



# The Internationalization of Chinese Family Enterprises and Dunning's Eclectic MNE Paradigm

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**ABSTRACT** This paper applies Dunning's eclectic paradigm of Ownership, Location and Internalization (OLI) advantages to the international activity and performance dynamics of the Chinese family enterprise (CFE). Through the lens of Dunning's paradigm, we trace the role of cultural and economic factors in the success of this important form of organization. In demonstrating the relevance of a theory that originated in the analysis of Western multinational firms to this indigenous Chinese type of firm, the paper supports the larger effort to expand the scope of received theory to include Chinese as well as other non-Western forms of organization.

## INTRODUCTION AND OVERVIEW

Approximately 60 million culturally identifiable Chinese people have established enclaves in countries other than China. They encompass various ethnic and linguistic subgroups bound by their common origin in mainland China, and are known collectively as the Overseas Chinese. While typically comprising a small minority of less than 10 percent in any one country, they play a significant role in the economic landscape of Southeast Asia, where they hold a large majority of the corporate wealth in the region (Chen, 2001; Weidenbaum, 1996; Yeung, 1996). These firms tend to be family businesses, i.e., the family owns a controlling interest and also holds the majority of upper management positions. A Chinese family business is a family business 'where ownership and managerial control are both concentrated within a [Chinese] single-family unit' (Tsang, 2002, p. 23).

Many Overseas Chinese family firms are multinational in the scope of their operations, in part because they do tend to do business with each other, forming an integrated business network system. Indeed, the majority of the foreign direct investment driving the economy of China in the last decade has come from

Overseas Chinese sources. For example, it is estimated that more than 100,000 joint ventures have been established within China by Overseas Chinese, mainly in Guangdong and Fujian provinces. The Chinese family business is a unique form of business organization whose overseas operations are extensive and dynamic (e.g., Brown, 1995; Chen, 1995; Lim and Gosling, 1983; Redding, 1990; Weidenbaum, 1996), yet very little research has analysed its activities.

This paper examines these Chinese family businesses and their distinctive international competitive strengths from the perspective of Dunning's eclectic paradigm of multinational enterprise (MNE) (Dunning, 1981). Our purpose is to provide a comprehensive theoretical analysis of the international activity of Chinese family business enterprises, emphasizing the contribution of organizational characteristics originating in Chinese culture to competitive advantage and firm performance. This raises the analysis of Chinese family business from a descriptive to a theoretical level, linking the detailed portrayals of this important organizational form in the Chinese management literature to mainstream concepts in the field of international business.

The eclectic paradigm was first advanced in the 1970s (Dunning, 1977) to explain the patterns of international business activity. It focuses on the sources of competitive advantage that allow a firm to compete abroad, the locational choices that firms make, and the mode of entry into foreign markets. As 'the dominant analytical framework for examining the determinants of MNE activity' in the field of international business (Dunning, 2001, p. 187), it is a useful framework for analysing the international activities of Chinese family businesses. While it has been applied primarily to the Western MNE, it can also be applied to the international business activities of non-Western types of organizations (e.g., Dunning, 2001), though little published research has taken this approach. One contribution of this paper is to expand the application of the eclectic paradigm to non-Western organizations.

In particular, we use the paradigm to add a relevant conceptual dimension to the emergent understanding of the distinctive competitive strengths of Chinese family business (e.g., Brown, 1995; Chen, 1995) and its international expansion strategies (e.g., Tsang, 2002; Sim and Pandian, 2003; Yeung, 1999; Yeung and Olds, 1999). We integrate previous analyses that focus on a single aspect of Chinese enterprise (e.g., Boisot and Child, 1996; Chen, 2001) within a comprehensive conceptual framework for analysing the international activities of Chinese family businesses. This enhances understanding of the interplay between their distinctive organizational characteristics and successful economic performance.

We suggest that, like the Western MNE, the international Chinese family business is an effective organizational mechanism for capitalizing on particular configurations of competitive and locational advantages. Yet its defining characteristics are quite different from those of the Western MNE, particularly with regard to ownership, governance, resources, organization, competitive advan-

tage, and strategy. These differences can be seen as variations of the same basic constructs that explain the internationalization patterns of the Western MNE in Dunning's paradigm.

The eclectic paradigm has been re-formulated in recent years to account for the cooperative relationships embodied in 'alliance capitalism' (Dunning, 2001). The revised paradigm recognizes that international business activities can sometimes be organized more efficiently in cooperative inter-firm networks and alliances, such as those found in Japan (Gerlach, 1992). There are a number of world regions where inter-firm cooperation is the norm, Asia being a prominent example.

Inter-firm networks and alliances have characterized Chinese family business for centuries. Numerous well-known international business networks have evolved from the Chinese family business system in recent decades. Underscoring the role of culture in foreign direct investment activity, we focus on these internationalized, intra-family, inter-firm reformulations of the centuries-old Chinese family business networks based on kinship, as a refinement of Dunning's analysis of international activities under alliance capitalism.

Finally, we identify a number of interesting topics for future empirical research which are summarized in a later section. Possibly because the international expansion of Chinese-owned business in Southeast Asia is a relatively recent phenomenon, very few empirical studies have been published on this topic, despite their enormous economic impact in the region (Tsang, 2002; Yeung, 1999). Given the scarcity of empirical studies of Chinese family business in the management literature, our study should encourage future efforts to examine this increasingly important form of international business organization empirically, drawing on a range of theoretical and conceptual frameworks from a variety of academic traditions.

The paper is organized around the application of a general model of Dunning's paradigm to the specific case of the Chinese family enterprise (CFE). The first section is a portrayal of Chinese family business as it has appeared in the literature, including its cultural roots and paths to internationalization. In particular, we distinguish between the traditional Chinese family firm (CFF), and its more modern, international variant, the Chinese family enterprise (CFE). In the second section, Dunning's paradigm is introduced and discussed in terms of the Western MNE. The term Western MNE is used here to refer in general to North American and European firms engaged in foreign direct investment and international business activity. These include the multinational enterprises analysed in the 1980s by Bartlett and Ghoshal and encompass the 'international', 'multinational', and 'global' types in their well-known MNE typology (Bartlett, Ghoshal, and Birkenshaw, 2004). The third section examines the strategic and competitive advantages of the CFE in terms of the same theoretical constructs. In the fourth section, various directions for future research are suggested based on the research questions that flow from the theoretical analysis. Conclusions are summarized in the final section.

## CHINESE FAMILY BUSINESS

The traditional Chinese family firm (CFF) is a small-scale, domestically oriented, form of business organization that originated in China several hundred years ago and was dispersed throughout Southeast Asia by emigrating Chinese minorities in the 19<sup>th</sup> and 20<sup>th</sup> centuries (Wong, 1985). Its modern variant, the Chinese family enterprise (CFE) – a new term introduced here for the first time – is the larger, internationally active, family-owned Overseas Chinese enterprise that evolved from the traditional CFF outside China (Shapiro and Erdener, 2003). These organizations appear in the Chinese management literature as ‘Chinese conglomerates from Southeast Asia’ (Yeung, 1999), ‘Chinese business conglomerate’ (Yeung and Soh, 2000), etc.

In Chinese cultural enclaves outside the People’s Republic of China (PRC), business enterprises are typically owned and controlled by members of a single family (e.g., Carney, 1998). Many of their management functions are supplied by members of the controlling family. The family is also an important source of social capital, in part because other sources of social capital are underdeveloped in Chinese society (Redding, 2002). In other words, the organization of business among the Overseas Chinese is firmly situated in the socioeconomic system of family capitalism as embodied in Chinese family business (Fukuyama, 1995; Redding, 1995, 2002).

From the perspective of institutional theory, which focuses on the influence of ‘regulative, normative, and cultural–cognitive processes in shaping social behaviour and social structure’ (Scott, 2002, p. 59), the Chinese family is clearly a social institution. This is evident in the powerful influence it exerts on Chinese behavioural norms and social structure. The institutional nature of the family has been recognized implicitly and explicitly throughout the Chinese management literature (e.g., Bond and Hwang, 1986; Redding, 2002; Su and Littlefield, 2001; Tsui and Farh, 1997; Yang, 1993). The institutional logic of Chinese family business – the ‘array of material practices and symbolic constructions that constitute organizing principles guiding activity within a field’ (Bhappu, 2000, p. 410) – is also shaped by the basic Confucian principles of interpersonal relationships that are institutionalized in the family. Many characteristic features of Chinese family business correspond to the underlying institutional logic of the family.

The importance of the family in Chinese culture and society has been examined in detail in the Chinese management literature. In traditional Chinese societies, primary loyalties cluster around the family, surrounded by circles of decreasingly potent identities of the lineage group and then the regional clan (Redding, 1995). Interpersonal relations in China can be categorized according to *jia-ren* (family members), *shou-ren* (familiar persons such as relatives outside the family, neighbors or people in the same village, friends, colleagues, or classmates), and *sheng-ren* (acquaintances or strangers), each having different social and psy-

chological meanings and its own interpersonal norms (Yang, 1993). The *jia-ren* (family) relationship is characterized by relatively permanent, stable, expressive relationships in which the welfare of the other is part of one's duty. The general rule of exchange is that one must do his or her best to attend to the other's need with no or little expectation of return in the future. Strong family identification and role obligations lead to in-group favoritism based on kinship *guanxi* as defined and reinforced by social norms permeating Chinese societies (e.g., Su and Littlefield, 2001; Xin and Pearce, 1996). In other words, loyalty and related favoritism to family is an obligation, and it is rendered largely without an anticipation of reciprocity (Tsui and Farh, 1997).

In traditional Confucian society, where the multi-generational extended family was a kind of local community, the Chinese family helped reduce risk in uncertain, complex, and potentially hostile environments (Landa, 1981). The early environment of Chinese family capitalism was not unlike that of pre-industrial, pre-modern cultures in many other parts of the world, in that small communities often sought to protect themselves against outsiders (Redding, 1990, p. 36; Xin and Pearce, 1996). Thus to some extent, the identification of kinship with interpersonal trust can be traced to the characteristics of pre-modern society in response to environmental uncertainty (Giddens, 1990, p. 101).

The traditional CFF spread across Southeast Asia as various ethnic minorities emigrated from China (Kao, 1993). In their adopted countries, these small family businesses at first followed their historic pattern of focusing on the local market, then gradually began to expand within the region. Some have become prominent international conglomerates: the *Salim Group* headed by Liem Sioe Liong and the *Lippo Group* under Mochtar Riady in Indonesia; the *Kerry Group* under Robert Kwok and the *Hong Leong Group* under Quek Leng Chan in Malaysia; *Fortune Tobacco* under Lucio Tan in the Philippines; the *Hong Leong Group* under Kwek Leng Beng and the *Far East Organization* under Ng Teng Fong in Singapore; and the *Charoen Pokphand Group* under the Chearavanont family and *Bangkok Bank* under the Sophonpachich family in Thailand. This international expansion was triggered by entrepreneurial opportunities in China with the reorientation towards a market economy introduced by Deng Xiao Ping in the late 1970s, at a time when business environments in Southeast Asian countries were becoming less favorable for Chinese firms. Among the Overseas Chinese, family business was evolving in new directions that deviated from tradition and paved the way for international expansion (Yeung, 1999, pp. 106–11).

A common initial internationalization strategy of the Overseas Chinese has been vertical integration, backward to reduce costs and forward to access markets. Another very common internationalization strategy has been unrelated diversification, which spreads risk across diverse business environments while supporting the business interests of close associates and family members, irrespective of the core business. A very few studies describe the process by which the small, tradi-

tional CFF from China evolved among the Overseas Chinese into a modern CFE (e.g., Whyte, 1996; Yeung, 1999). This evolutionary process is illustrated by the following description of the Charoen Pokphand (CP) Group:

The Group was founded some 70 years ago by two ethnic Chinese brothers, Chia Ek Chor and Chia Seow Whooy, who arrived in Thailand in 1919 from the Shantou region of Guangdong (East Asia Analytical Unit, 1995: 323–6; Hamilton and Waters, 1995: 104–5; Weidenbaum and Hughes, 1996: 30–4). The CP Group started in the farm-seed business and moved into animal feeds and then into chicken farming and processing with initial technical support from the US poultry giant, Arbor Acres. . . . During the 1980s, the CP Group became Asia's biggest exporter of processed and frozen chickens, mainly to Japan, China and Brazil. . . . To tap into China's huge domestic market, the CP Group set up its first China venture, Conti Chia Tai, in Shenzhen in 1981, and was an early entrant into the China market. It now has operations in 26 of China's 30 provinces, indicating its broad interests in China and desire for greater geographic coverage. (Yeung, 1999, p. 112)

The evolutionary process typically brought other changes, including the declining power of senior family members and the rising status of females. However, a common feature has been the need to maintain family ownership and management of international operations. As they expand internationally, CFEs typically build on strengths and capabilities developed in their home markets as the basis for competitive advantages in the foreign country environment. In the non-Chinese cultural environments of some Southeast Asian countries, ethnic discrimination by the dominant cultural group forced Chinese family businesses to expand their business network beyond the kinship network. This also led them to form alliances with national governments. In Indonesia, for example, Chinese businesses cultivated strong economic ties to individual political leaders in the Suharto regime. In Singapore, on the other hand, they participated in government-sponsored economic programs. An illustration can be seen in the experience of the Overseas Chinese Salim Group in Indonesia, which gained monopoly positions in several industries by cultivating personal ties to the Suharto regime (Yeung, 1999).

Most of the very small number of published empirical articles on the international activity of Chinese family business (e.g., Sim and Pandian, 2003; Tsang, 2002) have relied on case research. While the patterns of ownership and management of Chinese business continue to evolve (Tsang, 2002, p. 27), they use an informal and unstructured approach to the gathering and analysis of information, and rely on family members to negotiate and manage the business. Strategic learning and experience are still not shared outside the family.

Thus, the CFE is an international firm, with uniquely Chinese characteristics originating in its Chinese family ownership. We now proceed to more fully analyse the CFE using the eclectic paradigm.

## **DUNNINGS ECLECTIC PARADIGM: AN OWNERSHIP, LOCATION AND INTERNALIZATION (OLI) PERSPECTIVE ON THE MULTINATIONAL ENTERPRISE (MNE)**

Dunning's eclectic paradigm is the most widely used device for analysing the complex decisions that determine where and why international production takes place. This theory with its variants explains why firms from one country engage in value-added activities outside their national boundaries, where they choose to produce, and by what means. These decisions are analysed in terms of ownership (O), location (L), and internalization (I), or OLI. Each of these factors is associated with certain advantages that can enhance firm performance. The OLI paradigm asserts that successful MNEs arise because they develop competitive advantages at home (O-advantages), which can be transferred to specific countries (L-advantages) through foreign direct investment (I-advantages).

The central thesis of the eclectic theory, or the eclectic paradigm since the mid-1980s, has always been that channels of international economic involvement or international economic transactions or the international competitiveness of a country's output of goods and services [are] determined by the possession of ownership-specific endowments of its enterprises, by the ability and desire of these enterprises to internalise these advantages or the markets to these advantages, and by comparative location endowments of home vis-à-vis foreign countries which are exogenous to firms (Dunning, 1977). (Tolentino, 2001, p. 195)

### **O-Advantages of the Multinational Enterprise (MNE)**

Ownership (O) advantages are firm-specific competitive advantages that have been developed in the home market. They are necessary for foreign production, to offset the costs of foreignness. O-advantages include tangible assets, factor endowments such as natural resources, manpower and capital, and intangible assets such as knowledge, brands, and organizational skills. They can also include the cultural, legal and institutional environment in which endowments are used, or the market structure of the industry in which the firm competes (Dunning, 1981). As the theory developed, O-advantages have been applied at the level of the country, the industry, or the enterprise (Dunning, 1981; Tolentino, 2001).

Another important ownership advantage may reside in a firm's ability to take advantage of common governance opportunities across borders (Dunning, 1993, p. 135). Such governance opportunities arise from economies of scale, scope, and learning that attend common ownership across national borders (Tolentino, 2001). Firms will differ in their ability to extend common governance to operations in other countries.

Directly relevant to this paper, Dunning (2002) has extended the notion of O-advantage to include relational assets, defined as the ability to engage in beneficial

relations both within the firm and with other firms and agents. Relational assets allow firms to access resources controlled by others, and to govern their joint use.

Thus, O-advantages cover a broad range of potential sources, and all may not hold for MNEs from all countries, or even for those from a single country at all points in time. There is strong evidence to suggest that firms which achieve a competitive advantage in their home markets, normally through control of proprietary technologies and strong brands, are more likely to produce abroad (Caves, 1996), and that the role of technology and product differentiation as determinants of overseas production is strongest for MNEs from developed countries, particularly those from the US and Europe (Caves, 1996). There is little evidence on the role of relational assets, a point to be pursued below.

### **L-Advantages of the Multinational Enterprise (MNE)**

The next step in the analysis raises the question of location (L) advantages. Given that the firm has the capability to produce abroad, what are the factors that impel it to actually do so, and in which countries? The choice of country to which the assets are transferred depends on various locational considerations related to the host country, and on the match between host and home country characteristics (Davidson, 1980).

This strand of the literature has been in all likelihood the most actively researched, with somewhat mixed results. What can be said with some certainty is that the major determinants of FDI inflows are market size, physical and political infrastructure, education levels, and income per capital. Large internal markets, effective and efficient transportation and communication systems, effective governance at the political and economic levels, and well-educated workers all contribute to location advantages. Evidently, these are mostly shared by developed market economies and so it is not surprising that most FDI flows are among such countries.

Importantly, there is little systematic evidence that capital always flows to low wage countries; the results depend on which host and source countries are included, and on the nature of the research design. More generally, the evidence on the effects of cost differentials, tariff and non-tariff barriers, natural resources, exchange rate stability, and tax rates all varies from study to study, and may be more important when the host countries are developing countries. Recent evidence on FDI flows over the period 1995–2001 suggests that after controlling for market size, governance structure, and other factors discussed above, China received a disproportionate share of the world FDI (Globerman and Shapiro, 2005).

Since the 1970s, the determinants of MNE locational strategies have changed. Motives for FDI of the 1970s and early 1980s were the search for natural resources (resource-seeking), new markets (market-seeking), and lower-cost factors of production (efficiency-seeking), each with its own priorities and objectives. In the



1990s, these types of FDI yielded to a fourth type, strategic asset-seeking, 'geared less to exploiting an existing O-specific advantage of an investing firm, and more to protecting, or augmenting, that advantage by the acquisition of new assets, or by a partnering arrangement with a foreign firm' (Dunning, 1998, p. 50). The shift is evident in a wave of cross-border mergers and acquisitions involving MNEs in Europe, Japan and the US, but less so in other world regions.

### **I-Advantages of the Multinational Enterprise (MNE)**

Internalization (I) advantages refer to the ability of a firm to leverage abroad its domestic advantages by internalizing markets. That is, the MNE as a foreign producer is defined by the common ownership and governance of production facilities domestically and abroad. This aspect of the paradigm is normally approached through the application of transaction cost economics to the question of how proprietary assets are best transferred (e.g., Buckley and Casson, 1998, 2002, 2003). Strong ownership links such as wholly-owned subsidiaries are seen as means to avoid the market failures associated with the transfer of assets, particularly intangible assets such as knowledge (Dunning, 1993). Knowledge assets are subject to valuation uncertainties, contractual disputes, and monitoring problems and are therefore more likely to be transferred internally rather than through market mechanisms to reduce transaction costs. However, transaction costs may not fully determine the range of ownership outcomes which may also depend on legal constraints on ownership, significant financial risk, and organizational advantages. The latter are particularly significant here because they suggest that internalization advantages may be related to the ability to process and disseminate knowledge within the firm.

It is difficult to summarize the direct evidence related to I-advantages because direct tests have been relatively rare, and those that exist approach the issue in different ways. Evidently there has also been a lack of balance in the literature, with a disproportionate emphasis on factors influencing the preference for licensing versus FDI to enter foreign markets (Dunning, 1993, p. 167). For these reasons, it does not appear that there is an empirical consensus on the nature of I-advantages. For example, high levels of R&D have been associated with full control of subsidiaries in some studies (e.g., Gatignon and Anderson, 1988), but not in others (e.g., Kogut and Singh, 1988), while another found it to be the case only when the subsidiary was not diversified from the parent (Gomes-Casseres, 1989). There is some agreement that cultural distance between source and home country does tend to favour joint ventures (Caves, 1996, p. 79; Kogut and Singh, 1988). Also, joint ventures appear to be motivated in part by the need to establish good relations with the host country government (Geringer, 1988).

These issues have been further explored in research that focuses on internationalization from the theoretical perspective of transaction cost economics noted

above (e.g., Buckley and Casson, 2003). We agree that this is complementary to the eclectic paradigm, but differs in purpose, scope, focus, and contribution (Dunning, 2001).

### **Ownership, Location and Internalization (OLI) Configuration and Dynamics of the Multinational Enterprise (MNE)**

As recently stated by Dunning (2001), the eclectic paradigm is about *both* the importance of each individual advantage, and the configuration among them. The paradigm can therefore accommodate many different types and combinations of OLI variables, and thus becomes context specific. O-advantages can differ across countries and firms, resulting in different locations being attractive to different firms. Dunning suggests that these differences will depend on the type of international production (e.g., market-seeking versus resource-seeking), as well as on the country, region, industry, and the firm itself (Dunning, 1993).

Over the years, Dunning has attempted to explain how OLI configurations can change as a result of changes in any of the constituent parts. As noted above, he has discussed how the OLI variables could be augmented to account for the more cooperative forms of organization associated with alliance capitalism (Dunning, 2001), and he has also introduced relational assets to the mix (Dunning, 2002). Nevertheless, it can be argued that the model is not fully dynamic since how it forecasts changes in OLI configurations over time is unclear.

### **AN OWNERSHIP, LOCATION AND INTERNATIONALIZATION (OLI) PERSPECTIVE ON THE CHINESE FAMILY ENTERPRISE (CFE)**

The Western MNE generally emerged by exploiting abroad a competitive advantage that had been previously acquired or developed at home. These advantages are typically based on the possession of proprietary assets, mainly in the area of technology or differentiated products, and on economies of size derived from economies of scale and scope. The ability to develop such assets, and to acquire the capital necessary to grow, was fostered by an environment with well-developed infrastructures, well-codified and enforced laws that sustained market exchanges and protected property rights, sophisticated financial institutions that provided financing, and a relatively free and responsible press that fostered transparency in the conduct of business.

Chinese family business arose under very different circumstances. In this section, we examine the characteristic attributes and capabilities of the CFE within the OLI framework. The O-advantages, L-advantages, and I-advantages of the CFE are discussed below, first separately and then in combination. Each category of advantages is illustrated with examples and empirical evidence from the research literature on Chinese enterprise.

### **O-Advantages of the Chinese Family Enterprise (CFE)**

O-advantages reside in the proprietary assets of the international firm, providing competences and capabilities that are the basis for strategic advantage. Proprietary assets can be both tangible and intangible. The intangible assets of the MNE encompass various forms of tacit as well as codified knowledge. In Chinese family business, O-advantages reside mainly in intangible proprietary assets, and these take the form of human and social capital. Such assets include specific managerial capabilities embodied in the individual manager and his personal network, including extended kinship structures (Bian, 2002). The benefits of relational O-advantages derive from their role in reducing inter-firm transaction costs, which can be explained in terms of preference interdependence among members of the same social group (Buckley and Casson, 1993). The main O-advantages of the CFE discussed here are: deal-making, relational contracting, operational control, risk management, and firm size.

*Deal-making.* The primary O-advantage of the CFE is identified as its ability to seize commercial windows of opportunity by efficient and effective action crystallizing in the ability to make deals (Chen, 1995). This requires recognizing favourable opportunities as they arise, then initiating and closing deals very quickly. Deal-making advantages derive from the mobilization of other organizational competences such as relational contracting, operational control, and risk management. The rapid entrance of Charoen Pokphand (CP), the Thai Chinese agricultural and food processing conglomerate, is an example (Chen, 1995).

*Relational contracting.* An important O-advantage of the Chinese family business is its ability to do business through personal relationships, networks, and negotiation (Chen, 1995). Such capability is recognized in the management literature as essential for success in the Chinese market (e.g., Fock and Woo, 1998; Luo, 1997).

The distinctive relational contracting capability of the international CFE derives from the institutional logic of the Chinese family business system. This fostered the development of skills involved in the ongoing relational process of establishing, developing and maintaining trust. For example, Hokkien Chinese traders reportedly extend credit to fellow Hokkien Chinese (whose trustworthiness can be validated via the kinship network) more readily than to non-Hokkien associates, because of mutual trust (Landa, 1981). It also encouraged the communication skills needed to facilitate efficient and accurate transmission of time-sensitive and possibly proprietary information.

Outside China, the Overseas Chinese faced additional pressures from their non-Chinese societal environments. As the rewards for learning how to overcome these difficulties increased, some of the more ambitious and entrepreneurial Chinese

family businesses perfected their traditional skills into a relational ownership advantage.

*Operational control.* The trust relationships required for success in uncertain environments are founded on maintenance of strict control over operations at all times. Tight control over the behavior of organizational members as well as over finances is required.

The Chinese family business system excels in controlling the behaviour of its members. Control flows from multiple bases through which the organization can simultaneously invoke a variety of mutually reinforcing control mechanisms in support of its objectives. These include personal, family, social, cultural, and economic controls, in addition to the usual organizational and bureaucratic controls.

*Risk management.* Under the pressure of numerous historical and contextual contingencies, the traditional CFF developed a certain competence in risk management or risk avoidance. This heritage enables the Chinese family business to establish and maintain trust at multiple and mutually reinforcing levels. Since it would be extremely difficult or impossible, as well as costly, for the Western MNE to match this capability, it is a potential source of advantage for the international CFE.

*Firm size.* In the Chinese family business system, organizational size is generally limited by the size of the family and the availability of managerial talent among family members. This is necessary to retain managerial control by the family. As a result, CFEs tend to be smaller than Western MNEs. This can be a source of competitive advantage under conditions that require centralized control. For example, small size is advantageous in industries in which it is strategically important to maintain tight control over operations, such as when companies must respond very quickly to sudden changes in the market, or where very efficient cost structures are required. However, small size can also be a disadvantage. This can be seen clearly with regard to the problem of succession, which is generally more difficult in a small family business than in a large, non-family firm, because the pool of available talent among family members is itself small.

In some industries, small size does not confer particular O-advantages. Examples include industries that require extremely large scale manufacturing operations to achieve economic efficiency, intensive expenditure on advertising to develop a strong brand image, and heavy investment in R&D. Chinese family business typically does not gravitate towards such industries.

### **L-Advantages of the Chinese Family Enterprise (CFE)**

Like any multinational firm, the international CFE seeks advantages by aligning its geographical location choices with its O-advantages. That is, it tries to create

a match between its O-advantages and the L-advantages of the host market. For example, since many overseas Chinese entrepreneurs retain personal connections in their ancestral home towns located on the mainland, the importance of local government for doing business in the PRC enhances the locational pull of specific regions in China.

Firms can benefit from locational choices when there is a strategic fit between the capabilities of the firm and the requirements and contingencies of its operating environment. To the extent that the main O-advantage of the CFE is its relational contracting capability, it must seek out locations where the environment for business is opaque rather than transparent, and relational contracting skills are crucial to successful performance (Yeung, 1999, p. 120). Thus the characteristically Chinese ability to do business through personal relationships and networks using highly developed relational skills gives the international CFE an O-advantage over the Western MNE in China, where business is conducted by negotiation within a system of networked relations (Boisot and Child, 1996).

However, relational skills alone would not give it an O-advantage over Chinese family firms already based in China. A favourable alignment of L- and O-advantages occurs when the international CFE has acquired superior managerial skills and technologies in its Southeast Asian domestic environment, and can use them to gain a competitive advantage in China. For example, the companies in Tsang's (2002) study focused on 'transferring their systems and ways of doing things to China, as well as recruiting and training a core team of mainland Chinese managers' (Tsang, 2002, p. 29). Another common alignment of L- and O-advantages occurs when the international CFE has accumulated a significant amount of capital outside China, which it can invest in China. This gives the international CFE a competitive advantage in China that is not shared by domestic Chinese firms that do not have comparable access to capital.

An interesting implication of aligning L- and O-advantages is that CFEs can thrive in other locational environments that may be considered unattractive by the Western MNE. That is, there are specific locational advantages for the international CFE to enter regions where it can utilize its ability to operate in opaque economic environments, where codified market-enhancing institutions are weak and/or where personal connections are required.

A similar argument can be made with respect to industry preference. MNEs and CFEs tend to operate and succeed in different industries. Thus, MNEs are not disadvantaged vis-à-vis the CFE in all industries in China, nor does the CFE always hold a competitive advantage over the MNE. This is because the strategic importance of the CFE's superior relational contracting capability is somewhat industry-dependent. CFEs are found in a range of industries, usually including real estate property development, banking and finance, as well as certain kinds of manufacturing, such as garments, food processing, and toys. While individual companies typically engage in non-related diversification, the overall pattern of indus-

try involvement is fairly consistent, typically involving industries with rapid return on investment, where the advantages of business networks can be most flexibly exploited (Yeung, 1999). Recently, however, a different pattern is taking shape as Overseas Chinese have moved farther afield into the US, Canada and Europe (Yeung and Olds, 1999). Some of these firms are now focusing strategically on the acquisition of new technology and exposure to advanced techniques of management and marketing (Yeung, 1999). For example, some CFEs have expanded into high technology industries.

Cultural familiarity and proximity are an important source of location advantage for firms that understand the culture of the local operating environment, and whose characteristics match the locational characteristics of the host country. Such advantages relate to specific cultural knowledge and skills. In the case of China, they may include linguistic proficiency not only in Mandarin Chinese, but in a local dialect spoken by Overseas Chinese descendants of inhabitants of particular villages or regions. Corollary advantages exist in geographic areas where organizational members have pre-existing personal relationships and social networks.

### **I-Advantages of the Chinese Family Enterprise (CFE)**

In MNE theory, I-advantages provide the incentive to undertake related international business activities within the firm, rather than contracting them out to other firms or exporting them. The I-advantages of the international CFE center on its characteristic ability to quickly mobilize coordinated action and resources, thereby gaining advantages of timing and flexibility vis-à-vis competitors (Yeung, 1999). These derive from its position in the network structure, which enable it to leverage assets and capabilities of others in the network.

The logic behind internalization can be explained in terms of transaction costs. When inter-firm transaction costs exceed the cost of intra-firm transacting, efficiency is improved by internalizing market transactions within the firm. Conversely, when intra-firm transaction costs exceed the cost of inter-firm transacting, efficiency is improved by externalizing transactions to the market. Comparing the cost of conducting inter-firm transactions among members of a network with the cost of intra-firm transactions within the internalized firm indicates that a well-functioning network can be the more efficient way to organize (Buckley and Casson, 1993).

The proprietary assets that give the international CFE its distinctive O-advantages are based on the highly intangible human capital assets involved in relational contracting capabilities and deal making skills. Unlike tangible assets, these cannot be easily transferred outside the firm. Therefore, in order to capitalize on these unique skills and capabilities, the CFE must retain hierarchical organizational control over its proprietary assets as it expands internationally. This is why it tends

to internalize its overseas subsidiary within the parent organizational structure by 100% or majority-owned foreign direct investment in foreign subsidiaries.

Intangible assets enable Chinese family business to economize on various kinds of costs. These include the cost of enforcing contracts, because the threat of network sanctions discourages contract violations; inventory costs, since the firm can procure supplies on short notice through the network, avoiding the need for storage; and information costs, since information is shared within the network (Landa, 1981, pp. 108–111).

Similarly, the superior flexibility and speed of the CFE are generally enhanced by combining its smaller size and more tightly centralized control (relative to the MNE) with access to a network that it can use to leverage the resources of other member firms. These are characteristics that cannot easily be sold in markets and must therefore be exploited internally, within the firm.

The resulting timing advantages account for the prevalence of the CFE in industries where windows of opportunity open and close quickly. The Hong Kong garment industry is an example. Hong Kong suppliers made their mark by their ability to economize on the costs of labour and production, and to do so very quickly. For example, they can beat competitors to the market with bargain-priced imitations of the latest high fashion trends. Another example is the Hong Kong toy industry, which has specialized in producing games and toys for the US Christmas holiday market. In industries driven by fashion and fads, the superior flexibility and speed of Chinese family-owned business give it important timing advantages.

Where start-up costs are high, the ability to mobilize capital on short notice through one's personal network is also necessary to secure timing advantages. This capability is a particularly important source of advantage in businesses that are subject to sudden unpredictable changes in demand, such as real estate and tourism.

Finally, since CFEs tend to be relatively small in comparison with Western MNEs, they are able to achieve a high degree of operating flexibility without sophisticated internal organizational processes and systems, or decentralized decision making. However, it also leaves them unable to expand the size of their organizations when it would be strategically advantageous to do so. In such cases, the business network can allow the family firm to overcome some of the limitations of size (Child, 1973, 1984), including economic and geographic limitations (Hamilton, 1996) and transaction costs (Buckley and Casson, 1993). This enables the smaller CFE to approximate the I-advantages of the larger MNE.

### **Ownership, Location and Internationalization (OLI) Configuration and Dynamics of the Chinese Family Enterprise (CFE)**

The analysis above suggests that like the traditional MNE, the CFE may be understood as an institution which seeks out business activities that capitalize on its

inherent O-advantages, and avoids those where it has no particular competence or advantage. Since these advantages are not marketable, international expansion occurs through their internal transfer to compatible locations. Thus we can summarize the distinctive advantages of the CFE with respect to each of the OLI factors in the following three broad propositions.

*Proposition 1: The distinctive O-advantage of the CFE is its strength in relational contracting, which enables it to seize fleeting commercial opportunities faster than competitors.*

These intangible proprietary O-advantages held by CFEs are by their very nature unique and not transferable via markets.

*Proposition 2: The distinctive L-advantage of the CFE is its ability to function effectively in unstructured and uncertain operating environments, especially China.*

In such environments, relational O-advantages enhance strategic performance and profitability, and may be essential for survival. Locations where relational O-advantages are a strategically important source of competitive advantage include China as well as transitional economies, developing countries, and emerging markets in general.

*Proposition 3: The distinctive I-advantage of the CFE is its superior control, combining hierarchical control over its proprietary assets with social and relational control accessed and leveraged through the network.*

Superior control is essential to the organizational and economic efficiency of the CFE.

The OLI configuration of the CFE provides a useful summary explanation for its ability to grow internationally, and especially for its success in China. The internationalization strategies of the CFE described above are also directly relevant to its OLI advantages. Backward vertical integration makes use of O- and I-advantages to reduce costs, while forward vertical integration uses O- and I-advantages to expand markets. Unrelated diversification capitalizes on the I-advantages of the CFE which derive from its position in the network. The strategy of retaining family ownership and management while expanding internationally enables the CFE to exploit its O-advantages in other locations.

The motives for FDI in China identified in Tsang's (2002) case studies suggest that CFEs are primarily interested in market-seeking and efficiency-seeking FDI. That is, the motive for FDI is dominated by the desire to capture market share and to take advantage of lower labour costs in China (Tsang, 2002, pp. 28–29). The limited number of empirical studies of CFEs (Tsang, 2002, p. 24) prohibits forming any definitive conclusions as to the relative prevalence of resource-seeking,



market-seeking, efficiency-seeking, and strategic asset-seeking types of FDI. However, there is some evidence of efficiency-seeking motives. For example, the establishment of export processing zones in coastal areas of South China likely attracted export-oriented FDI from CFEs in the surrounding Southeast Asian region. The relocation of manufacturing operations from Hong Kong to Guangdong Province in the 1990s as entire industries (e.g., toys, garments, and various other assembly operations) moved across the border is an example of efficiency-seeking FDI.

The O-advantages of the Western MNE are seen as arising from the possession of unique intangible assets related to intellectual property and knowledge of various kinds. These assets are quite different from those associated with the CFE, and are more closely linked to proprietary process and product technologies, brands, and governance economies. As such, the assets are difficult to transfer *via* market mechanisms. They are best exploited in environments where property rights are protected, and where the legal system is effective.

These differences between CFEs and MNEs are reflected in different strategic choices regarding which businesses to enter, diversification patterns, organizational size, and organizational structure, among others. The logical imperative behind a concentration, horizontal or related diversification strategy is less pronounced in the CFE than in the Western MNE, and expansion patterns typically follow the interests of individual members, resulting in less focused strategies. This reduced focus may be even more pronounced in the case of Chinese (and other) family firms because concentrated family ownership limits 'exit' options for owner-managers and enhances 'loyalty' options (Hirschman, 1970), possibly resulting in stable and more diversified holdings.

## DISCUSSION AND IMPLICATIONS FOR FUTURE RESEARCH

The theoretical discussion above suggests a number of implications and possible directions for future research on the CFE, the MNE, and their interaction, particularly in China. A number of these are summarized below.

### Understanding the Chinese Family Enterprise (CFE)

Our analysis suggests that the key OLI advantage of the CFE is its ability to use relational contracting, networks and personal contacts to make deals that create value, often in highly uncertain environments. In other words, the CFE's competitive advantage is based on the ability to generate and deploy relational skills not only to link networks of family members, suppliers and distributors, and political institutions, but to do so in a way that enables the individual firm to mobilize flexible and effective responses to entrepreneurial opportunities very quickly. We have suggested that the relational assets of the CFE encompass the elements of trust,

culture, networks, contacts and reciprocity, and that these in turn are rooted in the ethno-cultural origin and historical evolution of the CFE.

An important theme of this paper is that the relatively large, internationally active, geographically diversified Southeast Asian conglomerate and the small, locally oriented, traditional Chinese family firm are different types of organization. This is supported by various characterizations and examples that have appeared in the Chinese management literature and by a very few empirical studies. Further research on the differences between these two types of ethnic Chinese family business enterprise will strengthen and perhaps extend the typology developed in this paper.

Interestingly, recent literature suggests that relational assets may be critical for the MNE as well (Dunning, 2002). It is therefore important to critically distinguish the relational advantages of the CFE from those of the MNE, and to evaluate their respective dynamic properties. We argue that critical CFE advantages are rooted not only in ethnicity, but also in the distinctive locational environment of China. The CFE has emerged by matching the traditional attributes of ethnic trust and reciprocity found in the CFF with competitive environments where governance voids make those attributes valuable. In contrast, we would suggest that MNE relational advantages emerge from the need to extend and protect existing knowledge-based capabilities. More detailed understanding of these distinctions is required in order to understand the evolution of the CFE.

A major dynamic issue that emerges from our analysis is how the CFE will evolve as its OLI configuration changes. In particular, further research is required in order to understand if, how, and when the CFE will adapt its O-advantages in response to changes in its environment. For example, as market failures are reduced in emerging markets, the distinctive OLI configuration favoured by the CFE for operating in turbulent and opaque environments may well also change. In particular, the strategic importance of its distinctive competence in relational contracting may decline in environments where the rule of law is growing stronger, and where political influence and corruption are being reduced (e.g., Kock and Guillén, 2001). Similarly, it remains to be seen whether the OLI configuration that has sustained the CFEs can be modified to take advantage of emerging opportunities in North American and European markets, or whether the penetration of such markets will change the nature of the CFE (Yeung, 1999).

Longitudinal studies are necessary to explore these issues. For example, it is possible that the over-riding long-term competitive advantage of Chinese business is the highly fluid, pragmatic ability to adapt to changing circumstances. One cannot rule out the possibility that under fundamentally different circumstances, the centrality of relational advantages emphasized in this paper could eventually diminish as other capabilities become increasingly critical. Such a possibility is suggested by the recent expansion of Chinese firms into high technology industries dominated by Western MNEs, although relational advantages remain very important.

Similarly, the analysis must be extended to account for the growth of the CFE. As the scope of the company expands, both in terms of geography and business interests, the task of maintaining informal relational linkages is complicated. More formal relationships may be required. The problem is to define the mechanism that allows the firm to change its focus over time, while maintaining its family and ethnic character. A particularly important issue to be addressed is the potential relational 'lock-in' that might constrain the firm from adapting to both environment change and internal growth (Singh and Mitchell, 1996).

The preceding discussion also points to the need for further development of the I-advantage of the CFE. Although its relational advantages are a potential source of internalization advantage, since they are clearly not marketable, they may not be leverageable. The internal transfer of capabilities requires that there must be some excess capacity or under-utilized resource (Monteverde and Teece, 1982). To the extent that the CFE advantage is vested in a single person or family, such may not be the case, making it difficult or costly to leverage the advantage. The unique I-advantages of the CFE also restrict its potential for growth, given natural constraints on the availability of qualified family members to manage organizational expansion. Similarly, if both I- and O-advantages are related to the ability to process and disseminate knowledge, then the CFE should be evaluated in these terms. It has been argued that the MNE advantage rests on two-way flows between parent and subsidiary, and that advantage does not necessarily rest with the parent (Rugman and Verbeke, 1992, 2001). If so, firm advantage must be understood in part through the relationship between parent and subsidiary, and the way in which two-way knowledge flows are organized. Whether such flows are possible in an organization whose main advantage is not related to knowledge transfer is an increasingly important line of future research on the CFE.

A few recent studies have begun to analyse the nature and performance of business groups from emerging markets (Kock and Guillén, 2001). Comparison between CFEs and other successful business groups operating internationally remains an important avenue for future research. Other important lines of inquiry include the investigation of performance differences among CFEs in relation to particular configurations of OLI advantages in the strategies of individual firms.

### **Multinational Enterprise (MNE) Theory**

The existence of the CFE as an international business entity raises interesting questions for the theory of the MNE. Perhaps the most important of these relates to the issue of relational contracting. Relational contracting has been acknowledged as a potential O-advantage (Dunning, 2002), although only within a relatively specific context that does not directly identify family and ethnicity as potential sources of relational advantage. Even though their existence has not yet found its way into MNE theory, family firms are the dominant organizational form

internationally. The CFE provides a challenge to fully incorporate family firms into the theory of the MNE.

The existence of the CFE raises additional questions regarding O-advantages. These are typically seen as arising from home location environments. However, ethnic-based firms may possess advantages that transcend national boundaries, and are therefore either not rooted in any particular home environment or are rooted in a 'home' environment that is not defined by national borders of the firm's current location (or some combination). More research is required in order to understand more fully the relationship between ethnic origins and home location, particularly in light of the role of immigrants in forming business groups (Granovetter, 1985).

The CFE also provides a challenge to extend the understanding of location advantage. Most generally, the issue is how to incorporate into the analysis environments that support relational assets. If relational contracting is becoming more important, then locations that require it will tend to favour firms with corresponding skills, giving the CFE a potential advantage. Although there is some evidence on this matter (Globerman and Shapiro, 2002, 2003), the precise identification of location advantages that support relational contracting remains an important issue.

The CFE also raises the question of how organizational complexity and organizational dynamics fit within the OLI framework. As organizations grow and become structurally more complex, and as the environment changes, how does adaptation occur and how does it change the OLI balance (Guisinger, 2001)? An important related issue involves the application of the OLI framework to the specific case of network structures.

Finally, research that focuses on the CFE's preferences regarding market-seeking, efficiency-seeking, resource-seeking and strategic-asset seeking FDI is needed. This will help to clarify the circumstances under which it prefers one over the other, and will establish whether there has been a systematic pattern to preferences across industries, geographical regions, and/or over time.

### **Chinese Family Enterprise (CFE)–Multinational Enterprise (MNE) Interaction**

A final set of implications relates to the interaction between CFE and MNE firms. In particular, how will each evolve and compete in the economic space where they meet, most notably China? In this context, co-evolutionary theory seems particularly relevant (Lewin and Volberda, 1999). Co-evolutionary theory holds that observed change is the joint outcome of firm adaptation and environmental selection. As China liberalizes its economic and political environment, and in particular as it enters the WTO and introduces mechanisms for the protection of property rights, how will MNE and CFE firms adapt, and who will survive and prosper?

Unlike the Western MNE, the O-advantages of the CFE are typically not based on technical knowledge and intellectual property. As the location environment in China changes, there will be a better fit between MNE O-advantages and China's L-advantage, increasingly favouring the MNE. MNEs may also be more adept at transferring knowledge internally. Still, the cultural proximity between CFEs and China will remain an important factor that favours the CFE. Moreover, CFE advantages are embedded in social norms, subject to path dependency, and therefore extremely difficult to imitate. It is doubtful that these advantages could easily be acquired by Western MNEs. Finally, the CFE advantage in relational contracting may well allow profitable alliances with MNEs. Thus, the interaction may well be cooperative as well as competitive. China therefore provides a natural and important context in which to examine the CFE in comparison with the Western MNE in terms of current performance and sustainability, as well as the implications of increasing convergence in global standards of governance.

An essential difference between Western MNEs and CFEs is the importance of inter-firm relationships, which are central to the CFE. The OLI variables as originally conceived do not include personal or organizational relationships. However, their increasing importance under alliance capitalism has led to a recent reformulation of the eclectic paradigm to include relational assets (R-assets) as a fourth type of assets (Dunning, 2001, pp. 185–6). In this paper, we have identified relational assets as a previously overlooked type of O-advantage. The topic of relational assets is an especially promising area for future research on the international activity of Chinese family owned firms, and of MNEs in general.

The specific types of advantages incorporated into the initial formulation of the eclectic paradigm (Dunning, 1977, 1981) do not include the characteristic features of Chinese family business. In particular, they do not include the ability to make deals (Chen, 1995), which we identify as a distinctive capability. The absence of non-Western firms from Dunning's original data, however understandable in historic context, means that the results of his analysis were necessarily incomplete. Factors that might be sources of competitive or strategic advantage for non-western types of firms were not considered. As a direct consequence, a large body of empirical research based on the eclectic paradigm has operationalized the OLI constructs in terms of specific attributes of US and European multinationals. The relevance of these attributes to non-western multinationals was not established. When operationalized in terms of the characteristics of Western multinationals (following Dunning) but applied to non-Western forms of business (such as the Chinese family-owned international conglomerates of Southeast Asia), the OLI paradigm seems to suggest that these alternate forms cannot succeed internationally. One of the main objectives of this paper is to demonstrate that the OLI paradigm does indeed apply to non-Western forms, when operationalized more broadly to include other sources of O-, L- and I-advantage than those specifically identified by Dunning. Consistent with the argument presented in this paper,

Dunning has himself recently acknowledged that the OLI framework is enhanced by the explicit addition of relational advantage, and undertook to reformulate it accordingly (Dunning, 2002).

Despite the general neglect of family business studies in the US, the distinctive characteristics of family versus non-family business have been documented in the Western management literature for some time (Litz, 1985). This literature demonstrates that family business is inherently different from non-family business. The Chinese family business system can be considered as a sub-category within the general area of family business. While conforming to the general definition of family business with regard to family ownership and management, the Confucian heritage gives Chinese family business certain identifying characteristics that are unique in some regards. These distinctive characteristics are derived from the institutional logic of the family in traditional Chinese culture (Tsang, 2002). The process by which some CFFs evolve into progressively more international CFEs, and eventually begin to yield family-held upper management positions to selected professional managers is another important area for future research.

## CONCLUSION

A major conclusion of this paper is that the CFE is analytically distinct from other kinds of firms with respect to OLI advantages. This conclusion is reached on the basis of a detailed conceptual analysis of many descriptions of Chinese family business that have appeared in the Chinese management literature. The very small number of empirical studies published to date tends to support the accuracy of these descriptive narratives (Tsang, 2002). While the results of the conceptual analysis are not conclusive, given the lack of a broad empirical foundation, it makes an important contribution by charting a number of promising directions for future empirical research.

With the rapid international expansion of Chinese family business in the new global economy, it is increasingly important to recognize the large-scale Chinese family-owned enterprise, and evaluate its viability as an organizational and economic alternative for conducting international business activity. Rooted in Chinese culture, the institutional logic of traditional Chinese family business, and the unique historical experience of the Overseas Chinese, the CFE has emerged as a major organizational form for international business activity in the twenty-first century. A primary contribution of the Chinese management literature has been to identify distinguishing characteristics of Chinese family business and its roots in the Confucian system of family-based relationships.

A comprehensive theoretical analysis of the phenomenon of the CFE is developed in this paper through the application of Dunning's eclectic paradigm of the modern multinational enterprise. Analysing the workings of this type of organization within the framework of competitive advantages in relation to its distinc-

tive Ownership, Location and Internalization characteristics sheds light on the performance dynamics of the CFE, offering new insights regarding its successes as well as its limitations.

In demonstrating the ability of Dunning's eclectic paradigm to improve understanding of the international activities of this indigenous Chinese form of organization, we argue for expanding the application of MNE theory to encompass non-Western types of organizations. This makes the theory more robust and potentially more relevant in other developing countries, transitional economies, and emerging markets. In applying theoretical constructs and principles derived from research on firms based in the West to phenomena occurring in other world regions, we support the stance that 'theory-based learning can go both ways across the oceans' (Lee, 2002, p. 53).

## NOTE

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