

Abstract preview

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## **On Managing the Process of Global Network Legitimacy: A Chinese Company Perspective**

### **Abstract**

This manuscript combine concept from institutional and network theory to analyse and explain the currently observed behaviour of a Chinese telecommunication equipment company in securing their global network legitimacy. Legitimacy is garnered when the firm conforms to regulative processes, institutional norms and cognitive meanings within the international environment, without ignoring China's institutional endowments and institutional stances. For practitioners, this manuscript shows how companies in latecomer industrialising countries can overcome the late mover position in establishing their legitimacy in a globally, embedded technological network dominated by firms in the advanced economies. For academics, it demonstrates the importance of state's strong sense of protective paternalism in helping to construct competitive indigenous firms that could take on global giants.

**Key words:** China, Institutions, Network legitimacy

## Introduction

Today, firms from emerging nations like China are internationalizing in greater numbers and more rapidly than ever before. But internationalizing is also fast becoming increasingly difficult for these firms, given their position of lateness and newness to the global market. A key question often posed is whether Chinese firms can really challenge the global giants, where the main beneficiaries of the “global level playing field,” are those that are based in the advanced economies (Nolan, 2001). This manuscript contributes to this debate by seeking to gain a better understanding of the international expansionary activities of one Chinese firm and the challenges they faced.

We examined these challenges via the construct, “organizational legitimacy” (Suchman, 1995; Deephouse, 1996), combining it with institutional theory (North, 1990) and network theory (Hakansson, 1982; Ford et al, 2003). Legitimacy is garnered when firms successfully market their competencies to key stakeholders, by conforming to regulative processes, institutional norms and cognitive meanings within the international environment. Firms sharing the same environment often choose the same practices or strategies and become isomorphic with one another (DiMaggio and Powell, 1983; Baum and Oliver, 1991). In this way, legitimacy is concerned with how stakeholders perceived one another and how they may co-operate in future inter-partner alliances and programs. From a network perspective, legitimacy deals with firm’s ability to access other firm’s resources and activities needed in the production and transformation of industrial goods and services. Key to their success is their ability to relate to other firms in the network, in wanting their resources and the activities they perform.

But due to the liability of newness (Singh et al., 1986) and foreignness (Zaheer, 1995), firms from emerging nations like China face considerable difficulties and resistance in establishing their network legitimacy. The liability of newness occurs because young organizations have to learn new routines and forms of behaviour in order to conform to the environment. They therefore have a higher likelihood of failure than do older organizations (ibid). Young organizations must also compete with older organizations who have already achieved legitimacy (Singh et al., 1986) although the longer an organization survives in an environment, the more likely it is to have conformed to legitimacy pressures. Organizations that do not conform will not survive.

Indeed, Chinese firms pursuing an international network legitimacy agenda typically start off from the position of having to adjust to existing network norms, meanings and practices - much of it imposed by advanced, western economies. Closer examination of their legitimacy orientations is needed, not just internalized behaviour changes in making the transitional adjustment. Legitimacy orientations involve general and specific management of the firm’s network activities and resource dependency with key institutional stakeholders over the course of the transition. More important, these orientations have to be continuously justified and realigned - described derivatively as political, economic, technological and social manoeuvring processes that a firm undertakes - to ensure quality and fit with international network norms, meanings and practices. These takes place in the context of both local and international interdependencies, of both a complementary and a substitute nature, involving both cooperation and competition between key institutional stakeholders. Over time and over many exchanges, network orientations and justifications are linked to globally sanctioned network relational norms, meanings and practices. This central argument informs and entails the structure that we adopt in the following discussions.

The article is organized as follows. We begin with a section revisiting institutional theory and organization legitimacy from a market-as-network perspective, the central analytical concept in this paper. The second section examines the interface between network legitimacy orientations, legitimacy justification and alignment actions. Against this assessment, we present an inductive interpretative case analysis of Huawei Technologies, and examine its normative legitimacy seeking agenda in a globally embedded telecommunication network. The article concludes with a discussion of the theoretical and managerial implications, and the contributions are these:

1. We advance our understanding on how institutional and network theory could be combined to analyse and explain organizational legitimacy.

2. At the business level, we investigate how companies from developing nations pursue a global presence and establish their legitimacy.

### **Institutional theory and organization legitimacy: A network perspective**

In studying the adoption of particular organizational practices or strategies (e.g., Meyer and Rowan, 1977; DiMaggio and Powell, 1983; Scott, 1995), institutional theory is widely used. A central tenet of institutional theory is that organizations need to achieve and maintain environmental legitimacy, defined as 'a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs and definitions' (Suchman, 1995, 574). In order to survive, organizations conform to the rules and belief systems in the environment (Meyer and Rowan, 1977; DiMaggio and Powell, 1983) because this isomorphism earns them legitimacy (Suchman, 1995; Deephouse, 1996).

The process of legitimacy itself may be analytically decomposed into two, referred to as legitimation and justification (Parson 1977:358). We extend Parson's consideration by linking it with network theory, thus allowing its application in B2B markets from a network perspective. We described legitimation as the process in which specific network legitimacy orientations are generated. Over time and numerous interactions, these orientations which are targeted at key network stakeholders are accepted as approved features of network and institutional practices and norms.

These orientations, however, have to be justified. In an industrial network system, justification takes place in a context of interdependencies of both a complementary and a substitute nature. It involves both cooperation and competition between network constituents. Over time, and over many exchanges and interactions, these orientations are linked to sanctioned relational behavioral actions in the industrial network system. Justification is therefore a critical and inevitable part of the network legitimacy processes, being the establishment and nurturing of a firm's network legitimacy among the network constituents.

In a globally embedded telecommunications sector, legitimacy orientations and justifications manifest in transformation processes that stems from innovative technical solutions, originating from the management of resource and activity links connecting a firm's technology. As a result, existing technological networks are disrupted, new ones created, connecting the interrelated resource and activity parts of emerging networks, and transforming old industrial production, procurement and consumption. In this way, a firm's legitimacy depends on its ability in relating to others in the network, in wanting their resources. Coming from a late mover position, Chinese firms faced considerable tests of their ability to relate to others.

Figure 1 provides a preliminary model of proposed interactions among legitimacy orientations, justification, and a firm's network legitimacy. Legitimacy orientations and justification, however, must be considered in interaction. That is, particular local, global and transitional network dynamics produce changes in justification, while justification in turn determines what if any changes are necessary in legitimacy orientations. The resulting firm's network legitimacy produces changes in legitimacy justifications, and through a process of learning and unlearning, changes in legitimacy orientations. In this way, legitimacy orientations are both the medium and outcome of a firm's network legitimacy.

"Take in Figure 1"

### **Legitimacy orientations, justification and alignment actions**

Organization can build legitimacy into three traditional categories: pragmatic legitimacy, moral legitimacy, and cognitive legitimacy (Suchman, 1995). Wei and Bello (2004) added state-oriented legitimacy, partner-oriented legitimacy, and customer-oriented legitimacy for foreign business marketers in China. In our analysis of Chinese firms' pursuing an international legitimacy seeking path, we adopted an evolutionary legitimacy orientation - starting from a local, China - centric

legitimacy orientation before progressing to a multinational legitimacy orientation, and eventually developing aspirations to become a global giant, with a global legitimacy orientation.

The practice of initially marshalling its resources from a local market before moving onto a narrow global market is not unusual and is frequently seen as a viable option especially for multinational competitors from emerging nations. Such a practice is partly a reflection of China's historical institutional endowments and their institutional stances that inhibit pace and speed of the firm's internationalization path. They are also partly due to the transitional challenges confronting China within a broader, contextual global institutional setting as a result of regulatory reform and industrial liberalization, chief of which is China's entry into the World Trade Organization (WTO) in 2002.

For Chinese firms aspiring to make the transition from a China - centric legitimacy orientation to a global legitimacy orientation, there has to be a coherent and realistic legitimacy justification and alignment agenda. More important, this agenda need to incorporate the numerous institutional and network dualities that exist in China. For instance, and unlike enterprises from developed nations, Chinese enterprises faced the added pressure of maintaining their unique institutional duality on two fronts. Beside the need to comply with the needs and demands of the global community in which it is seeking legitimacy, Chinese firms also need to comply with the needs and demands of the Chinese government. This unique duality stems from the fact that Chinese enterprises are an integral part of the Chinese central government's economic growth policy that follow a principle of pragmatism, aimed at balancing the pace of economic reforms with social stability (Lin, 1998). How far and fast China will go along the current regulatory and restructuring route in the future will largely depend on the institutional stances taken by China's government. So far, this is affected by domestic policy constraints and counter-competitive forces in the short run, and by political and economic reforms in the long run ((Zhang, 2003). The failure of Chinese enterprises to internationalize has thus been attributed to government indecisions and bureaucracy (Nolan, 2001), often with the government having the final say on the speed and direction of their internationalization path.

Duality also extends to the existing local network community that has, through an ongoing historical process of negotiation and deliberation, created an interlocking system of legitimacy orientations and acceptable justification behavior. But increasing cost reduction pressures in bringing their technology to the global market, movement towards technology convergence and outsourcing has led to a corresponding increase in the level of bilateral, knowledge-creating relationships and their dual natures in terms of combining collaborative and competitive properties. This duality helps explain why there has been a dramatic increase in Anglo - Chinese mergers, acquisitions and technical and marketing alliances activities in recent years as they cope with the integration of information and technology and globalization of markets.

Put simply, despite China's historical institutional endowments of cheap labor access and its corresponding low-priced, low-tech products, foreign help is needed if Chinese telecommunication companies like Huawei are to become global telecommunication superpowers. Huawei has, and will continue to rely on firms like Motorola, Nortel, Nokia and Alcatel to seed the firm's technology. Huawei see these foreign giants as a catalyst for moving the firm up a few rungs on the global R&D ladder. Huge concessions have been made to US and European telecommunication giants as Huawei seeks to enhance its technological and market legitimacy. In a global network community undergoing major industrial liberalization, Huawei increasingly appreciates the importance of a global network, being a connected community of interdependent institutions, each with its own legitimacy. No longer would it be possible for any firms in the global network community to undertake actions without considering the actions and reactions of other firms.

In confronting institutional and network dualities, Chinese firms like Huawei face significant challenges in developing and pursuing a normative legitimacy seeking agenda. There is on-going tension between: (a) processes which take stock of the firm's internal and external legitimacy orientations, which is assumed in behaving legitimately, and (b) justification and alignment processes through its management of network resources and activity dependency, in a transitional economy and a liberalizing telecommunications sector. Both processes are important in our model on firm's network legitimacy. They occur simultaneously, with each assuming the other in its

operation through the processes and sanctions of local and global network interactions and relationships.

## **Research methodology**

In a technology dominated era, the telecommunication sector is a “politically salient sector” (Mahini, 1988): with active government involvement, locally and globally. In the case of China, the nation’s desire to become a global telecommunication player has resulted in this sector benefiting generously from government support through major structural reforms. But while the sector is being transformed, there are also increasing pressures to hasten the pace and transparency of the reform process especially given China’s WTO commitments. These characteristics represent an ideal “critical” or “polar” case in which “the process of interest is transparently observable” (Eisenhardt, 1989, p. 537). The process can be observed, for instance, through reported official press releases, company reports, trade journals, and through industry analyst’s briefings.

This data allows us to propose theoretical and empirical results in a study that combines institutional and network theory. It aims to provide some empirical descriptions and generalizations of network legitimacy. It is not to test hypotheses. This is achieved through the use of case research, allowing us to study interactions between ideas, empirical evidence, and any subsequent and persistent reframing of what is it we are studying (Dubois and Araujo, 2004). Case study research is particularly appropriate to our study given its exploratory nature, and its ability to capture and explain the dynamics of organizational legitimacy, identifying critical legitimation activities and resource connections, with key business, technological and political actors in the network. Indeed, where the phenomenon is complex, is context dependent, and where it cannot be operationalized in quantitative terms, a more qualitative orientation such as case research should be adapted.

Case analysis enable us to examine how organizations are attracted to, selected by, and become members of this network, i.e., legitimize their existence. The appropriate use of a case study in studying a phenomenon (Yin, 1994; see also work by Easton, 1995, Welch and Wilkinson, 2004), in this instance, network legitimacy, was further complemented by prior consulting experience in the industry. We also accessed multiple sources of information and undertook extensive content analysis. As a result, we were able to better understand the process of network legitimation based on anecdotal evidence via direct observation and industry experience, complemented by content analysis of secondary data. We examined this process through an inductive, interpretative case analysis of Huawei Technologies.

## **Huawei Technologies: Case analysis**

Earlier, we noted that network legitimacy may be described as political, economic, technological and social manoeuvring processes that a firm undertakes to ensure quality and fit between its legitimacy orientation and its acceptance by key institutional stakeholders. Over time, firms in the network achieved a sense of legitimacy through the linkages and roles they play in the ongoing interactive production and transformation process of resources in the network. We captured this process, highlighted in circular arrows, through an examination of Huawei’s roles and processes in this section. These are shown in figure 2, representing the AAR’s industrial network framework (see for instance work by Hakansson and Snehota, 1995; Hallen and Lundberg, 2004; Ritter et al, 2004, Hakansson et. al, 2004) and its perceived attractiveness.

“Take in Figure 2”

## **Network Resources**

Huawei was established in 1988 in Shenzhen, Guangdong as a private enterprise during the peak of China’s economic reforms and technological advancement. The company began by selling imported telephone call switches before manufacturing them. It grew rapidly by focusing on the relatively poor Chinese rural regions ignored by larger companies, making and selling low-end, low-

margin switches and access equipment. The company's competitive advantage remains its low-cost home base, a critical network resource. Over time, the company has emerged as one of the world's largest maker of low – end, low – profit margin products.

Its product line has since expanded to include high-margin optical network, data communications networks, wireless networks, handsets and terminals (see [www.huawei.cn](http://www.huawei.cn)), with substantial investments in NGN and wireless technology, especially on third-generation (3G) technologies, in particular Code Division Multiple Access (CDMA) and China's own Time Division Synchronous Code Division Multiple Access (TD-SCDMA). Recent acquisitions offers Huawei the opportunity to cement its global optical communication technologies and free space optic (FSO) technology, thus providing access to the high profit margin, high-end fiber optic market.

Huawei's internationalization has been achieved through a two pronged strategic approach emphasizing price competitiveness and value-added technology products. While the hard-driving expansion of Huawei is taking business away from the more established manufacturers through their well-known low prices, they also have a new weapon in "competitive technology" (Rhoads and Hutzler, 2004). Huawei's price competitiveness and its suite of value - added technology products enable Huawei to have business relationships with major telecommunications giants. It enables the company to satisfy market requirements and helps pave the way for its legitimacy in a globally embedded telecommunication network.

Huawei's most potent network resource is access to the local, burgeoning market. The need to participate in China's greatest telecommunication market is compelling because China's growth offers many telecommunication giants a chance to survive outside of their mature markets. Indeed, as Western industrial technological clusters devolve and relocate to China, access to Huawei's local network community of political, social, economic, technological and legal ties and connections becomes critical. Huawei is aware of this and is using its local market access and power to gain local and global business and technological legitimacy.

### **Network Activities**

How Huawei's manage its activities transformation and configuration also influences its network legitimacy. In recent years, the company has actively engaged in joint ventures, marketing alliances, mergers and acquisitions activities, with numerous local and global network constituents.

For instance, in 2002, it established its 3G Mobile Internet Open Laboratory in Shanghai in conjunction with NEC. Since then the company has signed a cross-licensing agreement of Wide Code Division Multiple Access (WCDMA) related products with Nokia. In 2004, the company set up a joint venture with Siemens, specializing in the development, sales and service of Time Division Synchronous Code Division Multiple Access (TD-SCDMA) technologies and products to boost TD-SCDMA commercialization. In early 2006, Huawei announced a plan to jointly develop ultra broadband products for delivery of converged services with Nortel.

Besides technical joint ventures, Huawei has also actively participated in global marketing, sales, and distribution alliances. For instance, in 2003, Huawei developed a \$US160 million joint venture with U.S.-based 3Com to manufacture and market low-end routers. In early 2005, Huawei announced a mutual distribution agreement (MDA) with Marconi U.K. where the two companies will resell parts of each other's product portfolio. Part of the agreement involves a process wherein they will leverage their respective sales and marketing teams' capabilities and regional strengths on an account-by-account basis. In early 2006, the company also agreed to supply exclusive Vodafone-branded 3G handsets for Vodafone across 21 countries for at least 5 years.

In 2003, Huawei acquired U.S.-based Cognigine and Optimite. These acquisitions offer Huawei the opportunity to cement its position in the global optical communication technology market through Cognigine's innovative network processor and Optimite's Super Dense Wavelength Division Multiplexing (SDWDM) technologies. These acquisitions also complement Huawei's strategic

partnership with U.S. based LightPointe on free space optic (FSO) technology, in turn allowing Huawei access to the high profit margin, high-end fiber optic market.

Collectively, these technical, sales and marketing, merger and acquisition activities have propelled Huawei's market and technological legitimacy onto the world stage. There is a serious danger that global telecommunication giants choosing to bypass Huawei will do so at their own risk. It raises the prospect that no longer is the world able to impose their form of legitimacy if they are to access China's and Huawei's network resources.

### **Network actors and institutions**

Despite being a latecomer to industrialization, China's central government has not wavered from implementing state-led industrial telecommunication policies aimed at constructing large, globally competitive indigenous firms. It has, and will continue to play a key role in generating high rates of equity investment and stimulating technical progress through alliances, mergers and acquisitions. It has also provided soft loans to help with Huawei's international expansion. Further, government-led initiatives in leading tender talks in developing nations have significantly raised Huawei's global profile. The government's strong sense of protective paternalism also ensure that local operators like China Telecom, China Unicom and China Mobile continue to purchase telecommunications equipment from Chinese manufacturers.

In addition, the government's preoccupation with control over standards have resulted in the formation of a complex array of standards advisory groups formed in various Chinese ministries and departments, creating basic application rules for emerging technologies in any number of industries (Kahn, 2004), including telecommunications. These rules are however subjected to various compliance interpretations. In turn, compliance rules affect the behaviour of firms especially in relation to current and future investments. Fuelling this problem is the Government's unwillingness to step back and let the various firms determine these standards. As Ms. Zhang Qi, the Director of the Department of Electronics and IT in China's MII remarked recently:

*"Owning and winning the initiatives in setting industrial standards should be top priorities for domestic manufacturers. MII would help form various alliances among domestic manufacturers to gain the upper hand against foreigners in setting industry standards."*

These institutional policies and actions are not the entire story. It does, however, reinforce the view put forth by Child and Tse (2001) that there are three institutional spheres affecting the operations of firms in China – government, the structure of industries and firms, and business relevant intermediate institutions. While there has been massive institutional change since 1979, any institutional changes remain highly complex. In this formerly closed, state-dominated system, institutions have developed into a massive inter-dependent, multi-level network whose logic of operation depends as much on political influence and personal relationship as on concern for efficiency (Child and Tse, 2001). Rather than stepping back and letting the market operate, "government influence and industry protectionism" have instead resulted in a raft of conflicting and ambiguous policy announcements.

While ambiguous policies generate uncertainties for both local and international firms operating in China, companies like Huawei are better able to deal with institutional changes and resulting ambiguous policy announcements. Thus, institutional changes have provided the potential for Huawei to construct successful local and global R&D and technical joint ventures and marketing alliances. Paradoxically, China's bureaucracy, which has a tendency to limit the expansion of ambitious, and increasingly entrepreneurial indigenous firms like Huawei, could also limit its global legitimacy seeking efforts.

### **Conclusions and Managerial Implications**

In our model, we propose that network legitimacy is an important condition for organizational success in a technologically embedded global network. Firms from emerging nations like China have faced difficulties in gaining global network legitimacy because of their newness and the liability of foreignness. Many start off from the position of having to adjust to existing global network norms, practices and belief systems. This often involves demonstrated commitment to the interests of key institutional stakeholders and network constituents.

For Chinese firms, commitment takes place against the backdrop of the institutional endowments of China's traditionally closed state-dominated system as well as consequential institutional stances taken as a result of global regulatory reforms and industrial liberalization. The pursuit of a global normative legitimacy seeking agenda by Chinese firms needs to be continuously justified and realigned, taking into account the political, economic, technological, social interests of key local and global institutional stakeholders. Over time, these firms achieved a sense of legitimacy, through their ability to conform to institutional norms and practices and belief systems.

Chinese firms like Huawei appear to have grasped the significance of network legitimacy, evident in their spread and intensity of its network activities. The firm actively participates in and engages in technical and marketing alliances, joint research and development programs, world-class management practices, infrastructure, and international technology benchmarking, with key local and global network constituents. This has allowed the company to gain valuable experience and information about acceptable network values, norms and practices as it attempts to develop and implement its global legitimacy agenda.

Importantly, the company has developed strong views on interaction interrelated to the management of their network legitimacy. From working with both government controlled carriers like China Netcom and China Mobile and also global giants like Nortel, Marconi, NEC and Vodafone, Huawei can lay claim to its business and technological legitimacy in key global business and telecommunication networks. "Making the World Listen" is how one journalist (Dolven, 2004) writing in the *Far Eastern Economic Review*, explains Huawei transition from a relatively unknown indigenous Chinese telecommunications company to a potential, global telecommunication giant.

"Take in Figure 3"

From a managerial perspective, our analysis extends our understanding of organizational legitimacy in industrial networks by combining institutional and network theory. Given the ambiguity of context that manifest in greater pressures for organizational legitimacy, we have now developed an understanding of the interaction between network orientations, justification behaviour and network legitimacy. Any interaction must, however, regard institution and institutional change as the central and most consequential feature of Chinese firms' transition and its impact on the management of resources and on activity dependency and transformation.

But there are limits to the pace of institutional changes. Economic reforms in China need to take into account social stability. There is also the policy challenge of whether it is feasible or desirable to construct indigenously owned large businesses, which can challenge the global giants (Nolan, 2001). At a firm level, Huawei is still a privately-owned company and does not report its final results. While there has been talk of an IPO, this has remained elusive. As a business entity, Huawei's legitimacy might therefore be compromised and reinforcing the stereotype that China's state owned firms invest overseas at Beijing's bidding (ibid) in their quest to construct an indigenous global giant.

Furthermore, with more foreign competitors entering China's telecommunications markets, pressure will increase to reform and replace the current centrally administration – oriented resource allocation system with a transparent, fair, timely and pro-competitive one (Zhang, 2003). Of immediate concern to China and Huawei is the role of the World Trade Organization (WTO). As an exogenous institution for the member states, the WTO influences its members' domestic telecommunications regulatory institutions, at least theoretically (Zhang, 2003). While the actual effects may be different and will depend on the institutional endowments of host countries and their institutional stances, it is

only a matter of time before standard policies, practices and norms are made known, well understood and compatible with similar worldwide practices and norms. Delays in implementing its full WTO commitments may mean that the full weight of the international pressure being brought to bear on it to observe the Agreement it has signed. This will severely compromised Huawei's ability to global legitimacy in the global telecommunication market.

Finally, while the Huawei case represents a "polar" case, and hence limits the generalisability of our findings, it does offer a measure of support of some of the concepts and proposed interactions among concepts of the model depicted in Figure 1. Future conceptual frameworks that seek to deal with network legitimacy would do well to take into account these interactions between concepts. While these interactions remain untested, the model we have proposed remains subject to modification. In the context of a transitional global telecommunication sector which constantly changes and the emergence of companies from developing nations who seek a global presence and legitimacy, this setting should prove ideal.

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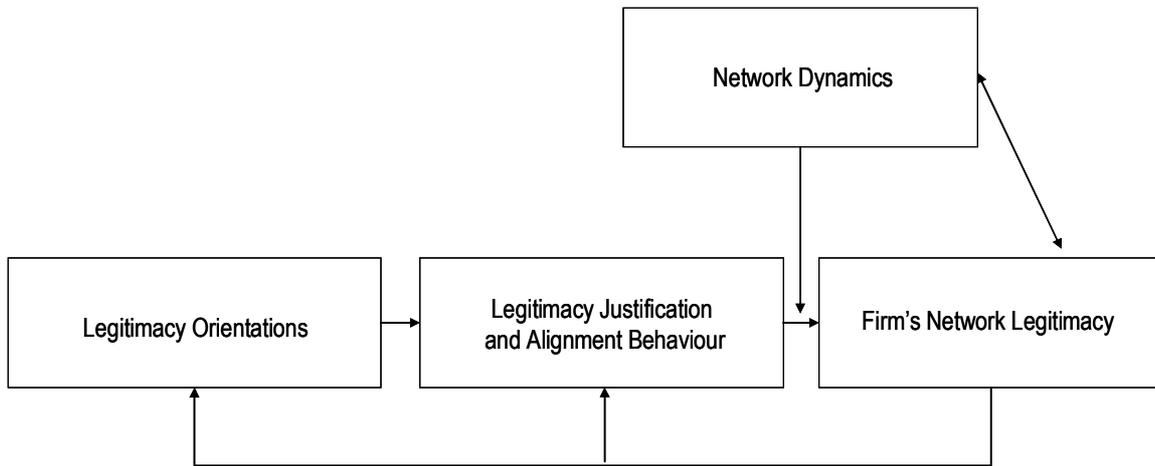
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**Figure 1: Legitimacy orientation, justification and outcomes – A Network Perspective**

Legitimacy Orientations	Legitimacy Justification Behaviour Interface			Outcome
	Actors	Activities	Resources	
China Focus	Government Institutions and Bodies	R & D Manufacturing	Technological Financial	Local and Global Network Legitimacy
Developing Nations	Equipment manufacturers	Sourcing Exporting	Local market access Quality control skills	
Developed Nations	Carriers Investors	Benchmarking Training & Education	Price Competitive and Value Added Product	
Global	Private & corporate customers	Social & regional development Mergers & Alliances	Global mergers and alliances International management skills	

**Figure 2: Network Legitimacy Orientation and Justification Behaviour of Huawei Technologies**

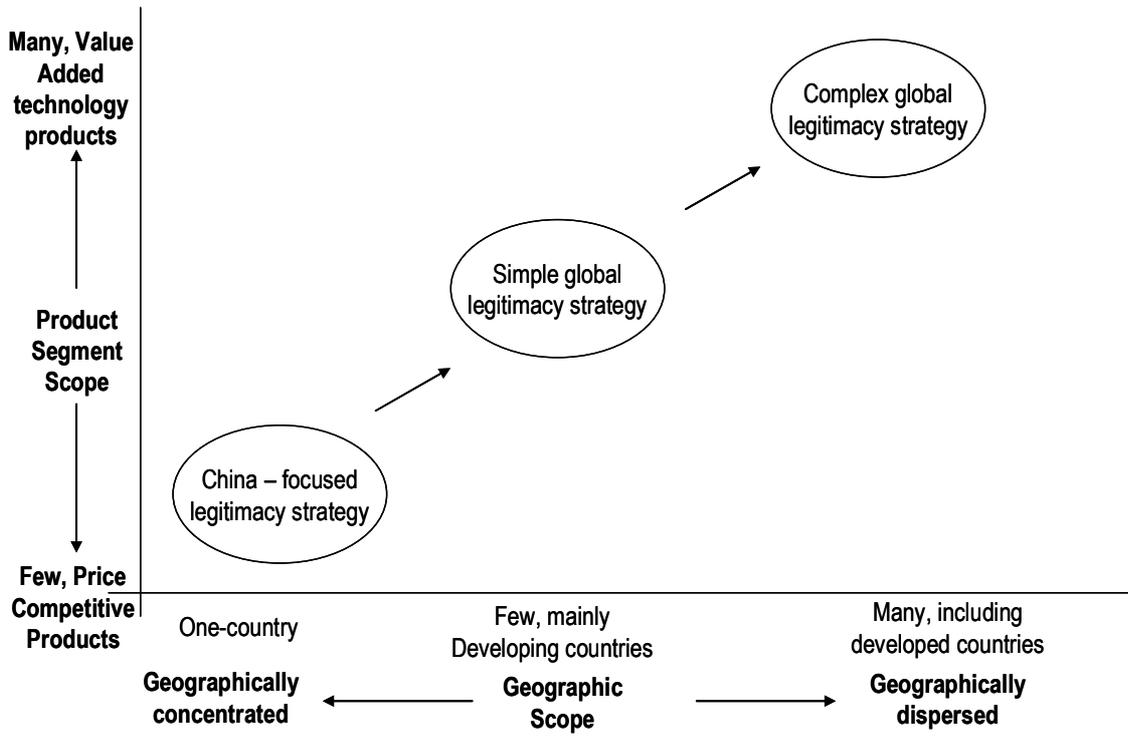


Figure 3: Evolution of Huawei's Network Legitimacy Orientations