Navigating Chinese national strategically important sectors

- *a study of how - and if - the Chinese government strategically uses foreign companies to cultivate the home market and ultimately to promote the growth of the Chinese economy*

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"Experience is not what happens to you. It is what you do with what happens to you."

Aldous Huxley (1894-1963)

Executive summary

Based on the hypothesis that from a western perspective doing business in China is either viewed as a pot of gold: a vast market with endless opportunities to earn big money, or viewed as a trap for the unwary: that doing business in China equals loosing know-how and core competencies to Chinese partners, suppliers or competitors, this thesis sets out to examine the Chinese government's possible agenda of strategically using foreign companies operating in national strategically important sectors to cultivate the domestic enterprises and thereby boost the Chinese economy.

In acknowledgement of the importance of viewing the dilemma from an emic-etic approach, the thesis wears two pairs of glasses, examining the hypothesised dilemma from two perspectives: the Chinese government perspective and the foreign company perspective. The Chinese government perspective examines how, and if, the Chinese government takes the best from foreign companies operating Chinese national strategically important sectors in order to upgrade domestic companies and ultimately promote the growth of the Chinese economy. The Chinese government perspective is analysed with political and economic data from China as well as by an expert interview with a professor in Chinese political economy. The foreign company perspective examines how foreign companies face the Chinese institutional set-up of national strategically important sectors, and how foreign companies ensure staying in competition, despite transferring knowledge and technology to Chinese competitors and suppliers. The foreign company perspective is analysed through three case examples of Danish companies operating in sectors that have national strategic importance in China.

In an analysis combining the two perspectives the thesis concludes that although the Chinese government is strategically using foreign companies to cultivate domestic enterprises, foreign companies are not necessarily pacified and crowded out. This thesis finds that there is momentum where the Chinese government's and the foreign company's goals can align and a win-win situation, so often proclaimed by the Chinese government, can be achieved. In conclusion, it is within this momentum that both players can navigate the Chinese national strategically important sectors successfully.

About the Author

This thesis is the final step in becoming M.Sc. in International economics and business administration from Copenhagen Business School. I hold a B.Sc. in International Business and Chinese language from Copenhagen Business School. During my B.Sc., I have lived, worked, studied, and travelled in China for more than two years and both speak and write mandarin Chinese. During my masters I have spent one semester in Boston, USA, taking courses about the Chinese economy. In my professional career I have worked for Danish-Chinese Business Forum in strengthening the commercial relationship between Denmark and China, and I now work for DONG Energy where I have assisted the Vice President with his role as an advisor for the Chinese government on energy efficiency.

In the process of writing the thesis, I have been grateful for the possibility of 'going deep' into studies about a region of the world that excites and interests me immensely. My passion for international business derives from the complexity of it. The numerous dimensions of politics, economics, behaviour and routines of human beings all influence and make a difference when studying and doing international business.

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Vanessa McGrail

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Part 1 Introduction and research plan

Introduction

Since the 1978 economic reforms and opening up policies the Chinese government has welcomed foreign companies to invest in the Chinese market. Since the very beginning, the influx of foreign investment has been through carefully selected channels such as Special Economic Zones (SEZs) established by the Chinese government. By establishing themselves in Chinese SEZs foreign companies could get access to advantageous benefits such as tax reductions, preferred geographical locations, and carefully selected Chinese joint-venture partners, being mainly State-Owned Enterprises (SOEs). From the perspective of foreign companies these benefits mean a 'safer' yet lucrative way into the Chinese market. From the perspective of the Chinese government, on the other hand, this means transfer of know-how and technology to SOEs and subsequently cultivation of the domestic market. By channelling foreign companies entering the Chinese market through SEZs, the Chinese state places foreign companies in a controlled environment where the Chinese state possesses a powerful position in terms of foreign companies' expansion in the Chinese market. By being beneficial for both foreign companies and Chinese SOEs, the SEZs fulfil a 'mutually beneficial win-win strategy of opening up', a rhetorical phrase proclaimed by the Chinese state again and again (State Council 2006, MFAa 2009, MFAb 2009, Xinhua 2007A).

Since the opening of the first SEZ, China has undergone massive market reforms and the Chinese government is continuously adopting policies and measures to cultivate the domestic market and thereby ensuring economic growth. The influx of foreign investment is still welcomed by the Chinese state yet continuously under highly controlled policies and conditions. Some markets have been opened faster than others and especially primary sectors that have importance for economic security have seen slow, incremental opening to foreign investment. The steel industry and the energy sector are examples of industries that have importance for national security and therefore occupy a vital part of any basic economy. The 'national strategically important sectors'[1] in China are, as in most economies, very complex markets highly regulated by state. Consequently, the opening of these markets is first and foremost taking place at the political level. An example of this includes a Sino-US bilateral agreement that has resulted in the establishment of an American-Chinese Clean Energy Research Center in July 2009 (CNN News 2009). Other political incentives to promote renewable energy in China include mandates to support the development of domestic technologies and industries. For instance, the Chinese Energy Conservation Law from 1997 requires that international wind

[1] Since the phrase 'national strategically important sectors' is important to the topic of this thesis, the author has decided not to abbreviate this phrase throughout the thesis.

turbine manufacturers must use 70% of components made by Chinese manufacturers (DK Eksportråd 2009). From one perspective, wearing the glasses of the Chinese state, it may be argued, that the Chinese government at first gives foreign companies lucrative starting conditions in the Chinese market through for instance partnerships and SEZs in order to 'take the best' from foreign companies, thereby, strategically using foreign companies to cultivate domestic companies and boost economic growth. From another perspective, wearing the glasses of foreign companies, things look different. Transferring know-how and technology from foreign companies to Chinese enterprises, foreign companies may, perhaps unwillingly, help upgrade the skills of the Chinese enterprises. Therefore, one might argue that there is a high risk for foreign companies to lose competitiveness to Chinese enterprises. The challenge for foreign companies is thus to ensure staying competitive and not being 'crowded out' of the Chinese market, despite transferring competencies and production know-how to Chinese enterprises.

Hypothesis and research questions

Hypothesis

Due to the highly controlled opening of national strategically important sectors and the managed channelling of foreign investment, it may be argued that the Chinese government is pursuing a certain agenda or strategy when welcoming foreign companies. By enforcing policies that make it valuable to enter the Chinese market albeit containing strict conditions that enable Chinese companies to take the best from foreign companies, it could be argued that the Chinese government is strategically using foreign companies to cultivate and upgrade the domestic market and thereby promote the growth of the Chinese economy. With the historical, incremental opening of the Chinese market and the Chinese government's continuous control of certain sectors and thus managed channelling of foreign investment in mind, I find it interesting to examine the following hypothesis:

The Chinese government is strategically using foreign companies to cultivate the home market and ultimately to promote the growth of the Chinese economy.

The hypothesis aims to explore how, and if, the Chinese government strategically makes sure to have an influence on the strategy of foreign companies operating in the Chinese market and how this influence ultimately has a positive effect on the Chinese economy. In order to explore this, the thesis wears two pairs of glasses, taking two perspectives on how, and if, the Chinese government is strategically using foreign companies to cultivate the domestic market. The first perspective, the perspective of the Chinese government, will allow studying how, and if, the Chinese government through policy making and policy enforcement strategically takes the best from foreign companies operating in the Chinese national strategically important sectors. The second perspective, the perspective of the foreign company, will allow studying how foreign companies face the institutional set-up of selected Chinese sectors. The second perspective aims to show how Chinese government policies influence the strategy of foreign companies operating in the Chinese market, and how the foreign companies ensure staying competitive vis-á-vis Chinese enterprises. The hypothesis may be exemplified through studying the influence of the Chinese government policies on foreign companies operating in Chinese national strategically important sectors. Three case examples on three different companies have been chosen as these companies operate in Chinese sectors which have national strategic importance. The first, Vestas Wind Systems, producer of wind turbines, operates in the energy sector. The second case example, Novozymes, is producer of enzymes, and operates in the biotechnology industry that supplies biotechnology solutions to sectors such as agriculture and pharmaceuticals. The third case example is RM Group, producer of processed and manufactured steel, operating in the steel and heavy metal industry.

These three sectors are all examples of Chinese national strategically important sectors. In 2006, the Chinese government issued a 'Guiding Opinion Concerning the Advancement of Adjustments of State Capital and the Restructuring of State-Owned Enterprises' in which it was recommended that state capital is concentrated in "major industries and key sectors (…) [which] include industries involving national security, significant basic infrastructure and major mineral resources, industries supplying important public goods and services, and major backbone enterprises in 'pillar' industries and high and new technology industries" (OECD 2008, Xinhua 2006B). The energy sector, the biotechnology sector and the heavy metal industry sector are all mentioned in the guiding opinion and are identified as 'pillar' industries (OECD 2008, Xinhua 2006B).

Research questions

In order to examine how, and if, the Chinese government strategically uses foreign companies to cultivate the home market and ultimately to promote the growth of the Chinese economy, the following research questions have been formulated:

Research question one: How does the Chinese government enforce policies that ensure the transfer of competencies from foreign companies to domestic companies in order to make the latter competitive?

Research question two: What is the level of enforceability of Chinese policies?

Research question three: How does Chinese government policy influence the strategy of foreign companies operating in the Chinese national strategically important sectors?

Research question four: How do foreign companies ensure staying competitive despite transferring competencies to their Chinese competitors?

Research question five: Which elements of the Chinese institutional set-up foreign companies face when operating in Chinese national strategically important sectors influence the strategy of foreign companies?

Research Plan

This thesis aims to explore how, and if, the Chinese government strategically uses foreign companies to cultivate the home market and ultimately to promote the growth of the Chinese economy.

Structure of the thesis - two perspectives

This thesis wears two pairs of glasses, taking two perspectives on how, and if, the Chinese government is strategically using foreign companies to cultivate the Chinese domestic market. The first perspective, the perspective of the Chinese government, will allow studying how the Chinese government through policies and policy enforcement strategically takes the best from foreign companies operating in the Chinese national strategically important sectors in order to upgrade domestic companies to a level where they are able to compete with and perhaps even crowd out foreign companies. The second perspective, the perspective of the foreign company, will allow studying how foreign companies face the institutional framework of Chinese national strategically important sectors, how Chinese government policies influence the strategy of foreign companies, and how the foreign companies ensure staying competitive vis-á-vis Chinese enterprises.

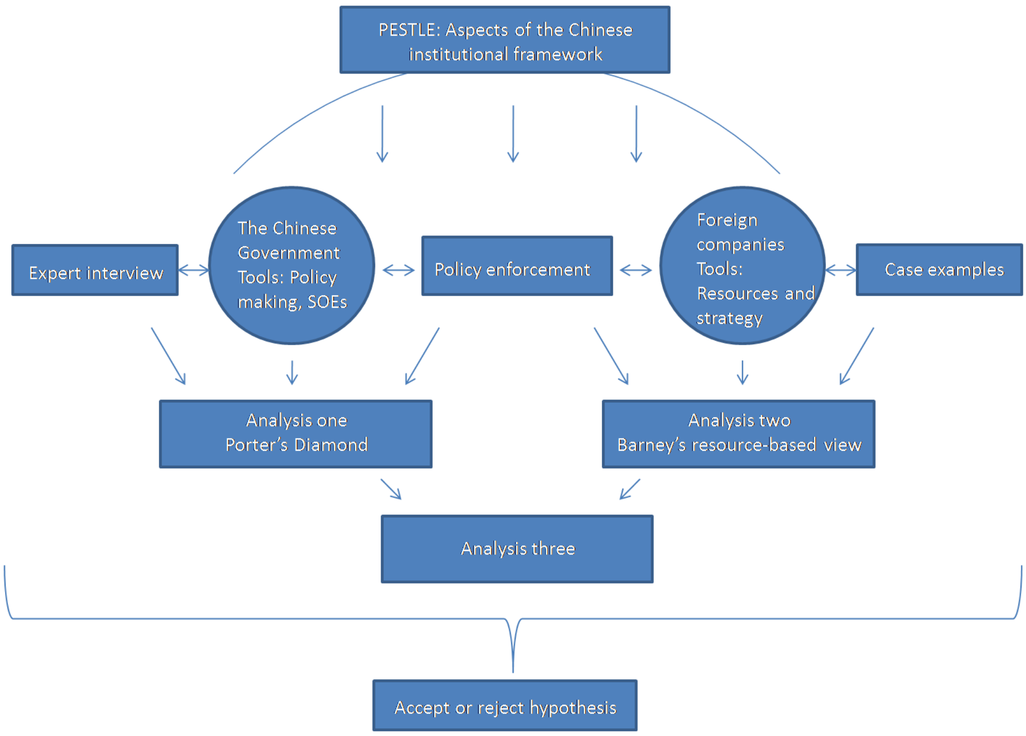

Figure 1: Illustration of the path this thesis takes to reject or accept the hypothesis.

Figure 1 illustrates the methodological approach of this thesis. At the first level, aspects of the Chinese institutional framework, provides an umbrella affecting all other parts of the thesis. This is illustrated by the arrows pointing downwards from the box at the top of figure 1. In the PESTLE framework[2] aspects of the Chinese institutional set-up relevant to the national strategically important sectors will be highlighted in order to organise the data important for the three analyses and to provide grounds upon which to reject or accept the hypothesis.

The two perspectives of the thesis, the Chinese government perspective and the foreign company perspective, are illustrated by the two circles underneath the umbrella of the Chinese institutional framework. Between the two perspectives is a box representing policy enforcement. Policy enforcement is affected by both of the two players the Chinese government and the foreign company. Reversely, policy enforcement affects the two players, illustrated by the two-directional arrows from and to the two circles representing the two perspectives.

At the far left and right of the second level of the model are two real-life examples presented to respectively exemplify the Chinese government perspective and the foreign company perspective. The far right box illustrates the three different foreign companies operating in the Chinese market. These have been chosen to exemplify the foreign company perspective with respect to the theme raised in the hypothesis. The three case examples have been carefully selected, representing three different industries within the Chinese national strategically important sectors. The examples may reveal the level of influence of Chinese government policies on foreign companies operating in the Chinese national strategically important sectors and how the foreign companies overcome the challenge of being crowded out by domestic enterprises. The far left box illustrates an expert interview conducted to verify and contribute to the understanding of the Chinese government perspective. It has not been possible to interview Chinese government representatives and therefore the thesis will draw upon secondary data as well as the expert interview to exemplify the Chinese government perspective.

Finally, three analyses will lead to an understanding upon which the five research questions can be answered. The answers of the research questions will help to reject or accept the hypothesis.

The first analysis will focus on the perspective of the Chinese government and will answer research question one and two: *1. how does the Chinese government enforce policies that ensure the transfer of competencies from foreign companies to domestic companies in order to make the latter competitive? 2. what is the level of enforceability of Chinese policies?* Analysis one will utilise data from the PESTLE framework as well as findings from the expert interview organised by Porter's Diamond (1990) model. Thus, Porter's Diamond (1990) will be used as a frame to organise data from

[2] In this thesis the PESTLE framework is used to organise data about the **P**olitical, **E**conomic, **S**ocial, **T**echnological, **L**egal and **E**nvironmental aspects of the Chinese institutional framework.

the PESTLE framework and findings from the expert interview. The Chinese government perspective, the expert interview and policy enforcement will therefore provide the background for analysis one. This is illustrated by the three downward pointing arrows on the left side of figure 1.

The second analysis will focus on the perspective of the foreign company and will answer research question three and four: *3. how does Chinese government policy influence the strategy of foreign companies operating in the Chinese strategically important sectors? 4. how do foreign companies ensure staying competitive despite transferring competencies to their Chinese competitors?* Analysis two will utilise findings from the three case examples to theoretical insights of Barney's resourced-based view of the firm (1991). Thus, the foreign company perspective, the three case examples and policy enforcement will provide the background for analysis two. This is illustrated by the three downward pointing arrows on the right side of figure 1.

Finally, the third analysis will combine the two perspectives, the Chinese government perspective and the foreign company perspective from analysis one and analysis two, to enable answering research question five: *5. which elements of the Chinese institutional set-up foreign companies face when operating in Chinese national strategically important sectors influence the strategy of foreign companies?* Having answered all five research questions in the three analyses thus enables grounds upon which to accept or reject the hypothesis.

Choice and application of theory

As described, aspects of the Chinese institutional set-up from the PESTLE framework will provide insights into which set-up the foreign companies face when operating in the Chinese national strategically important sectors. Aspects of the Chinese institutional framework also provides an understanding of which set-up or starting point the Chinese government operates from when meeting the foreign companies in the Chinese national strategically important sectors. Therefore, the Chinese institutional framework will affect all other parts of the thesis, illustrated as an umbrella in figure 1.

In order to understand the processes of policy enforcement within the Chinese institutional framework, it is important to understand the role of institutions and how they evolve over time. The mix of formal and informal rules and norms as well as policy enforcement and governance influence economic performance. The aspects are thus vital in order to understand the Chinese institutional framework. Institutions define the scope companies operate within, corporate governance, ownership rights, incentives for environmental protection, etc. Therefore, Scott (1995, 2008) and North's (1990) perspectives of institutional theory will provide a general understanding of the influence and role of institutions in an economy. With regard to China, institutions may be particularly important as the country is both in transition and developing at a rapid pace. Studying the role of Chinese institutions may help to understand the enforceability of Chinese polices. Insights and theoretical notions of prominent scholars such as Carney (2005), Peng (2002AB) and Dunning (1993, 2000) will also be drawn upon to broaden the understanding of the dynamics and complexity of Chinese institutions. As mentioned, it has not been possible to obtain primary data from Chinese government representatives. Hence, data for the PESTLE framework are all secondary data. To ensure objectivity of secondary data from sources such as Chinese governmental homepages and the European Commission homepages as well as American World Bank Reports, several studies and theories by international acknowledged scholars have been drawn upon.

Analysis one, the government perspective, will apply Porter's Diamond (1990) somewhat different to the traditional application.[3] The purpose of using Porter's Diamond (1990) as a framework to analyse factors enabling the Chinese government to pursue the strategic use of foreign companies is to present which tools the government applies to strategically use foreign companies to upgrade their own. Porter's Diamond (1990) is divided into four interlinked factors and activities that can be influenced pro-actively by governments (Porter 1990). The division into the four factors help apply Porter's theory to data about the Chinese institutional framework. This ultimately enables an understanding of policy enforcement from the perspective of the Chinese government. At the same time, Porter's Diamond will present external factors influencing foreign companies operating in the Chinese market. Findings from analysis one will be applied in analysis three in combination with findings from analysis two.

Analysis two, the foreign company perspective, will apply Barney's (1991) resourced-based view of the firm which helps to identify resources and capabilities that can be sources of sustained competitive advantage to a company. Furthermore, Barney's (1991) theory enables the identification of key resources enabling foreign companies to pursue a value-creating strategy in China. The perspectives of Brewster (2002), Teece, Pisano and Shuen (1997), Peteraf (1993) and Prahalad and Hammel (1990) adds additional insight to identify sources of sustained competitive advantage. These insights include effectiveness of management and decision-making (Prahalad et al. 1990, Peteraf 1993), knowledge[4] management (Gertler 2003, Newell et al. 2002), human resource practices (Brewster 2002) and boundaries of the company (Teece et al. 1997). In addition, Kostova and Roth (2002) provide insights to examine what happens internally in a foreign company when facing external forces in a foreign market. Therefore, focus will not only be on the strategic level (Prahalad et al. 1990, Peteraf 1993, Brewster 2002, Teece et al. 1997, Barney 1991), but will focus on the internal workings of a company (Kostova et al. 2002) when facing external forces such as the Chinese institutional framework or Chinese policy enforcement.

[3] Traditionally the application of Porter's Diamond aims to measure the competitive advantage of nations in global competition (Porter 1990, Porter 2003).

[4] According to the Oxford English Dictionary, knowledge may be defined as expertise and skills acquired by a person through experience or education (Oxford English Dictionary 2009).

Mahnke's (2002) evolutionary theory perspective[5] as well as aspects of the OLI framework (Dunning 2000) will be applied to give a more dynamic perspective on the utilisation of resources and strategies available to the foreign companies. These perspectives may be used to assess how the process of internationalisation or the changing of company boundaries[6] (Mahnke 2002) influences the dynamic capabilities of the company.

Thus, findings from analysis two will help to understand how foreign companies operating in the Chinese national strategically important sectors change in evolutionary and path-dependent ways in order to respond to pressures of change (Nelson et al. 1982, North 1990).

Analysis one and analysis two will therefore provide understandings of the two perspectives in relation to the problem hypothesised, making it possible to combine the two perspectives in the third and final analysis where findings will enable a rejection or acceptance of the hypothesis.

Data collection and interview design

Three case examples have been carefully selected, representing three different industries within the Chinese national strategically important sectors. The decision on using three case examples has been made in order to possibly identify a pattern in relation to the hypothesis. Yin (2003) has identified pattern matching relevant to ensure reliability in case studies. In order to ensure objectivity when making comparison, Yin (2003) argues that the use of multiple-case designs may be stronger than single-case designs.

In total three interviews have been conducted for the thesis. As illustrated in figure 1 the interviews have been categorised in the two perspectives represented in the thesis. For the Chinese government perspective, an expert within the field of Chinese political economy has been interviewed in order to explore, validate and support findings from secondary data and theory applied in the PESTLE framework. The other two interviews have been categorised in the foreign company perspective. Two interviews with representatives from two of the case examples of foreign companies operating in different Chinese national strategically important sectors have been conducted. Unfortunately, it was not possible to conduct an interview with a third case example. Instead, data provided by RM Group is used in the third case example. The aim of conducting the case example interviews has been to contribute to exemplify the foreign company perspective.

[5] For more on origins and precursors of modern evolutionary theory please see England, 1994, pp. 9-35.

[6] In this thesis the changing of firm boundaries refers to 'governance changes'. Governance change includes internationalisation of firms, partnering, merging, or outsourcing (Gertler 2003, Newell et al. 2002). An example could be when firms internationalise or partner with Chinese firms in the Chinese market and consequently change or move firm boundaries by renewing capabilities or resources, inherited or developed during the process of that particular governance change.

Expert interview

Kjeld Erik Brødsgaard is a professor at Copenhagen Business School, Ph.D. in modern Chinese studies, director of Asia Research Center at Copenhagen Business School, and Danish director of the Chinese Executive Leadership Programme (CELP). CELP is an executive education program for senior officials and managers from Chinese businesses and government agencies. More than 3800 high-level business leaders, scientists, government officials, bankers, and academics from every region of China have graduated from CELP (CBS 2009, Interview KEB 2010).

Kjeld Erik Brødsgaard is a widely acknowledged expert on Chinese social and political economy. He has been cited by several prominent journals and media on Chinese and East Asian affairs and he regularly appears on Danish National Radio, TV, and in international news media. Kjeld Erik Brødsgaard has published more than two hundred essays about China and is often invited to China by government representatives (Interview KEB 2010).

Prior to the face-to-face interview with Kjeld Erik Brødsgaard, e-mail correspondence has been the initial contact between the author and Kjeld Erik Brødsgaard. The initial e-mail introduced the theme of the thesis, the hypothesis and a few theme questions. Thus, the design of the expert interview has been semi-structured, exploratory and explanatory in nature (Saunders et al. 2003). However, due to the fact that the author of the thesis and Kjeld Erik Brødsgaard know each other well, the actual face-to-face interview was loosely structured in order to give the interview an informal setting opening for discussion and unforeseen subjects (Saunders et al. 2003). Thus, notes were taken after the interview and subsequently translated from Danish to English by the author.

Case example interviews

Interviews with representatives from two of the three case examples have been conducted for the thesis. Prior to the interviews, e-mail correspondence has been the initial contact between the author and the case example representatives. To the extent possible, the e-mails have been similar of structure and have had the same approach to introducing the theme of the thesis. The e-mails have all contained an attachment of one sheet with pre-defined theme questions. The pre-defined questions have been carefully formulated using themes of theory applied in the foreign company perspective section. The pre-defined questions have had similar structure and chronology for all three case example representatives yet modified to fit the particular company or representative's history and experience. Thus, the interviews have been semi-structured entailing interviewees to commence with a set of questions yet prepared to vary the structure of the questions as well as to be asked new questions in the context of the research situation (Saunders et al. 2003). Nevertheless, the pre-defined questions were only used as guidance, some were omitted and some were added, and the order of the questions was ad hoc to adjust to the specific context of the case example. The purpose of using semi-structured interviews has also been to enable the generation of qualitative data in order to understand and explore case example representatives' attitude and opinions (Saunders et al. 2003).

In exploratory and explanatory interviews, such as the interviews conducted for this thesis, there exists a risk of asking leading questions and a risk of interpreting answers in different ways than intended (Saunders et al. 2003). To mitigate the risk of subjective bias, questions for the case examples have been of similar structure to the extent possible. The case example interviews and data collection cannot represent a generalisation of foreign companies operating in the Chinese national strategically important sectors but merely give a snapshot of insight into some of the challenges experienced by one representative from each of the three case examples (Saunders et al. 2003).

To view the Chinese institutional set-up requires two set of understandings. First, it is necessary to understand the Chinese institutional set-up seen from the perspective of the Chinese government. Second it is necessary to understand from which starting point the foreign companies meet the Chinese institutional set-up when operating in the Chinese market. Upon understanding these two perspectives, it is then possible to combine the two perspectives and answer research question five: *which elements of the Chinese institutional set-up foreign companies face when operating in Chinese national strategically important sectors influence the strategy of foreign companies?* For this reason, both expert and case example interviews were purposely conducted after making detailed descriptions of the Chinese institutional set-up as well as gaining in-depth knowledge about foreign companies and their operations in the Chinese market.

Case example 1 representative

Current position: Project manager, Vestas Wind Systems, Denmark.

Previous position: Project manager, Vestas Wind Technologies China Co. Ltd. Tianjin, China.[7]

After the already mentioned e-mail correspondence, the interview was conducted by telephone. For the interviewee to feel at ease, to ensure open discussion and to gain insight into the interviewee's opinions, notes were taken after the interview. The language spoken was Danish, notes were written in Danish, followed by translation into English by the author.

Case example 2 representative

Current position: project manager, R&D Novozymes, Denmark.

Previous position: Director, Novozymes (China) Investment Co. Ltd. Beijing, China.[8]

After the already mentioned e-mail correspondence, the interview was conducted face-to-face. For the interviewee to feel at ease and to ensure open discussion and to gain insight to the interviewee

[7] Hereafter referred to as Vestas.
[8] Hereafter referred to as Novozymes.

opinions, notes were taken after the interview. The language spoken was Danish, notes were written in Danish, followed by translation into English by the author.

Case example 3 representative

An e-mail has been written to the director of RM Group. Unfortunately, it was not possible to conduct an interview with the RM Group representative. Instead, the author of the thesis had to draw on material about RM Group sent by the representative to be used as data for this thesis. The data has been collected between 2005 and 2009 by both students and professors at Copenhagen Business School.

Case example 1: Vestas

Vestas in Tianjin was established in 2005 and is located in Tianjin Economic-Technological Development Area (TEDA). TEDA is a SEZ with preferential policies for foreign companies establishing themselves in the Chinese market including land subsidies, financial support for R&D, and rewards for technological transfer (TEDA 2010). TEDA is home to nearly 30 wind power producers including LM Glasfiber who supply Vestas' production and manufacturing of wind turbines. Vestas in Tianjin has established five separate factories all producing the main components for Vestas' wind turbines, including completed control system as well as expanded generator and blade factories, making it Vestas' largest integrated wind power production base (Tianjin Commission of Commerce 2009). According to the Chinese government the base will "not only enhance the production capacity of Vestas in China but (...) introduce advanced wind energy equipment manufacturing technology to China so as to provide hi-tech and hi-quality wind turbines for Chinese and global markets" (Tianjin Commission of Commerce 2009). In China, the wind power tariffs supports the continued development of the wind turbine market which is driven by China's ambitious climate targets (Vestas homepage 2010). According to their homepage, Vestas seeks to promote a culture "characterised by independent initiatives and collaboration across professional and organisational boundaries and in which the dynamics and sense of responsibility that usually characterise a small company are retained" (Vestas homepage 2010). China has the largest wind turbine manufacturing industry in the world with more than 40 wind-component manufacturers including Goldwind, Sinovel Wind, Dongfang, Windey and Sewind, which are all local competitors to Vestas.

Case example 2: Novozymes

Novozymes headquarters and R&D center in China were established in 1995 and is located in the Shangdi Industry Zone of Beijing. The Shangdi Zone is located in Zhongguancun Science park, a technology hub often referred to as the 'Chinese Silicon Valley' (Interview Novozymes 2010, ZGC

Science Park 2010). The Zhongguancun Science Park has the largest concentration of hi-tech industry development and is “a national innovation base, an incubating base for the commercialization of scientific achievements and technology industry, a training base for innovating talents of high quality, an experimental zone for executing the strategy of rejuvenating the nation through science and technology, and a first-class science park in the world” (ZGC Science Park 2010). The park is a SEZ with preferential policies for foreign companies establishing themselves in the Chinese market including land subsidies, preferable income tax rates, financial support for R&D, and rewards for technological transfer (ZGC Science Park 2010).

Novozymes’ R&D center in China is equipped with a state-of-the-art biotechnology research apparatus and specialises in new enzyme research and applications, carrying out research within use of enzymes in detergents, textile food, and non food industrial uses of crops and other products e.g. biofuels, and environmental uses in China (NZ homepage 2010). Novozymes is a frontrunner in enzyme production in the Chinese market with few local competitors. In this thesis the focus on Novozymes will be within enzyme production for 2nd generation bioethanol production. In 2006, Novozymes and COFCO,[9] and in 2009 also refiner Sinopec,[10] started working jointly on developing an industry chain to collect agricultural waste, process it into bioethanol and distribute the biofuel through petrol stations (Interview Novozymes 2010).

With a strong sustainability profile Novozymes “aspire to make (...) commitment to sustainability an integrated part of all our business activities” (NZ homepage 2010). Novozymes seeks to integrate economic achievement, environmental performance, and social responsibility. Sustainability is a top priority at Novozymes and a “prerequisite for doing business in all countries” (Interview Novozymes 2010).

Case example 3: RM Group

RM Group trace back more than 110 years and is a family owned Danish company originally operating as sub-supplier in the metal industry (RM Group homepage 2010). For more than 70 years, RM Group was traditionally a machinery- and engine company with core products ranging within the metal industry, supplying processed and manufactured steel, production of machinery parts and machinery for different industries (RM Group homepage 2010). Today, after more than 10 years of total company make-over, RM Group has created an international organisation with core products ranging from metal work to outsourcing services (RM Group homepage 2010, Erhvervsbladet 2010). This means that RM Group has made a transformation of core competencies from producing machinery equipment to selling service in outsourcing. RM Group is continuously developing,

[9] COFCO: China National Cereals, China Oil & Foodstuff Corp.
[10] Sinopec: China Petroleum and Chemical Corp.

shifting or expanding its core competencies learning from experience. An example of this is RM Group's recent entry into the wind turbine industry in China (Erhvervsbladet 2010). RM Group is parent for seven companies each with international focus and their own speciality. Representation counts Poland, Turkey, Denmark and China. RM Group China Aps[11] was established in 2004 and entails RM Group Ningbo Co. Ltd. China and RM Group Invest. RM Group thus has a range of activities in China from processing and manufacturing of machinery for different industries to outsourcing services and guidance (RM Group homepage 2010, RM Group data 2009). RM Group in China is located in the Norwegian owned Nordic Industrial Park (NIP) established in 2003 and situated in Ningbo south of Shanghai. Ningbo is located in the area known as the Yangtze River Delta recognised as holding one of the largest concentrations of privately owned businesses in China (NIP 2010). The Ningbo area especially holds strong position within electronics, steel and stainless materials, metal processing, machinery and advanced mechanics, energy and environment (Styrbjørn 2010). NIP covers an area of 350,000 square metres and provides services to Nordic small and medium sized enterprises wishing to set-up activities in China including sourcing, sales, logistics, consultancy, engineering, assembly or production (NIP 2010). Using NIP as a step into China enables companies to obtain beneficial tax regulations corresponding to those of SEZs.

Delimitations

Although the goal has been to approach the thesis topic as objectively as possible, it is barely possible for a student from 'the west'[12] to fully reach an objective perspective or understanding of the Chinese government's perspective and operations. Literature about the Chinese market is often written by residents outside China which evidently may result in discussions taking departure in 'own-backyard' point of views. Is it then more legitimate if the discussion or literature is from China? Probably not, albeit being closer to real-life-examples, literature about China written by Chinese may suffer from subjective opinions influenced by agendas of local authorities. Consequently, the author realises that evaluations can never achieve complete objectivity. This line of thinking takes us into the world of the hermeneutic methodology (Gadamer in Voxted 2008). The hermeneutic methodology is based on the fundamental belief that as an outsider or reader you will never have the true understanding of meaning from e.g. a text or the author who wrote it. Hence, it is only possible to understand the meaning of something when you relate it to the context from which this meaning emerges. Edmund Husserl's (1913) ideas add further to this line of thinking, arguing that the conscious mind cannot be objective since human beings will always see the world as we experience it (Voxted 2008). Hence, no

[11] Hereafter referred to as RM Group.
[12] 'the west' or by the western way of thinking is meant the free market system inherently incomparable with a noncompetitive political system as it is believed that people cannot have true economic freedom without political freedom (Peerenboom 2006).

reader or writer is independent from the world we come from and will thus always place our own interpretations on what we write or read.

The emic versus etic dilemma

The emic-etic analogy (developed by Kenneth Pike 1954, Sinkovics et al. 2008) derives from the suggestion that two perspectives can be employed in the studies of society, taking the point of view from either the insider or the outsider. The emic, or insider, perspective strives to understand a phenomenon or society from 'the native's point of view'. The etic, or the outsider, perspective describes behaviour or phenomena from external criteria that are imposed by the researcher. Emic research builds on subjectivist, qualitative and insider perspectives, which supposedly is not necessarily comparable. The etic research on the other hand, relies on universal categories when collecting and interpreting data, arguing data to be comparable. However, there may exist a risk for the researcher to choose certain categories in advance and thus miss important aspects of the phenomena. The challenge of making observations that are both taking adequate departure in the context of the phenomena studied as well as being comparable across societies has been described as the emic-etic dilemma (Sinkovics et al. 2008).

To capture the multiple dimensions of international business studies, throughout the thesis, the emic and etic dilemma will be dealt through the two-perspective approach. The two perspectives of the thesis, the Chinese government as the macro perspective, and the foreign company as the micro perspective, leave the industry level, the mezzo level on the side. However, understanding the two perspectives dealt with in this thesis evidently touches upon the mezzo or industry level as both perspectives cannot be presented without relating to the industry level of an economy.

Triangulation

Since each method or theory used in this thesis has its unique strengths and weaknesses, using multiple methods and theories enables triangulation which ensures the validity and reliability of the data used (Saunders et al. 2003). Each of the three analyses applies multiple kinds of data and theories enabling triangulation of theories and data. On a theoretical level, triangulation comes about through the use of institutional theory, the PESTLE framework, Porter's Diamond and the resource-based view of the firm.

Thesis outline

In Part 1 introduction, hypothesis and research plan was outlined.

In Part 2 the PESTLE framework is used to organise data about aspects of the Chinese institutional set-up relevant to the national strategically important sectors.

Part 3 of the thesis comprises analysis one. This analysis focuses on the first perspective or player, the Chinese government. The Chinese government may employ policy making and the SOEs as tools to strategically use foreign companies to upgrade their own. They may use these tools through policy enforcement.

Part 4 of the thesis comprises analysis two. This analysis focuses on the second perspective or player, the foreign company. Foreign companies may use resources and strategies as a tool to avoid merely being used strategically by the Chinese government and avoid being crowded out of the market. Foreign companies may also employ these tools by actively affecting policy enforcement, helping them to stay in competition.

Part 5 comprises analysis three. This analysis combines the first and the second analysis and accepts or rejects the hypothesis.

Part 6 will outline findings and conclusions of the thesis as well as further applications and perspectives.

Part 2 Aspects of the Chinese institutional framework

In order to measure how, and if, the Chinese government is strategically using foreign companies to cultivate the domestic market we need to determine how the Chinese government enforce policies ensuring the transfer of competencies from foreign companies to the Chinese SOEs.

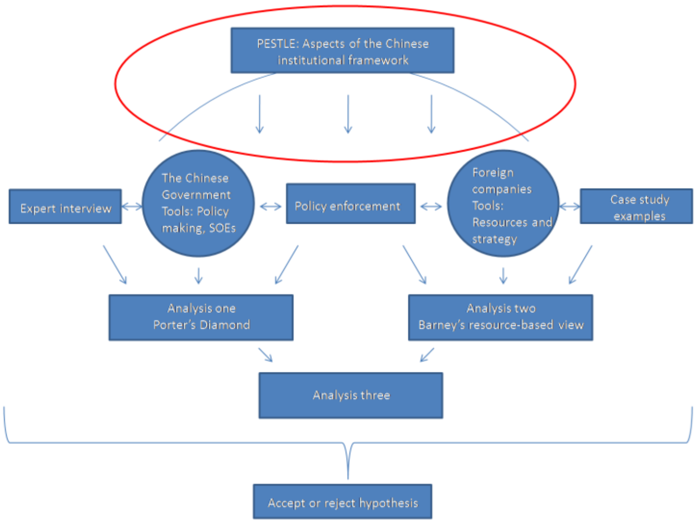

Figure 2: Illustration of the methodological approach focusing on the aspects of the Chinese institutional framework.

As illustrated in figure 2, the PESTLE framework and the institutional theory is helping set the overall frame for this thesis and provide a general basis for understanding the influence of institutions in Chinese society. Studying the role and influence of institutions in Chinese society will help to understand the enforceability of Chinese policies. In order to study the enforcement of laws and policies and the level of enforceability, this section takes a closer look at how the Chinese government legitimises the ‘visible hand’ that controls the operation of foreign companies in the Chinese market.

Institutional theory is a comprehensive field and in this thesis the focus within institutional theory is primarily on how the importance of legitimacy and policy enforcement emerge from institutional contexts. When looking at how, and if, the Chinese government strategically uses foreign companies to cultivate the domestic market, an important tool the Chinese government may utilise to influence foreign companies, is government policy. In order to identify how, and if, aspects of the Chinese institutional framework have influence on foreign companies operating in the Chinese market, certain aspects of institutional theory has been identified as the most important and is outlined here in Part 2. In the PESTLE-framework aspects of the Chinese institutional framework relevant to the national strategically important sectors will be highlighted in order to organise the data relevant for the

analysis and to provide grounds upon which to reject or accept the hypothesis. The PESTLE-framework will present the factors that enable the Chinese government to pursue its agenda as well as present external factors influencing foreign companies operating in the Chinese market.
The findings of Part 2 will be utilised in all three analyses in Part 3, Part 4 and Part 5.

Institutional theory

In its broad field, several scholars have sought define institutional theory in various ways. Nevertheless, some consensuses seem to prevail. According to Scott (2008) most scholars dealing with institutional theory assume that institutions are governance structures that embody rules for social conduct. And groups that follow these rules are given legitimacy – a condition contributing to their survival.

According to Scott (1995, 2008) institutions are “cognitive, normative, and regulative structures and activities that provide stability and meaning to social behavior” (Scott 1995:33). Scott (1995, 2008) recognises three elements that form a trinity of institutions. The three elements: cognitive, normative and regulative structures each represent what makes up institutions. Structures within the three categories include legally sanctioned rules, social or moral obligations, taken-for-granted behaviour, implicit knowledge and shared understanding. The three structures or elements never stand alone, institutions supported by one element may, as time passes and circumstances change, be sustained by different elements, thus making them mutually reinforcing. Further, the three elements are dynamic and may change over time or when one of the other elements changes. Thus, the three elements are not static and one element, for instance a normative element, may be affected by a change and take on characteristics of a regulative element. The three elements reflect all levels of society that contribute to the notion of institutions: political structures and the use of authority (North 1990), norms and values, kinship and social class, symbols and gestures that constitute the basis of order (Scott 1995, DiMaggio et al. 1991). Scott (2008) sees institutions operating at multiple levels, from the global economic system to interpersonal interaction. This means that from international political relations to a family of four, institutions play a role.
In the early stages of describing institutions little attention was paid to the role of organisations as an institutional form. However, during the 1950s and 1960s organisations were increasingly recognised as a field of study by e.g. Williamson (1985) and Parsons (1960) and came to be labelled ‘neoinstitutional’ theory or ‘new institutionalism’ (in Scott 2008).
New institutionalism introduces two different approaches to institutions: an economic-based view that concentrates on efficiency and the regulative role of institutions (North 1990, Williamson 1985) and a sociologically-based view that focus on legitimacy (Scott 1995, DiMaggio et al. 1991). North (1990)

emphasises institutions' capacity and constrained behaviour and define institutions as "(...) the rules of the game in a society or, more formally, (...) the humanly devised constraints that shape human interaction" (North 1990:3). North (1990) adds a dynamic aspect to institutional frameworks by arguing that institutional frameworks are made up of both formal and informal constraints. Formal constraints refer to political rules, economic contracts and laws, whereas informal constraints include socially sanctioned norms of behaviour that are embedded in culture and ideology (North 1990, Scott 1995, Scott 2008).

The two different institutional approaches are mutually reinforcing and create a holistic understanding of institutions incorporating both the formal regulatory aspects and the informal socially embedded aspects, consequently not taking a market-based institutional framework for granted (Peng 2002A). In his work, Peng (2002AB) explores the interaction among institutions, organisations and strategic choices. With an 'institution-based view of business strategy' Peng (2002AB) argues that strategic choices are not only driven by industry conditions and company-specific resources but are also a reflection of formal and informal constraints of the institutional framework that companies face. In order to take a holistic approach to how institutions affect strategic choices of organisations, Peng (2002B) incorporates a sociologically oriented view of institutions which is sensitive to institutional transitions in Asia.

Institutions and organisations

The different views in institutional theory are also reflected in the way scholars define the interplay between institutions and organisations. North (1990) observes that institutions provide the rules of the game whereas organisations act as the players of the game. North (1990) furthermore notes that institutional frameworks provide a base upon which choices are deemed acceptable and supportable for organisations (North 1990, Peng 2002A). In line with North (1990), Parsons (1960) claimed that organisations in certain environments are pressured to take the form best adapted to survive in that environment and are pressured to ensure that their goals match wider societal values (in Scott 2008). Consequently, it can be argued that organisations acquire similar formal structures when operating in the same environment. In this way, foreign companies may end up shaping their business strategy in a similar manner in order to adjust to the institutional set-up they face in the Chinese market. Peng (2002A) argues that given the influence of institutional frameworks on company behaviour, any strategic choice that companies make is inherently affected by the formal and informal constrains of a given institutional framework. In transition economies, such as China, Peng (2002A) claims that because of the weaknesses of formal institutions, informal constrains rise to play a larger role in regulating economic exchanges in these countries during the transition. Similarly, Carney (2005) argues that companies adapt to the institutional context they operate in, meaning that they are shaped in a path-dependent manner and influenced by the institutions that surround them. North (1990) argues that strategic choices made by organisations are influenced by the institutional framework and vice versa. Thus, organisations may also influence how institutional frameworks evolve. The reciprocal influence allows institutions to put pressures on social actors to take action in the market. With that pressure social actors are nevertheless given some power that may help them modify their actions which may end creating changes (Scott 2008). This means, on one hand, institutions have influence on how businesses operate in the market and, on the other hand, businesses might be able to use their power as actors in the market to create change that can influence institutional structures. Although a 'bottom-up influence' may at first sight seem an unlikely case in China where the government has a strong visible hand in the market, policy enforcement at lower levels of government agencies, such as county or city levels, might be influenced by interests of local SOEs (Wang 2009). North (1990) suggests that in situations where formal constraints fail, informal constraints will come into play, reduce uncertainty and provide constancy to organisations. Hence, by making sure that organisations follow the basic rules given by the institutional framework, institutions legitimise their authority and help reduce uncertainty for organisations. This can also be argued to be the case for foreign companies operating in China. In a transition economy, creating joint-ventures and tapping into the resources of domestic partners can help foreign companies navigate the uncertain waters of economic transition because foreign companies might have difficulty understanding and relying on the formal institutions of the Chinese market.

Creating legitimacy

It may be difficult to determine where legitimacy arises from, not to say who has the power to state that an act is legitimate or not. The influential sociologist Max Weber (1922) views legitimacy as a source of power that consists of the ability to get your way in spite of others' opposition (in Haralambos et al. 2004). In simpler terms Scott argues that "legitimacy is the proper of a situation or behavior that is defined by a set of social norms correct or appropriate" (Scott 1995:305). In general, scholars tend to agree that the notion of political legitimacy means more than just law and the enforcement of law (Scott 2008, Guo 2006). According to Scott (2008) legitimacy is a central rationale for institutional theory. In his introduction to institutional theory Scott (2008) argues that there are three levels of legitimacy: the regulatory, emphasising the conformity of rules, the normative, stressing a deeper, moral base for measuring legitimacy, and a cultural-cognitive conception pointing to legitimacy stemming from obeying a common definition of a given situation. The three bases do not stand alone but are mutually reinforcing. China is a good example of this, where the economy is partly organised through networks of interdependent and less autonomous economic actors. Furthermore, because of the weak legal framework, actors in the market will tend to rely on informal structures. This supports North's (1990) view that informal constraints come into play when formal constraints fail. Fligstein argues that government is the final authority in legitimating matters, as they have final say over the regulatory controls that allow an organisation to exist or not (Fligstein 2001). Some scholars argue that the state develops its own interests and operates somewhat autonomously from other societal actors (in Scott 2008). Nevertheless, Scott (2008) points out that the state is not just another actor in the market. The state, according to Scott, has an ability to rely on legitimate enforcement of regulation and can exercise authority over organisations (Scott 2008). This makes the state a distinct and powerful governance structure in the market, implying that the overall authority, when it comes to creating legitimacy, is the state. This is much in line with the traditional perception of legitimacy and the role of the state in China as we will see in the Chinese perspective on legitimacy described in the next section.

Scott (2008) argues that institutions and organisations need social acceptability and credibility in order to survive. Legitimacy may also be treated as simply another type of resource that organisations take out from their institutional environment. However, from an institutional perspective legitimacy is a condition reflecting perceived agreement with relevant rules and laws, and alignment with cultural inherited frameworks, and not just another commodity that can be exchanged (Scott 2008).

According to Weber (1922) (Scott 2008, in Haralambos et al. 2004) power becomes legitimised as authority to the extent its exercise is supported by prevailing social norms, whether traditional, charismatic or bureaucratic. Thus, legitimacy is created when the authority is able to enforce the rules and laws of society.

Enforcement

Organisations and trade associations are often used as indicators of legitimacy. "Actors confronting conflicting normative requirements and standards typically find it difficult to take action because conformity to one undermines the normative support of other bodies." (Scott 2008:60). The legitimacy of a given organisation can be negatively affected by the number of different authorities ruling it, by inconsistency in the actions of these authorities as well as the presentation of how it is to function (Scott 2008). This argument applies to agencies at the regional level of the Chinese state. The enforcement difficulties existing at these agencies might reflect a problem highlighted by Scott, namely that legitimacy of agencies can be affected negatively by the function of the authorities above them. Further, inconsistency in their way of enforcing policies can also have a negative impact on their legitimacy. Nevertheless, it can be argued that structures may persist because they are regarded as 'appropriate' by well-established authorities such as the Chinese state, although their legitimacy is challenged by other less powerful constituencies such as the regional agencies and officials in

Chinese provinces and counties. As Scott notes: " "Legitimate" structures may (...) be contested structures" (Scott 2008:61).

According to North "(...) theory of institutions (...) inevitably involves an analysis of the political structure of a society and the degree to which that political structure provides a framework of effective enforcement" (North 1990:54). The level of policy enforcement and laws may be of significant importance for the Chinese government to create and maintain its legitimacy. North (1990) also calls attention to problems that can arise if enforcement is undertaken by agents whose own functions influence outcomes meaning that the third part is not neutral. With this in mind, China has become notorious for its lack of a qualified legal system and its susceptibility to extra-legal influences such as local protectionism and lack of transparency (Barboza 2009, Jacobs 2009, Gamer 2003, Kennedy et al. 2001). Although the Chinese government is placing the combat of corruption in juridical agencies high on the political agenda, continuous international allegations about corruption in Chinese courts may undermine confidence in the Chinese court system in general, thus also domestically. Interests of local government officials that might have links to local businesses, combined with the fact that Chinese courts are not independent from the central government and the Communist Party China (CPC), may also be disadvantageous and result in allegations of corruption and inefficiency (Barboza 2009, Xinhua 2009B). The CPC permeating the legal system in China may "exert influence in areas of ideology, policy and personal matters and thus sway a court to render a verdict in line with the Party policy" (Wang 2009:323).

The Chinese perspective on legitimacy – walk before you run

It is generally acknowledged that the incremental post-Mao reforms have been characterised by "crossing the river by feeling for the stones underfoot" (Goldstein 1996:149).

Ignoring economists' recommendations of the advantages of the big bang approach for socialist regimes seeking to modernise the economy, and learning from the collapse of the Soviet Union, China has pursued an incremental approach to a modernisation of the economy. As North proclaims "history matters" [13] (North 1990:vii). China's incremental and path-dependent opening of the economy is widely known. Similarly, despite western economists' advocacy of rule of law and clear, enforceable property rights to create markets and promote economic growth and efficiency (Coase 1960, Naughton 2007), China has accomplished sustainable economic growth without enforcing these, although perhaps not without market and legal imperfections (Peerenboom 2006). Nevertheless, China is known for its sophistication in maintaining a long-lasting government. Early Chinese philosophers and political thinkers developed complicated theories of political legitimacy that Chinese leaders still resort to today. President Hu Jintao's rhetoric is by no means coincidental. For

[13] A 's' has been added for better understanding. The original sentence is: "history matter" (North 1990:vii).

instance, with regard to governance, his proclaimed philosophy is governing ‘for the people’ not ‘by the people’ (Peerenboom 2006, People's Daily 2008). One of the most influential philosophical systems in China is Confucianism.[14] Confucianism has exerted lasting impact on the Chinese political system and still permeates political ruling today, thus influencing the perception of how the state can legitimise itself and its actions (Guo 2006). The Chinese perception of legitimacy is path-dependent, rooted in its historical and political traditions. Chinese understanding of legitimacy has a strong emphasis on the will of the people and the belief in the government’s role as a provider has enabled rulers in China to play an important and active role in managing the economy (Guo 2006, Naughton 2007). This could be argued to be called a sort of ‘state paternalism’, meaning the ruler is a parent and should rule as such – in line with Confucian philosophy. This role of the state, parenting institutions in the market, might also be a result of the fostering of competition among agencies and other official institutions that ultimately maximises the control by top leaders (Lieberthal 2004). It can be argued that the Chinese legalist ground, as interpreted by a western way of thinking, may seem weak due to the strong influence of Confucianism which emphasises rule by virtue rather than rule by law. In line with the path-dependency apparent in the development of Chinese institutions, Scott identifies institutions as being resistant to change and “transmitted across generations, to be maintained and reproduced (...) [and] inhabited by people and their interactions” (Scott 2008:48). Corroborating this view, Carney argues that governance structure typically shaped by earlier events, being path-dependent, and will often ‘stick’ even when the institutional environment changes (Carney 2005). Thus, development in China depends on the various sticky institutions of a socialist and Confucian past.

[14] Confucianism refers to the teachings of Confucius (551-479 B.C.E) who sought to create the foundation of a harmonious society upon beliefs about human conduct, social values and practice, and the image of the ideal person. The societal values include benevolence, humaneness, and compassion. Confucianism also represents a hierarchical structure in society, distinguishing gentlemen from commoners. Confucius belief-system “intertwines ethics and religion to regulate social behaviour” (Gamer 2003:347). With regard to legitimacy, Confucius believed that the ruler’s virtue and the contentment of the people, rather than power, should be the measures of the ruler’s political success (Guo 2006). For more on Confucius and his teachings see Gamer 2003, chapter 12.

PESTLE – characteristics of the Chinese institutional framework

In this section, the PESTLE will provide a framework to organise data on aspects of the Chinese institutional set-up in a holistic manner. In the PESTLE framework will highlight characteristics of the Chinese institutional set-up relevant to the national strategically important sectors. Factors presented are relevant to both the Chinese government and the foreign company. The PESTLE framework will thus present factors that enable the Chinese government to pursue its agenda as well as the external factors that influence and also enable foreign companies to operate in the national strategically important sectors. Finally, the PESTLE framework provides a frame in which to organise the data important for three analyses and to provide grounds upon which to reject or accept the hypothesis.

Political aspects – policy making and political legitimacy in China

When examining the political aspects of the Chinese institutional framework it seems a necessity to describe political reforms together with economic outcomes as the two go hand in hand. The focus in this section on political aspects will be on the complex political structure that exists in China today, policy making, policy enforcement and international political relations.

Since 1949, the CPC has monopolised political power in China. Presented by Naughton (2007) the tumultuous period of political instability resulted in economic ups and downs. Naughton (2007) describes how each political 'leap' caused great fluctuations in investment, economic output and the design of basic institutions. Each leap caused fundamental problems including shifts in investment and reassignment of workers from agriculture to industry, including the Great Leap Forward,[15] and the Cultural Revolution[16] (Naughton 2007).

The year of 1949 was in many ways a turning point for China. Before 1949, China's economy was mediocre and in the nineteenth and early twentieth century China completely scattered politically as a result of pressures from the west (Gamer 2003, Naughton 2007). The 'socialist era' 1949-1978 presented political reforms that supported the establishment of a planned economic system to effectively make overall national development strategies prioritising heavy industry and SOEs. In late 1978, the 'Mao era' of plan economy was officially over. Since then, the CPC has pursued an open door reform policy transforming the Chinese economy from planned economy into its own brand of a 'socialist market economy with Chinese characteristics' (Gamer 2003). With the goal to create a

[15] Examples of institutional consequences of Great Leap Forward are the establishment of large scale communes, the shutdown of free markets, extreme emphasis on ideological motivation and political repression (Naughton 2007).

[16] Examples of institutional consequences of the Cultural Revolution are the overthrowing of political enemies to Mao Zedong, human capital investment severely disrupted, and universities closed (Naughton 2007).

‘harmonious and well off society’ (Gamer 2003, Washington Post 2006), the transition from plan to market economy means transition at all levels of the economy, thus, also being an institutional transition phase.

The structure of policy making in China – a matrix of power

The decisions made in the regime’s early years about the formal structure of the system have endured even after substantive reforms, policies, and changing allocation of power (Lieberthal 2004). At the center, the highest state organ is the National People’s Congress and the Standing Committee is the permanent organ of the National People’s Congress (State Council 2007). Under the National People’s Congress, the State Council is the highest organ of administrative and enforcement power and is also referred to as ‘the central government’. The State Council is composed of the National Development and Reform Commission, the State Economic and Trade Commission, the Ministry of Finance and the People’s Bank of China that are all working under the term ‘macro-control organs’ (China Info Center 2009).

Even though decentralisation reforms have delegated more power to provincial and local levels, there is an ongoing power struggle between local and central levels (Naughton 2007, Lieberthal 2004). China’s delegated powers can be divided into four territorial entities: center, provinces, countries and cities. The existing power struggles are a result of China being highly compartmentalised and divided along horizontal, territorial and vertical, functional, bureaucratic lines. This creates a complex ‘matrix muddle’ of ensuring effective ruling and policy enforcement with officials having multiple bosses along intersecting lines and across different levels (Lieberthal 2004). The central government encourages competition between the local agencies at the provincial levels. Therefore, these agencies lobby the central government for resources (Goldstein 1996). This has resulted in local governments at times being more devoted to achieve economic development rather than ensuring enforcement of policies that, in the short run, do not add to local economic development, an example being enforcement of national environmental policies (Goldstein 1996). The central government “cannot manage a country the size of China without important tasks being performed at lower levels of the political system” (Lieberthal 2004:166, EU Commission 2010). To ensure correct enforcement of laws, the central government decides which power to be delegated and thus which power to be exercised by province-level units and agencies (EU Commission 2010, Xinhua 2009C). Yet, the provinces are powerful actors in the political system. Although the central government, in theory, can override provincial powers, the provinces are a major source of income for the central government, thus giving local provinces a powerful role vis-á-vis the central government (Lieberthal 2004).

A rationalisation programme for the central government bureaucracy was conducted during the 1990s, cutting the number of ministries in order to decrease state intervention and the number of government employees at central and local levels (Tam 1999). To further legal infrastructure and to ensure enforcement of policies, a program of "Comprehensively Pushing forward Administration in Accordance with Law" was issued in 1999 with guidelines for 2014 that are supposed to establish 'a rule of law' government and 'separate government from enterprises and public institutions' (Zou 2006, Xinhua 2005). Due to the existing authoritarian fragmentation in the system, resolving a matter below the central government level often requires building a consensus among an array of relevant officials. The need to construct a consensus generally predisposes officials to negotiate with other relevant officials from an early point on. Consequently, Chinese policy-making may be characterised by an enormous amount of discussion and bargaining among officials to bring in the right people during decision making processes (Lieberthal 2004).

Rhetoric and political legitimacy

While western scholars may have trouble comprehending the Communist system of legitimisation in the context of Chinese political culture and history, the Chinese government has managed to legitimise itself throughout periods of dramatic changes (Christensen 2008). The Chinese government has demonstrated a high level of adaptability to the changing political environment and, as mentioned, China is known for its sophistication in maintaining a long-lasting government (Guo 2006).

After the 1949 Communist revolution, Communist ideology was crucial to the institutionalisation of the CPC's legitimacy. Without ideology, the Party had no claim to legitimacy. Scott (2008) identifies the importance of communication in constructing and shifting institutional arrangements. Communicative actions have long been used to build legitimacy for new types of practices (Christensen 2008). Accordingly, after the Communist revolution, Mao's writing became a source of legitimacy: "The people, and the people alone, are the motive force in the making of world history" (Marxists Archive 2010). Mao justified the Party's control by saying that "without the efforts of the Chinese Communist Party, without the Chinese Communists as the mainstay of the Chinese people, China can never achieve independence and liberation, or industrialization and the modernization of her agriculture" (Marxists Archive 2010). After 1978, reforms encouraged people to exercise initiatives and make money which consequently can be argued to have made the Chinese people less receptive to Communist ideology (Lieberthal 2004). The reforms opened China not only to foreign investment but also to foreign ideas. As a result, some argue that the Chinese people recognise that the Party misled them for decades about conditions in the industrialised countries of the world (Gamer 2003). Consequently, the economic reforms created strong incentives for local governments to make money for themselves which encouraged local officials to differentiate their own interests from those of the central government. Ideological, value-based incentives for local officials to obey the central government had diminished, thereby undermining the use of ideology as a source of legitimacy-creation (Naughton 2007).

Some scholars suggest that the media[17] are powerful social actors with the authority to legitimise actions (Gamer 2003). In China, the media is state-owned and controlled (Gamer 2003). The Xinhua News Agency (Xinhua) is the official media and press agency of the Chinese government. Xinhua News Agency issues information about laws, regulations and official government communication, thus being the voice of the government. That Xinhua is government owned is not significant per se.[18] However, when placing Xinhua in the proximity of a nation with no free press, it gives rise to credibility criticism (see for instance The Telegraph 2008). Lack of transparency may cause scepticism from outsiders about the Chinese government's way of handling information flows about the Chinese market. Consequently, scepticism from outsiders may result in having an effect on the international political relations to China. Further, the lack of transparency may also limit the access for foreign businesses of knowing 'what goes on in the market'.

As argued, sources of legitimacy for the CPC has long rested on ideology and today the legitimacy of the CPC can be argued to rest on three conditions: rising economic prosperity, social and political stability, and territorial sovereignty (Naughton 2007). The strongest source of legitimacy for the CPC may be argued to have been maintaining high economic growth rates. Some argue that in the future, the reassignment of property rights might be the driving force of China's growth and this shift will require institutional change (Dittmer 2006). The CPC has had to incentivise the economy by reassigning property rights from the state to individuals (EU Commission 2010, Jefferson et al. 2008). Examples include labour market reforms, giving businesses more control over accumulation and use of human capital, corporate governance reform with delegation of managerial control rights, privatisation of state-owned corporate assets, and issuing property rights laws. Some academics and economists (Naughton 2007, Jefferson et al. 2008, Dittmer et al. 2006) argue that while a central planning, socialist, and state-owned system focuses on managing the system by utilising its ownership rights to achieve its economic goals, the capitalist system is structured so that property rights are invested in individuals and private groups. Private ownership creates a continuous need to clarify the rights and mediate the conflicts that arise among individuals and organisations from the exercise of these rights (Naughton 2007, Jefferson et al. 2008). Mediation channels may include: courts, elections, protests, public debate, and legislation. When a system provides these effectively, it is argued to automatically acquire legitimacy (Jefferson et al. 2008). For the CPC to provide these mediation services, some argue that these should emerge from within China's political system, stemming from local not global procedures. Sources of local mediation services could include intra-

[17] Media here includes internet, newspapers, radio, television, published books and movies.
[18] For instance in Denmark the largest news agency Danmarks Radio is government owned (DR 2009).

Party diversity, local elections, independent judiciary, and Non-Governmental Organisations (NGOs) (Dittmer 2006).

Economic aspects – path-dependency and building the economy from within

A trial and error approach

China's transition from plan to market economy has so far been successful when compared to previous performance of economic reform programs such as Eastern Europe and the Soviet Union. China's has avoided the 'Big Bang' approach and pursued and adopted a gradual and incremental strategy for reforms, characterised by "taking two steps forward and – if in trouble – one step back" (Wong 2003:126). Hence, China's reforms have been 'open-ended' and pragmatic. Testing of reforms in selected provinces before implementing nation-wide reforms has been a distinctive trait of Chinese economic reforms.

The modernisation of the economy called for by Deng Xiaoping in the late 1970s has meant continuously high growth rates for the Chinese economy with real gross domestic product (GDP) growth rate above 7% annually (Naughton 2007, BusinessWeek 2009B). Accordingly, privatisation and opening of the economy to foreign investment has been incremental. As a result of the slow, but steady, opening to foreign investment, the Chinese government has pursued a strategy of establishing SEZs where foreign businesses receive favourable treatment such as support to buy land and various special tax breaks (Wong 2003). The SEZs use different institutional structures such as being fully government owned or being public-private operated. The influx of foreign investment has thus been targeted towards carefully selected and government controlled areas, where the Chinese state could pursue a trial and error path to decide just how open the market should become to foreign investment.

The SOEs - building National Champions

Building large indigenous business has been a crucial part of constructing the Chinese economy through the 1990s. During the 1990s a key economic policy slogan of the Chinese state was "grasp the large, let go of the small" (Nolan 2001:3). As soon as the Soviet Union collapsed, deep studies of 'what went wrong' were initiated in China (Pedersen 2009, Sabrinsky 2010). The lessons learned from the collapse of the Soviet Union as well as observation of development experiences of successful late-coming industrial countries and the industrial structure of advanced capitalism inspired China to build strong and large SOEs in selected and economically strategic sectors such as finance, steel, electricity generation, coal mining, and more.[19]

[19] More specifically these sectors included: energy, electricity generation, coal mining, automobiles, electronics, iron and steel, machinery, chemicals, construction materials, transport, aerospace, and pharmaceuticals (Nolan 2001).

The Chinese SOEs are often vertically organised and connected through various links and ties, characterised by interlocking directorates, cross-shareholding, debt and financing relations, and production and management relations. Cross-shareholding is a mean of improving the ties between the SOE and its stakeholders, especially the stakeholders that would otherwise be competitors (Keister 1998). The Chinese SOEs often have several specialised companies supporting the enterprise in e.g. R&D. The core of the SOE is often smaller SOE that has been turned into a limited liability company where the state continues to play a dominant role as the majority shareholder. In this way, the state retains control over SOE stakeholders partly or fully owned by the SOE (Keister 1998). Thus, in line with the Chinese state's slogan: 'grasp the large and let go of the small', the state transfers control from smaller companies to SOEs. The consolidation of SOEs to large enterprises has been vital in the Chinese government's attempt to build strategically important 'National Champions'[20] where the state can "take back direct control and provide preferential treatment so that they have the best chance of survival and growth" (Keister 1998:128). Thus, the Chinese companies are 'trapped' by their previous path and may not be able to keep up with the rapidly changing environment (Keister 1998). Nevertheless, the restructuring of the SOEs has mostly been a managerial reform. This includes transfer of managerial control rights to the SOEs, ownership change, welcoming foreign investment, and the establishment of joint-ventures or shareholding enterprises (Naughton 2007, EU Communities 2008).[21]

In late 2006, the State Council issued a 'Guiding Opinion Concerning the Advancement of Adjustments of State Capital and the Restructuring of State-Owned Enterprises' where it was recommended that state capital is concentrated in "major industries and key sectors (…) [which] include industries involving national security, significant basic infrastructure and major mineral resources, industries supplying important public goods and services, and major backbone enterprises in 'pillar' industries and high and new technology industries" (OECD 2008, Xinhua 2006B). Further, it was proposed that SOEs in national strategically important sectors should be fully owned by the state, that the state should be the majority shareholder or have the controlling stake of the company. Last, but no less important, the SOEs should continue to bring in private or foreign capital (MOFCOM 2006). Another proposal issued the same year, the 'Opinions on Revitalisation of Industrial Machinery Manufacturing Industry' initiated support of an increase in the market share of domestic enterprises in several different sectors by announcing preferential import tax incentives to "raise the core competitiveness and capacity for independent innovation of domestic industries" (OECD 2008, Xinhua 2006B).

[20] The National Champions refer to 120 SOEs operating in national strategically important sectors selected by the Chinese government to represent China abroad. The Chinese government is thus continuously working on making the National Champions competitive enough to internationalise. Bank of China is an example of a National Champion already internationalised (Nolan 2001).

[21] The legal section will deal more with the topic of property rights and rights for managerial control.

Building the economy from within

Although hardly affected by the 1997 Asian financial crisis, the current global financial crisis has had an effect on China. The large economic stimulus package released by the Chinese government in the autumn of 2008, representing roughly 15% of China's yearly GDP (Washington Post 2008), was an attempt to get the Chinese economy through the financial crisis. An attempt that may be argued to have worked (BusinessWeek 2009A). For a long period, China's economic growth has been highly dependent on exports. Nevertheless, the stimulus package had the primary focus of initiating large scale infrastructure projects, increasing the demand for cement, steel and other construction materials, thus stimulating markets that, as in other economies, have been affected by the global economic crisis (BusinessWeek 2009A, Xinhua 2009A). The Chinese economy has traditionally been an export driven economy (Gamer 2003)[22] and since the US is the largest export market for China and the US has been hit the most by the global financial crisis, Chinese exports have also been hit. Nevertheless, by focusing stimulation on infrastructure, China has been able to make the first steps of moving the economy from an export based market to cultivating the economy from within. Funds are to be spent on construction of railways, roads, airports and water conservation projects. An investment example is the Hong Kong-Zhuhai-Macau highway. A bridge and tunnel project connecting 35 ports in the Pearl River Delta to be completed in 2015. The highway will cut driving time from Hong Kong to Zhuhai, one of the strongest economic performance areas in China, from four hours to less than thirty minutes (Elegant et al. 2009). The impressive project may be argued to illustrate the ambitions of the Chinese government to modernise infrastructure. Ultimately, the stimulus package has prevented the Chinese economy from slowing down during the global economic crisis (BusinessWeek 2009A). In May 2009, the Chinese Ministry of Commerce issued a report saying that China wishes to loosen restrictions on foreign investment in China. According to the report, the Chinese government wishes to encourage foreign companies to invest in infrastructure projects, establish R&D centers and upgrade subsidiaries to regional headquarters. The government outlines measures such as improving supporting policies, upgrading infrastructure within SEZs and "make great efforts to create a stable and transparent policy environment (...) and a standardized and efficient administrative environment for foreign investment" (Xinhua 2009C). Further, the stimulus package is another chance for the Chinese government to address the wealth gaps between eastern and western China (Elegant et al. 2009).

[22] That the Chinese economy is based on exports has often been discussed and economists often compare the Chinese economy with the Indian economy which has been based much more on cultivating Indian businesses to build the economy rather than just exporting to larger markets (OECD 2009).

Social factors aspects – policy enforcement and governance

Policy enforcement and governance structures

A key issue in the process of economic change and development is the nature of the state and its relationship to society (Brødsgaard et al. 2000). Oi (2005) uses the term 'local state corporatism' to describe the relationship between the local agencies and businesses. If the local governments or local agencies of central ministries have this kind of relationship to businesses, entailing a possible agenda of developing their own interests, it may be difficult for the central state to impose policies from above (Wang 2009, Oi 2005). Brødsgaard and his colleague (in Brødsgaard et al. 2000) have examined the connectedness between state and society in China focusing on the informal economy. Brødsgaard and his colleague found a clear connection between state and society. Crossing the line, where for instance officials use private channels to get things done or make decisions according to personal relationships and local interests rather than state-set rules, is seen as informal. A large part of the Chinese economy is informal with unofficial business dealings and it is arguably working well (Brødsgaard et al. 2000). An important point here is that even though local agencies are embedded in various informal economic arrangements and institutional arrangements, such as the operation of 'guanxi', the informal economy is not in opposition to the state but rather a part of the economy and operates as an extension of the state. 'Guanxi' which means 'personal relations' or 'network' in Chinese and may be viewed as compensates for systemic inefficiency and institutional weakness. This is important in a business context involving for example Chinese partners. Since networks are an important part of doing business where legal frameworks are weak and thus of an uncertain nature (Peng 2002B).

Ownership and governance

When it comes to defining governance structures in China, China has often been called a moving target (Naughton 2007). China may have been inspired by foreign models, and may have been pressured internally and externally to converge and harmonise the corporate governance system to fit international standards.

Along with the decentralisation process, the problem of low enforcement of restructuring reforms might be further enhanced since Chinese enterprise managers may often act as community leaders with stakeholder objectives. This is also part of what Lieberthal (2004) calls the Chinese central-local schism of 'fragmented authoritarianism'. China's SOE reforms have been characterised by the Chinese saying 'draining the water before the tunnel is ready', meaning that a social security network is not yet in place to take over the responsibilities previously provided by the iron 'rice bowl'[23] (Naughton 2007). Since the SOEs are still burdened with social duties, the Chinese state attempts to get rid of the social burden in SOEs by listing them, thereby reducing the role of the state to that of a shareholder, thus, one with only partial or indirect social responsibility. According to Oi (2005), China's restructuring has been characterised by an overly 'agenda setting government' with a large interventionist role. It may therefore be argued that these pressures and constraints form the path of Chinese leadership.

Confucianism's influence on the political economy

The Confucian value system that has dominated China for over two millennia stresses reliance on leadership by example, not on compliance with formal rules, which have, in the absence of an independent legal system, been associated not with the 'rule of law' but with harsh punishments imposed by a dominating state power (Guo 2006, State Council 2007). One reflection of this is the tendency of the Chinese central government, over many centuries, to enact vague legislation with the explicit intention of allowing local authorities the flexibility to interpret it according to time and place (Guo 2006). Although Chinese law-making is becoming increasingly sophisticated, not least because of the increasingly open process of preparing legislation and a greater readiness to learn from foreign experience, elements of this tradition of deliberate vagueness persist (Guo 2006). With Communist roots of central bureaucratic planning, China may be argued to have developed its very own national system of political economy as well as its own distinctive form of state-led growth. The result is a "hybrid strategy that utilizes capacities inherited from the Maoist state and forms found in capitalist developmental states" (Oi 1995:1132). Thus, China today may be argued to not fit into one simple international political economy theory developed by western academics since the Confucian and Communist legacy does not fit western economic models (Christensen 2008).

Globalisation and foreign company influence

Nevertheless, China may be argued to be influenced by international trends and routines. One area that may be argued to respond to international trends is the shift of corporate governance in Chinese enterprises (Naughton 2007). International NGO's and foreign companies often bring local human resource practices, routines, and codes of conduct to be deployed in their foreign subsidiaries. Opening up to foreign direct investment (FDI), means training of domestic labour used in foreign enterprises that may help upgrade the overall labour force and work conditions within an economy. This means that for instance labour conditions in foreign subsidiaries may improve and have an effect on the governance structure of domestic partners and companies. Further, foreign companies' demand

[23] The term 'iron rice bowl' refers to an occupation with guaranteed job security and social benefits (Naughton 2007)

for improvement of property rights and business environments in terms of standards and regulatory framework may be a source of influence leading to convergence in the Chinese business environment as a whole. Several scholars such as Warner (2002), Gamble (2004) and Carney (2005), have noted that as a consequence of globalisation, foreign companies may influence domestic practices through changes in the labour market, industrial relations and human resource management practices. Warner (2002) refers to these changes as 'soft convergence', and through empirical studies Gamble (2004) found that human resource policies and practices being transferred from headquarters to foreign subsidiaries does have influence on domestic labour and practices of domestic partners, causing for instance changes in labour-management relations.

These trends may also push political agendas such as improved human rights and democracy in the market. Consequently, this bottom-up effect may lead to institutional changes and influence informal institutions and constraints, ultimately affecting the Chinese political system (Naughton 2007, Carney 2005).

Technological aspects – need-driven and 'indigenous innovation'

China's 15-year plan for science and technology

That technological development and R&D expenditure has become a top priority for the Chinese state is no secret. In 2006, the Chinese government issued the ambitious 15-year plan for science and technology[24] that spans from 2006-2020 (Xinhua 2006A). The plan reflects China's determination to not only overcome social and environmental problems through technology but also to become a world leader in innovation. The goal is "to make China one of the world's most important knowledge bases" and the plan represents a technology-driven view of innovation (Xinhua 2006A).

A need-driven R&D policy

China's transition has meant a transition in the driving forces of the economy. Rapid economic growth has also meant rapidly increasing challenges facing China. Technology-driven productivity has become a necessity to help China overcome the challenges of environmental damages, ensuring future demands of water, raw materials, and energy (Naughton 2007). Serger and Breidne (2007) have made an assessment of the plan and term China's R&D policies highly "need-driven" (Serger et al. 2007:159).

Technological development in China has traditionally been driven by a highly bureaucratic and hierarchical R&D structure. According to Serger and Breidne (2007), this plan still represents the

[24] Directly translated from Chinese the plan is called: National medium- and long-term program for science and technology development.

Chinese government's strong belief that innovation can be steered by the government. The 15-year plan for science and technology focus on enterprises and the business sector being the central driving force of the innovation process (Xinhua 2006A).

In order to reach the ambitious goal of high levels of technology proclaimed in this plan, the question of intellectual property rights (IPR) quickly comes to mind. China has had a long-standing strategy of attracting foreign technology and knowledge. The Chinese state's goal has been to raise China's domestic innovative capacity through FDI and the technology transfer expected to accompany these investments (Naughton 2007, Serger et al. 2007). However, the total number of patents registered by China with the World Intellectual Property Organisation remains small (Serger et al. 2007). One important goal of China's technology and research policy has been to establish domestic capacity to produce high technology goods (Naughton 2007). The central government's focus on combining FDI with development of technical expertise is an attempt to lead China through a transition from importing technology, to assimilating technology, and to generating indigenous technology. However, many sectors have not yet reached this goal, meaning that large shares of China's high-tech exports still consist of imported high-tech components assembled in China (Naughton 2007, Serger et al. 2007).

Indigenous innovation

An interesting emphasis in the plan is the aim to "strengthen independent or indigenous innovation" (Xinhua 2006A, Serger et al. 2007:136). If interpreted from a foreign company perspective, this could be understood as having implications for China's openness and a potential concern of 'techno-nationlism' and the protection of foreign IPR in China (Serger et al. 2007). However, Chinese policymakers have been criticising the behaviour of foreign companies in China with regards to demanding unfair licenses for patents and dominating technology standards. Consequently, this has resulted in domestic Chinese enterprises experiencing a crowding out effect of for instance skilled labour and monopolising technology standards. However, the plan aims to establish domestic technology platforms and enable China to lead development in new technology areas. The Chinese government might want to reduce dependence on foreign technology in part because foreign technology dominates strategic areas and perhaps also because it is a question of national prestige.

Implementation and execution

No less than 99 supporting policies have been issued for the implementation of the 15-year technology and science plan (Xinhua 2006A). The supporting policies are all concrete policy tools or action plans for implementation of overall objectives. The 15-year technology and science plan also emphasises the business level as the engine of China's innovation. To ensure the plan's execution, the

Chinese government will increase R&D expenditures and encourage SOEs to utilise these investments in innovative areas such as cleantech or efficient energy technologies. The plan directs local government agencies to support Chinese companies strong in innovation, by purchasing their goods and services. Further, one of the so-called political banks, China Development Bank, has been given the task to provide ‘soft loans’ to high tech companies. This active use of public procurement policies may have implications for foreign companies joint-venturing with domestic companies giving them a competitive disadvantage.

Legal aspects – ‘rule of law’ or ‘rule by law’ and foreign partners

Law-making can be argued to be the main channel for governments to communicate expectations to companies. Law may be used to create a stable, predictable environment conducive to investment (OECD 2008). An aspect that could be argued to affect the Chinese business environment is the state-led corporatisation and restructuring process. Since the early 1990s, state-led corporate restructuring or corporatisation, turning enterprises into shareholding companies has taken place (Oi 2005). With the reform process, the focus on property rights has been increased. The Company Law of 1994 outlines three categories of companies: wholly owned SOEs, joint-stock companies, and limited liability companies, i.e. private companies (Naughton 2007). What is noteworthy here is that in joint-stock companies only a partial listing of assets takes place, meaning that it becomes neither a SOE, nor a private company. The state still holds the majority of shares in these types of companies as well as in the wholly owned SOE, and, at times, hold shares in limited liability companies as well (Naughton 2007, Oi 2005). Regarding structure, the Company Law of 1994 stipulates that “the law promotes shareholder centralism and a two-tier board structure” (Tam 1999:48). China’s leadership has worked hard to make China a member of the WTO. This has required numerous reforms and there has been significant external pressure on the Chinese government to open up the Chinese commercial and financial markets. Furthermore, there has been pressure for China to implement regulations regarding the ‘rule of law’ and governance, a ‘modern corporate system’, as well as restructuring reforms in order to improve the profitability of China’s often ailing SOEs (Oi 2005). The degree to which the state is still entangled with the enterprises is still high - though more subtle than before.

Since trading of state-owned shares and full privatisation is often restricted and banks are state-owned and thereby “often directed by various levels and sections of the government to provide loans to SOEs” (Tam 1999:143), it may be argued that the notion of a free market diminishes. With banks most often owned by the state, the boundaries between financial markets, the state and the company, become blurred. The Chinese government often retain the same control since removal and hiring of principal managers and chairpersons of boards in companies are often conducted by the same officials (Tam 1999). Thus, the lines of roles in governance and control become vague due to lack of transparency in property rights, differing interests and different authorities exercising the same level of influence.

'Rule of law' – 'rule by law'

Despite recent legal reforms, the CPC still retains control of its monopoly power and has, for example, not agreed to govern the Party in accordance with law, but only agreed to a modified notion of 'ruling in accordance with law' (Xinhua 2006D). This can be characterised as 'rule of the Party by law' which may be argued to provide opportunity to intervene in business matters. Hence, there may be a risk of conflicting power centers and thus decreased efficiency. Consequently, it could be argued that the Chinese state may have broader stakeholder interests, i.e. interest in other objectives than the typical shareholder focus on profitability.

China operates under a civil law system, with legislative power flowing downwards from the highest organ of state power, the National People's Congress. According to the Chinese constitution, the National People's Congress and its standing committee exercise the ultimate legislative power of the state (State Council 2004). As such, the National People's Congress is empowered to amend the constitution and supervise its enforcement, as well as to enact, adopt, and amend all fundamental laws in China. Unlike a common law system, China's civil law system relies on statutory laws and interpretations which are "enacted and promulgated by the State" rather than unwritten laws (Wang 2009). Unwritten laws must be confirmed by the State to carry the force of law. The Constitution makes interpretation of the law an exclusive domain of the Standing Committee of the National People's Congress.

Joint-venture – a pot of gold or a trap for the unwary

In China, the options for foreign investment include equity joint-venture, cooperation/contractual joint-venture and wholly foreign-owned enterprises. Since China's WTO accession, the most prevalent form of foreign investment in China is the wholly foreign-owned enterprise. However, this form is not allowed in all sectors, including the sectors defined as national strategically important sectors. In these sectors there is a choice for foreign companies between investment in equity joint-venture or cooperation/contractual joint-venture. Arguably, there are advantages and disadvantages of the requirement of having a Chinese partner. On the plus side, having a Chinese partner may have certain benefits such as local government support, reputation, access to distribution and suppliers. However, there may also be side-effects of having to partner with a potential competitor. In his article on legal issues in China, professor of law Marcus Wang (2009) highlights the potential difficulties for foreign companies entering a joint-venture with a Chinese partner. Wang calls upon, what he terms, the “trap for the unwary” (Wang 2009:314). Wang argues that foreign companies might be surprised that under Chinese law, joint-ventures are considered “Chinese entities established under the Chinese law” (Wang 2009:314). Therefore, foreign companies are considered domestic entities subject to domestic jurisdiction and will only be regarded foreign related if the company retains foreign elements such as one or more person of foreign nationality. If this is the case, the Chinese courts applies to what the Chinese government refer to “one country, two systems”, distinguishing between whether contracts are foreign related or domestic related (Wang 2009:316).

It may be argued that from a Chinese government perspective influx of foreign investment to the Chinese market means attracting new technologies, managerial expertise, and present access to overseas supply and distribution channels. However, from a foreign company perspective, investment in the Chinese market may also mean investing in a market that lack strong IPR regulation, meaning that once resources or capabilities are transferred they may be lost to a competitor (Naughton 2007).

Property rights embodied in all of the people

Economists often emphasise missing IPR and lack of labour quality as missing in markets in transition economies (Naughton 2007, Jefferson et al. 2008). An argument put forward by Jefferson and Zhang (2008) is that China’s rapid growth has long been driven by reassignment of property rights from the state to individuals (Jefferson et al. 2008). They argue that the reassignment of property rights is transforming the central function of the political system: “from that of managing growth to that of clarifying and mediating property rights” (Jefferson et al. 2008). They argue that inequality, corruption, and environmental degradation are all associated with high growth and requires mechanisms that can mediate, and help solve, these consequences. Accordingly, the process of ‘clarifying and mediating property rights’ requires mediation channels such as courts, elections, protests, public debate, and legislation (Jefferson et al. 2008).

Any corporate governance system specifies the distribution of rights and responsibilities among different participants in the corporation: private equity owners, public shareholders, managers, government (Thomsen 2008). A feature of a socialist economy is that property rights are embodied in the state or “all of the people” (Jefferson et al. 2008). Hence, managers do not have the ability to reward high quality labour. The fact that managers do not have this authority, results in a market imperfection, or a non-existent market in labour quality and labour services. Labour quality and services are thus exchanged on the basis of quantity, not quality (Naughton 2007, Jefferson et al. 2008). Jefferson and Zhang (2008) emphasise that the solution to this problem should be an ‘institutional solution’. The transfer of property rights will require a clear assignment of managerial control that can then monitor and reward workers for their skills. This, Jefferson and Zhang (2008) argue, will raise the efficiency and welfare of the system.

Environmental aspects – government initiatives and the cost of going green

The past decades of economic growth in China has not only meant economic prosperity but also an exponential growth in environmental damage. Rapid industrialisation and heavy industry has been major drivers of China's economic growth. The pressure of a large population on China's limited resources has led to severe environmental damage. Between 1953 and 1978 per capita production of coal quintupled and 38% of total gross output in this period was in metal and machinery, consequently bringing a great deal of pollution in its wake (Naughton 2007).

The Kuznets Curve

According to the 'Kuznets Environmental Curve',[25] developed by Nobel Laureate Simon Kuznets (1941), environmental problems worsen during the early stages of economic growth but will improve as a country improves its income status. The Kuznets Curve shows a relationship between economic growth and environmental quality as an inverted U-shape. According to the Kuznets Curve, economic inequality decreases over time as a country develops. On top of the curve, at the peak of the inverted U-shape, when a critical average income is reached, economic inequality will begin to decrease. The Kuznets Curve has also been referred to in terms of state's concern for the environment. The basic argument for the shape of the curve to be an inverted U is that in developing industrial economies, little concern is given to the costs of economic growth (Naughton 2007, World Bank 2007). At a point, at the top of the curve, when there has been economic growth and the economy has reached a certain level of living standard, and pollution is at its greatest, focus will change from economic growth and GDP figures, to social costs such as pollution of water and air. It is argued that developing nations will skip some growth and pollution stages by early adoption of cleaner technologies and developing regulatory institutions to control pollution (Hayward 2005). Some critiques believe that the Kuznets Curve is not 'statistically robust' (Hayward 2005), however, some also believe that it is a good tool for organising a discussion on environmental problems in developing economies, such as China, which has been argued to be an 'ideal test case' (Naughton 2007, Hayward 2005).

[25] Hereafter referred to as 'the Kuznets Curve'. The Kuznets Curve was originally developed by Simon Kuznets to show that income inequality first increases and then declines with economic growth. In the 1990s, scholars applied the Kuznets Curve to the environment. The Kuznets Curve received acceptance as a key development concept, for example by the World Bank (Hayward 2005).

Government initiatives

Before the picture is painted pitch black it is worth to take a look at how China is trying to overcome these challenges. Economic growth is a major driver for the Chinese government, however, it may be argued that environmental costs, especially water availability, could be a driver for the Chinese government to act on environmental protection.

After 1978, China began to take advantage of its abundance of labour and moved into more low-tech, labour intensive industries such as textile that had been neglected during the planned economy. The move from heavy industry to less energy intensive, light industry meant less energy intensive and polluting production. Not only the creation of “industrial deepening” (Naughton 2007:330), but also FDI and the newer, less polluting and more advanced technologies that consequently follows, helps to move industries upwards in the production chain to less polluting industries. Technology is an important factor helping China to improve its environment, in energy efficiency, water preservation and air pollution. China's creation of SEZs and openness to FDI has resulted in inflow of and spill-over from advanced technologies, improving production efficiencies to increase environmental protection.

The Chinese central government is clearly addressing the challenges of economic growth. The 11th five-year plan and the 15-year plan for science and technology set ambitious goals to protect the environment. In the 11th five-year plan China has set the target of achieving more sustainable growth through increasing energy efficiency (State Council 2007). To illustrate this change there has, in the past decade been a growth in national environmental policies and environmental government agencies. Environmental issues have indeed become a high priority. In 1998, the State Environmental Protection Administration, now the Ministry of Environmental Protection was formed (Naughton 2007). Projections say that by 2010, 1.6 % of China’s GDP will be spent to control pollution (World Watch Institute 2006). However, foreign critics argue that the entanglement of regional officials with local enterprises that has had the consequence of poor enforcement of environmental standards is partly due to local government’s own interpretation of laws that encourage investment in environmentally-friendly industries (EU Commission 2010). Nevertheless, China is ‘going green’ and has created a system of charging fees for pollutants, encouraging companies to find methods to improve their environmental performances (Naughton 2007, Hayward 2005). Further, one might argue that the largest contribution to national and global environmental protection is the one-child policy that has decreased population growth immensely in China and thus also on a global scale.

The costs of going green

At the same time, there is also a cost of going green. In 2008 China banned free handouts of plastic bags. This caused 20.000 workers being laid off at China's largest plastic bag producing plant (World Bank 2008). In 2007 the World Bank made an attempt to calculate the costs of pollution in China. The study found that total air and water pollution costs were estimated at 8% of GDP yearly (World Bank 2007). Just as economic growth does come with costs, creating 'green GDP' also have its costs. It may be argued that true economic growth should also calculate in the costs of economic growth, not only GDP. If the costs of environmental damage are so high that you are damaging the efficiency of workers and usage of land, undermining the progress being made toward higher quality of living standards, one should question whether the GDP indicator can give a true picture of the level of successful economic growth (World Watch Institute 2007).

Sustainability perception

"Perhaps environmental quality is a luxury good, and demand for it increases more than proportionately as income grows. Even so, if citizens have no way to convert their preferences into effective demand and command over society's resources, it is hard to see a consistent motive force behind environmental improvement" (Naughton 2007:502). Notably, a search in the Chinese encyclopedia 2007[26] on 'sustainability' achieved no match or findings. [27] Instead, the rhetoric used by the Chinese government resembling sustainability is 'recycling economy' or since 2008 'circular economy' (State Council 2007, The National People's Congress 2008). Circular economy refers to "a new production mode and living style focusing on resources utilization and re-use, and optimization of energy" (State Council 2007) or "reducing, reusing and recycling activities conducted in the process of production, circulation and consumption" (The National People's Congress 2008). In comparison, the perception of sustainability in the west may be argued to not resemble the Chinese perception. The European Commission has integrated sustainability as a part of most policies, exemplified in the goal of developing a low-carbon economy. The European Commission defines sustainability as a strategy driven by social responsibility and business creation (EU Commission 2010A), thereby distinguishing sustainability in the west from China's focus on reducing, reusing and recycling activities.

[26] The China encyclopedia is an e-book issued each year by China Intercontinental Communication Center under the supervision of the State Council Information Office, P.R. China.
[27] Both 'sustainable' and 'sustainability' were entered.

Sub-conclusion to Part 2

Having gone through relevant areas within institutional theory it was found that understanding the importance of institutions in the Chinese market is vital for getting the overall picture of the institutional set-up that the Chinese government and foreign companies operates in. The PESTLE framework helped to organise aspects of the Chinese market relevant to the national strategically important sectors. It was found that aspects of the Chinese economy affecting both the Chinese government and the foreign companies' strategy and action in the Chinese national strategically important sectors are played out in formal and informal structures of the Chinese political system.

It was found that creating legitimacy is of outmost importance to the CPC and the Chinese government to maintain its one-Party rule. The Chinese perception on legitimacy was argued to be incremental, path-dependent and rooted in its political traditions. The influence of Confucianism still plays a large role for the political ruling today and influences the strong emphasis on the will of the people and the belief in government's role as a provider acting out a kind of state paternalism.

The Chinese government encouraging provincial level agencies to compete was found to possibly create tension between local agencies and between the central government and local agencies. The political struggles may challenge the Chinese government's legitimacy. However, regardless of possible political struggles, and that legitimacy of the central government may be challenged by the regional agencies, the CPC still retains control of its monopoly power and has not agreed to govern the Party in accordance with law, but only agreed to a modified notion of ruling in accordance with law as in 'rule of the Party by law'. Therefore, the overall authority in creating legitimacy is the state, as the state has an ability to rely on legitimate enforcement of regulations and can exercise authority over organisations.

It was found that SOEs operating in pillar industries carefully selected by the Chinese government as national strategically important sectors is an example of industries that the Chinese government uses to cultivate National Champions, subsidising preferential tax incentives to raise competiveness and independent innovation. Even so, it was found that the backside of being dominated by state as shareholder may result in the SOEs being trapped by their previous path, not able to keep up with the rapidly changing environment. However, the SOEs in the national strategically important sectors are conglomerates of several enterprises, spanning from supermarkets to banks. This results in a 'one country, two systems' approach, separating the SOEs from foreign companies consequently creating benefits for SOEs that are hard for the foreign companies to compete with. It was found that this complex structure and tight relation to government of SOEs may create transparency issues in the Chinese market, blurring the lines of roles in governance and control. The lack of transparency may create political matrix muddles that leave bottlenecks for policy enforcement.

Important to the national strategically important sectors it was found that Chinese government policies require foreign companies operating in national strategically important sectors to transfer knowledge and technology from the foreign company to a Chinese enterprise SOE or supplier. Partnering with a Chinese partner was found to possibly have both positive and negative consequences for the foreign companies. One positive effect is gaining access to local government support, to reputation, and access to suppliers. On the negative side, partnering with a SOE, means giving away core competencies and, in accordance to Chinese law, become regarded as a Chinese entity. Thus, operating in the Chinese national strategically important sectors was found to potentially become regarded as either a pot of gold or a trap for the unwary foreign company.

From the institutional theory section it was found that elements from all levels of society contribute to the making of institutions. When one element or structure in society is changed it will affect other structures of society, thereby changing the institutional set-up. This means that institutional set-ups exist of elements from society that are mutually reinforcing and dynamic.

One change identified is the Chinese government initiatives to make it attractive for foreign companies to invest in the market despite the regulation at times creating disadvantages for foreign companies. R&D is a top priority for the Chinese government. The issuing of the 15-year science and technology plan was found to be driven by a desire of the Chinese government to create innovation driven by technology and also by mounting needs for initiatives for environmental protection.

Chinese government initiatives taken to attract FDI were found to also bring international routines and requirements of standards. Along with international integration comes external influence and pressures from both foreign governments and foreign companies. These pressures creating a bottom-up trend of soft convergence was found to possibly lead to institutional changes and influences of informal constraints in the market, which ultimately may affect Chinese government policies. However, it was also found that the Chinese government is fully aware of this bottom-up effect and therefore may be argued to maintaining full control.

The next two parts will examine the two perspectives of the Chinese government and the foreign company. Findings from Part 2 will be utilised in the following three analyses. In Part 3, the hypothesis will be examined from the perspective of the Chinese government focusing on which aspects of the Chinese institutional set-up the Chinese government brings into play to strategically use foreign companies to upgrade their own. In Part 4, the hypothesis will be examined from the perspective of the foreign company focusing on how the foreign companies can navigate the Chinese institutional set-up and how the foreign companies can avoid being crowded out of competition, despite transferring know-how and technological skills.

Part 3 The Chinese government perspective: strategy for welcoming foreign companies

Part 3 will wear the glasses of the Chinese government to examine how, and if, the Chinese government strategically uses foreign companies to cultivate domestic enterprises.

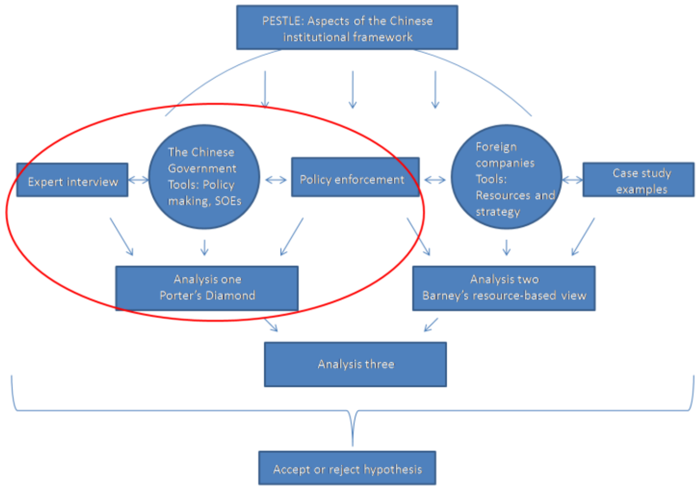

Figure 3: Illustration of the methodological approach focusing on the Chinese government perspective.

As illustrated in figure 3, the analysis in Part 3, analysis one, will draw on aspects of the Chinese institutional framework important to the Chinese national strategically important sectors from the PESTLE framework in Part 2 as well as findings from the expert interview. The expert interview will help to verify and contribute to the findings relating to the Chinese government perspective. The data from Part 2 will be applied to the theoretical considerations of Porter's Diamond (1990, 2003). Porter's Diamond will be applied somewhat different to the traditional application. Porter's Diamond will provide a theoretical perspective and be used as a framework to analyse the factors that may enable the Chinese government to employ elements of the Chinese economy to strategically use foreign companies. Porter's Diamond is divided into four interlinked factors and activities that can be influenced pro-actively by governments (Porter 1990). The division of factors will help to apply data about the Chinese institutional framework to Porter's theoretical factors that ultimately will enable an understanding of the policy enforcement from the perspective of the Chinese government. At the same time, Porter's Diamond will present external factors influencing foreign companies operating in the Chinese market applied in analysis three in combination with the foreign company perspective from analysis two.

According to Michael Porter, competitiveness is "(…) measured by productivity. Productivity allows a nation to support high wages, a strong currency, and attractive returns to capital – and with them a high standard of living" (Porter 2003:31). Productivity and innovation is a key concept in Porter's theories on competitiveness. It is companies' abilities to develop new business activities or expand already existing business segments that help them achieve a competitive advantage in industries. Further, Porter (1990, 2003) argues that companies should be able to compete freely with as little government interference as possible. This, he argues, helps foster an innovative business environment, where companies succeed based on their ability to create a competitive advantage instead of favouritism on the part of government, which, according to Porter (1990), distorts true competitiveness. Clusters of interconnected companies, suppliers, and institutions affect competitiveness by increasing productivity of industries, giving companies more efficient access to information, suppliers, and competitors, thereby increasing innovation and productivity growth and stimulating new business formations (Porter 2003). Porter (2003) provides the government with a substantial facilitative role in relation to industry clusters, arguing that clusters are not only a tool for managers but also governments in promoting economic development. To Porter (1990, 2003) the concept of clusters is broad and includes companies, suppliers, customers, trade associations, and government agencies. Hence the concept of clusters can also be applied to the Chinese SEZs.

According to Porter (2003) nations at different levels of development face different challenges. Thus, competitiveness is not a simple linear process but one where nations at different levels of development face different challenges and priorities (Porter 2003). Stable political, legal, and social institutions as well as sound macroeconomic policies create the potential for improving national prosperity. Wealth, however, is produced at the microeconomic level, in the business environment. However, according to Porter developing countries often fail to acknowledge this, "in developing countries, microeconomic failures nullify macroeconomic and social programs again and again" (Porter 2003:30).

Thus, in order for successful economic development to occur, companies in a nation must continuously upgrade their ways of competing. Porter's Diamond offers means of identifying the competitive as well as the uncompetitive conditions of business environments in a national framework.

Porter's Diamond – helping to understand the competitive conditions of nations

According to Porter (2003, 2009) within the Diamond framework, no single policy or element can create competitiveness, "almost everything matters for competitiveness" (Porter 2003:32), including schools, roads, financial markets or a nation's institutions, people, and culture. Accordingly, Porter (1990) argues that the way for a nation to achieve international success in certain industries relies on four determinants of national competitive advantage: *factor conditions*, *demand conditions, related and supporting industries,* and *firm strategy, structure, and rivalry*. In addition, Porter (1990) argues that two additional variables influence national competitive advantage. These are *the role of government,* and *the role of chance*. Thus, the Diamond consists of six parts as illustrated in figure 4. All parts are interrelated and mutually reinforcing, meaning that a change in any of the six aspects may influence positively any of the other parts if these are adequately prepared to cope with this change. It naturally follows that a negative change in terms of competitiveness in any part may also influence any of the other parts, regardless of whether the other part is prepared for that change or not.

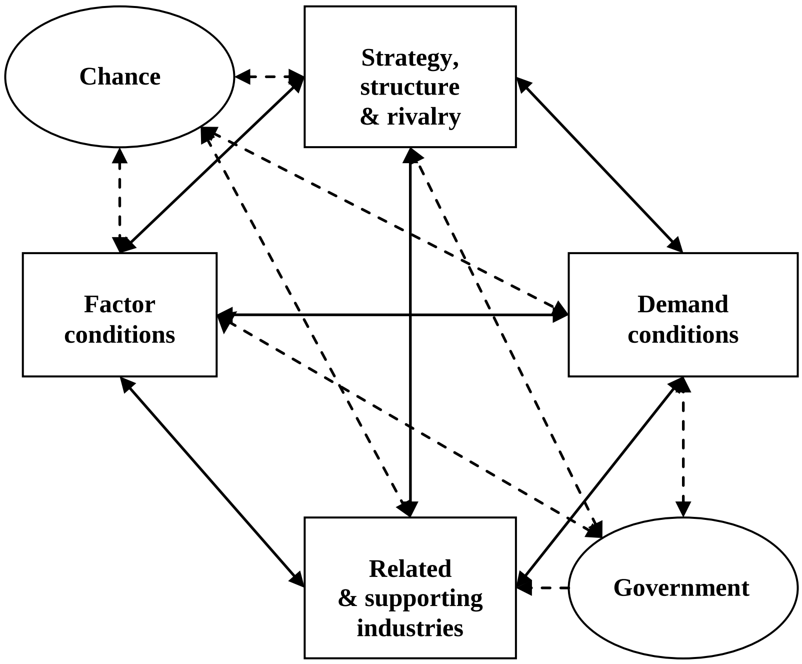

Figure 4: Porter's Diamond (Porter 1990).

Factor conditions – the nation's production factors

Factor conditions cover a nation's production factors, for instance the presence of people with skills required to work in a specific industry or capital required for production. An abundance of highly skilled labour as a knowledge resource is, according to Porter (1990), an important competitive advantage as it can enable companies to research and develop new or better products. Insufficiently skilled labour or a shortage of required capital impedes innovation in an industry. Another example of a factor condition can be infrastructure such as transportation systems and institutions e.g. SEZs. The location of the SEZs can thus also be a factor condition. Porter (1990) argues that a private sector is a necessity to create factor advantages in most industries. As described in Part 2, Chinese government policies require foreign companies operating in national strategically important sectors to partner with local companies. This includes transfer of knowledge and technology from the foreign company to the Chinese enterprise. Accordingly, it may be argued that when the Chinese government invites (private) foreign companies into national strategically important sectors, it may be a contribution to factor creation in these sectors, resulting in both a private and a government contribution to factor creation. Although China's greatest endowment factor has for many years been abundance of low-wage labour which has resulted in the Chinese economy being mainly export driven, this tendency is changing. As described in Part 2, the stimulus package that the Chinese government issued in 2008, has helped China take the initial steps of moving from an export-driven economy to now cultivating the economy from within. Apart from issuing the stimulus package, the Chinese government is taking other steps towards changing its factor conditions. As Porter (1990) argues, the competitive advantage from factors will depend on the efficiency with which they are deployed. By relaxing certain regulations toward domestic enterprises in the national strategically important sectors, the Chinese government is for instance seeking to upgrade local or 'indigenous' innovation through foreign investment.

Demand conditions – domestic or foreign driven demand

This determinant describes the home demand in an industry. At the most basic level, this simply means how much domestic demand for a given product or service there is. However, Porter (1990) makes a distinction between the quality of home demand and the quantity of home demand. Home demand has a high quality if it drives companies to innovate and develop new or related products or services. This demand need not to be high in terms of numbers, not when competitiveness is concerned as companies who succeed in their domestic markets. These can often find more demand in other markets, enabling them to achieve an international competitive advantage. Similar to this argument, Dunning (2000) suggests that when a company possessing ownership specific advantages (O-advantage) internationalises, the O-advantage may provide the company with a favourable position compared to their competitors. O-advantages refer to unique and sustainable competitive advantages not possessed by competing companies of other nationalities (Dunning 2000). This means, that Dunning (2000) assumes that once a company possesses O-advantages, this advantage can provide advanced levels of performance for a sustained period of time due to it being unique, making it somewhat static.

Porter (1990) argues that sophisticated and demanding buyers lead to innovative companies. Accordingly, the evolution of the middle-class in China may put pressure on Chinese companies to innovate and develop new products and services. The 15-year plan for science and technology described in Part 2 shows that R&D is a top priority for the Chinese government. The goal of making

China one of the world’s leading knowledge bases is not only driven by a desire of the Chinese government to create innovation driven by technology but arguably also by mounting needs for initiatives for environmental protection. Thus, the demand and need for environmental upgrading is a factor pushing the Chinese government to focus on developing strong innovative environments within industries such as cleantech, renewables, production efficiency, and biotech. However, as argued in Part 2, the 15-year plan for science and technology bear traits that the Chinese government fully believes innovation to be directed by the government. Although the plan highlights business environments and enterprises ideally being the driving force for innovation processes, enforcement and implementation of the plan have strong focus on business sectors and industries with state monopolistic enterprises such as the SOEs operating in the national strategically important sectors.

Although not directly mentioned by Porter (1990), foreign companies operating in the Chinese market may also have an influence on domestic demand. China’s incremental opening to foreign investment also means opening to the demand of foreign companies operating in the Chinese market. When multinational corporations (MNCs) establish subsidiaries, foreign companies will naturally bring with them basic requirements for operating in the market such as transportation needs, labour condition requirements, demand for skilled labour, minimum requirements for regulatory frameworks and stable policy enforcement. Thus, foreign demands can be argued to be a demand helping to upgrade conditions in the Chinese market bottom-up. As described in Part 2, the report that the Chinese Ministry of Commerce issued recently gave clear indications that the Chinese government is fully aware of this bottom-up effect. As argued in Part 2 this bottom-up trend of soft convergence might lead to institutional changes and influences of informal constraints in the market, which ultimately may affect Chinese government policies. An example is the environmental and sustainability standards that some foreign companies bring when operating in the Chinese market pushing the institutional set-up to adjust the foreign company demand. These demands might be used as an opportunity for the Chinese government to upgrade for instance environmental protection, thus meeting the need in China as well as the demands from foreign companies. Accordingly, the Chinese government place focus on creating stimulating business environments for foreign companies to invest in infrastructure projects, establishing R&D centers, and setting up regional headquarters. Porter (1990) does emphasise that due to distance from headquarters, companies operating in international markets do not have insider knowledge or access to the markets, making it harder to determine domestic demand in the international market and this consequently creates disadvantages for foreign companies.

Related and supporting industries – SOEs supplying to or partnering with foreign companies

Porter (1990) argues that an important benefit of domestic-based suppliers is the process of innovation and upgrading. Porter (2003) says that supplying or similar industries within a nation may help companies obtain a competitive advantage. If suppliers provide companies with parts, machinery or services that are superior in terms of quality, features or at a low cost, companies are able to price their product or services at a competitive price. Further, Porter (1990) argues that "suppliers help firms perceive new methods and opportunities to apply new technology. Firms gain quick access to information, to new ideas and insights, and to supplier innovations" (Porter 1990:103). Reversing this argument it may be applied in a Chinese context. Through SEZs and in national strategically important sectors, the Chinese government has constructed an environment beneficial for domestic Chinese companies. Being suppliers to or partners with foreign companies means gaining access to foreign companies' methods and technology. As Porter (1990) argues, working jointly on R&D issues lead to more efficient solutions. When innovation and R&D is transmitted through companies in an industry, e.g. through supplier relationships, the whole industry is upgraded. If using Porter's (1990) idea of clusters as an analogy and view SEZs as clusters, SEZs reduce communication errors and other transaction costs due to proximity to other companies operating in related industries. Further, it may be argued that the structure of the Chinese political economy of horizontal and vertical relations making a matrix may be viewed as a cluster of related and supporting institutions and organisations making operation of the Chinese economy possible to the Chinese state. Thus, the matrix might not be a muddle of complication but instead giving flexibility for the Chinese government to efficiently operate across several levels of the economy at one time.

The Chinese national strategically important sectors are still heavily monopolised by SOEs. As described in Part 2, SOEs are often conglomerated by several enterprises spanning from supermarkets to banks. Thus, when the Chinese Political Banks such as the Chinese Development Bank gives soft loans to SOEs operating in national strategically important sectors, this can be argued to be an example of a supporting industry or firm. As described in Part 2, this results in a 'one country, two systems' approach separating SOEs from foreign companies in the market consequently creating benefits for SOEs that are hard for the foreign companies to compete with.

Firm strategy, structure, and rivalry - using the SOEs to gain national competitiveness and to promote economic growth

According to Porter (1990), three elements help determine if an industry becomes competitive: the strategies that companies implement, their organisational structure, and the domestic rivalry. Yet, each of the three elements contains a large number of deciding factors. If being competitive in a particular industry is a matter of national pride, perhaps even national independence, this may inspire companies to compete and they may be aided by sustained investment to help achieve this. Arguably, as demonstrated in Part 2, SOEs operating in pillar industries carefully selected by the Chinese government as national strategically important sectors as National Champions is an example of industries representing national pride. It is also industries that the Chinese government uses to represent as nationally independent, subsidising preferential tax incentives to raise competiveness and independent innovation. Yet, the backside of being dominated by the state as a shareholder may result in the Chinese companies being trapped by their previous path and not being able to keep up with the rapidly changing environment as described in Part 2.

Porter (1990) argues that in relation to firm strategy, structure and rivalry national management traditions as well as corporate and personal goals also factor in. An example of this related to the Chinese market could be the influence of CPC membership as a tradition for top managers at Chinese enterprises. According to Kjeld Erik Brødsgaard around 90% of top level officials and chief executive officers (CEOs) are CPC members and circulate in jobs via a ‘nomenclature list’ held by the central committee and the CPC (Interview KEB 2010).[28]

According to Porter (1990), labour management relationships, the ability to coordinate across functions, and the way companies collaborate with suppliers and stakeholders play an important role in shaping innovation and productivity within an industry. As mentioned in Part 2, it is worth noticing that the Chinese government is continuously reassigning property rights from the state to individuals, especially through labour market reforms, giving businesses managerial control over human capital and corporate governance, enabling businesses to shape innovation and productivity. These measures are argued to raise efficiency and welfare of the system (Porter 1990, Jefferson et al. 2008). However, the question is whose efficiency is being increased. Arguably, allocation of managerial rights might not make that big a difference if the Chinese state can still overrule managers in SOEs whenever needed, making the reassignment of property rights a pro-forma act. Neither the foreign company needs will necessarily be met by this increase in efficiency. More likely, these measures of reform are to give the Chinese government more flexibility to operate SOEs as yet another part of the economic system. Companies’ organisational structures as well as their management practices, e.g. corporate governance, are important as they indicate how companies conduct themselves both internally and externally. Internally, when motivating employees and externally in their dealings with customers, investors, suppliers, authorities, and their competitors. As mentioned in Part 2, along the state-led corporate restructuring reform processes, the focus on property rights have increased, nevertheless the degree to which the state is still engaged in enterprise management is still high. As revealed in Part 2,

[28] According to Kjeld Erik Brødsgaard, the CPC unofficially holds a nomenclature list containing the names of CPC members that qualifies for top level positions in government agencies or SOEs (Interview KEB 2010).

a feature of a socialist economy is that property rights are embodied in the state or ‘all of the people’, consequently defining the governance structures in China. As found, there is a clear connection between state and society in China and crossing that line, you move into the informal economy that is transparent to all citizens, not regarded as an opposition to the state but rather a part of the economy, and operates as just another tool for the government to use when necessary. Governance in China may thus not be easily defined but operates in a zone grey to outsiders.

Chinese strategy, structure and rivalry

According to Porter (1990), in a market economy companies that are transparent in their dealings with investors, suppliers and authorities must be said to be more reliable and therefore more likely to succeed. Domestic rivalry is a source of competitive advantage if, as Porter (1990) argues, companies compete on equal terms in the market, creating new products or services in order to outperform competition. As revealed in Part 2, lack of transparency in the Chinese market blurs the lines of roles in governance and control. The lack of transparency might prevail due to ‘institutional problems’ such as fragmented authoritarianism as described in Part 2 as well as limited transfer of property rights. This is very much in line with North’s (1990) argument concerning the degree to which political structures provide a framework of effective enforcement and the problem that can arise if enforcement is undertaken by agents that are not neutral, but instead influence outcomes. If viewing SOEs as an agent that influences outcomes, this may be exemplified in the way that the Chinese government retains control over management of SOEs by not fully transferring the rights for managers to be in charge of daily management, including hiring, firing and rewarding. By retaining this control, the Chinese government holds the governance of SOEs within the walls of the central government, consequently blurring transparency further, thereby leaving outsiders in the blind to compete on unequal terms, resulting in, using Porter’s analogy, ‘an undynamic market not likely to succeed’ (Porter 1990).

With this in mind, it may seem natural to conclude that Porter would not believe that the Chinese National Champions are competitive due to having been subsidised and protected by the government. However, Porter also argues that “where an industry becomes a notable occupation or takes on national importance, competitive advantage often results” (Porter 1990:114). Further, national priority can be attached to not only industries but also to issues that affect many industries. The Chinese national strategically important sectors and the National Champions are exactly an example of such influence of national prestige or priority that affects industries.

The Chinese slogan of grasping the large and letting go of the small is evidently not a path to take if following Porter’s example. As described in Part 2, the Chinese SOEs are often vertically organised and connected through various links and ties, in a matrix muddle characterised by interlocking directorates, cross-shareholding, debt and financing relations, and production and management relations.

As revealed, R&D and innovation is a top priority for the Chinese government. Consequently, the 15-year plan for science and technology, mentioned in Part 2, focuses on innovation through public spending and top-down steering to ensure that current needs or lacks in the Chinese economy are met. The emphasis to stimulate independent or indigenous innovation to avoid domestic SOEs being crowded out by foreign companies with superior technologies is not in line with Porter's definition of innovative origin. Porter argues: "domestic rivalry not only creates pressures to innovate but to innovate in ways that *upgrade* the competitive advantages of a nation's firms" (Porter 1990:119). Porter's (1990) argument that innovation is a result of domestic rivalry does not seem to be a line of thinking adopted by the Chinese government. This means, if thinking in Porter's terms, controlled innovation will lead to insufficient growth due to lack of competitive environment and companies exiting the market as a consequence (Porter 1990, Porter 2003). However, China's eager determination to overcome growing social and environmental problems through technology by becoming a world leader in innovation as described in Part 2 has so far resulted in an increase in China's domestic innovative capacity through FDI and the technology transfer from foreign companies. As found in Part 2, foreign companies in China demand licenses for patents and technology standards, making the Chinese government fear domestic Chinese enterprises experiencing a crowding out effect of for instance skilled labour and monopolising technology standards. Nevertheless, as a result of issuing the economic stimulus package, the Chinese government's strong belief that innovation can be steered by government and the strategic opening of national strategically important sectors to foreign investment may work for the better for the Chinese economy. By opening the national strategically important sectors at the same time of issuing the economic stimulus package the Chinese government encourages foreign companies to invest in infrastructure projects. At the time of issuing the economic stimulus package and the consequent opening of certain sectors also lead to the Chinese government encouraging foreign companies to upgrade existing subsidiaries to regional headquarters and R&D centers. The Chinese government did this by improving the investment environment by upgrading supporting policies increasing transparency and administration efficiency. Only time will tell whether the method of stimulating innovation through controlled and need-driven steering adapted by the Chinese government will succeed or not.

Strategy, structure and rivalry causing for changes in the economy

Porter (1990) argues that companies' organisational structures and strategies are path-dependent. Representing a crucial part of the restructuring of the Chinese economy in the 1990s, the large SOEs in the national strategically important sectors are a result of the Chinese government deep and long studies on ‘how to do it right’ or ‘not to do what the others did wrong’. Porter (1990) argues that the goals of a company are strongly influenced by its ownership structure, and that companies’ organisational structures and strategies are path-dependent. As mentioned in Part 2, there is an ongoing struggle between central and local levels as a result of a matrix muddle of horizontal and vertical bureaucratic lines. Operating in this matrix of power, SOEs are highly influenced by government structures and, as mentioned in Part 2, perhaps trapped by this proximity but at the same time also provided with preferential treatment.

Interestingly, in relation to this, the central government, as described in Part 2, encourages competition between local provincial agencies. Just in accordance to Porter’s (1990) recipe of creating efficiency the Chinese government encourages competition at local official levels, however, is more reluctant to encourage competition when it comes to the company level.

The SOE-government interdependence not only inter-relates the SOEs to the political arena in China but makes them an integrated part of policy making and policy enforcement. It may even be argued that the central government is merely using the SOEs as a tool to enforce and policies to achieve economic growth, thereby placing the SOEs at the same level as any of the other macroeconomic organs such as the ministries and commissions. This would mean that managers of SOEs are still controlled by state albeit transferred managerial control. Despite controlling daily management, the state has the overall authority to overrule and decide expenditure and investment on behalf of the SOE.

As mentioned in Part 2, SOEs are interlinked with other SOEs and officials through for instance cross-shareholdings or board members, making their ownership structure highly connected to government. Consequently, as Porter (1990) argues, this makes the SOEs highly influenced by their ownership structure. Kjeld Erik Brødsgaard confirms this by explaining that there is an ongoing change taking place within education at the ministry level of governments and the management level of SOEs: “earlier, meritocracy was prevalent in China. It is now returning after a period of technocratic leadership. There is an ongoing modernisation of the educational system taking place [in China]. An ongoing change that also has an effect on [Chinese] firms” (Interview KEB 2010). The change is taking place from within the Chinese institutions but is highly influenced by international impacts: “the Chinese government knows that lacking management skills is one of the major barriers for the Chinese enterprises to compete internationally. Therefore, the state supports the SOEs by for instance providing them loans but also by giving leaders of SOEs the opportunity to participate in training programs abroad such as CELP. Here, management of major SOEs study international management and foreign social models that they perhaps can learn from. They study management philosophy and how they do it in the western world. Through these travels, managers of SOEs gain a unique chance to have strategic dialogues with foreign companies." (Interview KEB 2010, D2R 2008). As found, there may be a soft convergence taking place at the company level in China. Influences from foreign companies' routines, codes of conduct and views on sustainability deployed at their Chinese subsidiaries as well as their demand for improving property rights and the regulatory framework all contribute to this international influence. Kjeld Erik Brødsgaard agrees with this view: "through this new, modern educational system and the influence from abroad, there is an emerging soft convergence taking place" (Interview KEB 2010). In Part 2, the presentation of Scott's (1995, 2008) view of institutions showed that the trinity of institutions formed by the three elements: cognitive, normative and regulative are structures that are interchangeable, mutually reinforcing, dynamic and likely to change over time or when one of the other elements changes. It may be argued that the modernisation of the educational system just described is such an example changing other elements.

As Porter (1990) argues, corporate governance plays a role in determining an industry's potential competitiveness since corporate governance indicates how a company conducts itself internally and externally. To Kjeld Erik Brødsgaard corporate governance and management plays an important role not only in the Chinese political system but also in the private and state-owned companies in the Chinese market: "leaders and managers are educated over a long period of time (...) they are all vertically educated" (KEB interview). Although Kjeld Erik Brødsgaard nods to the notion of a soft convergence taking place in China he makes it clear that Chinese leaders see themselves at levels above westerners: "Chinese are pragmatic. In relation to influences from abroad, albeit agreeing that there are things they can learn, they will not forget where they come from. For instance they are unaffected by criticism. That is China's constraint, if a leader succumb to foreign influences or believes in the west, then you are doomed out by fellow Party members" (Interview KEB 2010).

The role of government – passive or active, acting as a catalyst or over-regulating

Porter acknowledges that it is tempting to make government a fifth determinant, yet he argues: "government's real role in national competitive advantage is in influencing the four determinants" (Porter 1990:126). This argument has been contested by those who argue that while this may be the ideal role of government, in many cases governments go beyond influencing and become an actual fifth determinant. The Chinese government's influence at all levels of the Chinese society is hard to ignore. An easy conclusion to this section would be to say that the state has the final saying and influence all of the determinants of the Chinese economy. However, as seen in Part 2, the Chinese government acts as a catalyst and uses its influence strategically, placing focus on areas that will provide overall economic growth. An area perhaps more interesting to look into is the relationship between the state and the CPC. This might, at first sight seem like the same authority, however, taking a deeper look into Chinese officials' methods of enforcing law, it seems to be the CPC that has the overall authority. As mentioned in Part 2, the CPC still retains control of its monopoly power and has not agreed to govern the Party in accordance with law, but only agreed to a modified notion of ruling in accordance with law as in 'rule of the Party by law'. Supporting this view, Kjeld Erik Brødsgaard sees the CPC as the overall authority.

Further, enforcement of policy and law is of significant importance to the Chinese government and for the CPC to maintain its legitimacy. As mentioned in Part 2, North (1990) says that "(...) theory of institutions (...) inevitably involves an analysis of the political structure of a society and the degree to which that political structure provides a framework of effective enforcement" (North 1990:54). As made clear in Part 2, the CPC is permeating the legal system in China, influencing when strategically called upon to render verdicts in line with the Party policies. Enforcement difficulties existing at the Chinese agencies might reflect a problem highlighted by Scott (2008), namely that the legitimacy of the agencies could be affected negatively by the function of the authorities above them. Inconsistency in policy enforcement can also have a negative impact on legitimacy. However, although legitimacy of the central government may be challenged by the regional agencies, through the ability to enforce, the central government is an appropriate authority, or as Scott (2008) describes, a legitimate but contested structure. According to Kjeld Erik Brødsgaard the state and the Party can be separated: "the Party has the final and decisive power. Judges may function as the Party, not the government" (Interview KEB 2010).

Confucianism and Communism – the odd match?

To examine the Chinese government's approach to regulating the economy in the perspective of Porter's (1990) theories requires looking beyond the 'western starting point' of perceiving Confucianism versus Communism as well as the free market versus the controlling state as 'clashes'. As mentioned in Part 2, the, from a western view point, 'clash' of Communist central planning utilising capacities inherited from the Maoist state and steering capitalist developmental state elements of the economy, continues to be a puzzle to western academics. Thus, Confucianism may at first sight seem an odd match to Communism. In the early days of Communism, as a part of the break with the old system, Chairman Mao decided that there was room for only one belief system in China, namely Communism. However, during the years Confucius thoughts and sayings slowly made its way into the Chinese political rhetoric again. As mentioned in Part 2, President Hu Jintao's rhetoric is well planned and each word carefully chosen. Taking office in 2003, President Hu Jintao's talks build on 'harmonious and well off society' as a starting point, resembling a clear echo of Confucius teachings. Kjeld Erik Brødsgaard argues that Confucianism can be traced in the Chinese political system: "Confucianism and Communism can actually go hand in hand. This is especially proven in the [Chinese] focus on social harmony and that everyone should have equal access to education" (Interview KEB 2010). Equal access to education, Kjeld Erik Brødsgaard argues, is "exemplified in the fact that all members of state as a rule has access to the same possibilities and can thus make do with education from the very beginning, despite their background (...) so Confucianism does works with Communism" (Interview KEB 2010).

In line with this, it is interesting to note that there are more than 300 Confucius institutes spread all over the world. Confucius institutes are non-profit public institutes offering education in Chinese language and culture (State Council 2007). The first Confucius institute was initiated in 2004 in Beijing "to satisfy the surging overseas demand for Chinese language learning" (Xinhua 2007B). According to representatives from the Beijing Confucius institute, the aim is to establish more than 1,000 institutes world wide by 2020 (Xinhua 2006F). The Confucius institutes are rooted in universities which may arguably resemble an ambition to spread Chinese thought and culture (Confucius Institute 2009). Officially, the Chinese government "hopes to dissolve the misconception of its development as the China threat by making its traditional value systems known to the world" (Xinhua 2006E) and acknowledges that "culture is a soft power that effectively penetrates to quench misunderstanding and hostility between people" (State Council 2007, Xinhua 2006E). Critics of the approach argue that the Chinese government can use the institutes as an assistant, a platform for the government to gain insight and knowledge about foreign companies and management and a platform to use as a propaganda tool (The Times of India 2009). By establishing cultural institutes worldwide, the Chinese government may succeed in increased foreign acceptance or understanding of Chinese 'ways and routines'. The establishment of the Chinese Confucius institutes may be argued to be a soft tool in gaining influence on international relations, i.e. company managers learning Chinese at the Confucius institutes as well as a means to gain insight into foreign management methods in line with Kjeld Erik Brødsgaard's comments on Chinese CEOs getting international education through CELP.

Ideological legitimacy - 'the people have to lead the people'

In line with this discussion, as mentioned in Part 2, Scott (2008) emphasises the three mutually enforcing elements, cognitive, normative and regulative structures, where each represents what makes up institutions. The three elements are dynamic and may change over time or when one of the other elements changes. An example of an element changing over time in China is ideology. According to Kjeld Erik Brødsgaard "ideological legitimacy is an organisational tool to eliminate risk" (Interview KEB 2010). As mentioned in Part 2, Scott (2008) believes that the state develops its own interests and operates autonomously from other societal actors. According to Scott (2008), the state has an ability to rely on legitimate enforcement of regulation and can exercise authority over other organisations. To Scott (2008) the overall authority, when it comes to creating legitimacy, is the state. As discussed, the Chinese government has accomplished to keep legitimacy intact through employing ideology. Further, the Chinese government has managed to change the ideology over time. During Mao's reign, legitimacy was achieved through the belief in Communist ideology. Today, President Hu Jintao, quite obviously rules according to Confucius ideologies, thereby achieving to maintain legitimacy despite of changing the ideology creating the legitimacy over time. If following Scott's (2008) line of thought, this one change in an institutional element would create changes all over the society. A change may be argued to be happening in what Kjeld Erik Brødsgaard refers to as the modernisation of the educational system. Kjeld Erik Brødsgaard states that "the slogan that 'the people have to lead the people' still succeeds. And now this is also carried out at the company level, they are now also taking part" (Interview KEB 2010). Indisputably, the strong emphasis on the will of the people, the notion of state-paternalism, i.e. the belief in the government as a provider, is very much in line with Confucius thought. However, the modernisation of the education system also means a professionalization of Party members and may be argued to entail creating a gap between the people and the state. If Party members are no longer 'regular people leading regular people' it might be a sign of a polarisation of Party members resulting in the Party moving itself away from society. This move would also mean that society would have to adjust to the system, thus not being the system that adjusts to society. This might entail a risk of the Chinese government to move too far away from society and the people, the Party consequently losing its legitimacy.

As mentioned, Kjeld Erik Brødsgaard and his colleague have found a clear connection between state and society. They argue that a large part of the Chinese economy is informal with unofficial business dealings and is working well. This existing informal economy is not in opposition to the Chinese government but working as a part of the economy – as yet another extension of the state.

Further, as mentioned in Part 2, the Chinese legalist ground, as interpreted by a western way of thinking, may seem weak due to the strong influence of Confucianism which emphasises rule by virtue rather than rule by law. To the foreign eyes somewhat weak legal framework increases the gap of misunderstanding between China and international relations and may result in international hesitance to invest in China. Consequently, China may be argued to have developed its very own national system of political economy as well as its own distinctive form of state-led growth. The result is the CPC carrying out a hybrid strategy employed at several levels using various elements and institutions in the economy available to perform: from the central government to local agencies and from SOEs to foreign businesses, the CPC and the Chinese government strategically deploy performers of the economy to make an overall collected contribution to the growth of the Chinese economy. As Kjeld Erik Brødsgaard notes about the CPC: "the Party acts as an emperor in a dynasty" (Interview KEB 2010).

The role of chance – changing international policies, integrating into the global economy as an instant of chance

From the outside, it may look as if the Chinese government retains control and a visible hand in the market to the extent that the possibility of chance to influence the economy is non-existing. However, we will see in this section that chance has been important to Chinese economic development as well as the maintenance of political legitimacy of the Chinese government.

Porter defines chance as events that "can unfreeze or reshape industry structure and provide the opportunity for one nation's firms to supplant another's" (Porter 1990:73). Thus, chance is important because it can create completely new competitive conditions within an industry and change the status quo. In the context of the Chinese national strategically important sectors, it may be argued that a range of external factors or chances have affected the Chinese government's choice of national strategically important sectors and how to use these to create economic growth. China's integration into the world economy may be argued to exist of several incidents of chance. As mentioned in Part 2, learnings of the collapse of the Soviet Union led China to pursue a trial and error approach to modernisation of the economy in order to avoid another Big Bang. Hence, the collapse of the Soviet Union may be argued to be an instant of chance leading to China's deep studies of 'what went wrong'. China entering the WTO can be argued to be a case of chance influencing all other factors in Porter's Diamond. As mentioned in Part 2, China's commitments have meant intense restructuring and numerous reforms in almost all industries of the Chinese economy but especially the commercial and financial markets. Entering the WTO has obliged China to open up sectors for foreign investment and enhance transparency and sustainability of the business economy. Further, integration into the world economy such as entering the WTO and welcoming further foreign investment has a profound impact on the competitiveness of both foreign and Chinese enterprises.

As mentioned in Part 2, along with international integration comes external influence and pressures from both foreign governments and foreign companies. Foreign companies operating in the Chinese market often bring local practices and routines, requiring the same standards to be available in the Chinese market and at their Chinese suppliers and buyers. As mentioned in Part 2, this kind of bottom-up influence or soft convergence have influence on domestic practices pushing political agendas to shift. This push may lead to institutional changes and influence informal institutions and constraints, ultimately affecting the Chinese political system.

It may also be argued that the global financial crisis is a case of chance that has affected the other factors of Porter's Diamond. Porter (1990) argues that "nations that feel the effect of a chance event first, or most severely, may move early to deal with it (...) while chance events can allow shifts in competitive advantage in an industry, national attributes play an important role in what nation exploits them" (Porter 1990:126). As mentioned in Part 2, the fast respond to the global financial crisis by releasing the large economic stimulus package focusing on infrastructural investments has resulted in a chance for China to take the first steps of moving the economy from an export based market to cultivating the economy from within, "Chinese government policy has been timely, correct and decisive" (Elegant et al. 2009:33). The stimulus package may have effects for the Chinese economy that is yet to be seen. The Chinese government hopes that investment in infrastructure as well as efforts on making transparent policy environment and standardised and effective administration will also lead foreign companies to establish regional headquarters. According to an article in Time magazine assessing the financial stimulus package, the crisis has not only been an opportunity to strengthen global competitiveness already accomplished but also an opportunity to lay the foundations for the future: "nationalist voices in the media are already framing the crisis as a transformational moment in China's rise" (Elegant et al. 2009:34). Another area that is being addressed by funds from the stimulus package is the environment. About 18% of the stimulus package is allocated to environmental projects (Elegant et al. 2009).

Lastly, it may also be argued that another external incident of chance is the Olympics 2008 held in Beijing. Hosting the Olympics meant large changes in infrastructure and in certain industries such as energy and transportation due to the wish of cutting pollution as well as changes in international relations. Needless to say, hosting the Olympics gives any country additional income opportunities for domestic enterprises. For China, not only additional income opportunities were the outcome of hosting the Olympics. The foreign athletes and companies involved in the Olympics brought with them routines and requirements that may be argued to have an influence on business routines and transparency in the Chinese economy. This year, China is hosting the Expo 2010 which most likely will have even further external pressures and influences on the Chinese economy.

Sub-conclusion to Part 3, analysis one

The aim of Part 3 was to examine the Chinese government perspective in relation to the hypothesis raised about how, and if, the Chinese government strategically uses foreign companies to cultivate the domestic market and thereby boost the Chinese economy. Another aim of Part 3 has been to reach an understanding from which to answer research question one and two.[29] Reaching this understanding has been done by examining the factors that enable the Chinese government with tools that can be employed to pursue its hypothesised agenda. Porter's Diamond (1990) provided the theoretical perspective and a framework in which to apply data about the Chinese institutional set-up from Part 2,

[29] Research question one: *how does the Chinese government enforce policies that ensure the transfer of competencies from foreign companies to domestic companies in order to make the latter competitive?*
and research question two: *what is the level of enforceability of Chinese policies?*

to understand policy enforcement from the perspective of the Chinese government. Thus, Part 3 has also presented the external factors influencing foreign companies operating in the Chinese national strategically important sectors.

In the examination of the Chinese government perspective, it was found that very much in line with Porter's recipe of successful economic development, the Chinese government is aware of the importance of wealth created at the microeconomic level and for companies to continuously upgrade their ways of competing. Due to the Chinese government policies requiring foreign companies operating in Chinese national strategically important sectors to partner with local companies and transferring knowledge and technology, the Chinese government is reaching an upgrade of local innovation through foreign investment. At the same time, the Chinese government is reassigning property rights from the state to SOEs, giving the SOEs managerial control rights over human capital and corporate governance. In theory, this assignment should enable SOEs to shape innovation and productivity. However, the assignment is merely pro-forma since the Chinese government, despite issuing these rights, can still overrule the Chinese SOEs when necessary. It was found that very much in line with Porter's ideas, innovation is a key driver and priority for the Chinese government in the national strategically important sectors. Various drivers underlie this reasoning, one being mounting needs for initiatives for environmental protection. In relation to this, it was found that the SOEs are trapped by the proximity of complicated governance structures of a matrix muddle characterised by interlocking directorates, cross-shareholding and with production and management relations. On one hand, these structures may slow decision making, on the other hand, these structures also provides preferential treatment. The SOE-government interdependence not only inter-relates the SOEs to the political arena in China but makes them an integrated part of policy enforcement placing the SOEs at the same level as any other macroeconomic organ for the Chinese government to operate to achieve economic growth.

Further, Porter's notion of 'everything matters for competitiveness' was found to be taken to the heart of the Chinese government. It was argued that the Chinese government is using all elements of the economy strategically. From SOEs to foreign companies and from official local agencies to international organisations, these are all employed as macroeconomic organs like any other institutions to enhance economic growth. Moreover, it was found that in China, property rights are embodied in the state or 'all of the people' consequently fading the line between state and society and the formal and informal economy. The informal economy should not be regarded as an opposition to the state but rather as a part of the economy as yet another tool for the government to use when necessary.

It was found that opening up for foreign investment means opening up for foreign requirements of a stable regulatory framework, labour conditions and infrastructure minimum requirements. These bottom-up pressures may be a part of a soft conversion that can lead to institutional changes. This change may be welcomed as foreign company demands may be used as an opportunity for the Chinese government to upgrade for instance environmental standards thus meeting the need in China for environmental upgrading as well as the fulfilling the requirements of foreign companies. Thus, the Chinese government is creating stimulating business environments for foreign companies to invest in, benefitting both the Chinese government and the foreign companies. In this context, the SEZ are important to both the Chinese government and the foreign companies as they can be used as clusters giving preferential conditions and the infrastructure needed for foreign companies. However, influences from international impressions were found to not only originate from the foreign companies operating in the Chinese market. The overseas education of Chinese leaders opens for influences to be integrated in the Chinese system. This was argued to be an example of an institutional element causing a change in the system.

Now, we will wear the other pair of glasses, taking the perspective of the foreign company operating in the Chinese national strategically important sectors. From the foreign company perspective we will examine which tools foreign companies may utilise in order to ensure staying in competition, despite transferring resources and competencies to Chinese partners and competitors.

Part 4: The foreign company perspective

In order to understand in which way Chinese government influences the strategy of foreign companies operating in Chinese strategic important sectors and to find out what tools foreign companies can use to avoid being crowded out by their local competitors, this section will wear the glasses of the foreign company. The purpose of this section is also to analyse which tools foreign companies may utilise in order to ensure staying in competition, despite transferring resources and competencies to Chinese partners and competitors. This analysis will thus provide understanding upon which to answer research question four.[30] The analysis will apply findings from interviews with the three case examples of foreign companies operating in Chinese national strategically important sectors chosen to be relevant to this thesis: Vestas, Novozymes, and RM Group.

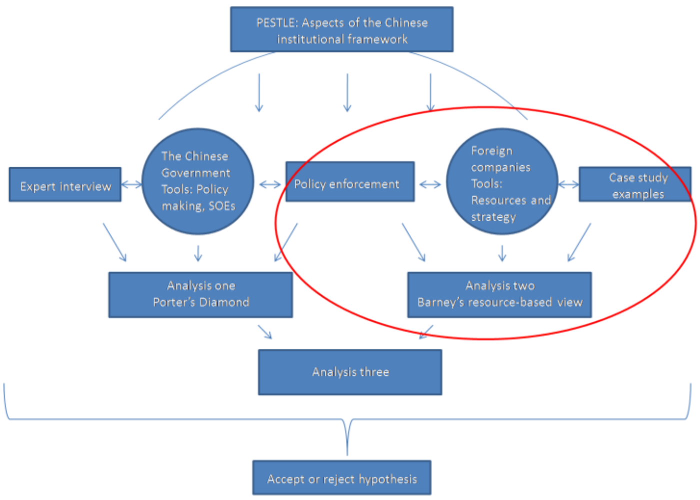

Figure 5: Illustration of the methodological approach focusing on the foreign company perspective.

As illustrated in figure 5, to view the problems highlighted in the hypothesis and research questions from a foreign company perspective, this section will first focus on what core competencies, resources, and capabilities are to a company (Prahalad et al. 1990, Barney 1991). In Part 5, the third and final analysis, these may prove to be tools for foreign companies to employ to ensure staying in competition in the Chinese market. Second focus will be on how companies respond to the process of what will be termed here as governance changes. Governance changes[31] refer to processes in which company boundaries expand or move (Gertler 2003, Teece et al. 1997, Mahnke

[30] Research question four: *how do foreign companies ensure staying competitive despite transferring competencies to their Chinese competitors?*

[31] In this thesis governance changes include internationalisation of firms, partnering, merging, or outsourcing: ultimately changing firm boundaries (Gertler 2003, Newell et al. 2002). An example could be when firms internationalise or partners with Chinese firms in the Chinese market and consequently change or move firm boundaries by renewing capabilities or resources, inherited or developed during the process of that particular governance change.

2002). In this process, companies might inherit or develop new resources and capabilities that can be sources of competitive advantages. Focusing on the process of governance change will help to gain a dynamic understanding of not only what external pressures companies face in foreign markets but also how companies deal with these changes internally, from the diversified unit to corporate headquarters. Thus, this analysis will also provide understanding to answer research question three.[32] Consequently, focus will not only be on the strategic implications of foreign companies operating in Chinese national strategically important sectors but also the internal implications across all units of corporations (Brewster 2002, Kostova et al. 2002). Both Prahalad and Hamel (1990), and Brewster (2002) argue that core competencies are the 'glue' that binds existing businesses together and that core competencies are drivers for new business development, changing and expanding the boundaries of the company (Prahalad et al. 1990). In order to determine how governance change has an impact on companies, theories and notions on knowledge management (Gertler 2003, Newell et al. 2002, Brewster 2002), knowledge integration (Teece et al. 1997, Mahnke 2002) as well as decision-making by managers (Brewster 2002, Nelson et al. 1982) will be drawn upon. Concepts and insights gathered from these theories will contribute to a dynamic understanding of the tools foreign companies might be able to apply and utilise in order to ensure staying in competition, despite transferring knowledge and competencies to Chinese companies.

With this dynamic understanding in place, findings from this analysis will together with findings from analysis one, contribute with inputs to analysis three, which will give understandings allowing research question five to be answered.[33]

Core competencies, capabilities and resources: sources of sustained competitive advantage

The resource-based view of the firm (Barney 1991, Wernerfeld 1984) demonstrates how internal and external resources and capabilities of companies can be sources of sustained competitive advantage promoting a value-creating strategy of a company. Barney (1991) suggests that the resource-based view can be used as a framework to determine whether or not resources can be sources of sustained competitive advantage. From a resource-based perspective, "(...) sustained competitive advantage is implementing a strategy not simultaneously being implemented by any of its current or potential competitors" (Barney 1991:102) and whether or not a competitive advantage is sustained "(...)

[32] Research question three: *how does Chinese government policy influence the strategy of foreign companies operating in the Chinese national strategically important sectors?*
[33] Research question five: *which elements of the Chinese institutional set-up foreign companies face when operating in Chinese national strategically important sectors influence the strategy of foreign companies?*

depends upon the possibility of competitive duplication" (Barney 1991:102). The resourced-based view rests on the assumption that company resources are heterogeneous and imperfectly immobile across companies. That resources are heterogeneous simply means that resources are unevenly distributed across industries giving some companies comparative advantages (Peteraf 1993, Barney 1991). Imperfect immobility refers to assets that are e.g. inter-connected in the sense that they are context-specific and do not have the same value when employed in other contexts. Further, the level of mobility depends on the process and environment in which the resource was accumulated. This means that resources which are sources of competitive advantage are path-dependent and involves degrees of tacit knowledge (Peteraf 1993, Gertler 2003). The three case examples have shown to each have their own strategy to obtain and make use of resources promoting a value-creating strategy. Looking to Novozymes a major strength is the systematic implementation of 'Novozymes practices' with strong focus on sustainability at all their locations across the globe (Interview Novozymes 2010, NZ homepage 2010). Novozymes' strategy for implementing sustainability practices contains methods and strategies not implemented by other companies thus making these routines a possible contribution to competitive advantage (Barney 1991). At RM Group, competitive advantage has been found through a hardcore learning process where cutting into the bone i.e. through lessons learned that are all experiences unique to RM Group. RM Group's ability to apply the experiences in current and future operations is one of the reasons for RM Group's success today (RM Group data 2009). In this case, as Gertler (2003) argues, path-dependency and tacit knowledge has made a large contribution of what are the core competencies of a company.

Barney (1991) argues that for a company's resources to have sustained competitive advantage the resources need to have four attributes: *valuable*, *rare*, *inimitable*, and *original*.[34] For a resource to be a source of competitive advantage and thus *valuable* to a company, the resource must have the ability to improve efficiency of a company's overall strategy. Novozymes' deployment of sustainability practices may be an example of a resource improving efficiency of Novozymes overall strategy. Novozymes' approach to implementing sustainability practices is to minimise the negative environmental impacts of economic, social and business operations conducted by Novozymes (Interview Novozymes 2010, NZ homepage 2010). For RM Group, the shift in core competencies to outsourcing advisory in the field entails advising RM Groups own internal business units. The experience and knowledge from outsourcing is a tool for improvement of business practices, thus making it effective and efficient and a resource that improves the overall strategy of RM Group (RM Group data 2009). For Vestas, a strong valuable asset is the technology skills around building wind turbines. Establishing factories within the same industrial area of TEDA is an effective method of

[34] For simplification and easy understanding, the titles have been modified by the author. The original titles by Barney are: valuable, rare, imperfectly imitable, and non-substitutable (Barney 1991).

lowering transportation costs when producing and assembling wind turbines. However, the interview with Vestas revealed that the close location of factories was poorly utilised. There is no systematic communication between Vestas' units located in TEDA or in China in general (Interview Vestas 2010). Thus, it may be argued that Vestas is not utilising potential valuable resources. In order to be a source of competitive advantage, resources should be *rare*. To determine whether a resource is rare, Barney (1991) argues that it is simply a matter of whether that resource is possessed by a large number of other companies or not. Barney (1991) pays special attention to the importance of managerial talent in relation to the process of implementing strategies and thus the ability to generate competitive advantage to the firm. To both Novozymes and Vestas the new employees in China overtaking the interviewees' positions have been local Chinese which may be argued to have influence or perhaps a loss in the practices and routines performed since the local Chinese employee will not have the same experience and path as the Danish representative. The third factor determining whether a resource can be a source of sustainable competitive advantage is to assess whether the resource is *inimitable*. Whether a resource is inimitable depends on which degree the resource has emerged from unique historical conditions. The resource needs the right proximity in order to add value to the firm (Barney 1991). This means that whatever valuable and rare resources a company possesses today is a consequence of the company's unique path through history. Resources can also be inimitable as a consequence of what Barney (1991) describes as social complexity. Social complexity represents trends and circumstances that companies cannot control or influence. Social complexity could be interpersonal relationships, a company's corporate culture, the institutional framework companies operate in, or tacit knowledge surrounding the products a company produces or sells. All three case examples revealed to possess a social complexity that is unique and inimitable. In the example of Novozymes, a strategy employed is to educate local managers in 'the Novozymes way'. "I introduced flexitime at the office in China (...) in the beginning the team managers were pretty restrained but after a while they all adjusted and really like it" (Interview Novozymes 2010). Introducing the concept of flexitime was one of tasks assigned for the Novozymes representative during his stay in Beijing, and one of many elements to implement 'the Novozymes way' at the Beijing office. "It showed a confidence in my employees that they had not experienced before (...) but I also made it clear that cheating would not be tolerated under any circumstances" (Interview Novozymes 2010). Similarly, getting people to work independently was one of the biggest challenges for the Vestas representative. "I am proud of the fact that I got my Chinese colleagues to work independently. But the result did not show until later. It was a long journey to get there" (Interview Vestas 2010). The final important factor to determine a resource's potential to be a source of sustained competitive advantage is whether the resource is *original*. For a resource to be original depends on whether the resource is easily imitated or substituted. An example of an original resource is a management team. A unique management team cannot be substituted since managers will not possess the exact same talents. Managers will be unique to the company they work in since their interpersonal relations and tacit knowledge will follow the manager when he leaves the company, thus making the manager, as an isolated resource, less valuable to other companies (Nelson et al. 1982). All case example interviews revealed that the China representatives have worked for companies abroad before. The experience accumulated may have helped the representatives in their work in China. The Vestas representative has worked for Vestas in other emerging economies but still never felt ready for what he was to meet in China "in India I learned to build relationships but first they had to assess me. Many Danes don't know this. That creates collisions (...) but you can never really be ready for China, you have to take it as it comes" (Interview Vestas 2010). All three representatives are professionally established in the sense that they have been in the industry for years and all have solid professional foundations. According to RM Group one advice when internationalising is "to make use of the best employee and send him to represent you" (RM Group data 2009, Danish Wind Industry Association 2010). Nelson and Winter notes "(...) skills, organization, and "technology" are intimately intertwined in a functioning routine, and it is difficult to say exactly where one aspect ends and another begins" (Nelson et al. 1982:104). Thus, the more activities are interconnected with other activities, the less the asset is of value when used in isolation. Consequently, competencies are likely to be firm specific and according to Teece (1997) competencies and capabilities are "intriguing assets as they typically must be build because they cannot be bought" (Teece et al. 1997:518). An example of a valuable, inimitable, rare and original resource is 'guanxi'. In all three case example interviews, guanxi was mentioned as a prerequisite for "surviving the business" (Interview Novozymes 2010, RM Group data 2009, Interview Vestas 2010). Guanxi or relations have been used as a tool to improve efficiency by all three companies. "As long as you have your relations, your guanxi in place, you can get most work done" (Interview Vestas 2010). Guanxi is valuable because it may help a company improve efficiency of operations. Guanxi is inimitable due to its path-dependency. In addition, guanxi is socially complex since it emerges from a unique network of relations. Guanxi is rare and original because each relationship is person specific and unique. However, because guanxi is person specific it cannot be regarded as a company owned assets in the long run. The guanxi will follow the person that created the guanxi in the first place.

Governance change - a risk or opportunity

The process of governance change might create an opportunity to shift core competencies. RM Group is an example of a company with the ability to identify external resources as potential to become integrated to the operations consequently adding to core competencies. An actual shift of focus for RM Group was when RM Group was pressured out of the Danish market due to lower prices from competitors. RM Group was forced to seek low cost production activities in other countries. This became the initial step to a range of outsourcing activities that ultimately gave RM Group enough experience to develop new business advising others about outsourcing strategies. However, when a company changes its boundaries by e.g. internationalising, the company faces new requirements and challenges to develop and maintain capabilities. As found in Part 2, according to the Chinese Company Law of 1994 (Xinhua 2006C), foreign companies operating in Chinese national strategically important sectors have to transfer knowledge and technology to Chinese partners or suppliers. This might include transferring resources that are or have potential to be sources of competitive advantage. As Mahnke argues "successful outsourcing often requires putting valuable knowledge assets at risk"[35] (Mahnke 2002:20) and Singh (2007) similarly notes "the concern is that, in addition to being a source of valuable knowledge, (...) subsidiaries might (...) be a channel through which domestic technology falls into the hands of foreign competitors" (Singh 2007:765). Consequently, when going into a partnership or collaboration in the Chinese market, the manager of a foreign company has to be aware of the impacts that the process of governance change has on existing capabilities. Whether or not companies or managers are willing to engage in processes of change is arguably path-dependent. A study of organisational change outlined by Greve (1998) found that companies will base their future actions which may involve risk on previous experiences (Greve 1998). The notion of change being dependent on the development path of a company and thus be an evolutionary process has been brought forth by several scholars (Teece et al. 1997, North 1990, Scott 2008) and among others owes its origin to Darwin (1859), Marx (1862) and Schumpeter (1954) (in England 1994). [36] Scott (2008) argues that path-dependency relies on the notion that "(...) developments in the same direction are rewarded, whereas the cost of switching to an alternative increases over time" (Scott 2008:122). Hence, path-dependency of a company influences both the present and future behaviour and a company's strategic positioning. As mentioned, RM Group is a good example where path-dependency has influenced both present and future behaviour of RM Group's strategic positioning. Novozymes has also expanded focus since starting operating in the Chinese market. Being present in the Chinese market has made it possible for Novozymes to expand its enzyme production to not only to be applicable to pharmaceutical products to also be applied in the production of foods and bioethanol. Being in the same group as Novo Nordisk that produces pharmaceutical products, Novozymes was born with beneficial synergies of the production of enzymes to pharmaceutical products. Thus, it may be argued that the expansion of focus to foods and ethanol production may be a result of the operations in China (Interview Novozymes 2010).

[35] As previously mentioned, internationalisation also includes outsourcing. Thus, Mahnke's argument can also be applied to internationalisation processes of firms.
[36] For more on precursors on evolutionary economics and the notion of path-dependency please read the excellent description and arguments made by Geoffrey M. Hodgson in England 1994, Part 1.

Sticking to routines

The evolutionary perspective on organisations is concerned with the process of change, planned or unplanned, and the importance of knowledge flowing internal and external during governance changes. Scholars within the field of knowledge management, identifies knowledge as strategically important to any company (Gertler 2003, Newell et al. 2002, Brewster 2002).[37] Successful identification and integration of new resources and capabilities, requires knowledge management skills of managers and employees as well as the right conditions for knowledge to flow in a bidirectional manner, from the international unit of a firm to its corporate headquarters (Brewster 2002, Teece et al. 1997). Hence, knowledge in the company is seen as a tool to manage and control the identification and integration of new capabilities inherited or developed when internationalising i.e. when changing boundaries. Dosi and Marengo (1994) note "(...) organizational knowledge (...) emerges as a property of the learning system and is shaped by the interaction among the various learning processes that constitute the organization" (Dosi et al. 1994:162). Since routines or the 'way of doing things'[38] in a company develop in a tacit, path-dependent, learning by doing manner, routines may constrain governance changes as causal relations. Interfaces between them are often based on tacit knowledge rather than explicit understanding (Gertler 2003, Teece et al. 1997, Mahnke 2002). This is also in line Carney's (2005) notion that governance structures tend to stick even though the environment changes. Similarly, Gertler (2003) refers to tacit knowledge as being spatially sticky (Gertler 2003). To Nelson and Winter (1982), a company sticks to its routines when economic results remain above targeted levels, giving the company no incentives for change. Very much in line with this, director of RM Group states that "relocation was necessary, had we not taken the required steps, the company had not existed today" (RM Group data 2009). Thus, poor economic results were a direct driver for RM Group to change boundaries of the company. "The internationalisation was based on a necessity not adventurism" (RM Group data 2009).

A company's most precious asset

Schumpeter (1950) described dynamic competitiveness of companies as the ability to strive to be leaders within innovation and carry out actions from developed and externally assessed capabilities, thus promoting growth (Mahnke 2002, in Nelson et al. 1982). This means that for resources to be successfully deployed depends on the managerial capabilities of identifying and integrating those

[37] Knowledge is argued to be contextual, differing from information, which is simply viewed as statement of facts (Newell et al. 2002, Brewster 2002). Brewster (2002) defines knowledge as a recipe that specifies how to carry out activities. Knowledge can be distinguished as context specific and tacit or context generalised and explicit (Gertler 2003, Teece et al. 1997).

[38] Nelson and Winter defines routines in organisations as a 'way of doing things' and further emphasises the importance of acquiring inputs that can add smooth functioning of a firm's routines (Nelson et al. 1982).

resources as well as the institutional environment in which the company operates. Changes in the context and the adaptive responses by companies are thus key drivers of change in capability maintenance and development. Which capabilities should be renewed, can only be discovered by talented managers in the process of governance change. According to Mahnke (2002), a manager in charge of processes of governance change has to be able to decide when and how to adapt the scope of a company's activities. To be able to choose the right moment to adapt new capabilities that might affect boundaries of a company is thus of great strategic concern. At any point in time, managers face difficulties in judging whether they are dealing with resources and capabilities of critical strategic need. Thus, governance change when internationalising results in adaption of competencies and capabilities and unless well integrated, governance change can be a costly affair (Teece et al. 1997). To Prahalad and Hamel (1990) the real sources of advantage are to be found in management's ability to consolidate corporate wide skills into competencies that empower the corporation to adapt quickly to changing opportunities, enabling core competencies to change company boundaries and create new products or businesses. In this way Prahalad and Hamel (1990) argue that people are the company's most precious asset.

The subsidiary – caught in between two institutions

Identification and discovery of possibilities to improve capabilities of the company becomes of great importance when changing the boundaries of the firm. However, during governance changes, learning processes might be influenced by particular characteristics of the environment to which companies are subjected. An argument Adam Smith already noted in 1776: "the division of labour is limited by the extent of the market" (in Mahnke 2002:19). It could be argued that to the extent that when a company is removed from its relevant base of experience and knowledge, the more vulnerable to changes in the environment it might become. The evolutionary perspective emphasises sensitivity to the contextual embededness of organisational competence and capability maintenance and development (Mahnke 2002). There may also be external factors in the competitive environment that limits the potential scope within which a company can develop its capabilities. In the case of the three examples, both Novozymes and Vestas expressed the tradition of copying as a constant external threat when operating in the Chinese market. However, as Vestas' representative expresses: "then you just have to place your trust in those you cooperate with. We know that China is the country where you copy. They have always copied, they can only learn their characters and language by copying so it's been like that since they were born" (Interview Vestas 2010). At Novozymes the fear of copy is small: "we are not producing products that can be separated down to the final bolt, like for instance

Grundfos.[39] We have so technologically advanced and superior products that there is simply no one in the market that can copy what we make at this point in time" (Interview Novozymes 2010). Facing different environments or external forces has an impact on the foreign company. The foreign company has to prevent or mitigate the influences and this may clash with the internal forces from headquarters. In their article on adoption of organisational practices by subsidiaries of MNCs, Kostova and Roth (2002) found that a subsidiary's response to headquarters' assignments is influenced by the subsidiary's interpretations of practice. And these practices are shaped by the external institutional context of the subsidiary. The two authors refer to this as 'institutional duality'. The institutional duality refers to the dilemma or conflict of interests in the subsidiary. The subsidiary arrives in the foreign country with routines and practices that have been formulated in the home country's institutional context. However, the subsidiary faces a different institutional setup in the foreign country which means that the subsidiary has to relate to both the forces of the home country's institutional set-up as well as the institutional set-up that it operates within. In this way, the home country's or headquarters' influence is indirect and adapted to local practices suited for the context of the subsidiary. Nevertheless, Kostova and Roth (2002) argue "even if a subsidiary is relatively disconnected from its host environment by ownership or otherwise, it is still subject to institutional influences through its employees who carries institutions" (Kostova et al. 2002:218).

Managing and integrating knowledge to develop new capabilities

Practices used by corporate headquarters may be applicable in other countries and vice versa. Yet, applying practices and routines of corporate headquarters, embedded in the company's home country, to the subsidiary in another country might depress rather than improve the overall productivity and effectiveness of the company (Brewster 2002, Kostova et al. 2002, Singh 2007). In defining the relationship between headquarters and subsidiaries, Kostova and Roth (2002) mention dependence as an important factor. It is argued that when dependence between the subsidiary and headquarters is high the subsidiary will comply, and when dependence is low the subsidiary may manipulate the environment and question the institutional settings originating from headquarters. Thus: "MNCs are characterized by a tension between subsidiary managers' autonomy and the parent's need for control" (Kostova et al. 2002:218). In relation to this, Kostova and Roth (2002) argue that it is important for the subsidiary to be able to identify itself with home country headquarters. Identification will reduce a possible tendency for the subsidiary to detach itself from the parent company. Thus, "subsidiaries are not only concerned with establishing legitimacy with both the external host country institutional environment and the internal environment of the MNC, but also may find it difficult to reconcile

[39] Grundfos is a Danish owned company and is the world's largest producer of pumps for a range of industries such as heaters, air conditioners, water supply, waste water (Grundfos homepage 2010).

these two institutional pressures" (Kostova et al. 2002:220). RM Group's ability to adjust to changes is a unique competency possessed by the management of RM Group. To both Novozymes and Vestas, the interviews conducted revealed a lack of sharing knowledge obtained by the employees returning from China to Denmark (Interview Novozymes 2010, Interview Vestas 2010). Knowledge or experience hand-over to new employees in China have in the two cases been random or non-existing (Interview Novozymes 2010, Interview Vestas 2010).

Vestas' internationalisation approach may be argued to bear traits of being 'multi-local' (Torben Pedersen in EBST 2010). The multi-local approach to internationalisation entails a decentralised organisational structure where production adopts to local needs and only little communication flows between headquarters and subsidiary. Knowledge is produced and stays at the subsidiary. According to the Vestas representative, knowledge-flows between the Tianjin office and other Vestas offices in China were close to non-existent. "We operated as independent units (...) unfortunately we did not have time to share knowledge across units (...) we only reported back to headquarters when encountering production errors" (Interview Vestas 2010). Novozymes' approach to internationalisation may be a bit more 'transnational' (Torben Pedersen in EBST 2010). A transnational approach entails that the organisation adapts to local conditions and integrate knowledge at a global level. The organisational structure resembles a network of units where knowledge is produced and shared at all locations. Officially, Novozymes' Beijing office operates as a business unit integrated in a Novozymes network of offices across the globe. However, the interview conducted with Novozymes revealed that in practice knowledge-flow and communication is met by bottlenecks of very basic character: "when I was at work they slept in Denmark and when they attended work in Denmark we slept in China. Consequently, there was not much time for check-up" (Interview Novozymes 2010). That said, Novozymes ensures job rotations including training of Chinese managers at headquarters in Denmark. "The current country manager is Chinese but he has had three years of training and management experience in Denmark prior to his position in China" (Interview Novozymes 2010). When compared, Novozymes and Vestas' practices of knowledge sharing and communication between headquarters and the Chinese subsidiaries reveal a significant difference. Where Novozymes strives for the 'transnational internationalisation strategy' in which the subsidiary functions as an independent unit albeit closely integrated in a network of offices creating a platform for knowledge flow and communication, Vestas' units have not received headquarters' mandate to function as a part of a transnational network of business units. For RM Group the strategy has been simple: "to make use of the best employee and send him to represent you" (RM Group data 2009). The director of RM Group in China has many years experience of doing business in Asia, he both writes and speaks Chinese fluently (RM Group data 2009).

As identified above, to successfully absorb and grasp new opportunities and knowledge requires the manager to be able to create the right conditions allowing knowledge to flow bidirectional and be integrated into the organisation itself, thus emphasising the absorptive capabilities of workers and creating good grounds for 'learning by doing' procedures (Gertler 2003). However, Gertler (2003) argues that tacit knowledge is best acquired via experience and application, and thus difficult to share and exchange over distances. Novozymes' job rotation thus seems to be of significant importance for knowledge sharing in Novozymes.

Sub-conclusion to Part 4, analysis two

The aim of Part 4 was to take the perspective of the foreign companies operating in the Chinese national strategically important sectors. By taking the foreign company perspective, Part 4 illustrated which tools foreign companies may utilise in order to ensure staying in competition, despite transferring resources and competencies to Chinese partners and suppliers. The analysis thus provided understanding upon which to answer research question three and four.[40]

Barney's resource-based view of the firm (1991) provided theoretical insights to what sustainable core competencies are to a company and how resources can help to promote a value-creating strategy for companies. It was found that all three case examples each have their own strategy to obtain and make use of resources promoting a value-creating strategy. It was argued that systematic implementation of routines is an important source of competitive advantage for all three companies. However, both Novozymes and Vestas has room for creating additional value-creating routines such as making routines for knowledge to flow between their own subsidiaries in China. Social complexity was found to be of outmost importance since it is unique and inimitable for all three case examples. An example of this was the introduction of flexitime for the Chinese Novozymes employees. Also important is for subsidiaries to balance its institutional duality. This means that although the subsidiary arrives in China with routines formed by headquarters, the subsidiary has to relate itself to the external influences whether being pressures or sources of competitive advantages. The governance change of for instance internationalisation results in the foreign company being exposed to new influences. New influences might be discovered as sources of competitive advantages that need to be integrated into the whole organisation. This requires a competent manager who is able to identify and integrate these influences to thereby upgrade the core competencies of the foreign

[40] Research question three: *how does Chinese government policy influence the strategy of foreign companies operating in the Chinese national strategically important sectors?*
and research question four: *how do foreign companies ensure staying competitive despite transferring competencies to their Chinese competitors?*

company. For the whole organisation to benefit from these new influences it was found important to have bidirectional flows of knowledge between subsidiary and headquarters.
As argued, for the foreign company to not drown in both being exposed to external influences, pressures from headquarters and transferring knowledge to Chinese enterprises, the subsidiary's capabilities and resources need to be dynamic and renewed over time. Thus, instead of only reacting to internal and external pressures, the subsidiary has to proactively integrate and renew core competencies as well as balance the institutional duality to be beneficial for the subsidiary, avoiding being choked by pressures from headquarters.

In the next section, Part 5, the third and final analysis, findings from the two perspectives just analysed will be combined. Combining the two perspectives will help understanding the dilemma hypothesised from the two perspectives and finally enable an answer to research question five and ultimately to reject or accept the hypothesis.

Part 5 Combining the two perspectives - benefitting the Chinese government and the foreign company

Part 5, the third and final analysis will combine the two perspectives just analysed. As illustrated in figure 6, combining the two perspectives will provide understanding from which to answer research question five and ultimately to reject or accept the hypothesis.

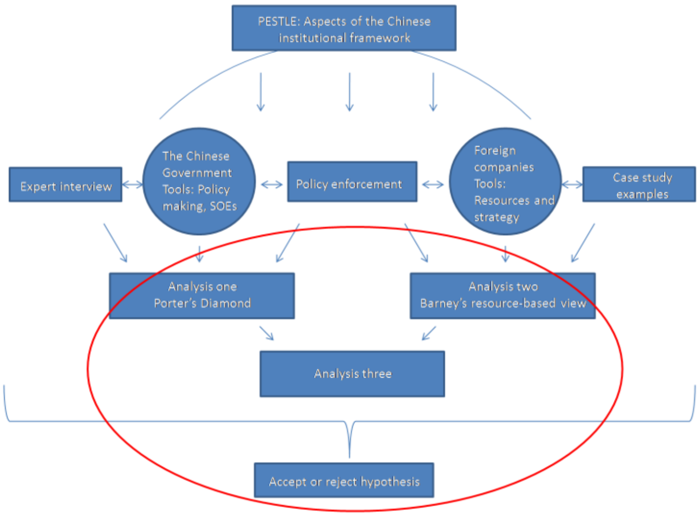

Figure 6: Illustration of the methodological approach focusing on combining the Chinese government perspective and the foreign company perspective.

In Part 3, Porter's Diamond provided a theoretical framework to analyse factors that enable the Chinese government to employ elements of the Chinese economy to strategically use foreign companies. It was found that opening up for foreign companies to operate in Chinese national strategically important sectors through SEZs is a factor that supplies management and technology skills to the Chinese economy. Furthermore, it was found that foreign companies operating in China have less access to the market than local players, creating disadvantages. Nevertheless, this seems to be the case for foreign companies operating in any foreign market. On the other hand, operating in SEZs was found to be beneficial due to the proximity of related companies. Opening for foreign companies to operate in the Chinese market also entails opening up to demand and requirements of standards, ultimately playing a part in the upgrading of Chinese enterprises and the Chinese economy. It was found that these bottom-up effects of upgrading standards may also affect Chinese government policies. In Part 4, it was found that operating in SEZs, potentially gives foreign companies advantages in terms of being in proximity with suppliers and partners, thereby limiting communication errors and transportation costs. However, it was found that neither Novozymes nor Vestas utilise this potential to the fullest.

In Part 4 it was found that both Novozymes and Vestas brought and implemented own practices and routines to their subsidiaries in China with great success. Arguably, this may result in a bottom-up effect in terms of standards and working conditions for Chinese workers in general. The implementation of flexitime or working independently may stick with the employee. This means, should the Chinese employee move to another company, the employee may bring with him or her the new routines learned enabling implementation in other companies. In this way, there is not only influence flowing from the Chinese government to the foreign companies but also influence flowing from the foreign companies to the Chinese companies.

In Part 3, it was identified that the Chinese middle-class is on the rise, gaining more and more influence and continuously put pressure on Chinese enterprises to innovate in order to stay in competition. Pressure to upgrade environmental protection is another factor pushing the Chinese government to develop innovative environments within the Chinese national strategically important sectors. Yet, it was found that the Chinese government's approach to build 'indigenous innovation' is not as indigenous as one might expect. The Chinese government is aware that foreign companies' contribution to innovation is necessary and unavoidable. In this respect, the Chinese government is dependent on foreign company's innovative operations in the Chinese market. In line with this, as mentioned in Part 2, North (1990) argues that strategic choices made by organisations are influenced by the institutional framework and that organisations influence how institutional frameworks evolve. In relation to this, it was found that the Chinese government encourages competition between provinces and official agencies, in line with Porter's (1990) argument that in creating efficiency, rivalry has to be present. Further, the Chinese government makes room for rivalry to take place at the industry level, however, only to the point where the rivalry is beneficial to domestic companies. In this way, the international impacts, from e.g. foreign companies, are collected and utilised to the benefit of the Chinese enterprises and the Chinese economy. Hence, from a foreign company perspective it is hard to see the potential to survive if core competencies are not sustainable. However, the Chinese government's beneficial treatment may not be a zero-sum game as we will see in the following section.

As found in Part 4, one way for the foreign company to sustain competitive advantage is for the subsidiary to first, recognise that the institutional set-up it operates in differs from the intuitional set-up headquarters operate in. Second, to sustain core competencies, these need continuous upgrading. This requires the manager of the subsidiary to be able to identify, integrate and manage sources of core competencies to benefit governance changes of the company. For the whole organisation to benefit from these new influences it was found important to have bidirectional flows of knowledge between subsidiary and headquarters. It is important for the new knowledge to flow from the subsidiary to the headquarters, enabling for the new sources of competitive advantage to be integrated in the whole organisation. As mentioned in Part 2, in a transition economy, creating joint-ventures and tapping into the resources of domestic partners can help foreign companies navigate the uncertain waters of economic transition because foreign companies might have difficulties understanding and relying upon the formal institutions of the Chinese market.

In Part 3, it was found that understanding the relationship between the CPC and the state is important because it shows where the motivations and creation of legitimacy from the Chinese state to the Chinese people originate from. It shows what it takes to remain a one-Party state. Basically, it requires economic growth, that people are fed, and keeping opposition at a minimum. It was found that two trends are occurring in the political arena. First, Confucianism has found its way back into Chinese political rhetoric. The focus on a 'harmonious society' and 'equal access to education' is a step away from technocratic thinking towards meritocratic leadership. It was found that a great part of the making of institutions in China is based on ideology and ideological legitimacy and is used as a tool to eliminate risk. The state may operate autonomously yet the people's belief, support and provision of legitimacy are of outmost importance for the survival of the one-Party state. The Chinese government has accomplished keeping legitimacy intact through changing leadership and over the course of a long period of time. The Chinese government's ability to make these changes has spurred change throughout Chinese society. However, the second trend, professionalization of the Party, is taking place through a modernisation of the educational system in China. This professionalization trend may be creating a gap between the people and the state. The sign of polarisation of Party members may result in the state moving away from society. This move may result in society adjusting to the system and not the system adjusting to society. Sustaining economic growth and increase in living standards of the people may continuously give the state the legitimacy needed to remain in power. Having society adjust to the system may be argued to provide another instrument for the Chinese government to have a hand in the economy. The Chinese government's ability to hold on to its legitimacy may help this change and adjustment. According to Weber (Scott 2008, Haralambos et al. 2004) power becomes legitimised as authority to the extent its exercise is supported by prevailing social norms, whether traditional, charismatic or bureaucratic. Thus, legitimacy is created when the authority is able to enforce the rules and laws of society that benefit the people. It was found that the Chinese economy is partly organised through networks of interdependent and less autonomous economic actors. This is in line with Scott's (2008) argument mentioned in Part 2 that legitimacy may be utilised at three levels: the regulatory, the normative, and the cultural-cognitive level. The three levels are mutually reinforcing and in an economy where the informal economy is a tool to be employed by the Chinese government as yet another economic organ, legitimacy may be created at multiple levels of informal and formal constraints. The regulatory legitimacy of the Chinese government is thus created by emphasising the conformity of rules.

In Part 3, the structure and routines of the Chinese economy was found to be a matrix, not muddling but actually enabling flexibility for the Chinese government to operate across several levels of the economy simultaneously. Furthermore, the Chinese government, on the surface, assigns managerial control rights to the SOEs. However, it was found that the Chinese government assigns these rights to the SOEs in order to gain flexibility to use SOEs as macroeconomic organs of the Chinese economy. Therefore, it does not make sense to look at the SOEs operating in the Chinese market as organisations understood from a western or neoclassic economic perspective. Rather, they should be understood as macroeconomic organs to be utilised for a higher purpose, to stimulate the growth of the economy. Similarly, policy making can be argued to be the main channel for governments to communicate expectations to companies, to create a stable, predictable environment conducive to investment. As mentioned in Part 2, from another perspective, policy making may also be characterised in accordance with the Chinese 'rule of the Party by law' which may be argued to provide opportunity for the Chinese government to intervene in business matters. Hence, there is a risk of conflicting power centers and thus decreased efficiency. Consequently, it could be argued that the Chinese state and the CPC may have broader stakeholder interests i.e. interest in other objectives than the typical shareholder focus on profitability, using the SOEs as yet another macroeconomic element.

All in all, the result is a state carrying out a strategy with tools to manoeuvre at several levels of the economy simultaneously to increase economic performance: from the central government to local agencies, SOEs and foreign companies. They are all instruments contributing to play a symphony of economic growth with the Chinese government and the CPC as the conductor. In relation to this, Part 3 mentioned that Porter (1990) argues that the mobility of resources is a necessity to promote economic growth. In this way the informal economy can be seen as another example of a flexible resource for the Chinese government to utilise when needed.

The vertical and horizontal political representation in the Chinese economy may be used as a path down to the lowest part of the economy to get things done, making this political economy an excellent tool to enforce policies. China's economy is a hybrid of capitalism and socialist command economy that has given the government greater flexibility to intervene. This way of using every unit of the economy as players in the macroeconomic orchestra may create a tune which is disharmonious to a western ear. Neoclassic economy does not allow for the free market to enfold in government controlled regimes. However, in China this is what happens. And to the Chinese this does not seem to be a paradox. Rather, government measures should be viewed in a holistic perspective of whether they contribute to the overall goal of economic growth. If economic growth is the outcome, most tools may be acceptable to the Chinese. As North (1990) argues, institutions provide the rule of the game whereas organisations act as the player of the game. The Chinese government role may be argued to be the parenting institution in the market. The lines of Chinese economic logic are blurred to the eye of the foreigner since the perception of what is right and wrong in an economy has a completely different starting point in China. The goal in China is to maximize profits for state, not for companies as it traditionally is in a neoclassic economic perspective.

As identified in Part 4, foreign subsidiaries with the ability to balance the external and internal forces influencing the foreign company, will most likely have better chances of surviving in the Chinese market. The institutional duality is thus important for the manager of the foreign company and it is important for the manager to have the ability to control and balance the institutional duality in the subsidiary. As found in Part 4, it is important for the foreign company to continuously be ready to change its boundaries at the same pace of the changes taking place in the market it operates in. If the foreign company arrives in the Chinese market only with practices formulated in the host country this may not be beneficial for the subsidiary's performance. The external forces of the Chinese institutional set-up would be too strong a force. The foreign company has to relate to these forces and find a balance between utilising its own capabilities and making itself significant enough for the Chinese government to rely on its operations. This means that the foreign company might not have the possibility to avoid being used strategically as an economic instrument by the Chinese government. However, if the foreign company is capable of balancing external and internal forces, and can continuously upgrade itself, it may get into a position that is important for the Chinese government to use in its strive to boost economic growth. This position enables foreign companies to have the possibility of navigating the waters of the Chinese economy. This line of thinking very much resembles Peng's (2002AB) arguments that strategic choices are not only driven by industry conditions and company specific resources but are also a reflection of formal and informal constraints of the institutional framework that companies face. Consequently, foreign companies in the Chinese market may end up shaping their business strategy so as to adjust to the institutional set-up they face in the Chinese market. This is in line with Scott's (2008) argument that organisations in certain environments are pressured to take the form best adapted to survive in that environment, and that organisations are pressured to ensure that their goals match wider societal values.

Thus, there is room for the Chinese government to strategically use foreign companies to upgrade their own and within this room there is space for foreign companies to gain something, not only give.

The two players might have different goals or agendas but some of the methods used to achieve those goals have positive spill-over that is mutually beneficial to both players. This line of thought is illustrated in figure 7.

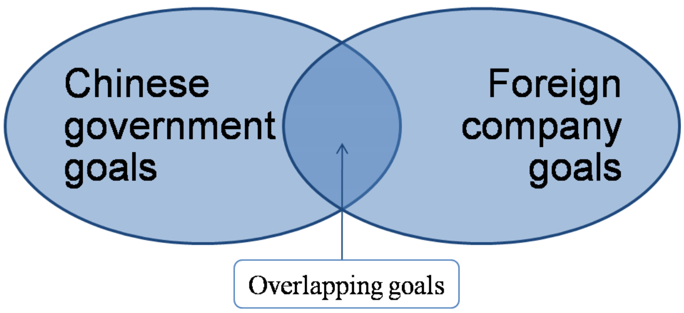

Figure 7: Overlapping goals creating a win-win situation.

Figure 7 illustrates that the two players, the Chinese government and the foreign companies, may have different goals but there is an overlap where each of the players' goals can align, for the benefit of both. That the Chinese government may be using the foreign companies strategically to upgrade their domestic enterprises, and thereafter use the foreign company as another part of the economic tools available to the Chinese government, does not necessarily pacify the foreign company to be crowded out. By continuously upgrading their core competencies, foreign companies will continue to have something that the Chinese enterprises need, thus making the Chinese government dependent on the foreign companies. In addition, possessing unique competencies that capture the Chinese government's interest, the foreign company gets special treatment when establishing itself in a SEZ. By operating in the SEZ, the foreign companies may also get external input to upgrade their core competencies and expand their area of business operation. Thus, the two circles are dynamic. The Chinese government and the foreign companies may continuously upgrade or change their goals and thus the overlap and their mutual dependency may change as well. However, within the area where goals overlap, some areas will remain somewhat static. Although the goals of the two players may be dynamic and change, there will still be an overlap, which is where both dependency and a win-win situation for the two players are present.

The national strategically important sectors are sectors that have outmost importance for the Chinese government. These are also sectors in which foreign companies are often ahead of the Chinese enterprises. Thus, Chinese enterprises operating in the national strategically important sectors are dependent on the transfer of knowledge and technology from the foreign companies operating in these industries.

Figure 7 also illustrates that although the two perspectives have different starting points it is important for both players to understand each other's starting point. By understanding each other's starting point it will be possible for both the Chinese government and the foreign company to find out where the overlap of goals is, and thereby aligning in a win-win situation.

Sub-conclusion to Part 5, analysis three

The aim of Part 5 was to combine the two perspectives analysed in Part 3 and Part 4. Combining the two perspectives provided the answer to research question five[41] and an understanding upon which to reject or accept the hypothesis.[42]

The Chinese government was found to be dependent on foreign companies' contribution to innovation and thus foreign companies' operation in the Chinese market. Especially, the Chinese government is dependent on the technological advance that foreign companies possess to be utilised in the national strategically important sectors that may be argued to all urgently need environmental upgrading. It was thus found that institutions influence organisations and that organisations may influence institutions

Further, much in line with Porter's (1990) theories on competitiveness, the Chinese government encourages competition between provinces and official agencies creating rivalry and ultimately growth, efficiency and innovation. The Chinese political economy is a matrix of complex power structures. However, further analysis revealed that this matrix does not necessarily create bottlenecks for the enforceability levels of policy. On the contrary, the vertical and horizontal lines making a matrix of political representation actually enables flexibility, allowing the Chinese government to operate across several levels of the economy simultaneously. Thus, the Chinese government uses several elements of the political economy as a tool to enforce policies. The Chinese government is allowed to do this by maintaining its legitimacy to the people by continuously upgrading living standards and promoting economic growth.

The Chinese government also makes room for rivalry to take place between companies but only to the extent where rivalry is beneficial for the Chinese enterprises. It may thus at first sight seem impossible for foreign companies to navigate their strategy in the national strategically important sectors. However, it was found that one way for the foreign company to sustain competitive

[41] Research question five: *which elements of the Chinese institutional set-up foreign companies face when operating in Chinese national strategically important sectors influence the strategy of foreign companies?*

[42] The hypothesis: *the Chinese government is strategically using foreign companies to cultivate the home market and ultimately to promote the growth of the Chinese economy.*

advantage is to continuously upgrade core competencies. By identifying and managing sources from the environment to which the foreign company is exposed, the foreign company may use governance change beneficially.

Finally, seen in the light of the findings throughout these three analyses there seems to be significant support for accepting the hypothesis. However, although foreign companies are strategically being used by the Chinese government to cultivate the domestic market and ultimately promote economic growth it does not pacify the foreign companies to merely being macroeconomic organs benefitting from operating in the Chinese market.

Although the two players may have different agendas and methods, there is room for both the Chinese government to strategically use the foreign companies and room for the foreign companies to gain something, not only provide to the Chinese enterprises. By proactively upgrading their core competencies, for instance through the beneficial treatments in SEZs, foreign companies will continue to have something that the Chinese enterprises need, making the Chinese government dependent on the foreign companies.

Although the two perspectives may have different goals, it is important for both to understand each other's starting point. By understanding each other's starting point it is possible for both the Chinese government and the foreign company to identify where their goals overlap and thereby align in a win-win situation.

Part 6 Conclusions and Further Perspectives

Conclusions

This thesis set out to explore the Chinese government's possible agenda of strategically using foreign companies operating in national strategically important sectors to upgrade their own and thereby boost the Chinese economy. The introduction and hypothesis of this thesis was:

"The Chinese government is strategically using foreign companies to cultivate the home market and ultimately to promote the growth of the Chinese economy."

The thesis examined the hypothesised dilemma from first, the perspective of the Chinese government and second, the perspective of the foreign company. The two perspectives were each analysed and finally, the two perspectives were combined in a third and final analysis.

Taking departure in understanding aspects of the institutional set-up in China relevant to the national strategically important sectors, it was concluded that understanding the importance of institutions in the Chinese market is vital for getting the overall picture of the institutional set-up that the Chinese government and the foreign companies operate in. Aspects of the Chinese economy affecting both the Chinese government and the foreign companies' strategy and action in the Chinese national strategically important sectors are played out in formal and informal structures of the Chinese political system.

From the examination of the Chinese government perspective, it was concluded that the Chinese government is pursuing a strategy with tools to manoeuvre at several levels of the economy simultaneously to increase economic performance: from the central government to local agencies, and from SOEs to foreign companies. These are all instruments contributing to play a symphony of economic growth with the Chinese government and the CPC as the conductor. The vertical and horizontal political structures of the Chinese economy were found to not be a muddling matrix but actually enabling flexibility for the Chinese government to operate across the economy. In this way, Chinese political structures are as a path down to the lowest part of the economy to 'get things done', making the political economy an excellent tool for the Chinese government to enforce policies. China's economy is a mixture of capitalism and socialist command economy providing the government greater flexibility to intervene in business decisions. The Chinese government is allowing competition to take place in the market, but only to the extent where it is beneficial for the domestic companies. This way of using every unit of the economy as players in the macroeconomic orchestra may create a tune which is disharmonious to a western ear. Neoclassic economy usually does not allow for the free market to enfold government controlled regimes. However, in China this is what is happening. To the Chinese, this does not seem to be a paradox. Rather, government measures seem to be viewed in a holistic perspective of whether they contribute to the overall goal of economic growth or not. If economic growth is the outcome, most tools seem to be acceptable. Therefore, in the case of the Chinese government, and the foreign companies operating in the national strategically important sectors, it is concluded that Chinese institutions provide the rules of the game, whereas organisations act as the players of the game. The Chinese government's role is argued to be the parenting institution in the market. The lines of Chinese economic logic are blurred to the eye of the foreigner since the perception of what is right and wrong in an economy has a completely different starting point in China. The goal in China is to maximize profits for the state, not for companies, as it traditionally is viewed in a neoclassic economic perspective.

Obviously, foreign companies are influenced by this government strategy. The strategic choices of foreign companies operating in national strategically important sectors may not only be driven by industry conditions and company specific resources, but are also a reflection of formal and informal constraints of the Chinese institutional framework the foreign companies face. Therefore, it is argued that the foreign companies may end up taking the form best adapted to survive in the environment of the national strategically important sectors, that is, to ensure that their goals match wider societal values in China. With regards to the national strategically important sectors it was found that Chinese government policies require foreign companies operating in these sectors to transfer knowledge and technology from the foreign company to a Chinese enterprise partner or supplier. Partnering with a Chinese partner has both positive and negative consequences for the foreign companies. A positive effect is that partnering with a SOE means gaining access to local government support, reputation, and access to suppliers. A negative effect, partnering with a SOE, means giving away core competencies and, in accordance to Chinese law, become regarded as a Chinese entity.

Inviting foreign companies to operate in the Chinese market also entail a bottom-up trend of soft convergence. This trend may lead to institutional changes and influence informal constraints in the market, which ultimately may affect Chinese government policies. An example is the environmental and sustainability standards that some foreign companies bring into the Chinese market, pushing the institutional set-up to adjust to the foreign company demand. In the analysis combining the two perspectives it was concluded that these demands of foreign companies are welcomed as they may be used as an opportunity for the Chinese government to upgrade for instance environmental standards thus meeting the need in China for environmental upgrading, as well as fulfilling the requirements of foreign companies. This means that, to the Chinese government, foreign companies' contribution to innovation is necessary. In this respect, the Chinese government is dependent on foreign companies' innovative operations in the Chinese national strategically important sectors.

Based on the findings from the three analyses it was found that there is significant support for accepting the hypothesis. This thesis concludes that the Chinese government is strategically using foreign companies operating in national strategically important sectors to cultivate domestic enterprises to ultimately promote economic growth. However, being strategically used as a tool in the Chinese economy does not necessarily pacify foreign companies to give up and be crowded out. From the examination of the foreign company perspective it was found that for a foreign company to not drown in being exposed to external influences, pressures from headquarters, and transferring knowledge to Chinese enterprises, the foreign subsidiary's capabilities and resources need to be dynamic and renewed over time. Thus, instead of only reacting to internal and external pressures, the subsidiary has to proactively integrate, and renew core competencies as well as balance the institutional duality in order to be beneficial and avoid being choked by pressures from headquarters. Therefore, it is important for the foreign company to continuously be ready to change its boundaries at the same pace of the changes taking place in the Chinese environment around them. By continuously upgrading their core competencies as well as balancing external and internal pressures, foreign companies will continue to have something that the Chinese enterprises need which is important for the Chinese government to use in its struggle to boost economic growth. Although the two perspectives have different starting points and goals, it is important for both players to understand each other's perspective. By understanding each other's perspective it is possible for both the Chinese government and the foreign company to find momentum where goals can align and a win-win situation, so often proclaimed by the Chinese government, can be achieved. It is within this momentum that both players can navigate the Chinese national strategically important sectors successfully.

Further Perspectives

From hero to victim

This thesis concluded that the Chinese government is strategically using foreign companies operating in national strategically important sectors to cultivate domestic enterprises to ultimately promote economic growth. However, it was also concluded that foreign companies are not necessarily pacified and give up and do nothing. One conclusion was that the foreign companies need to continuously keep up with the Chinese environment around them. It was concluded that the Chinese government is dependent on the advanced knowledge and technologies that the foreign companies possess. It may be argued that the foreign companies operating in national strategically important sectors are ‘China heroes’ since the Chinese government offer them beneficial treatment and possibilities not offered in other sectors. However, as argued in this thesis, nothing is static and this also includes the foreign companies’ ‘hero treatment’. For example, what happens if a SOE has absorbed the knowledge and skills from the foreign company and the Chinese government does not need the foreign company anymore? The Chinese government may then put a stop to the preferential treatment of the foreign company, which is partnering with the SOE. If the foreign company is relying on business operations mainly fulfilling the Chinese government’s need to upgrade that specific SOE, the foreign company will quickly go from hero to victim. Therefore, it could be interesting to document and analyse each step that foreign companies operating in national strategically important sectors go through - from hero to victim. Such an analysis would help identify exactly which tools should be used in each phase, or step, in order to avoid being crowded out. Identifying these steps would be relevant not only to foreign companies operating the Chinese market, but also in similar transitional markets. SEZ and national strategically important sectors with preferential treatments are found all over the world including Brazil, Peru, India, the Philippines, Korea, Russia, etc. Thus, such a study may enable the production of a generic model available to foreign companies operating in emerging economies all over the world.

Legitimacy and China in a global perspective

This thesis’ findings about the Chinese government’s ability to not only maintain legitimacy through changing leadership but also its ability to utilise the legitimacy in the Chinese economy is quite remarkable. However, several trends touched upon in the thesis may be the first strokes of a painting illustrating the CPC and the Chinese government finding it harder to maintain the legitimacy of the people. The soft convergence of international influences, both at the business and the individual level, may result in the emergence of conflicting perceptions of values.

This thesis concluded that it is possible for the Chinese government to maintain the paternalistic role achieving legitimacy to both ‘take the best from’ free market economic tools and use them in a socialist command economy. However, in the future, it may become a major challenge for the Chinese government to avoid a clash between the understanding of values and the spirit of the nation, versus the open market economy, especially if economic growth should slow down. This would perhaps make legitimacy creation more difficult and thus make it harder for the Chinese government to maintain its visible hand in the market.

China and global competitiveness

In a global perspective, Chinese legitimacy is already challenged. The Chinese government's method to get access to resources, in for instance Africa, has received massive international critique. Nevertheless, the Chinese government maintains its focus making bilateral agreements with other nations, with a 'no intervention in internal affairs' attitude. A completely different challenge of opposition is when the SOEs are expanding to developed economies. Chinese management methods and routines may be argued to not live up to international standards which disable the Chinese enterprises and hinder their successful operation in developed markets.

International business in a new perspective

The conclusions of this thesis emphasises the need for objectivity in international business studies. International business studies made from the west may be argued to often overemphasise rational perspectives, viewing international business from a neoclassic economic perspective, inevitably raising the possibility for international business studies to produce ethnocentric cross-cultural comparisons, biased towards 'own starting point'. It may thus be argued that international business research calls for taking two perspectives in cross-cultural studies. Emphasising both emic and etic approaches in international business research would therefore create a more holistic picture.

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