of institutions, touches upon political, legal and societal aspects. The groundwork of these institutions will be initiated according to the corresponding circumstances of the market.

Furthermore, market demand and technological change, act as the most dominant economic variables in a “task environment” that functions as the axis for research. The interaction of informal institutions with other variables seems to be unobtrusive in international business research (Peng, Wang & Jiang, 2008) (Kapodistrias, 2020). An institutional framework that is predominantly market market-based, might undermine the importance of societal norms and inherent social networks when trying to get a better understanding of strategic behaviour in the market. In a fluctuating environment, in order to get a grasp of how determinants will interact with each other, various factors that affect strategic behaviour or market performance have to be observed. The theoretical tools that will derive from an expansive analysis as such, will influence new theoretical tools to emerge that will help with the accurate perception of a shifting environment. For instance, China’s market has been flourishing while the business strategies that are observed in the market appear to be effective, despite the lack of a formal institutional framework in the market. The determinants that affect the business strategies in China seem to be to some extent interconnected with informal institutions. In emerging markets such as China, major transitions towards a distinctive institutional infrastructure than in western developed markets. This institutional shift appears to have an influential effect on the international business ecosystem while in some cases they can be groundbreaking. For instance, taking the colonial escalation in the 1600, we see countries like the United Kingdom or the Netherlands, effectively affiliating strong institutional foundations (e.g British East India Company) that have both formal and informal institutional elements that can be directly tied with business strategy (Roukis. G, 2004).

As far as institutional infrastructure is concerned, emerging economies have been contending against the norm. In order for regions to achieve substantial economic growth, it has been long accepted that a strongly regulated economy with concrete formal institutions is necessary. Although, countries like China have managed to develop at a fast pace despite their lack of formal institutional arrangements. The institutional arrangements in China consist of informal attributes that function as determinants that affect strategic structures and market procedures. Furthermore, the networks of trust in the Chinese market have been signalling to have a meaningful influence in international business strategies. The informal relationships in the market have been affecting business endeavours and consequently altering the ways that the market functions. The informal institutional parameters, altogether shape the

inter-organisational strategies that eventually will have to respond to the informal institutional signals (Peng, Wang & Jiang, 2008).

2.2 Why are western DMNEs attracted to China?

Since 1979, China has been a rapidly increasing region for inward FDI. In 2002 China surpassed the United States and eventually became the world's largest recipient of foreign direct investment. As of 2015 the utilisation of foreign capital in China has accumulated to 1479.401 billion dollars (Zhang & Corrie, 2018). It is of great importance and interest to study the numerous projects of FDI since it does not only provide us with important information regarding the competitive aspects of the Chinese market but it also advocates the pivotal point of the Chinese economy. The approach towards structuring and organising the inward FDI in China is based on various factors that will be analysed, explained and criticised throughout the course of this paper.

In order to get a better grasp on how China became the largest recipient of FDI, the first stages of its economic reform have to be analysed. The first step towards China's commencement to the world economy happened between 1979 to 1982, when China passed the Law of the PRC on Chinese-Foreign Equity Joint Ventures. The main purpose of the act was to encourage inward FDI and protect the interests of foreign investments (X. Zhang & B. P. Corrie 2018). Despite the stage advancement, low levels of formal institutions and low policy transparency discouraged inward FDI (only 1,119 billion dollars in 4 years). In the second stage of FDI growth (1983-1991), policies regarding foreign capital utilisation became more responsive. As a result, coastal port cities and coastal economic development zones started to succeed while more advantageous policies were introduced. With the success of those areas and 4.366 billion dollars in foreign investment by the end of 1991, China began a progress towards a rapid development of FDI (Zhang & Corrie, 2018). Moreover, the State Council started taking more clear cut measures and applied numerous schemes in order to support the development of the FDI. More precisely, After Deng Xiaoping's speech in 1992, the Yangtze river was utilised by opening up 13 inland boundary cities and 18 provincial

capital cities at its banks in order to promote a more sufficient and reasonable environment for investments. The absorption of FDI was brought to a new level and the development of the FDI started gathering intensive momentum. In 1992 foreign capital amounted for 11.008 billion dollars. By the year 1997 China attained 45.257 billion dollars in investments and constantly remained over 40 billion by the year 2000 (X. Zhang & B. P. Corrie 2018). After China became a member of the WTO in December 2001, various measures were introduced in order to take the development stage of the FDI to the next level. For instance, a hefty amount of tariff reductions and non-tariff measures in order to provide a more transparent investment area and trading network.

2.3 Information on EMNEs and their importance to DMNEs

Emerging markets have been progressively developing and expanding due to a wide variety of justifications. Despite their complex nature and intricacy to define, emerging economies are collectively playing a significant role in the global economy. International trade has been continuously shaped around developing markets. DMNEs and international corporations have been branching towards emerging markets in order to utilise particular gains regarding Foreign Direct Investment (FDI), outflows of high-value trade and continuous advancement towards goods and services. Furthermore, it is meaningful to state that developing economies are becoming much less passive as far as international economic activities are concerned. This leap towards international commerce involvement has brought up significant structural changes in the developing economies (Raghunath & Rose, 2017).

The unceasing appeal that developing markets are promoting, has been continuously attracting MNEs from developed economies. This constant flow of foreign entry and investment has been providing cost-efficient solutions towards raw material and low-cost production for western DMNEs. Although, due to a large customer base and increasing purchasing power in the developing markets, an increasing trend towards outwards FDI and exporting has been evident (Raghunath & Rose, 2017). Regardless of the great significance of

outward FDI in developing countries, inward FDI endures at a rather large extent. More specifically, 55,5% of the world's inward FDI in 2014 was directed towards developing markets (Raghunath & Rose, 2017). At the same time, countries such as India, China and Brazil have been amongst the most attractive recipients of FDI (Raghunath & Rose, 2017).

Regarding export patterns, a large variety is observed within emerging economies. To get a better grasp of this statement, the two main emerging economies of India and China are analyzed. China has a really strong exporting outflow in which the percentage of exports for tangible goods is much larger than the exports of services. India on the other hand, appears to have contrasting export patterns, with the exports in the service sector being much larger than the exports of goods (Raghunath & Rose, 2017). More precisely, China's service sector represents 9.2% of export of goods while India's export of services represent 48.4% of its total exports in 2015 (Raghunath & Rose, 2017). While the patterns of exports may be of great importance, outwards FDI patterns form the emerging markets should not be neglected. Historically, outwards FDI would be observed almost exclusively in Europe during the 20th century, but this is certainly not the case today. In 2014 the accumulated flow of FDI in emerging markets stood at 34.6% of the global outward FDI (Raghunath & Rose, 2017). The strong presence of inwards FDI in emerging markets through the years has internally affected the structures and the outwards FDI strategies of the EMNEs. The fact that prior inwards FDI has been a critical factor for shaping the consequential outwards FDI will be thoroughly examined in order to get a better insight towards these influential patterns from the West (Hertenstein, Sutherland & Anderson, 2015).

Outwards FDI is a good metric for determining the global strength of Chinese EMNEs. The strong and growing export market in China means that, according to Hennart (2012), the bargaining power of technology and other intangibles from developed multinationals is decreasing. This means that for DMNEs wanting to enter China, there is more emphasis on learning how to compete locally rather than exploiting their firm-specific advantages.

2.4 Guanxi

Guanxi is an informal institution in China that directly translates to “relationships”. Mao, Peng & Wong (2012) define it as “the closeness of a relationship that is associated with a particular set of differentiated behavioural obligations based on social and ethical norms” and Wang (2019) describes it as “the invisible hand that steers and synchronizes the political, economic, and social systems in China through the hierarchical guanxi web”. In reality, the definition of Guanxi differs greatly depending on who is being asked. It is a system that is deeply rooted in Confucian culture, stemming from the reciprocal morality between family and friends or rulers and subjects (Wang, 2019). A quantitative study with “13,780 American managers and 4464 Chinese entrepreneurs” conducted by Burt and Burzynska (2017) discovered “that less than a tenth of manager relationships in America qualify as guanxi, and two-thirds of the Chinese entrepreneurs’ key contacts qualify as guanxi”. Wang (2019) attributes this difference to be about how social networking differs in China and the West; in the West it is a “number game” but in China it is a “member game”. The same study suggests that trust is high in guanxi circles, and the relationships were built on two or more years of experience working together. This is one of the major reasons why DMNEs struggle to establish themselves in China. Guanxi circles are impossible to infiltrate in the short-term without merging with or acquiring a Chinese firm that already has high guanxi.

Some authors (Wellman, Chen & Dong, 2001) have compared guanxi to what we call “networking” in the West and ascribe the difference in importance to the difference in formal institutional structure. For example, Dunning and Kim argue that “guanxi is often an alternative to formal institutions—a sort of compensation for inadequate formal incentive structures or enforcement mechanisms” (Dunning & Kim, 2007; Wang, 2019). Du and Luo (2016) say similar things about the Chinese economy: “formal institutions are weak and managers cultivate social ties as important nonmarket strategies for dealing with environmental uncertainty and interdependence.” Most of the reviewed literature suggests that weak formal institutions are the root cause of the importance of guanxi, but it could be

possible that the prominence of guanxi is the reason for weak formal institutions. This interdependence of informal and formal institutions will be analysed further on in this paper.

2.5 The Uppsala Model

Johanson & Vahlne's Uppsala Model (1977) is an internationalisation theory stating that there should be a proportional relationship between market knowledge and market commitment. These "state variables" go on to influence the "change variables" (Johanson & Vahlne, 2017), commitment decisions and current activities. This influence process is reciprocal; state variables influence change variables and change variables influence state variables in a constant cyclical process. The model focuses heavily on process innovation, which is particularly relevant in emerging markets due to their accelerated change in market conditions. At its core, the Uppsala Model suggests that internationalisation is an incremental process and should be treated as such by strategic decision-makers.

The model is built on the idea of "process ontology" (Johanson and Vahlne, 2017). This is the idea that is much more valuable to analyse the change itself (the process) than analysing multiple static points in the firm's timeline. Hence, Johanson and Vahlne treat the internationalisation process as a fluid process where decision making impacts the state of change of the firm rather than its current state. They treat knowledge as one of the key development factors for internationalisation and a key part of their model is the so-called "knowledge-development process", which is split into the three subsections "learning, creating and trust building" (Johanson and Vahlne, 2017) with regards to various stakeholders in the firm's internal and external environment. This is the catalyst of the model; if knowledge-development increases then the firm is able to commit more resources to the market, titled "commitment processes" (Johanson and Vahlne, 2017) in the model.

These processes are directly related to the firm's state variables, "commitments/performance and operational capabilities" (Johanson and Vahlne, 2017). Operational capabilities are simply the bundle of firm-specific advantages that allowed the firm the right to consider internationalisation in the first place. They can be stronger or weaker depending on the host country's market conditions and the firm's external environment. The ability to exploit these FSAs is dependent, once again, on the state of knowledge of the firm. It is worth noting that the Uppsala Model also includes soft factors "such as relationships and organisational culture" (Johanson and Vahlne, 2017) to be a part of this FSA bundle. Commitments and performance are Johanson and Vahlne's way of describing the current resource allocation of the firm and how it has been performing in a particular market. Analysing these state factors can help to direct the change factors.

As both state and change factors increase and a firm becomes more involved in a market, risk increases, especially in volatile emerging markets. Johanson and Vahlne (2017) say that firms must be "dynamically capable" to succeed due to this increased risk. This means that firms must be willing to continually adjust strategy based on internal and external conditions, and the variables in the model must be analysed constantly. Being aware and willing to engage with change, and the processes that cause change, is the key to the model's success.

2.6 Porter's Diamond Model

Michael E. Porter in his work "The Competitive Advantage of Nations", expands the capabilities for understanding international competition. His attempt to reexamine economic theory may seem aggressive but it compiles into a solid conclusion that suggests new methods for firms to gain competitive advantage. "A nation's competitiveness depends on the capacity of its industry to innovate and upgrade. Companies gain advantage against the world's best competitors because of pressure and challenge. They benefit from having "strong domestic

rivals, aggressive home-based suppliers, and demanding local customers” (Porter, 1990). Porter’s opening statement, interprets the notion of his model while it portrays the contradictory nature of his work. Moreover Porter argues that competitive advantage can be created and sustained as a localised process. Various factors such as national values, culture, economic structures, institutions and history are used as parameters that affect competitive success (Porter, 1990). The patterns of competitiveness that are observed, promote the concept of the home environments effect towards a country’s success in a specific market or industry. These conclusions, that are based on ten leading trading nations, negate conventional economic models and go against the growing tendencies that consider labor costs, interest rates, exchange rates and economies of scale being the core determinants of competitiveness (Porter 1990). Porter argues that these approaches towards competitiveness are not only flawed but they mislead nations towards short term solutions that altogether undermine real and sustainable competitive advantage.

In the international market, companies that have achieved international leadership become successful due to their strategic judgement. There are different strategies observed in every successful case that vary on every level but still have some common traits. Innovation can be perceived as the core of success for companies as it encompasses a broadest sense of a “new way of doing things” (Porter, 1990). Nevertheless, innovation involves even ideas that are not “new” since its realization will depend on the physical aspect of the firm. For instance, investment in skill and knowledge, as well as the brand's reputation, are factors that will help the company perceive or implement innovation through different contexts. The ability to seize a market opportunity that others have ignored while being able to utilize it, inhabits the potential of yielding competitive advantage. Besides, when competitors have a slow or badly timed response, the innovating firm might have to anticipate a more extensive multitude of customer needs. On the one hand, international concerns that will be related to the firm's innovation, will give them the ability to reassure their relevance on an international level. On the other hand, innovations that respond to a more specific segment of the firm's home country might create a false estimate of their international potential (Porter, 1990). Furthermore, information is an important factor that cannot be neglected. As far as innovation is concerned, exclusive information can boost its process and prompt competitive advantage. Exclusive information can mostly be acquired as a result of investment in R&D and as a

product of “unusual effort” on an exact market segment. In order for companies to be able to gain from sustainable competitive advantage through innovation, they have to exert improvement constantly (Porter, 1990). Advantages can be easily imitated by other companies and will most probably overtake innovating companies that either slow down their development processes or stop innovating at an adequate pace. For instance, the Japanese automakers upgraded their approach towards competitive advantage by adopting a global approach strategy. They started building compact modest cars on the basis of low labor costs. Through their process of innovation, they started becoming “innovators in process technology, pioneering just-in-time production, and a host of other quality and productivity practices” (Porter, 1990). These improvements along with their own international marketing channels gave them the competence to take advantage of foreign technology, gain or improve market access and make use of lower wage rates as a n initiative for growth (Porter, 1990).

The diamond of national advantage consists of the attributes of nations that determine the field that each country should invest and focus on in order to gain competitive advantage. It provides insight on the factors that enable countries to innovate consistently, improve through more sophisticated sources of competitive advantage and overcome the barriers to change and innovation. The model consists of four expansive attributes of nations that determine the base that countries establish and operate their industries (Porter, 1990). Those attributes are: Factor Conditions, Demand Conditions, Related and Supported Industries, Firm Strategy Structure and Rivalry. The diamond as a system, affects the elements that drive international competitive success (Porter, 1990). It provides insights on the relevance between the availability of resources, the necessary skills for international competitive advantage, the opportunities that companies receive and the direction that they pursue for resources and skills, the goals of managers and individuals in companies and the constant push on the companies to invest and innovate (Porter, 1990).

Firstly, factor conditions consist of “the nations positions in factor of productions, such as skilled labor or infrastructure, necessary to compete in a given industry” (Porter, 1990). Porter starts by presenting a new perspective on standard economics by explaining that previous doctrines that were focusing on a country’s factor endowments in order to determine their exports are deficient and have to be revised. Moreover, Porter explains that nations do not inherit the vital factors of production but create them by investing in specialised industries

in order to satisfy specific needs. When a concrete and sustainable system of factor creations is established, it will result in competitive advantage that nations can leverage in order to mobilize for further upgrades of their current model (Porter, 1990). Besides, nations and firms have to be able to deal with disadvantages and innovate to be able to compete. The challenging position that nations are being put in in order to deal with specific disadvantages, may function in their favour with the appropriate handling. For instance, countries such as Japan and Italy have managed to turn specific factor disadvantages into competitive advantage by developing exceptional ways of facing detriments. In order for countries to effectively turn disadvantages into advantages, firstly, they have to be able to pick up the right signals from foreign rivals in order to be able to structure their approach in advance and compete effectively. Secondly, favorable circumstances are required in the other attributes of the diamond such as access to specialised people and domestic rivals that will simultaneously create pressure to innovate and provide a productive rivalry that will shape the levels of sustained commitment in correspondent markets (Porter, 1990).

Demand conditions, according to Porter, incorporate the nature of the home-market demand for the industry's product or service (Porter, 1990). The nature of the home demand is a vital component for gaining competitive advantage. It is commonly misperceived that the size of the home-market demand is as significant as the character of the home demand. Nations will gain competitive advantage if they have a clear image of the emerging market needs, while they need to be in close contact with the buyers needs and respond to their pressure. When an industry segment grows larger in its domestic market than the international market, it will naturally draw attention from large companies in the nation. Competitive advantage can derive from successful market segments as such but the nature of the domestic buyers cannot be neglected. Sophisticated buyers that are demanding in terms of what they need will not only provide a evident view of the buyer needs but also force the companies to respond to demands and innovate more efficiently. The specific needs that derive from demanding the domestic market needs (e.g silent air conditioning units developed in Japan due to limited space) can help companies gain advantage. For instance, if the needs of a domestic market, shape or satisfy needs in foreign markets, they may gain competitive advantage. Additionally, nations should more generally expect the commencement of a global trend if they manage to satisfy foreign market needs while promoting a wholesome view of

the nations values and ideals, alongside their products or services. The channels and networks that will promote the nations values and tastes will also play an important role as far as global trends are concerned. Political influence, media, companies and citizens can all affect the 'image' of a nation that will effectively shape how their trends or international endeavours are perceived (Porter, 1990).

The third determinant of the diamond is 'Related and Supporting Industries'. It consists of the presence of other related or supporting industries in the nation that are competing on an international stratum. By having internationally competitive home-based suppliers in the near range, advantages will prevail for the associated industries. Due to their international success they can offer low cost inputs with high efficiency that will be highly advantageous especially in the early stages of development. Moreover, by focusing on related and supported industries, innovation will be highly reinforced due to close distance relationships between the firms. This constant flow of information will inspire many new ideas and boost innovation overall. When a range of interconnected industries or clusters are formed in close proximity to each other, the relationship between them will be mutually advantageous and eventually they will attain high international potential. The more this range of interconnected industries grows the more the international potential and the less the dependency on their domestic market (Porter, 1990).

The fourth determinant that Porter suggests is "Firm Strategy, Structure and Rivalry". This determinant advocates that national circumstances or tendencies get developed over time in nations and altogether shape a managerial approach of "doing things in a specific way". For instance successful Italian companies have been predominantly medium-size, are privately owned and are being run by a small number of people. To the contrary, firms in Germany are customarily being run by a hierarchical system that is directed by top managers. Nevertheless, even though nations have developed efficient structures that can successfully compete on an international level, a single key way to success does not exist. Moreover, nations that succeed in specific market segments internationally will need to have very well structured management practices. The product or service that will be realized has to derive from the confluence of the firm's common management practices and the character and the style of the nation that it originates.

2.7 Chapter Summary

The literature suggests that China's rapid growth has resulted in a complex, volatile institutional structure that can be both beneficial and harmful to firms depending on their involvement and understanding of it. Informal institutions are particularly relevant due to their power relative to developed countries. In China, the formal institutional system is weak, giving way to informal institutions to control the majority of market decision-making. Unique informal systems such as guanxi pose a direct threat to foreign firms and a competitive advantage to long-term Chinese affiliates and DMNEs have to find strategies to incorporate themselves in the market. The Uppsala Model is of significant relevance to China due to its incremental learning system, and Porter's Diamond Model is useful due to its flexible approach on competitive advantage.

3 Methodology

3.1 Research Approach

Given our inexperience of the topic in a practical setting, we decided that the best approach to data acquisition was a constructivist approach (Mogashoa, 2014). This means that we used external professionals to provide the experience necessary to transform our pre-existing ideas about informal institutions into data-driven arguments. By combining these two, we were able to contrast and compare the differences between the realities that show up in our data, and the theory that we had seen in existing emerging market research papers. Then, we used theoretical tools such as the Uppsala Model and Porter's Diamond Model to explore the content of our interviews. These tools allowed us to bridge our independent and dependent variables, data gathered on informal institutions and business strategy.

3.2 Research Design

Our highest priority regarding data was that it came from reliable, experienced sources. Our sampling criteria were managers that had first-hand experience of the Chinese market from both a local perspective and a foreign multinational perspective over as long a time period as possible. These sources were acquired through personal ties or relations to Lund University. We would have also liked to get the opinions of an EMNE representative in China in order to get their opinion on DMNEs' relative competitiveness, but this was not possible due to the limitations stated below.

Our two interviewees were the following two professionals:

Sino-European Product Leader at Voi Technology David Almström

David Almström (2020) has decades of experience of working with DMNE business strategy in China. He had a significant role in Ericsson's successful entry into China in 1997 and was their Vice President of Business Strategy from 2000-2002. Since 2012, he has been a director at Tiandi AB, which is a Sino-Scandinavian firm that provides bi-lateral strategic consulting, investment strategies and engagement services. We believe that he is an excellent interview candidate for our research question due to the aforementioned experience.

Freelance Retail Specialist George Kaidantzis

George Kaidantzis has a long lasting experience with the Chinese market. He started as a manager for the Jumbo retail company in Greece. Due to the wide variety of products retailed by the firm, his main focus was in retail chains from abroad. After a couple of years of expanding into diversified foreign markets, China started to become the central axis of their business and the main producer of their products. Kaidantzis later on specialised as a category manager specialising in juvenile items for 13 years. He would invest in products and be responsible for their importing from China and their success in sales. Since 1995 he has been working as a freelancer with a focus on retail trading. Through his networks and relations, he managed to get a large clientele in China that granted him thorough insight on the Chinese market. The focus on the needs of the customer gave him a specific outline on what is wanted and what is needed in the market. "This amount of insight would never be possible without a strict protocol that focuses on the clients needs and constant physical contact with China".

3.3 Data Collection Method

The data collection was done in the form of video interviews, using Google Hangouts and Skype. To get the most of our constructivist approach, we tried to conduct the interviews in an informal, conversational style whilst being as neutral as possible. We felt that this would provide us with much more genuine opinions and would encourage our interviewees to speak more freely about their experiences of working in China.

3.4 Data Analysis

Our analytical process is based on the integration of what we discovered from our interviewees' first-hand experience and opinions and the theory that we researched in our literature review. A lot of emerging market theory is generalised across all emerging markets and we wanted to test whether some of this was absolutely applicable to the unique case of China. For the theory that is directly focused on China, we are testing whether or not it has stood the test of time or if China's rapid growth and ever changing development status has made some aspects of it redundant. China is unique in its pace of development relative to other markets, even if it is heading towards a plateau (Wang, 2019), meaning that strategic theory is likely to become outdated quite rapidly.

3.5 Validity and Reliability

Bryman & Bell define validity as "the integrity of the conclusions that are generated from a piece of research" (p.42). Having such a small sample size of interviewees is likely to hinder validity but we believe that due to there being no incentives for interviewees to share purposefully false information, our data should have measurement validity, and thus be reliable. Our analysis focuses on the effects of informal institutions and due to their abstract nature, we have to remain conscious of other external factors such as formal institutions and culture in order to have internal validity. The effects of formal institutions on business strategy are measurable and obvious, so it is easy to acknowledge them. External validity relies on whether conclusions based on our interviewees' specific industry experience can be extrapolated to other industries in China. We believe that this will hold true due to informal institutions existing due to country-specific factors such as corruption levels, political ideology and culture (Kaufmann, Hooghiemstra & Feeney, 2018). Our conclusions are indirectly ecologically valid because of the social benefits of understanding informal

institutions in China for both businesses and occupants. Bryman and Bell's definitions are aimed towards quantitative research, but are applicable to our study as well.

Reliability is "the question of whether the results of a study are repeatable" (Bryman & Bell, p.41). This is once again aimed towards quantitative research, but there are some implications for qualitative studies. Whilst our data is unique, it would be possible to draw similar conclusions from a different primary data source. We believe that this is enough to ensure reliability.

3.6 Limitations

Due to the ongoing COVID-19 pandemic, access to potential interviewees was limited. For example, finding an interview from a Chinese firm that operates with or competes against DMNEs was simply impossible, despite our best efforts. We had to rely on personal ties to access interviews and the data does not have the scope of personnel that we would have ideally used.

The fact that we are only using two interviews is likely to limit our scope, even with the amount of experience that our two interviewees have. Hence, the deductions taken from primary data must be taken with a pinch of salt, since they are based on unique opinions without reinforcement through other primary data. They will be reinforced through secondary data and existing theory, however.

4 Analysis and Discussion

Western multinational enterprises that invest in the Chinese market, need to have an all around perceptive approach in order to understand how different cultural, governmental and market determinants interact with each other. In order to get a better grasp of the current interpersonal structure in the Chinese market the cultural aspects will be analysed according to the research findings. Firstly, one discernible difference that has to be analysed is language. Depending on the country, the ability to speak the native language may have an important influence on business endeavours and strategic planning. According to George Kaidantzis, if you have the ability to speak the language of the person you are working with, every kind of proposal, strategy or demand will most likely be more straight-forward and will grant some level of efficiency. Nevertheless, when it comes to the Chinese language there are some major adversities that have to be noted. Essentially the language itself is very difficult to be learned and used effectively by westerners, especially in a business setting. Apart from the complex and unfamiliar nature of the language for westerners, the fact that there are numerous dialects in the country makes the flow of knowledge even more challenging for DMNEs. Furthermore, misunderstanding between parties can be quite common due to language barriers making it a very delicate procedure that has to be handled with great precision in order to avoid risks of confusion in the partnership or venture. It is imperative, when a Westerner is trying to learn the Chinese language to likewise focus on the Chinese culture and the diverse ways of business conducting. For instance, lack of knowledge or awareness of the market scene from the dmne's side of an affiliation, may result in their image and trustworthiness to be overthrown. Especially in cases when dmnes are trying to exploit the situation, their reputation is going to be affected negatively since other Chinese companies will try to protect themselves. The knowledge of Chinese should not be the first priority of a western dmne but instead a focus on understanding the needs of the people, the spending patterns, the cultural norms and the informal social rules are of great importance for western mnes. The risk of practising Chinese during a business endeavour will sometimes increase the overall risk if it is

not carried out correctly. Another vital component of the Chinese culture as far as business is concerned is the “guanxi”. According to Kaidantzis, the guanxi networks are social networks that promote some kind of balance while they assist the impartiality in the market. Firstly, the philosophical value behind the guanxi has to be understood. China definitely has its own philosophy when it comes to conducting business. In addition, the differences from region to region in China are profound. For instance, southern China differs in many ways from the rest of the country. The southern parts of China, even though predominantly business oriented, appear to be more costly due to lack of specialised professionals. The consistent relation with DMNEs in southern China gave them very good insight and infrastructure for foreign investment that later on gradually moved towards the mainland. Depending on the level of western involvement, the regions in China can be very different. For instance, numerous areas are much more risky for business affiliations due to lack of previous western associations. In addition, some areas are difficult to approach due to lack of trust networks making it difficult to get market insight and rather risky to invest. The division of regions in China could also be assumed according to how close they abide to formal procedures and to what level the informal institutional infrastructure is affected by governmental regulation. It is common for regions to have their own “way of doing things” and that should not be neglected. As far as networking is concerned, according to Kaidantzis, the Chinese people have it in their philosophy to form networks of trust and therefore leverage their connections. The majority of the firms in China, take personal relations and trust building seriously and try to promote it more and more since it serves a valuable infrastructure for an efficient setting. Due to China’s rapid development, the essential nature of business has changed to the point that it has unique traits. In order to be able to cope with rapid change, informal institutions started coming to the surface.

Secondly, regarding market aspects, the Chinese market has a lot of vital idiosyncrasies. According to Kaidantzis, the Chinese market needs cannot be directly related to the ones in the West. There are major differences in the market needs that especially in China have been changing at a fast pace. Due to a long lasting affiliation with western multinational enterprises, the spending patterns of the Chinese are getting closer to the western standards but are still not the same. The increase in purchasing power together with the introduction of various western prototypes, have changed the way the Chinese are

investing or spending their money on common goods. The common friction with the West has had a meaningful impact in various segments of the Chinese market. For instance, 20 years ago Chinese businessmen had less knowledge than the Western associates and they were compelled to learn and adapt accordingly. Nowadays, the Chinese have been progressively initiating traits and procedures that are unique to the Chinese market and in certain cases can work in their favour. This step towards differentiation creates informal layers in the market that might not be fully acknowledged by western multinational enterprises. After long term realities with developed markets, the advancement of the Chinese market started speeding up. In order to be able to cope with rapid change, while maintaining control of the situation the Chinese started to find ways to support the social networks while minimising foreign exploitation. Weaknesses in the market function regarding, legal and formal procedures also acted as a justification for new institutional formations. Several informal institutions had to be brought to the surface in order to counteract some of these problems while they would promote a general cohesion and efficiency in the market. The multiple unjust endeavours with foreign DMNEs, forced the Chinese market to pay attention to multiple morals and standards in the way they conduct business. The function of the informal institutions also act as a median for balancing the unequal information in the market. In the production sector, the informal institutions can act as a driving force that maintains the trust levels in the market. In addition, sectors in the market that tend to be highly recognised for their sustainable long-term growth, will be supported by the informal institutions. This reciprocal approach that the informal institutions have shown in the market between the powerful growing market segments, the people that are involved and the new investors that enter the market, provides a cost and time efficiency that counteracts the weaknesses of the state.

In a country like China, governmental intervention in the business sector is inevitable. According to Kaidantzis, networking with government officials is very common and in most cases consequential. Every kind of business endeavour that takes place in China and is of a larger scale, has to be commenced through the government. Depending on the scale of the venture, governmental involvement may be more or less protracted. Social networking with government officials is also quite common in the Chinese markets. It is not unusual to see high end managers trying to leverage their political relationships with Chinese officials. Since corruption levels are high in China, the government official may utilise their position for

personal gains by helping the DMNE achieve a certain goal. On the one hand, specific market segments are almost entirely controlled by the government so having some arrangement in an informal institutional degree has proven to be very efficient in certain cases. In situations as such, the informal institutions prove their value in the market since they can function as a mechanism that surmounts the fundamental weaknesses that exist due to corruption. On the other hand, creating networks of trust with government officials in China may have a negative consequence if not carried away with caution. Chinese law is fair in paper but in reality it is weak and complex. If the DMNE is explicitly relying on their informal relations with the government to succeed, the outcome in the long term may be catastrophic. For instance if a certain Chinese official promises a specific arrangement with an investing DMNE, even if it is carried away as promised, their power and the reality of the arrangement might fundamentally change after they are not in power anymore. Western multinationals may get misled when they are trying to leverage informal connections in the Chinese market, while their connections may provide an inaccurate representation of the reality. Furthermore, when it comes to governmental regulation in China, there are a few things that every DMNE should be aware of before investing. For instance, the legislation as far as the ownership of land is concerned, is rather different in China. According to Kaidantzis, apart from the differences in the legislation behind land ownership, the fact that the government can use any piece of land at any time will most probably affect the strategic plans of the western multinational. For instance, if the government decides to utilise a piece of land close to a branch or a factory of a DMNE, they will be affected directly and their factory or subsidiary may face serious adversities. Understanding the limits of land ownership in relation to governmental regulation is vital. Moreover, grasping the limitation that informal institutional involvement has in relation to the government is imperative, since it can be the stepping stone for the DMNE's progress or it may have calamitous effects on the company's success.

From the DMNE's point of view, there are certain factors that can possibly make an important difference regarding their affiliations with the Chinese market and the informal institutions. If the developed MNE manages to utilise the networks of trust and the guanxi network in the market, they may benefit and manage to attain a long-term position in the market. Firstly, there are several elements that might affect the business strategy of a DMNE when entering the Chinese market. According to Kaidantzis, despite the fact that the Chinese

market is quite distinct to most western markets, it is usually under the businessman's ingenuity to overcome certain obstacles that might occur. A fact that should not be neglected is that the biggest percentage of institutions in China are informal. If the businessman has reliable knowledge regarding institutional limitation and how the function network of trust and the guanxi, the company will benefit to some extent. Apart from understanding how informal institutions work, dmnes have to understand how to leverage their connections without increasing the overall risk. In the past 20 years, the Chinese business men have managed to learn about western business procedures and get much more aware of the situation in China. Unequal information in China is starting to lean against the Westerners while the Chinese have explicit knowledge regarding the informal institutional function. At this point it is worth noting that personal relations and informal institutions in the Chinese market certainly have limitations. No western DMNE will succeed explicitly due to their informal institutional relations. Moreover, DMNEs cannot rely on their abilities to leverage their informal ties to the same extent as the Chinese firms. The lack of experience and presence in the Chinese market will limit the insight of the DMNE while their trust levels in the market will be much lower than Chinese firms that have been active in the market for generations. It is imperative for DMNEs to recognise that informal institutions and networks of trust certainly have limitations. Nevertheless, informal institutions can protect western enterprises from exploitation in the local business networks. Besides, if the DMNE proves to be trustworthy and reliable, their reputation can be promoted in the Chinese market through the informal institutions. A fair and reasonable approach from the Chinese counterparts should be expected if the DMNE proves their integrity. Chinese firms will stay true to the arrangements that were agreed within the affiliation and the informal institutional association will in some cases ensure for practices as such. Furthermore, according to Kaidantzis, DMNEs and western investors do not take informal institutions under consideration extensively. The nature of the product or venture of the DMNE might determine the level of informal institutional involvement. Western firms usually have a concrete business strategy before entering the Chinese market that will usually not be altered explicitly due to informal institutional influences. The anonymity and overall legitimacy of production in China may act as a threshold for this statement, For instance depending on the western enterprise's objective and budget, the level of informal institutional involvement might be determined in advance.

According to Kaidantzis, when DMNEs affiliate with firms in China, it is important to go with trustworthy and reliable formal arrangements but there will always be some attributes that have to be dealt with in an informal manner. For instance when western firms buy products from a Chinese factory, even if they are legitimate and formal in their procedures, aspects such as material sourcing and certification of the components will have to be dealt with on an informal level. Informal institutions and informal arrangement in regards to DMNEs are also related to the cost of the product or service. Western companies that focus extensively on informal institutions might do it in order to cut down on cost. It is rather common that the cost benefits DMNEs will have in China will be to some degree related to informal parameters. Due to the fact that China is highly corrupt, it is currently not possible to apply a very impactful array of regulation, as far as all the products and services are concerned. The informal institutions in China's production sector have been a fundamental component awards minimising cost and maximising efficiency in areas where the government regulation is weak. Besides, it should be noted that in the long-term, stability due to informal institutional relations might be breached. In a fast developing environment such as China, even well established companies will have to face groundbreaking problems at some point due to the rigorous significance of the Chinese government. The reach and straightforwardness of the Chinese government should not be underestimated by DMNEs.

In our interview with David Almström (Appendix A), we were able to gather primary data about informal institutions from someone with an extensive strategic history in China. He has been able to witness both successful and failed ventures and is knowledgeable in Chinese cultural standards from years of practical experience. In the interview we uncovered various cultural, market-based and governmental implications for both new and established DMNEs in the market, and the following chapters serve to summarise them.

Almström's main observation about guanxi is that it is very different to the informal networks that are often discussed in literature. Guanxi is a multi-generational interpersonal trust building system that is inaccessible without extensive time spent in the market, whereas informal networks can be used to some degree by anyone. Guanxi circles are powerful enough to influence things such as political instatement through decades of reciprocal trust building amongst affiliates. Established Chinese firms will simply be able to leverage trust better than

DMNEs with no exceptions, but this does not necessarily mean that being trustworthy is a futile exercise for DMNEs. Trust building is at the core of the institutional system and is commonplace at all levels of business. With strategic market positioning, DMNEs are able to avoid competition with heavily guanxi-orientated firms and have success in the market. This is why finding specialised people to deal with communication and networking in China is vital.

One more effective system that Chinese entrepreneurs have is the “club culture” that exists in business schools. Almström raises the example of the Cheung Kong Graduate School of Business, which has a very extensive alumni system built on networks of trust. With such a large group of entrepreneurs intertwined through networks of trust, these clubs are able to generate capital at accelerated paces and form competitive startups much faster than in developed countries. These clubs are impossible to infiltrate without some affiliation to the school so it is near impossible for DMNEs to take advantage of, yet hinder the ability for them to exploit USPs and FSAs because the clubs can quickly build businesses to rival them. Taobao is an example of the potential rapid growth of these startups.

According to Almström, there is a large differential between perceived law and actual law in China due to the mutual effects of poor law enforcement and informal institutions. While laws might look reasonable on paper, they are often misaligned with culture and the end outcome is that informal institutions become the main regulatory body in the market. One of Almström’s more controversial opinions is that the presence of corruption is not necessarily a bad thing in China because it can help to hide some of the inconsistencies of the system. These three aspects, formal law, informal institutions and corruption work in tandem to control the market, but have different strengths at different stages of a market’s development. Formal law and corruption are likely to be inversely proportional due to being directly related to one another, and informal institutions fill the void of control that is left. This trio could be defined as the mechanisms of institutional control and are particularly relevant in emerging economies. Almström also stated that the effectiveness of formal law should increase alongside the development of the marketplace, so it is likely that China’s informal institutions will have lower relevance in decades to come. This is visible already through regional disparities; for example, in the developed coastal provinces such as Guangdong formal law is respected far more than in central regions such as Jiangxi.

Due to the long-term foundations required to obtain *guanxi*, DMNEs are unable to use it to their advantage in the majority of cases. Almström states that DMNEs that are aware of *guanxi* benefit through risk mitigation rather than gain. By understanding the social mechanisms of China, DMNEs can realise the frailty of perceived ‘strong’ networks of trust; this is especially prominent when there is a change in local power and new local governments make existing networks of trust invalid. Almström suggests that the best way to avoid depending on networks of trust is to be able to create a “win-win” situation for your company and local governments. By generating enough tax income to keep local governments happy, irrespective of personnel, DMNEs should be able to have long-term success without having to rely on specific networks of people. One of the reasons why succeeding companies fail is due to greed; these informal networks can be tempting to gain in the short-term through bribery or other corrupt activities, but inevitably they fall apart when formal institutions are reorganised.

4.1 Uppsala Model Analysis

The most relevant section of the Uppsala Model with regards to informal institutions is the knowledge development process and Johanson and Vahlne (2017) split this process into learning, creating and trust-building. In China, our data suggests that at the core of knowledge development is the trust-building process. *Guanxi* poses significantly higher barriers of entry to trust than in western economies and how companies overcome these barriers is a vital strategic decision. From our interviews and historical cases we can identify important strategic adjustments that can be made in order for DMNEs to better equip themselves against China’s informal institutions.

Kaidantzis suggests that over time, the knowledge differential in China has shifted towards being in favour of local businesses. Decades ago, Western businessmen were able to leverage their firm specific advantages against local competitors in China to overcome their liability of foreignness, and in turn they would get the most value out of the bundle of Western knowledge intangibles and local resources (Hennart, 2012). This is the general theoretical understanding of how emerging markets should operate, but modern day China is

vastly different. Due to China's growth outpacing its institutional reform, there is now an imbalance in this bundling process that heavily favours local firms. The implications of this shift is that it is now imperative that DMNEs integrate with local informalities should they wish to succeed. This integration naturally occurs alongside the knowledge development process and has to be in process before any significant resource commitments can be made. Historically the best way to catalyse this process is through personnel acquisition or a knowledge-influenced shareholder structure in joint ventures and acquisitions. Almström mentioned the successful shareholder structure of Ericsson in the early 90s. They entered the market as minority shareholders with a 49% holding alongside a host firm that also held 49% and the other 2% was owned by a middleman that had extensive guanxi connections all over China. This ownership structure accelerated Ericsson's development in China and was ultimately one of the key reasons for their success. The other option, personnel acquisition, can be attributed to the failure of American firms in China. Key examples such as eBay and Microsoft have used Western managers in the past with flawed Western-led strategies. Both of these examples could be described as high commitment and low knowledge, which according to the Uppsala Model is a strategic failure. With highly knowledgeable personnel acquisition commitment can increase, but without highly knowledgeable managers companies must treat expansion into China as an incremental learning process, like the Uppsala Model suggests.

Another feature of the Uppsala Model is the relationship between intended strategy and realised strategy (Johanson & Vahlne, 2017). Firms must be flexible enough in their strategy implementation to allow for realised strategy to be significantly different to intended strategy. One of the core issues that Almström identified with American firms is that they are too plan-centric. It is culturally embedded in these firms to focus on the plans instead of the goals, and this doesn't work due to the required flexibility in China. He credits this goal-centric attitude to be the reason why European firms, in particular Scandinavian ones, perform better in China. Flexible strategy implementation is also useful due to how institutional reform can affect market conditions. Since institutional power is influenced heavily by networks of trust related to those in power, when new powers are instated, new networks of trust influence competition. This means that there is a much greater shift in the

competitive landscape whenever there is local political reform and DMNEs who are not heavily involved with networks of trust have to adapt strategically.

4.2 Porter's Diamond analysis

Porter's Diamond Model has helped researchers expand their understanding of international competition and business strategy. Certain elements of the model are relevant to informal institutions and the current situation in the Chinese market and thus will be used in order to analyse the primary findings of the thesis. Firstly, factor conditions according to Porter, consist of "the nation's position in factor production such as skill labor or infrastructure, necessary to compete in a given industry". In order to determine their exports. Countries have been focusing on factor endowments, wrongfully signifying that countries can inherit vital factors of production. Instead, Porter suggests that by investing in specialised industries, and by creating a sustainable system of factor creations, competitive advantage will emerge and can be leveraged for further upgrades of their structure. In the current case of China, many attributes helped inward FDI to be aided and in the long run specialise into specific industries. By initiating policies regarding foreign capital utilisation, the Chinese government started taking clear cut measures and applied multiple new schemes in order to support inward FDI. After the Yangtze River was utilised in 1992, 13 inland boundary cities and 18 provincial capital cities started specialising in production and services in the banks of the river, with the main aim being the promotion of a more sufficient and transparent environment for investments and trading networks (X. Zhang & B. P. Corrie, 2018). Moreover, the fact that China put in a challenging position and had to deal with various disadvantages, forced them to take effective measures and turn some of their disadvantages into advantages. In order for the Chinese to turn specific advantages and disadvantages they had to find new methods of dealing with foreign detriments. Firstly, the corruption in the Chinese government was creating weaknesses in the market and the DMNEs were trying to exploit this weakness since they were more aware of their business goals and intention than the Chinese firms. In order to counteract disadvantages as such, the Chinese started increasing informal institutional involvement and began to take aspects such as trust more seriously in

order to create specialised market segments in the country and gain competitive advantage. According to Almström, networks such as the guanxi are necessary for China since it is where they have all the trust levels in the market. Apart from the law enforcing being too weak in the country, the justice system and the belief system are not really in line with the law, turning the networks of trust into the enforcing mechanism of the market. According to Kaidantzis, by initiating informal institutional involvement in the manufacturing field, the Chinese managed to turn the inefficiencies of the government structure into cost and time efficiencies that allowed them to specialise into specific segments of production and develop their business scheme to be much more competent. The constant friction with western DMNEs, gave the Chinese the chance to pick up the right signals from the foreign rivals and structure their approach towards more effective production and thus gain competitive advantage. Kaidantzis claims that the Chinese businessmen nowadays know more about the Chinese market than foreign businessmen making their specialised knowledge and tactics beneficial for the further advancement of the market. As far as human resources are concerned, both Almström and Kaidantzis agree that Chinese university graduates that want to have an active role in the market, will almost always get involved with informal institutions. Besides, their competence is enough to create a productive rivalry in the market that will create pressure to innovate and possibly outperform western enterprises that are investing in the market.

Demand conditions according to Porter, incorporate the nature of the home-market demand for the industry's product or service. Although China has a sizeable home-market demand due to the large magnitude of the population, the character of the home demand is very powerful. According to Kaidantzis, in the 1990s Chinese people did not have a very strong character regarding the home demands, mostly due to the political forecast in the country and the lower purchasing power of the average labourer. China adopted the character of a low cost high supply manufacturing sector due to two main reasons. Firstly the initiation of big amounts of inward FDI from western DMNEs forced the Chinese market to provide an efficient and legitimate infrastructure for investment. The weaknesses in the country regarding government regulation and formal institutional infrastructure, encouraged the DMNEs to exploit the circumstances in order to gain cost advantages. Secondly, the constant push towards reducing cost and increasing the manufacturing efficiency created an international demand character that was to some extent unique to the Chinese market.

Furthermore, the perpetual business endeavours that China has been having with DMNEs gave the Chinese firms a clear outlook of the market needs. Eventually, the character of a system that offers low cost and high product output turned into an international trend that gave China the opportunity not only to satisfy foreign market needs but to set the Chinese reality as the new standard of international competition. According to Porter, the channels and networks that promote the nations values and traits will play an important role regarding global trends. The role of the informal institutions in this case was vital. According to Almström, informal institution and networks such as the guanxi are necessary for the Chinese market since the function as the equilibrium of trust between enterprises. Besides, the cost of breaking or breaching a partnership between Chinese firms may be larger than breaking the law. Without the support of the informal institution an efficient and straightforward business field in China would probably not exist.

The third determinant of the Porter's diamond "Related and Supported Industries" consists of the presence of related and supporting industries in the nation that are competing internationally. Porter argues that by having internationally competitive home-based suppliers in the near range, advantages will prevail for the associated industries. In the case of China this determinant is highly relevant. According to Kaidantzis, regions in China differ greatly from one another. They could be divided depending on many different factors and one of them is market orientation. Newly founded companies in China can benefit from low cost inputs and high efficiency especially in their early stages of development. Moreover, due to the fact that related and supported industries in China are both highly competent internationally and are in rather close proximity, firms can certainly attain competitive advantage. Besides, by having a strong informal institutional infrastructure in the market, apart from the mentioned benefits (e.g trust levels, just business endeavours) knowledge transfer plays a vital role. The fact that certain markets in China are in close proximity, interconnected industries and clusters will form, making the relationship and the unfastened nature of knowledge transfer to prove mutually beneficial for them. By building this strong interconnected line of businesses, firms in China have a strong international potential that might not have to depend entirely on foreign markets. In addition, informal institutional infrastructure inside the interconnected industries or clusters will only support the easy flow of knowledge while it restricts exploitation.

Lastly the fourth determinant that Porter suggests is “Firm Strategy, Structure and Rivalry”. The determinant, analyses the national circumstances and tendencies that over time shape the managerial approach of a nation, or in other words breaks down the way that nations are “doing things in a specific way”. In China, the fact that the market works in a unique way has proven to be successful. According to Kaidantzis, China has its own philosophy when it comes to conducting business. This is also influenced by government regulation and foreign involvement. Almström argues that in an underdeveloped formal system such as the one in China, corruption in certain cases can cover up the inconsistencies in the market while it helps shape the ways of doing things. Moreover, inspect worth noting when talking about informal institutions and unique market function is Confucianism. Confucianism as a philosophical framework has influenced East Asia to a considerable extent. Additionally, according to Almström, Confucianism says that people should listen to the leaders and the scholars in the society. This acts as the reasoning behind the common patterns that can be observed around Asian countries, but China has a unique mix of Confucianism into their strategies. Almström claims that the mix of Guanxi networks, Confucianism and the Chinese political system, altogether shape a rather different mix of “ways of doing things” that is unique to China. He also stresses that the Chinese “way of doing things” is one of the most efficient in Asia. For instance, Japan is also influenced by Confucianism and has proven to be very competent and responsive as a market. Although, their implementation of its philosophical value into their business strategies had a negative effect that pushed new opportunities away. Moreover, the fact that Chinese enterprises have managed to assign several segments of their production performance, to be dealt with in an informal institutional manner, has had a considerable effect in their business arrangements. According to Kaidantzis, aspects such as material sourcing or certification of product components, happens in an informal manner. The fact that certain attributes are assigned to be dealt with in an informal institutional manner changes the character of the market and therefore shapes the managerial approach of the nation.

5 Conclusion

The Uppsala Model's suggestions and our data are very similar. The knowledge development process should be fully intertwined with business strategy in China due to both liability of foreignness and the inconsistent rapid change we are witnessing in the market. Long-term success in the Chinese market is based on learning how to adapt to the volatility of the market conditions rather than treating current market conditions as a knowledge acquisition exercise. Businesses should be looking at how they can innovate communication and learning processes in order to fully integrate with the market's ever changing expectations. There is huge potential for gain for DMNEs given that the market is heading towards a more solid formal institutional framework and a more effective, inclusive governmental system. Having experience in markets where this is already the case will give DMNEs a competitive advantage, assuming they have already established themselves in China by that point in time.

The best ways for businesses to adapt to informal institutions seems to be through ownership structure or personnel acquisition. While DMNEs can succeed through an effective knowledge-building process, the most significant short-term gains come from merging with Chinese firms who are already well equipped to deal with the market conditions. This to some degree negates the knowledge-building process because accelerated learning can be done since it is mutually beneficial for the home firm and the DMNE. In some cases, this may require losing the majority holding in the business, which might not be in the best interests of the firm and its shareholders. Hence, this serves as a safer but less valuable method of integrating with Chinese institutions.

The factors that Porter's diamond model presents are highly relevant to the informal institutional influence in business strategy. Porter suggests four broad determinants in his model that are all to some extent influenced by informal institutional parameters. In combination with the findings from the interviews, a rather consistent interconnectedness is observed. The structure in the Chinese market is in certain cases directly connected with

informal institutions while their function towards bridging the gaps in the Chinese regulation are evident. The fact that informal institutions promote the levels of trust in the market and set the paradigm for the “way of doing things” should also not be neglected. The informal institutions also support a more unrestrained flow of knowledge that can prove to be very useful for investing DMNEs while the networks of trust will act as the threshold for DMNEs. Realizing the limits of informal institutions should also be a part of the DMNEs strategy since it can help them guide around the market securely. The findings advocate that in particular cases the interpretation of the limits of the informal institutions can prove to be either highly favorable for the DMNE, and the misinterpretation can prove to be catastrophic.

5.1 Research Aims and Objectives

Our research served the purpose of painting a general picture of how informal institutions influence business strategy for DMNEs in China both now and in the past, but perhaps missed the opportunity to delve into some of the nuanced applications of these informal institutions. We are happy with the fact that, through modelling, we were able to identify the most important areas of strategic development in China such as trust-building and flexibility, but perhaps there is room for more specific findings. For example, it could’ve been worthwhile to do this research in partnership with a firm in order to generate much more useful research but for a smaller sample. On the other hand, we feel that keeping the scope of the project allows us to have learned more about the future implications of informal institutions in China and what the overall timeline looks like.

5.2 Practical Implications

Our research has practical implications for the lifecycle of informal institutions. From analysing how informal institutions have changed alongside economic development for the last several decades we can see that there is a parallel institutional lifecycle alongside the

economical one. This lifecycle will likely be at the forefront of future research when it comes to institutional research in China.

5.3 Future Research

It could be possible that despite informal institutions being a positive factor in China's rapid growth up to now, they may impact the country negatively in the future. According to Cunningham and Dibooglu (2020), "in the absence of formal institutions, informal institutions have accounted for China's growth, and while this has worked without too many hiccups, it is unlikely to guarantee long-run sustained growth". They argue that formal institutions can be either "extractive" (Acemoglu & Robinson, Cunningham & Dibooglu, 2020), where "a small number of powerful individuals try to take advantage of the rest of the society" (Cunningham & Dibooglu, 2020), or "inclusive" (Acemoglu & Robinson, Cunningham & Dibooglu, 2020), where "governance tends to follow mutually beneficial arrangements for a large number of people and exploitation is minimal" (Cunningham & Dibooglu, 2020). Whilst an extractive system with a persistent informal institutional framework is beneficial for "catch-up growth" in emerging markets, Cunningham and Dibooglu say that this is unsustainable due to inclusive policy being a prerequisite for innovation-based, sustained growth. While this may be inductively true, we feel like China has behaved against the understood 'rules' of internationalisation theory time and time again, and this could be a similar instance. Hence, it is still vital for DMNEs to be treating China as the extractive system it is today, rather than be basing strategy on predictions of its potential future inclusive state. This should not be disregarded entirely, but companies should be well prepared to shift strategy to a more inclusive system because the markets in which they currently operate are already inclusive. However, this shift from an informally-driven emerging economy to a formally-driven one over the next several decades will be worthy of constant research, and the progress that both businesses and the Chinese government make in facilitating this is of particular interest. Many of China's biggest multinationals are already well-equipped to deal with this given that they have been operating in developed markets for a long time now, but there will be a shift in

competitive advantage for smaller local firms against both foreign and local multinationals looking to grow within China.

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Appendix A

Interview with Sino-European Product Leader at Voi Technology David Almström

Do you think that informal institutions are more prevailing in the Chinese market than in western markets (from your experience)?

Informal institutions in China seem to be more prominent than in European markets. Enforcements of law is one thing but a big percentage of the market is ruled by informal institutions. The government appears to try to formalise business endeavours and legal procedures more and more but informal institutions seem to affect legal procedures from the background. Moreover, networks of trust are of great importance if the investing company wants to advance according to the desired standards. Knowing people and networking appropriately should be a part of the business strategy of the investing enterprise.

Do you think that being able to speak Chinese will affect business endeavours or strategic planning?

It is both important and unimportant. In certain cases, the ability to understand Chinese is essential. For instance, when it comes to legal contracts or papers, western characters are not allowed and everything has to be in Chinese characters including non Chinese names. When it comes to higher education in China, there are no requirements for English meaning that Chinese people will expect you to be somehow acquainted.

Are you familiar with the term guanxi?

The real meaning of the guanxi is heavily misunderstood. It's commonly perceived that guanxi translates into social networks that function as a background for the business scene. The real power of the guanxi system depends on the level of involvement of the firm in question. For instance, if two families that are part of the guanxi have been working as affiliates for two to five generations, the power of leveraging this relationship is going to be much more evident than a foreign enterprise that just entered the market. Furthermore if we take this relationship into the political scene, it is observed that the family that supports the political parties in power will be a strong part of the guanxi that will eventually create a large network that will function as a leverage between the businesses and the government. Even when it comes to picking a political leader, it will often come down to the families involved in the guanxi networks. The guanxi networks mostly function as a trust equilibrium between affiliations. For instance when two parties are engaged in a common venture, if one of the parties helps the other party through leveraging from their relationship, the other party will have to return the favour in order to sustain a good reputation and level of trust. This exclusive side of relationship and trust building in China usually will not work in favour of DMNEs. Western enterprises will usually have a hard time leveraging the guanxi networks in their favour since they do not have any history or roots on the market that justify trust. On the other hand, for Chinese businessmen, leveraging a network of trust is second nature. Foreign firms can not compete with Chinese firms in terms of leveraging their networks. Mitigating this contrast is possible from the DMNE side through strategic positioning in order to balance out the networking benefits of the Chinese. To summarise, when networks such as the guanxi are in question, it all comes down to trust building. If a foreign company manages to promote a trustworthy impression, they can use that as a leverage to their favour.

Are Guanxi networks or networks of trust something that serves a valuable infrastructure?

Networks such as the guanxi are necessary for China since it is where they have all the trust levels in the market. As far as the law of China is concerned, on paper it is fair and reasonable but when it comes to law enforcing it is weak. The reasoning behind this is that the justice system and the belief system are not really in line with the law, turning the networks of trust into the enforcing mechanisms of the market. The cost of breaking a partnership between

Chinese firms may be larger than breaking the law. On the one hand, in an underdeveloped formal system such as the one in China, corruption may help in certain cases by covering the inconsistencies of the system. On the other hand when countries reach a further development phase, they can start trusting the law and the justice systems and the corruption can be diminished efficiently since it is not necessary anymore. What that means is that networks such as the *guanxi* appear to be very important in developing markets since they help firms overcome the weak aspects of the legal institutional frameworks. Furthermore, an aspect worth noting when talking about informal institutions in China is Confucianism. Confucianism as a philosophical framework has influenced eastern Asia to a considerable extent. The main relevance to the current case is that Confucianism says that people should listen to the leaders and to the scholars in the society. Because of that specific patterns can be observed around Asia that exist mostly because of the common Confucianism beliefs. In contrast to other eastern Asian countries, China has a unique mix of Confucianism into their strategy that will not push new opportunities away (as it has happened in Japan). If we would have to compare China with another emerging market such as India, it is observed that the mixture of *guanxi* and Confucianism seems stronger than Hinduism and a less flexible political and informal system.

Do you think that companies that get accustomed to the guanxi networks benefit more than the rest?

They may not benefit more but they will certainly have to be aware of it, not so much in order to gain from it but more in order to be able to mitigate risk. If a foreign company would be in the position to depend on a network of trust or *guanxi* exclusively they would not be in an ideal situation. For instance, if a western DMNE would acquire a piece of land from the government (either through social relations or even bribing), the political situation of the country may affect the firm directly in the long-term. More specifically, if the connection that helped the company acquire the land would not be in political power anymore, the relationship of trust between them will not be of any value and the DMNE might have to face lawsuits or fines from the new government or individual in charge. To summarise, there is a

big risk for companies to depend on networks of trust since they might not be sustainable in the long-term and are not a part of the real guanxi. Understanding the limitations of networks as such is key for long-term stability.

Do you think that social networking with government officials is common in the Chinese market?

Apart from it being common, it is also very important for firms. The main reason is that in China you can not get anything done without government approval, so firms will have to network with the government. Nevertheless, this networking with the government would not occur on a guanxi basis but more in the sense of promoting a win-win situation for the parties involved (e.g if you show the government that you will increase tax income by a reasonable amount, they will also help you achieve certain objectives). If the firm proves to be correct with their ambition and manages to help the government as mentioned then the relationship between them will be valuable and will build trust. Cases as such should not be misunderstood as guanxi but should be perceived as loose informal institutions that will change according to the political forecast of the country or the management of affiliating companies. Because of that, large companies might hire specialists for government relationships and networking when they invest in China not only to be able to leverage their connection but also to make sure that those connections will not turn into a liability or an obstacle for the firm.

Are there any notable examples of western companies failing strictly due to failure to comply with informal institutions? (and vice versa)

Ericsson's success in China is definitely due to their involvement with informal networks. In their case they managed to leverage their relationships in very efficient ways. When Ericsson entered the Chinese market, they could not own the majority in operation, they had to be minority shareholders. When DMNEs are setting up joint ventures, the DMNE can have a maximum of 49% and the Chinese counterpart will also take 49%. The remaining 2% will go to the middleman and this was a key aspect for Ericssons success, by finding a company in

Hong Kong (as a middleman) that had guanxi connections all over China. When Ericsson got into the business in the early 90s, their aforementioned middleman managed to provide all the required connections (both governmental and through networks of trust) that played a vital role in the company's success. On the other hand, informal institutions fail when the companies get greedy and try to control their connections in their favour often by breaking the law in order to develop or expand faster than they should.

To what extent will the guanxi or the informal institutions and networks affect unequal information in the Chinese market?

Guanxi is not really a network, it's more individual - person to person. If you break that trust, you're not going to be able to be successful. That person will work against you instead. But then you have these informal networks, where you're trying to gain trust with governments and so on; once again, you can't really break that because they won't trust you and that will spread very fast. For instance if you deliver the wrong thing to a customer or hospital in China for example, everyone will know about it, even if you don't break the contract. The contract is just a piece of paper, you can fulfill the contract but break the intentions of it.

Do you think that informal institutions are taken under consideration from the DMNEs (in their strategy)?

The ones that have been there longer have. The problem is when they change management and people don't really know how it is. The typical example is Microsoft - for 15 years they've never managed to get anything done in China. They come in with a plan of how they're going to break China, how they're going to make China happen, but they have no patience and change the chief rep every few years because the plan didn't work. You have to really master and maneuver within China to get things done the way you want to get them done. You have to look at the goal, not the plan. American companies have a tendency to look at the plan and enforce the plan because then you'll meet the goal. In China this doesn't work, that's why you often have a lot more European companies, in particular Scandinavian and

Swedish companies. We're used to this flexibility, we're such small countries so we have to listen to what the customers want so we're fairly adaptive. Whereas American companies just want to come in with a big stick and hit it hard.

Are companies like VOI acquainted with the networks of trust in China?

No, voi has a much easier task because we're a customer. Whenever you come with money they often jump very high. It's not difficult to get things done if you want to buy things, unless it's facemasks at the moment, but in general if you come as a customer it's fairly easy to do it. Voi has also been working with having Chinese in our company in Stockholm, but also in China to make sure that we get the things that we order, we have to make sure that they deliver to what they promise. Often these exporting companies have a much better understanding of working with foreign companies, they understand that if they mess up one time it might be ok, two times doesn't work. And they have other big companies like 'B...' and Lime. It's a divided situation, when you want to work with suppliers in China versus when you want to sell in China, they're two very different things. If you want to set up a factory to sell to Chinese customers or to export to yourself, it becomes much more tricky.

Do you think that these exclusive networks in China can be sustainable for long term growth?

It's a threshold when you get into it. The more the country develops, the less important Guanxi will be. But you can't look at China as one country, if you compare Shanghai region versus Jiangxi for example, it's like looking at Sweden and Morocco in terms of economic development. It's a very divided situation, you have the east west disparity; the coastal regions are very rich, very well developed. Look at Guangdong, it has the same GDP as Germany, whereas Jiangxi, as I said, is more like Morocco or at least Italy. Depending on where you are in China, the importance of Guanxi might be more or less, whereas in Jiangxi it's much more about what happens around the dinner table.

Do they create exclusive circles and push away new opportunities?

I would say no at the moment, since there's so much development to be done, so the exclusive networks make things more efficient. There are more informal networks than guanxi as well, guanxi is the strongest one but you see these business schools that become these clubs, and they do a lot of business within these clubs and it's very hard to get into these clubs. That's not really guanxi, that's more the network of trust. You're part of this club, we trust you, we want to do business with you. Like the Cheung Kong Graduate School of Business that I was referring to, they have this entrepreneur club where everyone that has been an entrepreneur of name in China has been to this school. So they can get things done very quickly, they can set up a 2 billion dollar fund to invest in opportunities. They think this is a great idea, they call a few friends and all of a sudden they have the seed capital for 200 million dollars to get going, then they can raise another 5 or 6 hundred million to get going. The networks of trust speed things up - I would say that for China that's more important not than inclusiveness. China is far from developed so this will continue for another 10 or 15 years at least.

Appendix B

Interview with Freelance Retail Specialist George Kaidantzis

Do you think that being able to speak Chinese will affect business endeavours or strategic planning?

If you have the ability to speak in the language of the person you are working with, any kind of proposal, strategy or demand will most likely be more straight-forward and efficient. Nevertheless, there are some major adversities when it comes to the Chinese language. Firstly, the language itself, especially in a business setting is very difficult to be learned and used effectively by westerners, not only due to its complex nature but also due to the numerous dialects used in the country. Misunderstandings between the parties affiliated can be quite common and unfavorable because of that. Secondly, when a western executive is trying to comprehend the pulse of the market in order to be on top of things, apart from the importance that lies in the Chinese language, the understanding of the Chinese culture itself is of great importance. The main goal for Chinese sellers is to sell all of their products in stock while maintaining a good reputation. If they notice that their affiliation with their western counterpart has a lack of knowledge or respect towards the Chinese market (e.g if they are trying to exploit the situation) the results can be negative for the DMNE resulting in a great loss of competitive advantage. The Chinese counterpart would not undermine their affiliation to go against them personally, but to protect themselves and their reputation within the networks of trust. The Chinese will have a much more prominent leveraging power of the informal institutions that their Western counterpart. Moreover, the needs of the Chinese market cannot be directly related to Western markets since they are quite different. More specifically, the needs of the customers are different and they are changing at a fast pace. The spending patterns of the Chinese are getting closer to western standards but are still not the same. Concluding, the understanding of the needs, the spending patterns, the cultural norms and the informal social rules are probably of greater importance for a western MNE than

learning the Chinese language since it can have major negative effects if not carried out properly.

Are you familiar with the term guanxi?

For a period of five years I worked in China and was very close to my customers and affiliates. This gave me the chance to understand some things from up close and come in contact with a lot of Chinese business graduates that were getting involved in Chinese affiliations with DMNEs for the first time. From my point of view, the Guanxi networks are social networks that share the same values and their function is to promote some kind of balance and promote the impartiality in the market. The biggest importance would be the philosophical value behind the Guanxi and it is imperative to be respected and understood.

Are Guanxi networks or networks of trust something that serves a valuable infrastructure?

China definitely has its own philosophy when it comes to conducting business. This of course changes a lot from region to region. For example south China has been more business oriented but more costly due to a lack of staff and specialised people available. The consistent contact with the Western MNEs in southern China gave them very good insight and infrastructure for foreign investment that later on gradually moved towards the mainland. Depending on the region, China can be quite different. For instance there are areas that business affiliation and investing is much more risky and difficult to approach due to lack of trust networks or lack of western involvement. The regions could also be divided according to how closely they abide to the formal procedures. Furthermore, the ownership of land also affects the way business works. For instance if the government decided to utilise a piece of land close to a branch or a factory of a DMNE, they will be affected directly. Understanding the limits of land ownership in relation to governmental regulation is vital. To conclude, in general, even though the culture of the Chinese can be related to other eastern countries, it is changing at a fast pace. Their strategy has also been changing through the years with the appropriate focus in the latest market trends.

Do you think that companies that get accustomed to the guanxi networks benefit more than the rest?

The Chinese people have it in their philosophy to form networks of trust and leverage their connections. The size and the type of business endeavour can also determine the level of social involvement that is needed. For freelancers or medium sized firms, network involvement might prove to be more important than in DMNEs. The biggest percentage of the firms in China take personal relations and trust building seriously and promote it more and more. The rapid development of the Chinese market changed a lot of things in the nature of business in China. In order to be able to cope with rapid change, specific informal institutions had to be brought to the surface. The constant realities with foreign investors and DMNEs in some ways forced the Chinese market to pay attention to multiple morals and standards in the way they conduct business.

Do you think that social networking with government officials is common in the Chinese market?

Since every kind of large business has to happen through government approval, it is usually mandatory. Specific things have to be controlled by the government, so having a good relationship with government officials may be beneficial. On the other hand it might provide fake expectations that will mislead the firm. For smaller business endeavours it might not be as common.

Are there any notable examples of western companies failing strictly due to failure to comply with informal institutions? (and vice versa)

No matter how different the market, it is usually under the businessman's ingenuity to overcome certain obstacles. The biggest percentage of the institutions in China are informal. If the businessman knows the limits of those institutions and understands how to leverage their connections their firm will probably benefit to some extent. For instance 20 years ago Chinese businessmen had less knowledge and experience than the Western associates and

they were compelled to learn from them and adapt accordingly. Nowadays, the Chinese have developed, and the unequal information in the Chinese market is leaning against the Westerners. As a middleman it is sometimes easy to observe the lack of knowledge from the DMNE side of an arrangement. In this case it also depends on the region and the specifics of the case. Personal relations or networks of trust, certainly have limitations. No western MNE will succeed explicitly due to their informal relations. Moreover, DMNEs cannot rely on their abilities to leverage connections and personal ties. Nevertheless, informal institutions can certainly protect you from exploitation, they can promote your image if you prove to be trustworthy, they will treat you fairly and reasonably, they will stay true to the arrangements that you have agreed. These are components that informal institutions will definitely support and promote but the limitations are imperative to be understood meticulously. The legal attributes of the association might not be affected by informal institutions as much, firstly due to the protracted reach of the government and the eminence of specific segments of the Chinese law.

Do you think that informal institutions are taken under consideration from the DMNEs (in their strategy)?

Usually DMNEs and investors do not take informal institutions under consideration extensively. This might differ depending on the nature of the product or the venture but in general it is under perceived. Western firms usually have a concrete business strategy before entering the Chinese market that will usually not be altered explicitly due to informal institution influences. The anonymity and legitimacy of production in China might act as a threshold for this statement. For instance, depending on the western firms' needs and budget, the level of informal institutional involvement will be determined in advance.

Are companies like yours acquainted with the networks of trust in China?

In the service field such as mine, I always have to offer some kind of valuable arrangement for my clients. When you cooperate with firms in China, it is important to go with trustworthy and reliable arrangements but there will always be some attributes that have to be dealt with

in an informal manner. For instance when you are buying a product from a Chinese factory even if they are totally legal and formal in their procedures, aspects such as material sourcing and certification of the components will probably have to be dealt with on an informal level. Informal institutions and informal arrangements with DMNEs are also related to the cost of the product or the service. Western companies that focus extensively on informal institutions might do it to cut down on costs. It is very common that the cost benefits DMNEs will have in China will be to some degree related to informal parameters. For China it is not currently possible to apply a very strong array of regulation, at far as production is concerned. The informal institutions in the production sector in China have been a fundamental component towards minimising cost and maximising efficiency in areas where the government and regulation is weak due to corruption.

Do you think that these exclusive networks in China can be sustainable for long term growth? (since they create exclusive circles and might push away new opportunities)

The nature of the informal institution will shift according to the needs of the market. For instance if the government decides to stop the production in China, everything is gonna change on an international level. Due to China's significance for the International market, the informal institutions and the way they affect business strategy will be more intensively based on the international market than the government in China. With the current momentum that the Chinese market has gained, the future timeline suggests that they are gonna compete in the first position as the biggest market. If they manage to continue in the same way, the repercussions it will have towards the international market would be close to what the repercussion of the international market would be towards China. To some extent the way that informal institutions and networks of trust function in China is not only connected to the local philosophy and norms since the government is affecting almost everything directly. This interconnectedness between the society, the informal institutions and the government has proved to be successful but it is difficult to criticise its sustainable prospect or potential. For instance, the Chinese have been very productive and efficient with the current governmental layout and they have developed techniques in their business strategy that are unique to the

Chinese market (e.g the tendency to focus on selling all stock products). The respect that the Chinese show towards their Western associates proves a sustainable nature into their methods. On the other hand there are definitely markets in China that are somehow generic and very difficult to be proven sustainable. Sustainable and concrete fields in the Chinese market tend to be highly recognised and respected.

What is the most efficient way to get associated with informal institutions in China?

The best way would have to begin with research. Being up-to-date is very important in order not to lose the pulse of the market. Moreover, being honest and transparent has always been recognised by the Chinese and it is very important for sustainable relation of trust. Moreover, the physical presence in the Chinese market is essential. In the long-term, if there is no physical contact with the Chinese company associated, the relationship of trust might break.

Is there any specific ranking system when it comes to informal institutional influence on the market?

It is difficult to say for certain because the government still has the most impactful influence. Everything changes in the long-term. Even very well established companies will face groundbreaking problems at some point due to the rigorous and exacting significance of the Chinese government. As long as the government's power and significance is concerned, the repercussion towards both local and western enterprises will be immediate and straightforward.