How do Institutions Matter for the Internationalization of Emerging Economy Firms?*

: Evidence from China

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Abstract

Research proposes that institutions matter in shaping firm strategic behavior as well as the performance implications of such behavior but is less forthcoming with respect to how they matter especially during the process of internationalization of emerging-economy firms. We build on the institution-based view to propose that emerging-economy firms often involve significant interplays with institutional rules as well as the changes of such rules when going international. We argue that the institutions in emerging economies play a central role in shaping the international expansion and the performance outcomes of such strategic behavior. In other words, institutions may shape and determine directly how emerging-economy firms formulate and implement strategies that create a competitive advantage. We test the proposed hypotheses using a comprehensive longitudinal data of internationalizing firms from China and offer important contributions and insights to better understand how institutions matter in explaining the internationalization strategy and performance of emerging-economy firms.

Keywords: China, Emerging-economy Firms, Institutions, Institution-based View, Internationalization

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I. Introduction

The international business environment has witnessed unprecedented changes over the past several decades that have metamorphosed the very approach to business for firms. In this relatively nascent paradigm, emerging-economy firms are increasingly expanding internationally and have greatly contributed to the rapid growth of global economy. For instance, emerging-economy firms now accounts for more than 40% of exports and a quarter of outward foreign direct investment flows in the world. In 2008, the leading emerging-economy multinational firms mainly from Asian economies such as China and India, on average, operated with 39% of their employees, 34% of their assets, and 45% of their sales from their international activities (UNCTAD, 2010). It is argued that internationalization has emerged as an important strategic approach for emerging-economy firms to seek strategic assets valuable for global competition, which represents new potential opportunities to build sustainable competitive advantages and catch up with established global players (Guillen and Garcia-Canal, 2009; Luo and Tung, 2007; Mathews, 2006).

Despite the increasing significance in the global competitive landscape of emerging-economy firms (Aulakh et al., 2000; Khanna and Palepu, 2006; Mathews, 2006), there is a relative paucity of such empirical research on emerging-economy firms (Contractor, Kumar and Kundu, 2007; Hitt et al., 2006; Thomas, 2006). Current knowledge on the topic of internationalization originates from research on multinational enterprises from advanced economies (Hitt et al., 2006; Zahra, Ireland and Hitt, 2000), where developed-market institutions allows firms to build competitive advantages through experiential learning that they can exploit internationally. While the prior research in reviewing and synthesizing the literature on internationalization has widely assumed institutions as "background" (Peng, Wang and Jiang, 2008), the institutions in emerging markets, which are more than background conditions, are drastically different from those in developed markets (Seligman, 1999; Shenkar, 2005). This represents a notable research gap in the literature.

The institution-based view highlights the central role of institutions in shaping firm strategic choices and performance. While the proposition that "institutions matter" is widely accepted in the literature (North, 1990), how they matter remains a hotly contested question in the international business literature (Eden, 2010; Henisz and Swaminathan, 2008; Jackson and Deeg, 2008). To gain understanding of role of institutions, more work is needed to help us specify what institutions are and how they matter, under what circumstances, to what extent, and in what ways. According to the institution-based view, the role of institutions is more salient in emerging markets because the rules are fundamentally and comprehensively changing, and the scope and pace of institutional changes are unprecedented (Peng, 2003). It seems impossible to explore the internationalization issues of emerging-economy firms comprehensively without an understanding of how the interplay between institutions and firms in emerging markets affect their strategic choices and performance of such interplay (Hoskisson et al., 2000; Peng, Wang and Jiang, 2008; Wright et al., 2005).

Therefore, the objective of this study is to...
fill the research gaps in the literature on internationalization of emerging-economy firms by applying and advancing an institution-based view to examine the antecedents of internationalization as well as the performance implications of such behavior of emerging-economy firms. Specifically, we contribute theoretically and empirically to the literature by examining the roles of institutionally-shaped firm characteristics and institutional environments in driving internationalization strategy, and their relationships with firm performance, which will shed important light on our understanding of internationalization of emerging-economy firms. In this study, we seek to correct the deficiencies in the extant literature on internationalization by providing an exploratory research on internationalization, and to better understand how institutions matter in explaining the internationalization strategy and performance of emerging-economy firms.

We test our propositions using longitudinal data of internationalizing firms from China. As China, the largest emerging economy in the world, has been rapidly integrated into the global economy and achieved rapid economic development in the last three decades, firms from China, such as Haier, Lenovo, and Huawei, are quickly expanding internationally and are becoming important global players in the international business arena, which opens up new avenues for academic theorizing and forces driving internationalization of emerging-economy firms, and how the extent and nature of their internationalization strategy as well as the performance outcomes of such behavior differ from those of multinational enterprises from advanced economies (Child and Rodrigues, 2005; Kim, Kim and Hoskisson, 2010).

II. Conceptual Framework and Research Hypotheses

The institution-based view has emerged as a central perspective for understanding organizational phenomena within international business research (Peng, Wang and Jiang, 2008). The institution-based view argues that firm strategy and performance are, to a large extent, determined by the interplay between institutions and firms. Defined by North (1990, 3) as "the rules of the game", institutions can be broadly categorized as formal and informal ones that may constrain or motivate certain strategic choices and determine the performance of firms, particularly in emerging economies (Peng, Wang and Jiang, 2008). Concurrent with the recent development in the literature and building upon the institution-based view, we argue that the institutional context may have a significant role in explaining the extent and nature of internationalization strategy as well as the performance of emerging-economy firms.

We construct the estimation of how the institutionally shaped (or determined) firm characteristics and institutional environments may drive the international strategic choices of emerging-economy firms as well of how the institutional factors can further explain the variation in performance outcomes of such strategic behaviors. The firm characteristic in emerging markets that are most significantly shaped by local institutions is government involvement through ownership control/pattern or government-firm relationship. In addition, institutional environment factors, such as institutional free market development and big institutional events like China's entry into the WTO, which have mostly been
neglected in the extant strategic management and international business literature, have been widely recognized as important forces to drive firms' behaviors and strategic choices, especially in emerging economies that are experiencing significant institutional changes (Park, Li and Tse, 2006; Peng, 2003; Peng, Wang and Jiang, 2008).

Moreover, it is more important, then, to understand whether international expansion matters for them, whether it is beneficial, whether institutional environment is helpful for them in achieving benefits and positive performance outcomes from internationalization and under what conditions these firms can reap the benefits of internationalization by making use of institutional advantages. For the role of institutions in explaining the variation in performance outcomes of internationalizing firms in emerging economies, we consider the role of market-oriented institutional environment improvement in affecting their performance outcomes of internationalization. We aim to investigate whether and how better market-oriented institutional environment is helpful for internationalizing firms to offset their initial internationalization discount (or negative performance) and reap more benefits from internationalization by utilizing institutional advantages. In other words, the market-oriented institutional development may help emerging-economy firms effectively allocate resources in the industry and further help them achieve more benefits from internationalization. Thus we expect that the better market-oriented institutional environment may play an important role in shaping the performance outcomes of international expansion in internationalizing emerging-economy firms. 

Fig. 1 presents the research framework employed in the current study.

1. The Institution-based View and Internationalization of Emerging-economy Firms

As noted above, we embrace a framework which considers the role of both institutionally
determined firm characteristics and institutional environment changes in shaping emerging-economy firms’ international expansion strategies. More specifically, we examine the impact of institutionally shaped firm characteristics, such as government involvement through state control in the ownership structure and close government ties with the firm and market-oriented institutional environments on the internationalization behaviors of firms in emerging economies. We argue that the role of institutional determined firm characteristics and institutional environment changes should be analyzed together to explain strategic behaviors of firms in emerging economies.

In this study, we posit that government may exert informal and formal institutional effects over the internationalization and propose that such government involvement may depend on two distinct firm-level institutional dimensions: the degree of state ownership within an emerging-economy firm, and the level at which the firm is affiliated to government (government-firm relationship). Our basic idea is that, because government institutional systems are not unified or coherent (Scott, 1995), the type and magnitude of institutional pressures for internationalization may vary drastically across emerging-economy firms based on different degree of government involvement.

The first dimension (i.e., the degree of state ownership) argues that government in emerging economies may influence a firm’s internationalization decisions by owning the firm, at least partially. Due to the relatively weak effective market-based governance mechanisms in many emerging-economy firms, a direct state control can influence international expansion decisions of the firm. Government can influence firm internationalization decisions by introducing regulations regarding state-owned assets (Cui and Jiang, 2012). Emerging-economy firms with a higher degree of state ownership have to balance political need and market requirements, and the decision-makings, including international expansion, need to be aligned with the objectives of the government. Therefore the government involvement by controlling the ownership of the firm will be most likely to affect the effectiveness of resource use and willingness to internationalize (Cui and Jiang, 2012; Xiao et al., 2013). Governments with a higher degree of state ownership within an emerging-economy firm may influence firm decisions by appointing executives and by regulating state-owned assets (Wang et al., 2012). Consequently, managers of emerging-economy firms with a higher degree of state ownership tend to pay more attention to caring about whether their strategic decision-makings are coinciding with the government goals. Hence the internationalization decision in these firms with a higher degree of state ownership is driven partly by the need to fulfill political objectives (Cui and Jiang, 2012; Xiao et al., 2013).

**H1**: A higher degree of state ownership leads to a lower level of internationalization of emerging-economy firms.

In contrast, the second construct, namely, government involvement through different levels of government-firm relationship can also exert influence on internationalization decision of firms in emerging economies. It is argued that a firm’s strategic choices may depend on factor availability in home-country
environments (Castrogiovanni, 1991). However, the ties with governments in emerging economies can be either higher or lower. Different levels of government in emerging economies can have divergent interests, goals and different abilities of accessing valuable resources which encourage and enable firms to go international. A close ties with governments are helpful for the firms not only to enjoy state favors, access new resources and compensate for the lack of factors (Wang et al., 2012), but also to overcome constraints relating to use of existing resources through favorable treatment (Lu and Ma, 2008). Hence the advantages arising from a firm's close ties with its home-country government affect its decision making to internationalize and purse foreign opportunities (Guler and Guillen, 2010; Wang et al., 2012).

**H2:** A higher level of government-firm relationship leads to a higher level of internationalization of emerging-economy firms.

Moreover, institutional environments might play an important role in supporting the effective market mechanism and facilitating market transactions of firms (Meyer et al., 2009). As a big institutional event for China, its entry into the WTO in the late 2001 may act as a booster to firms' internationalization process. Indeed, China's WTO accession has sparked fundamental, wide-spread, and substantial institutional changes in the competitive environment. Under agreement with the WTO, China has to conform to requirements and open more industrial sectors to foreign investors making domestic competition became fiercer. Many firms in China paid more attention on building competence and competitive advantages. The domestic competitive pressures heightened by the WTO entry will thus encouraged more Chinese firms to go abroad.

**H3:** The WTO entry heightening Chinese domestic competitive pressures will encourage Chinese firms to go international.

Another construct of institutional environments refer to the market-oriented institutional development. Improved institutional environment helps firms reduce information asymmetries, and thus lowering the cost of searching for information needed for internationalization (Lu, Xu and Liu, 2009). We argue that home country market-oriented institutional development has a strong impact on the internationalization strategies and performance of firms from emerging economies (Hitt et al., 2006). China has pursued a gradual approach in its institutional reform, thus creating various levels of institutional development across regions (Xiao et al., 2013). In some regions, governments are less likely to intervene into the market, given the fact that a more advanced market economy plays a more important role in guiding the operations in such regions. We expect that more developed market-oriented institutional environments in emerging economies can help firms in these economies reduce some costs in the internationalization process, and thus encourage firms to pursue internationalization.

**H4:** Firms located in regions with a better market-oriented institutional environment are more likely to go international and have a higher level of internationalization.
2. Internationalization and Performance of Emerging-economy Firms

We also examine the performance outcomes of internationalization from an emerging-economy point of view, and further investigate how institutional environment may moderate the influence of internationalization on their performance among these firms. However, internationalization tends to be a "two-edged sword". Internationalization can generate both internationalization discount and premium. While it has been theorized that firms can obtain new resources and transfer their core competencies to new market through internationalization, past studies also suggest emerging-economy firms typically suffer from a number of liabilities of foreignness and newness when going international. They are at a disadvantage with respect to multinationals from advanced economies because they have less financial, managerial, and technological resources, established brands, and innovative products (Aulakh et al., 2000; Cuervo-Cazurra and Genc, 2008; Hussain and Jan, 1999).

Hence it is likely that the nature of a positive relationship between internationalization and performance observed in firms from developed markets might not apply similarly to firms from emerging markets. As firms from emerging markets like China are generally experiencing initial international expansion process, and tend to be young or recently privatized, it is likely too early to expect positive benefits from internationalization for these emerging-economy firms. Instead, they may be likely to suffer from an international expansion discount (i.e., negative performance outcomes) when initially going international. We thus propose that:

H5: The internationalization of emerging-economy firms will be negatively related to firm performance.

Building on recent international business research and the institution-based view, we further examines whether an advanced institutional environment is helpful for the emerging-economy firms to offset their international expansion discount (i.e., negative performance). We expect that the improved market-oriented institutional environment can explain such performance variation from internationalization for firms in emerging economies. Our intention features the interplay between internationalization and improved institutional environment in explaining the variation of performance improvement. The effectiveness of internationalization depends on the institutional environment within which firms operate. In particular, an advanced or well-established institutional environment can provide efficient incentives to improve firm performance. When the manangers have the control over decision makings, they have the highest incentives to perform well and to become the de facto owners of the firm (Park, Li and Tse, 2006). We thus propose that better market-oriented institutional environment in a region reflects the level of institutional development and managerial incentives to improve firm performance in the internationalization process. This leads to:

H6: Firms located in regions with better market-oriented institutional environment are more likely to achieve better performance when going international.
III. Research Methodology

1. Data

In this study, we argue that institutions in emerging economies like China may play an important role in significantly shaping the internationalization strategies and performance of firms, and thus adding institutionally determined firm characteristics and improved institutional environments in examining the drivers of internationalization behaviors and performance outcomes will shed important light on our understanding of internationalization. In order to explore institutional divers of internationalization and its effect on performance, the investigation focuses on Chinese firms that are actively engaged in international expansion activities. Inasmuch as the literature offers relatively limited coverage to the internationalization for emerging-economy firms, an exploratory research on Chinese manufacturing firms was conducted. We tested the proposed hypotheses using a comprehensive longitudinal data set covering 1998-2003 from China which provides detailed information on a firm’s identification, assets, liabilities, capital structure, institutional changes, internationalization, and financial performance. After observations with missing data on key variables or unrealistic numbers possibly from data entry errors are removed, there are 33,862 valid firm-year observations, including 11,288 firms in the Chinese manufacturing sector.

2. Measurement of Variables

Consistent with previous studies, we utilize return on assets (ROA) as the measure of firm performance in this study. As it has been suggested that ROA may be sensitive to financial leverage or non-operating income, e.g., asset sales and tax payments, we also use another measure, operating return on assets (operating ROA) which is calculated as operating income divided by total assets, to measure firm performance.

Internationalization refers to the extent of a firm’s international operation (Dentos and Beamish, 1999), thus capturing the international involvement of the firm. We reviewed prior international business research for measures to operationalize the concept of internationalization, and found that there has been no agreement or standard approach as to the measure of internationalization. The ratio of foreign sales to total sales (FSTS) has been widely used in many studies (e.g., Capar and Kotabe, 2003). Therefore in this study, because of data availability constraints and for comparison purposes, internationalization is operationalized as the FSTS ratio.

The degree of state ownership is measured as the share of state-owned capital in the total capital of the firm. The government-firm relationship is continuous number that represents these five hierarchical levels of government: state, provincial, city, county and township. The market-oriented institutional development is measured using the institutional index developed by the National Economic Research for regional marketization level for different provinces in China (Fan, Wang and Zhu, 2011). To measure the big institutional event and its effect of the WTO entry, we create a dummy variable (post-WTO =1).

In addition, firm leverage ratio, measured by the ratio of debt to total assets, intangible
resources as fixed assets, firm age, measured by the number of years since the establishment of the firm, firm size, measured by the natural logarithm of total number of employees, and foreign ownership using the ratio of capital owned by foreign investors to total capital, are controlled to eliminate the variation in firm performance. For location, we use four dummy variables for the coast provinces, Guangdong, Shanghai, and Beijing and Tianjin, with the northern, central, and western provinces as the baseline. Furthermore, industry and year dummies are also included as control variables in the model estimation.

IV. Empirical Results

<Table 1> presents the descriptive statistics and the correlation coefficients. All correlations are fairly low, and variance inflation factors (VIFs) are well below the acceptable level 10, ranging from 1.00 to 3.82, indicating no serious problems of multicollinearity. Nevertheless, we mean-centered variables in the interaction terms to avoid problems of multicollinearity and increase interpretability of interactions following Aiken and West’s (1991) procedures. To test the hypotheses, we constructed tobit and general linear squares (GLS) regression, respectively, to test the hypotheses. <Table 2> provides the results of tobit models used to test the institutional drivers of internationalization for firms in an emerging economy of China. Model 1 in <Table 2> includes several control variables. We test the effects of institutionally determined firm characteristic and institutional environment

| Variables                  | 1   | 2   | 3   | 4   | 5   | 6   | 7   | 8   | 9   | 10  | 11  | 12  | 13  | 14  | 15  | 16  |
|----------------------------|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| 1. ROA                     | 1.00|     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 2. Operating ROA           | 0.92| 1.00|     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 3. Internationalization   | -0.03|-0.02| 1.00|     |     |     |     |     |     |     |     |     |     |     |     |     |
| 4. Foreign capital         | -0.02|-0.02| 0.46| 1.00|     |     |     |     |     |     |     |     |     |     |     |     |
| 5. State ownership         | -0.15|-0.15| 0.02|-0.14| 1.00|     |     |     |     |     |     |     |     |     |     |     |
| 6. Government-firm relation| -0.18|-0.18| 0.01|-0.06| 0.51| 1.00|     |     |     |     |     |     |     |     |     |     |
| 7. Institutional environment| 0.06| 0.06| 0.07| -0.02|-0.27|-0.23| 1.00|     |     |     |     |     |     |     |     |     |
| 8. WTO entry               | 0.03| 0.03| -0.10|-0.22|-0.07| -0.04| 0.55| 1.00|     |     |     |     |     |     |     |     |
| 9. Firm age                | -0.03|-0.03|-0.22|-0.04| 0.08| 0.07|-0.06|-0.02| 1.00|     |     |     |     |     |     |     |
| 10. Leverage ratio         | -0.01|-0.01|-0.00|-0.01| 0.00| 0.01|-0.01|-0.01| 0.00| 1.00|     |     |     |     |     |     |
| 11. Firm size              | -0.07|-0.07| 0.08| 0.08| 0.25|-0.10|-0.06| 0.06|-0.02| 1.00|     |     |     |     |     |     |
| 12. Intangible asset       | -0.05|-0.04| 0.01| 0.01|-0.02| 0.03| 0.03| 0.07| 0.01|-0.01| 0.09| 1.00|     |     |     |     |
| 13. Coast regions          | 0.05| 0.04| 0.11| 0.14|-0.34|-0.29| 0.60|-0.01|-0.06| 0.00|-0.03|-0.01| 1.00|     |     |     |
| 14. Guangdong              | -0.04|-0.02| 0.26| 0.33|-0.06|-0.06| 0.29|-0.04|-0.01|-0.01| 0.05| 0.00| 0.27| 1.00|     |     |
| 15. Shanghai               | 0.02| 0.00|-0.03| 0.03|-0.12| 0.06| 0.08|-0.03|-0.02| 0.02|-0.08|-0.04| 0.26|-0.12| 1.00|     |
| 16. Beijing and Tianjin    | 0.01| 0.01| 0.00|-0.02| 0.15| 0.21|-0.09|-0.00|-0.01| 0.01|-0.13|-0.04|-0.43|-0.12|-0.11| 1.00|
| Mean                       | 0.04| 0.04| 0.14| 0.08| 0.25| 2.01| 5.96| 0.41| 21.04| 4.99| 4.96| 0.02| 0.61| 0.10| 0.09| 0.12|
| STD                        | 0.19| 0.20| 0.31| 0.24| 0.42| 1.20| 1.47| 0.49| 0.86| 0.13| 1.27| 0.06| 0.49| 0.30| 0.29| 0.31|

Note: Correlations with an absolute value greater than 0.01 were significant at the 5% level.
drivers of internationalization in Model 2, and found that the degree of state ownership has a significant and positive effect on internationalization, which rejects H1. Model 2 in Table 2 shows a positive and significant effect of the WTO entry on internationalization and an insignificant coefficient for market-oriented institutional development, which supports H3 and rejects H4, respectively. Models 1-3 and Models 4-6 presented in Table 3 report the results for hypotheses pertaining to the effect of internationalization on firm performance and the effect of interplay between internationalization and institutional

### Table 2. Results of Estimates of the Drivers of Internationalization for Emerging-economy Firms

| Variables           | Model 1         | Model 2         |
|---------------------|-----------------|-----------------|
| Constant            | -2.122***       | -2.173***       |
|                     | (0.281)         | (0.281)         |
| Firm age            | -5.46×10^5      | -6.50×10^6      |
|                     | (7.14×10^5)     | (7.25×10^5)     |
| Leverage ratio      | 1.06×10^4       | 1.05×10^4       |
|                     | (5.88×10^5)     | (5.90×10^5)     |
| Firm size           | 0.135***        | 0.129***        |
|                     | (0.006)         | (0.006)         |
| Intangible asset    | 0.152           | 0.152           |
|                     | (0.106)         | (0.106)         |
| Foreign capital     | 1.307***        | 1.330***        |
|                     | (0.028)         | (0.028)         |
| Coast regions       | 0.667*          | 0.677*          |
|                     | (0.368)         | (0.368)         |
| Guangdong           | 0.252           | 0.349           |
|                     | (0.243)         | (0.244)         |
| Shanghai            | -0.287          | -0.221          |
|                     | (0.243)         | (0.244)         |
| Beijing and Tianjin| 0.154           | 0.198           |
|                     | (0.281)         | (0.281)         |
| State ownership     | 0.044**         |                  |
|                     | (0.019)         |                  |
| Government-firm relation | 0.033***   |                  |
|                     | (0.006)         |                  |
| Institutional environment | -0.014   |                  |
|                     | (0.010)         |                  |
| WTO entry           | 0.246***        |                  |
|                     | (0.030)         |                  |

**Notes:**
1. Standard errors in parentheses.
2. Industry and year effects are included and not shown.
3. * p<0.1, ** p<0.05, *** p<0.01.
environment on firm performance. The results for ROA and Operating ROA are highly consistent, and we further found that both the effects of internationalization term and its interplay with institutional environment are highly significant for ROA as well as for Operating ROA, leading support to H5 and H6. Specifically, Model 2 and Model 5 reported in Table 3 both show a negative and significant coefficient on internationalization.

More importantly, the results in Model 3 and Model 6 presented in Table 3 both show a positive and significant coefficient on the interplay between internationalization and institutional environment. This indicates that emerging-economy firms in China can offset their international expansion discount by locating them in regions with better market-oriented institutional environment.

Taken together, we found supporting evidence for both H2 and H3. However, the results do not support H1 and H4. Contrary to our expectations, the positive effect of state ownership on internationalization may suggest

### Table 3. Results of Estimates for the Effect of Internationalization on ROA and Operating ROA, Respectively

| Variables                      | ROA            | Operating ROA | Operating ROA |
|-------------------------------|----------------|---------------|---------------|
|                               | Model 1        | Model 2       | Model 3       | Model 4       | Model 5       | Model 6       |
| Constant                      | 0.069(0.028)** | 0.067(0.028)**| 0.062(0.028)** | 0.073(0.030)**| 0.072(0.030)**| 0.066(0.030)**|
| Firm age                      | -1.59×10^{-5}  | -1.59×10^{-5} | -1.59×10^{-5} | -1.50×10^{-5} | -1.51×10^{-5} | -1.50×10^{-5} |
| (8.79×10^{-5})                | (8.79×10^{-5}) | (8.79×10^{-5}) | (8.42×10^{-5}) | (9.41×10^{-5}) | (9.41×10^{-5}) |
| Leverage ratio                | -1.06×10^{-5}  | -1.04×10^{-5} | -1.04×10^{-5} | -1.23×10^{-5} | -1.22×10^{-5} | -1.21×10^{-5} |
| (9.88×10^{-5})                | (9.88×10^{-5}) | (9.87×10^{-5}) | (1.65×10^{-5}) | (1.05×10^{-5}) | (1.05×10^{-5}) |
| Firm size                     | -4.60×10^{-5}  | -1.38×10^{-5} | -2.79×10^{-5} | -9.24×10^{-5} | -7.02×10^{-5} | -8.72×10^{-5} |
| (8.73×10^{-5})                | (8.76×10^{-5}) | (8.77×10^{-5}) | (9.12×10^{-5}) | (9.15×10^{-5}) | (9.17×10^{-5}) |
| Intangible asset              | -0.102(0.016)***| -0.102(0.016)***| -0.103(0.016)***| -0.104(0.017)***| -0.104(0.017)***| -0.105(0.017)***|
| Foreign capital               | -0.026(0.004)***| -0.019(0.005)***| -0.017(0.005)***| -0.021(0.005)***| -0.016(0.006)***| -0.014(0.005)***|
| Coast regions                 | -0.107(0.044)***| -0.105(0.044)***| -0.102(0.044)***| -0.113(0.046)***| -0.112(0.046)***| -0.108(0.046)***|
| Guangdong                     | 0.101(0.035)***| 0.103(0.035)***| 0.101(0.035)***| 0.109(0.037)***| 0.110(0.037)***| 0.107(0.037)***|
| Shanghai                      | 0.137(0.035)***| 0.136(0.035)***| 0.135(0.035)***| 0.129(0.037)***| 0.128(0.037)***| 0.128(0.037)***|
| Beijing and Tianjin           | 0.036(0.028)***| 0.036(0.028)***| 0.038(0.028)***| 0.029(0.030)***| 0.029(0.030)***| 0.032(0.030)***|
| State ownership               | -0.039(0.003)***| -0.039(0.003)***| -0.039(0.003)***| -0.039(0.003)***| -0.038(0.003)***| -0.038(0.003)***|
| Government-firm relation      | -0.019(0.001)***| -0.019(0.001)***| -0.019(0.001)***| -0.021(0.001)***| -0.021(0.001)***| -0.021(0.001)***|
| Institutional environment     | 0.003(0.001)** | 0.003(0.001)** | 0.003(0.002)** | 0.002(0.002)   | 0.002(0.002)   | 0.002(0.002)   |
| WTO entry                     | -0.015(0.005)***| -0.014(0.005)***| -0.015(0.005)***| -0.007(0.005)  | -0.007(0.005)  | -0.007(0.005)  |
| Internationalization          | -0.014(0.004)***| -0.016(0.004)***| -0.011(0.004)***| -0.014(0.004)***| -0.014(0.004)***| -0.014(0.004)***|
| Institutional environment     | 0.007(0.002)*** | 0.008(0.002)*** | 0.007(0.002)*** | 0.008(0.002)*** | 0.007(0.002)*** | 0.008(0.002)***|
| $R^2$ (%)                     | 6.90           | 6.95           | 6.99           | 6.61           | 6.63           | 6.68           |
| Wald c$^2$                    | 1414.85        | 1430.41        | 1438.76        | 1406.62        | 1415.7         | 1427.05        |

Notes: 1. Number of observations=33,862.
2. Standard errors in parentheses.
3. Industry and year effects are included and not shown.
4. * p<0.1, ** p<0.05, *** p<0.01.
that governments in emerging economies, like China, actively encourage firms to “go global” in order to nurture more “rational champions” in the global market. The insignificant effect of institutional environment may indicate that better institutional environment may do not directly affect the internationalization, but have a moderating effect on the performance implications of firms’ internationalization in emerging economies. Finally, as the effect of internationalization and its interplay with institutional environment are highly significant for both ROA and Operating ROA, these results corroborate H5 and H6.

V. Discussion and Conclusion

The goal of this study is to examine the impact of institutionally-determined firm characteristics and institutional environments on internationalization and performance of firms in emerging economies. This research provides important contributions to our understanding of firms' internationalization and performance implications of such behavior in emerging economies. The results suggest that the institutional factors driving internationalization and performance of firms need to be considered both individually and interactively with institutional changes and development. International business scholars, policy-makers and strategic managers should all note that institutions do matter, although in ways that may be different than they believe. Our research thus supports recent arguments from international business scholars who suggest an institution-based view that is substantially different from traditional advanced-economy-based perspectives. Most importantly, our research demonstrates that the developed-economy foundations (e.g., the industry- and resource-based views) of our international business literature may deserve reconsideration in light of our increasingly global business and its emerging economies.

The research reported herein uniquely contributes to knowledge of internationalization and suggests new directions for future research. The relative scarcity of existing research on emerging-economy firms and on the role of institutions in shaping international strategic choices as well as the performance outcomes of such behaviors warrants some discussion of potential managerial implications that could be derived from the above empirical findings. The theoretical base and the propositions of this study advancing an institution-based view of the international business strategy point scholars toward a new theory of the firms especially in emerging economies. More specifically, this study points to some extensions for future research with an attempt to conduct an empirical research on emerging-economy firms. Given the fact that very little attempt has been made to date to investigate the issue of internationalization of firms in emerging economies, and particularly, how institutions matter for them when going international, our study, hopefully, provides a stepping stone for further theory building and development in international business and management.

This study offers important contributions and insights for the research on an institution-based view of international business strategy in general and provides important theoretical, managerial and policy implications in particular. Our findings suggest that governments might be playing an important role as promoters in facilitating
international business activity and firm internationalization. While the successful internationalization of some SOEs create a challenge to existing theoretical approaches and assumptions about their competitiveness and behaviors, our study provides a unique opportunity to challenge and extend existing theories of the internationalization, and can help address the core issue that dominate debates on the global role of SOEs. We should improve our understanding of this phenomenon as well as to promote extension of current theories to account for this new phenomenon.

More importantly, our findings that the WTO entry tends to encourage Chinese firms to internationalize may also provide interesting insights. It indicates that since China's entry into the WTO at the end of 2001, Chinese firms faced increasing international competitive pressures, forcing them to accelerate their internationalization process. We believe that the findings of this research will also dictate important guidelines for other emerging-economy firms including Korean firms to better understand the issue of the role of institutions in shaping their strategies and performance.

Finally, our study reveals that the characteristics of emerging economies make the effect of internationalization on firm performance different from that of the West. The encouraging finding is that better institutional environment creates more opportunities for emerging-economy firms to enhance profitability in their internationalization. For emerging economies, it is critically important to create better institutional environment so that the internationalization strategy can be useful and effective. As creating better market-oriented institutional environment is an enduring process, the gradualism approach of institutional development implemented in China may be a useful reference for other emerging economies.

Our study is subject to several limitations. We examined the impact of institutionally-determined firm characteristics and institutional environments on firms' internationalization in China. Those variables are not exhaustive. Future research can further explore the impact of other firm-specific and environmental variables as well as host-country institutions on firms' internationalization in emerging economies. Moreover, as the institutional environment varies significantly across emerging economies (Kim, Kim and Hoskisson, 2010), our focus on China could raise some concerns over generalizability. In this regard, a useful extension would be to employ firm data from other emerging economies or comparative research, which should strengthen and further validate this study's results.

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