

Institutional capability in SME internationalisation: empirical cases from China

Authors

1. Tian, Anna Y, annatangok@hotmail.com, [Presenter], (Xi'an Jiaotong Liverpool University, Suzhou, China)
2. Nicholson, John, j.nicholson@hud.ac.uk, (University of Huddersfield, Huddersfield, United Kingdom)
3. Chi, Renyong, chirenyong@mail.hz.zj.cn, (Zhejiang University of Technology, Hangzhou, China)

Abstract

This is an empirical research paper based on the data of 20 in-depth interviews with SME aiming for international markets. The paper presents evidence of institutional voids (Tracey & Phillips, 2009) and the process in which SMEs' attempts to build up relationships with institutional and organisational entities. The focus of the empirical investigation is to suggest SMEs' institutional capabilities and capital in the process of attempting international markets.

Extant literature discussing relationship and networking building of Chinese SMEs has been extensively focused on *Guanxi* – a culturally grounded notion of social and relational proximity – and interpersonal relationships (e.g. Barnes et al., 2015, Su et al., 2015). This is mainly because Chinese SMEs have been involved in a rich history of interpersonal relationships, often developed historically to compensate for formal institutional weaknesses or voids. Scholars suggest that efficient markets depend on supportive formal institutions that may provide both formal and informal rules of the game (Boschma, 2005). There is very limited research undertaken to understand non-interpersonal based relationships (Wright et al., 2005). Our study is intended to discover how non-interpersonal based relationships, mainly with institutions and organisations, are created, developed and maintained. We followed a conceptual framework of proximity and distanciation offered by Nicholson et al. (2013) to study how the Chinese SMEs developed institutional capabilities to obtain optimisation of relationship building.

The context of this paper is that the Chinese SMEs have to face relationships and network building outside their traditional interpersonal relationships. For example, they have to face legislative changes and reforms launched by the Chinese government, respond to foreign firms that enter their domestic market, as well as contact foreign customers in overseas markets. Traditional interpersonal relationships and networks do not seem to be effective in working in this new context. Therefore, we aim to processually study the relationships that the sampled SMEs built up and how they develop these relational and indeed dynamic capabilities (Tece, 2009) of actor networking with institutions and organisations.

The study undertakes a processual approach to understand how the Chinese SMEs reacted to low levels of institutional resources in the business environment. The sampled SMEs were selected in terms of SME definitions in China. The data was collected from manufacturing companies located in the North to South China along the East coast, where SMEs importantly contribute to economy of mainland China. Theoretical sampling was adopted to maximise opportunities to collect data in the chemical and engineering sectors. In this paper, data of 20 cases was collected between January 2008 and August 2016. In all interviews, the respondents shared experience overcoming institutional barriers and difficulties; as well as their

engagement with the extant institutional environment. They also explained how they intended to build up relationships with institutional and organisational entities when they try to venture in international markets.

Building on ideas developed by Tian et al., (2018), this paper proposes certain patterns of relationship that the sampled SMEs have been going through with local institutions or organisations when aiming international markets. There are five phases suggested in the paper to illustrate how the SMEs built up institutional capabilities in an evolutionary process. Based on the empirical data, the paper is intended to provide theoretical contributions to the current literature in terms of institutional capability and relationship building in an emerging economy.

1. Introduction

China has a great transformation in the last four decades from the centrally planned economy to a market-based economy along with marketization, liberalization and privatization (Hitt and Xu, 2016). Institutional transition has also become an emerging area that the Chinese government intended to focus during the course of internationalisation. The local political and regulatory systems, legal frameworks, and market structures are undergoing a dramatic change in order to build a more supportive institutional environment. Many scholars show great interest to study institutional evolution and transition from various perspectives. For instance, Hitt and Xu (2016) explore how the changing institutional environment and its characteristics affect local and foreign firms' behaviours in a context of China. Tracey and Phillips (2008) also investigate how entrepreneurs exploit low levels of institutionalization in emerging markets. In this paper, we are looking at institutional evolutionary process from a perspective of SMEs,

First, one needs to understand how institutional factors and the environmental dynamics in emerging economies impact on strategic choices of managers in domestic firms. Second, it is important to recognize that these factors may have different impacts on the strategies of various organizational forms, such as small firms, business groups, and state-controlled firms (Hoskisson et al, 2000: 11).

It is also important to note that networks may be more difficult to operate in developed economies because of the legal and institutional infrastructure that prevent fluid operation of such networks due to intellectual property right laws and other laws restricting cooperation or collusion between firms (Hoskisson et al, 2000: 15)

Emerging economies have been showing great power to develop business and contribute to international markets. Alongside the great contribution, there is also institutional settings and business environment recognised to be challenges for business due to its weak institutional infrastructure, political instabilities and a lack of market-based management skills (Hoskisson et al., 2000). Under this kind of macro environment, SMEs in the emerging economies have endeavoured to survive in domestic market and also venture in international markets. They may have various strategies to overcome institutional barriers both in domestic and foreign markets.

One of the important strategy that SMEs normally would utilise is network and its associated social capital. It's the relationship between individual actors facilitate business interactions for

SMEs. There are resources that SMEs would be unable to access or approach due to its scale. On the contrary, that kind of resources may be controlled by large corporates. For instance, some business groups take advantage of intermediaries and organisational arrangements to fill institutional voids (Khanna and Palepu, 2000; Khanna and Rivkin, 2001; Nachum, 2004). To SMEs in most emerging economies, this is rather difficult.

Institutional arrangements appear to carry relationships and interactions between different organisational entities. SMEs tend to participate in institutional arrangements through various business transactions. A challenge arise to how to develop relationships between different organisational entities and convert that to build up capability related to institutions. This paper is therefore to explore how SMEs create and develop institutional capability within existing institutional settings in an evolutionary process to international markets.

In the following sections, we firstly discuss the theoretical approach of institutional capability; and followed by research methodology and data collection; in section 4, we presented the research gap. In section 5, we offer empirical findings; in section 6, we elaborate discussions and in section 7 we conclude the paper.

2. Literature review

2.1 SMEs and institutional voids in China

As North (1990) suggests, institutions are “humanly devised constraints that structure political, economic and social interaction” (1991: 87). Firms are embedded in both internal institutional environment consisting of the structures, systems and practices (Meyer and Rowan, 1977) and external institutional environment, which provides a context of institutional settings to share with many other firms (Granovetter, 1985). They develop various strategies to be adaptive to formal and informal institutions with “rules of the game” for an economy (Meyer, 2001). Previous scholars suggest that a sound and growing economy largely provides a positive institutional environment that firms can act in a market efficiently (Mo-Gomez-Vazquez et al., 2018; Meyer, 2001). Recent research gives its great attention to emerging economies whose institutions differ significantly from those in developed economies as formal institutions and related institutional facilities in emerging economies are considered not as supportive for SMEs as that in the developed economies (Golenkova & Igitkhanian, 2008; Meyer, 2001; Peng; Puffer & McCarthy). For instance, the legal, regulatory and political systems in China remain weak in the older institutions with inconsistent enforcement prior to the 2000s (Ahlstrom et al., 2003; Park and Luo, 2001).

Institutional voids have been recognised by Chinese government whilst the continuous inward international business with foreign firms. Chinese government called for an urgent development of more effective laws and regulations along with appropriate enforcement procedures (Chen, 2007). The most important institutional changes began in the early 1990s, for example, market reforms began in 1992 prior to the policy of encouraging SMEs to invest in overseas markets (Puffer et al., 2010; Bhaumik and Co, 2011). Although new policies, laws and regulations have been put in place, but they are far to be properly implemented and they also require the development of different norms and a cognitive mindset to accept at a national level (Hitt and Xu, 2016). Meanwhile, due to the limited time of development, most Chinese SMEs had not well experienced the international markets and built up capabilities to make these investments successfully although they intended to learn from alliance partners (Hitt et al., 2005).

Scholars argue that in a business environment where the institutional mechanisms enforcing impersonal obligations are often weak or non-existent, then individual's personal obligations are likely to be given priority (Puffer, McCathy and Boisot, 2009). The mainland Chinese market-based structures were still in the early development, requiring SMEs to overcome institutional barriers and disadvantages using traditional practices derived from culture. Therefore, informal obligations and relationships would play a significant and complementary role in regulating behaviours and relationships between firms (Chen and Chen, 2004; Luo, 2000; Gao et al., 2010). Specifically, Chinese SMEs relied on informal relationships as a means of doing business, the practice of which is referred to as social capital or *guanxi* (Xin and Preace, 1996; Fuller and Tian, 2006; Trusov, Bucklin, and Pauwels 2009). The informal relationships and networks allow firms to overcome the limits of weak institutional infrastructures, access external resources and information, and deal with business uncertainty in China (Adler and Kwon, 2002; Shengetal, 2011). Moreover, the informal relationships and networks also absorb the institutional uncertainty that cannot be reduced through formal institutional arrangements and settings whilst individual entrepreneurs build up relationships (Boisot & Child, 1996; Li et al., 2013). The business partners and alliances are often given access to critical resources and trustworthiness is established in a reciprocal process (Carney et al., 2009). Hence, informal institutions serve as substitutes for the voids of formal institutions in the context of China (Child and Rodrigues, 2011; Nicholson, Tsagdis and Brennan, 2013; Hitt and Xu, 2016; Sok, O'Cass and Miles, 2016).

In the real business world, Chinese SMEs would also naturally associate business relationships with social capital and pay a good attention to networks and relative capabilities (Tian et al., 2018; Chollet et al., 2014). It is effectively useful for Chinese SMEs to create and maintain business relationships in order to innovate, create values, and build up competitive advantage (Adler and Kwon, 2002; Burt, 1992; Inkpen and Tsang, 2005; Mu et al., 2017). It can also help them leverage resources, gain support and advocacy needed for product development and therefore to improve performance, as well as access market information of emerging regulatory policies and firm information that may be unavailable publicly (Mu et al., 2011; Sheng, Zhou, & Li, 2011; Acquaah, 2007; Peng & Luo, 2000)., networking capability allow them to establish strong relationships with government and authority leaders at local and national levels (Child and Rodrigues, 2011; Hitt and Xu, 2016).

2.2 Institutional capability in SME internationalization

Having considered the institutional voids in domestic market, Chinese SMEs also have to face institutional challenges when venturing aboard. Particularly, they may carry the similar understandings and perceptions to deal with relationships with foreign institutions as they do in domestic market (Jack 2005; Johannisson 1996; Uzzi 1997). When trading with business in international markets, Chinese SMEs tend to look for opportunities effectually (Brouthers, O'Donnell, & Hadjimarcou, 2005) and seek for gaps between low levels of laws and institutions (Mol-Gomez-Vazquez, Hernandez-Canova and Koeter-Kant, 2018). Previous studies have emphasised institutional and market forces as major drivers for SMEs to be strategically adaptive (D'Aunno et al., 2000; Voss et al., 2010; Huber & Wargotter, 1998; Peng, 2001). On one hand, they flexibly take advantage of institutional protection for business; but on the other, they are also vulnerable to the institutionalised settings and arrangements that are set and designed for large corporates (Groh, Von Liechtenstein, and Lieser, 2010). Even worse,

sometimes the formal institutional void could create an environment in which SMEs can be destructive (Baumol, 1990) or impeded (Voss et al., 2010).

Both traditional institutionalism and neo-institutionalism suggest that firms attempt to incorporate norms from existing institutional environments so that they can gain access to resources, environmental stability and legitimacy (Dimaggio & Powell, 1983; Meyer & Rowan, 1977). SMEs and their capabilities are likely to be shaped by framework around institutionalised settings or formal relationships between organisations, for example, within strategic alliances or R&D co-operations (Hoskisson, Eden, Lau, & Wright, 2000; Wright, Filatotchev, Hoskisson, & Peng, 2005; Huber, 2008). Despite the fact that SMEs have very little opportunity to contribute to any decisions of institutional environment, the extant literature provides much evidence of how SMEs engage with the formal and informal accesses to open markets and distribution channels by its advantageous features of flexibility and developing social capital, networking and interpersonal relationships (Jack, 2005; Anderson, 2007; Tian et al., 2018).

In international markets, SMEs' performance is highly dependent on dynamic capabilities, which assist them to integrate, renew and reconfigure their competitive advantages to exploit opportunities and resources (Teece et al., 2007; Chan et al., 2010). According to dynamic capability theory, firms utilise multiple capabilities to adjust to, and succeed in, turbulent and competitive business environments (Eisenhardt and Martin, 2000; Kogut and Zander, 1992; Teece et al., 1997). Dynamic capability involves a number of different functions within SMEs and it includes various aspects (Konwar et al., 2017), for example, networking capability is considered as one of the important capabilities that SMEs have to have when facing uncertain and turbulent business environment in emerging economies (Acquaah, 2007). In response to the unique characteristics of resource environment in overseas markets, SMEs should develop dissimilar types of capability, such as financial capability (Karna, Richter and Riesenkauff, 2016), marketing capability (Konwar et al., 2018), risk management capability (Gao, Sung and Zhang, 2011), knowledge creation capability (Smith, Collins and Clark, 2005) and production capability (Bruton and Aslstom, 2003). Especially for the Chinese SMEs, it's even more important to develop its capability to respond to institutional unfamiliarity and uncertainty in overseas markets (Tracey and Phillips, 2011).

The extant literature the provided some understandings of firms' institutional capabilities. For example, Carney et al. (2016) document how an Indonesian multinational firm develops its Asia market through offering social, physical and regulatory infrastructure. In that study, they define institutional capabilities as heuristics, skills, and routines that facilitate the execution of institutional strategies in host countries and argue that institutional capabilities are transferred with network penetration, relational contracting and business model innovation. Mair and Marti (2009) investigate institutional entrepreneurship with a focus on an NGO case in Bangladesh and respond to how business groups step in to self-regulations and other mechanism of trust when the existing institutions are weak. These are one of the few studies focusing on a large multinational enterprise rather than looking from a SME perspective. There are other research on strategic restructuring to indicate how institutionalisation is under taken in terms of financial, and organizational restructuring (Bowman and Singh, 1993; Gibbs, 1993), organizational structure, internal reorganizations, and downsizing (Johnson, 1996), venture creation (Tracey and Phillips, 2011). Meanwhile, the studies in emerging economies have been very limited due to institutional constraints and lack of developed factor markets. They are

surrounded with the importance of networks (Spicer et al., 2000), the necessity of environmental scanning (May et al., 2000), the importance of risk taking (Makhija and Stewart, 2002), the interactions between institutional transitions and adaptive capabilities (White and Linden, 2002), and the challenges associated with corporate performance (Bruton and Ahlstrom, 2003; Bruton et al., 2003). It is certainly true that “studies of simultaneous evolution or coevolution of organizations and their environments are still rare” (Lewin & Volberda, 1999: 526). Particularly, how SMEs in emerging economies develop institutional capabilities to assist them to leverage internal and external resources and build up competence to survive and outstand amongst other market players.

3. Methodology and data collection

In this section, we outline our approach to process theorizing, along with the more procedural aspects of the methods in the finding section.

We adopted process research of temporal patterning mainly because it “examines events, activities, and choices as they emerge and sequence themselves over time” (Bizzi & Langley, 2012: 225). The empirical research was conducted inductively from a social constructionist (Cunliffe, 2008) perspective and concomitantly we took an “event based human time view of processes,” within that “events are given their meaning by their human connection to past, present and/or future events” (Halinen, Medlin, & Törnroos, 2012: 216). We took internationalisation context from the retrospective accounts of respondents (Golden, 1997). In this way, we expose both past-loadedness of events lying in the across experiences, but also the future-loadedness of expectations built into business relationships (Hedaa & Törnroos, 2008). The historical narratives given by respondents allowed us to probe for events, moments and incidents which led to remarkable changes in institutional engagement and development for the case companies.

The fieldwork was conducted during 2008 and 2016. Semi-structured depth-interview approach was deployed from the outset to invite new understandings to emerge from the respondents (Dick, 2002). One of emergent findings was that many respondents expressed the barriers of accessing to foreign companies and international markets. The particular isolation appeared when interviewees complained about unacceptable interpersonal relationship with foreign companies. This issue identified with effectuated behaviour of developing institutional framework within and outside the Chinese SMEs. Analysis of these interviews allowed us move from open coding (first order analysis) to the identification of a series of macro-narratives (Makkonen, Aarikka Stenroos, & Olkkonen, 2012) relating to institutional barriers and opportunity of creating and developing institutional related resources. Five phases are therefore empirically and inductively identified. Within these phases, we then sought to identify SMEs’ capability of navigating between institutional voids at different levels. Through the use of broad grained, and fine grained bracketing, we aim to demonstrate an evolutionary process of institutionalisation activity in China.

Respondents were senior figures (see Table 1) within 20 Chinese SMEs in the chemical and engineering sectors with between 5 and 16 years’ experience of international business, each of whom had significant experience of the process of internationalization in those firms. The companies were located throughout North-East and South-East China, areas where international business has been growing exponentially over the last three decades, but which still manifest greater formal institutional weakness than core areas of China. This allowed us

the opportunity to gain insightful views of institutional development in the internationalisation process. The available cases were selected according to the definition of ‘SME’ in China as being less than 2000 employees. Firms were selected through local government agencies and later snowballing techniques. Each interview lasted between 1 and 2 hours. The interviews were recorded translated and transcribed by a professional bilingual researcher in order to capture depth of meaning.

4. Research gap

Hoskisson et al. (2000, p. 253) observed that ‘The number of theoretical and empirical studies using an institutional perspective in emerging economies is limited’. Most studies have been focused on institutional capability in developed economies and countries (e.g. Huber, 2008, Meyer, 2004). Moreover, studies exploring institutionalisation related issues in emerging economies rarely focused on SMEs (e.g. Mair and Marti, 2009; Carney et al., 2016). This has indeed offered a new area to be explored in how institutional capability of SMEs in emerging economies is developed (Wright et al., 2005). Therefore, Tracey and Phillips (2011) suggest there is an agenda to explore how SMEs develop institutional capability from low levels of institutionalization in emerging markets.

For Chinese SMEs, strategic decisions and choices are not only driven by industry conditions and firm capabilities, but are also a reflection of the formal and informal constraints of a particular institutional framework that they have to confront (Bruton, Dess, & Janney, 2007; Carney, 2005; Chelariu, Bello, & Gilliland, 2006; Khanna & Palepu, 2000, 2006). The strategy that Chinese SMEs undertake would be utmost showing intentions of maximising competitive advantage although the strategy also has to be set with restrictions and limitations of resources. An empirical investigation of institutional capability is therefore not only about how institutions matter (Davis, 1971; Smith, 2003), but also how Chinese SMEs navigate between institutional voids and develop the relationships with institutional entity. Particularly, China has developed with a very fast velocity in the last three decades although its business environment is accompanied with underdeveloped institutions and uncertain markets. Scholars are puzzled: “How can China be achieving rapid rates of growth, while retaining such an institutional order?” (Boisot & Child, 1996: 607) and “How to play the game, when the rules of the game are changing and not completely known” (Peng et al., 2008)

Additionally, majority research around institutionalisation was conducted quantitatively to testify variables related to institutionalisation (e.g. Huber 2008; Tracey and Phillips, 2011). There is very limited qualitative research to explore institutionalisation and its related issues (Bryman, 2004). This may simply be because the analysis of qualitative data is an intuitive, creative and dynamic process, and the outcome is to understand the assumptions and elaborate relationships that constitute the situated experiences, or everydayness, of the participants (Basit, 2003).

Therefore, we aim to present an empirical research of how Chinese SMEs engage with the institutional settings and arrangements to develop institutional capability and fill voids left by the formal institutional settings. This is also aimed to depict the institutionalisation process that the Chinese SMEs have been undergoing through its internationalisation.

5. Findings

1) Phase I:

In this research, we collected data from the respondents who started business in the 1980s. They worked and lived in an environment with very under-developed institutional facilities and mechanism. They were mostly doing business without any consideration of institutional process. For example, one respondent told us when he intended to start his business,

“I am afraid, [...], but really didn't know where to do the registration, how to do it and when to do. No one gave us any information. We were not able to find any information anywhere. We were just doing simple trading, so probably it was not necessary...” [Case 15]

Indeed, there is lack of assistance to institutional and legal process of registering business. The respondent did not seem to have an idea of registering the business even after he ran the business for ten years. It is quite remarkable that the respondent tended to ignore the legal and institutional process when there was limited legal and institutional process in society. This might have led the Chinese respondents to substantially rely on individual personals and non-institutionalized mechanism. For instance, when the respondent was requested to apply for an approval, he had to source from his personal friends,

“We collected bits and pieces of information time to time. We are unable to judge the information that we heard and obtained from our friends was correct or wrong. Sometime, one friend told us one thing, and the other told another thing. [...]... one day a friend told us one place to obtain a requested permission, and we didn't find out it was not right until we got there...” [Case 15]

Prior to 1980s, there was very limited institutionalised mechanism embedded in business culture and environment in mainland China. This unfortunately resulted in strong unawareness and scarcity of knowledge for institutionalised mechanism. The Chinese respondents were therefore unable to understand the relationship embedded between the foreign firms and institutional environment. Some respondent even doubted the need of institutionalised framework and usefulness of institutionalised arrangement in foreign markets and that had been brought to domestic markets. For example, one respondent felt frustrated when a foreign client insisted to see a quality certificate after all the manufacturing facilities were inspected and reviewed physically.

“He [the client] saw all the facilities, all the process, all the workers working on that, he was satisfied with the product and quality that we provided ...[...] But he said, 'It's our policy...[...]... we have to see the certificate.' I don't understand why he stuck to that certificate [...]... so stubborn.” [Case 8]

On the contrary, the respondent explained his different reaction to the same circumstance,

“I certainly won't sign a contract without seeing facilities. I used to 'inspect' a supplier [...]. I cared about quality, but once I had seen them all, I could tell ... [...] In reality, most business can't provide paperwork because there is no paperwork... We would not be bothered [by paper work] as long as we saw the facilities and people working on site.” [Case 8]

It seems that there is a controversy of what to be trusted in business. The respondent did not seem to appreciate ‘the certificate’ which is credited and legislatively approved by institutional framework in Western economy. Instead, he tended to trust what he used in an environment

based on personal experience. Paperwork and certificate are an example related to a society with highly institutionalised mechanism. What this respondent reacted reflects a common issue in mainland China during the 1980s and 1990s. They lived and worked in an environment with an under-developed institutional mechanism, which formed the Chinese a substantial lack of institutional concept and a perception against any institutional related process and arrangement.

2) Phase II: Internet application to plant seeds

Internet appeared in mainland China in the late 1990s. However, it did not seem to be widely accepted by the Chinese SMEs for a very long time, particularly by the old generation. One respondent told us that his father had a strong feeling against the Internet,

“My father said, ‘it’s not human. Who knows what is behind that? Sometimes, you can’t even trust a person, how can you trust a machine?’ He used to visit our clients on foot. It was all he liked to do because that was how he felt being interactive and communicable.” [Case 13]

The younger generation seemed to be more appreciated to the Internet and its application in business, especially for those who studied overseas before,

“I do see necessity of using emails to contact prospective customers in foreign markets. Actually, even in our domestic market, there had been a tendency of using a lot of internet facilities. [Case 12]

Whilst the younger generation started to utilise Internet for their business, there were many challenges. For example, there was very limited engagement on Internet in mainland China. Vast majority Chinese SMEs did not seem to display correct information on website; and they did not seem to realise that this is an institutional tool.

“A lot of Chinese companies display their information or email online just for the sake of website. They never really utilized it... [...] if we contacted them via emails or online enquiry... they never replied... Their contact email never works, no one responded or fake email...” [Case 5]

The challenges had also been coming from under-developed Internet facilities, both hardware and software. Most SMEs that we interviewed were from rural areas where roads were still very muddy; their communications were carried out by messengers.

“In rural areas like this, we had no chance to install Internet cables. The reason is simple... Not many people had computers and wished to use Internet as their life style had been always with farming...” [Case 6]

This physically makes the Chinese SMEs felt difficult to transfer the traditional business practices onto an Internet basis. However, there were respondents having a clear global mind set and paying attention to Internet application in business. Just like one of them said,

“It is a fight between traditional and modern business model.” [Case 9]

In order to break out the existing barriers, some respondents chose to relocate their company to the east coast of China as where they would be able to take advantage of modern infrastructure and engaged with foreign firms via Internet. One respondent said,

“Internet was not very popular...even not every company had computers at that time. We were trying as there was no reference at all...we sent an email to a foreign company’s email address and ... next day we had a reply surprisingly...It was a real thing.” [Case 6]

The respondent talked about excitement when they firstly received a response from an unknown person who was thousands miles away. To them, email contact opened a path for international communication. Once some Chinese respondents had the benefits of utilising Internet for their business, they seemed to keep it going. Particularly, they felt it was cost effective when contacting online,

“For the international business...it’s not possible to talk to them face to face... We can’t send people to overseas daily... but we can send emails to those countries every day...we extended our contacts. [Case 5]

When the Chinese SMEs gradually adopted Internet and started to utilise online resources for their business, they tended to include non-personal instrument for communications. This might have taken a while for the Chinese respondents to get used to, but planted seeds to grow up new style and opportunities in business.

3) Phase III: Break institutional barrier

Since the Internet lighted approaches to foreign markets, the Chinese SMEs had been seriously entrepreneurial to explore opportunities of learning business skills and process in foreign markets. Those foreign companies firstly entered mainland China became the most attractive targets for the Chinese SMEs to approach for collaborative opportunities and daily business management. For example, there was a respondent seeing a multinational company in the same building where he participated in an international exhibition in Shanghai. He decided to approach to this foreign company to see any possible business opportunities,

“We were eager to obtain business collaborations. We thought there might be something if we go and ask them...I did not think many others would have courage to do so.” [Case 16]

Then we asked him if he had planned to do so before the exhibition or he knew somebody in the company. He said,

“We just knocked the door and pretended to see somebody... when a security guard walked to us... [...] We thought it was a great opportunity to have the company door opened.” [Case 16]

However, the respondent felt quite disappointed afterwards,

“The security guard brought a staff member and said to us, ‘Sorry, we didn’t have any appointment with you. We are a part of operation team located here. You need to contact the person or the particular department and make an appointment. We don’t meet up anybody otherwise... All information is on our website’.” [Case 16]

He admitted that he misinterpreted the message when a security guard answered the door and later reflected on this in the interview,

“We only thought to approach them physically. We could not wait to approach to them as we were eager for business opportunities... [...] and collaborations with foreign companies... but their door was not open to us.” [Case 16]

What the respondent felt annoying is that he was refused with a good reason already set in rules, which he had no choice but to accept. He expressed his dissatisfaction and blamed it in his way,

“To us, those glass doors in the office building are really something we can’t breakthrough... those glass doors look opaque, you can see people walking and talking in their office, but you can’t talk to them in person. [...] We, as outsiders, feel difficult.[...]” [Case 16]

Indeed, the glass doors in the office buildings were intended to prevent the company to be disrupted by any uninvited strangers. However, the respondent might not realise that it was the institutional barrier excluding them to get in the company as they had not built up relationship to share certain level of information. Later on, when we asked what he planned to do after that event, he said that,

“It is their way or no way. We had to change. This is the rule of game. Otherwise, we will never have our own brand...” [Case 16]

‘Their way or no way’, it seems not a choice for the Chinese SMEs but to follow the ‘rule of game’ which was set by foreign companies. The respondent clearly realised that their disadvantage of focusing on manufacturer only, which resulted in a fact that the Chinese SMEs are utilised for manufacturing and excluded from technological collaborations.

Impressively, we also noted a successful case that the respondent managed to participate in product development with a foreign company. The respondent told us,

“We met this company at a conference in Guangzhou years ago. They were looking for a type of API. I presented a process to them ... But they told us it was not perfect as they expected... They kindly sent us a requirement of that [...]. We sent them our first sample [...] ... Not quite right yet... So we tried it again... until the purity was higher than that was produced in Europe.” [Case 3]

It was the specific technology that the respondent developed making them to participate in a collaboration with a foreign company. We also asked them if the customer company could develop the technology themselves or source it from somewhere else. The respondent said,

“I don’t think they were able to do it after they looked for other places. We may not have a chance if we did not manage the technical process.” [Case 3]

It looks like that the respondent had its competitive capability developed around a specific technology, which helped to break through institutional barriers at this stage. They changed their strategy from focusing on networking with personal contacts to developing core technology after they realised the importance of technological competence in international competitions. We considered this as a very important stage because it shed a light on a path for the Chinese SMEs started to break the institutional barriers.

4) Phase IV: Institutional representative

Looking at domestic market, we see evidence that the Chinese SMEs started to build up approaches to the existing institutional mechanism. In the traditional Chinese society,

interpersonal relationship (i.e. Guanxi) and its associated social capital have played an important role and formed a regime based on interpersonal relationship (Tian et al. 2018; Pearce and Xin, 1996 etc). However, we do see an evolutionary change in terms of interpersonal relationship and the role that individuals play in the developing institutional environment.

Firstly, we observed in some cases that interpersonal relationship has played a slightly different role, that is, the individuals acted as a representative on behalf of the existing institutional mechanism. For example, we observed a respondent from Case 3 experiencing an official auditory by a local tax bureau. During the whole process, he looked quite anxious,

“We haven’t done anything illegal, [...] but if we did not pay tax or paid less tax, breaking the laws, then the inspector would not cover us either. [...] He would have to take us to the court...even if we keep a good personal relationship with him... We do what we can, but if we had a bad relationship with him, he still could find some fault if he intended to...” [Case 3]

When asking why the inspector could still find some fault if he intended to, the respondent said,

“... Because we are not perfect... there are areas that we don’t know...” [Case 3]

The respondent, after the interview, mentioned that there were some areas that they didn’t have expertise, therefore, they had to rely on the inspector. In this case, we believe the respondent referred it more as a personal friend. The inspector would indeed guide them to ‘walk the line’ sometimes as a personal friends; however it seems that the inspector would also had to follow the existing rules and regulations. This is a situation where the inspector is placed between interpersonal relationship and existing institutional mechanism. We propose the individual as institutional representative. We suggest that it differs from the individuals who used to rent their authority for personal benefits (e.g. in corruption or bribery) as at this role the individuals had to follow the existing institutional framework and restricted their use of authority with responsibility.

A further example of this was the respondent from Case 15 intending to relocate its business into a specialized economic zone. The respondent had been trying to invite the officer who is in charge of the process for dinner and business holidays. However, that did not work. The respondent said,

“We felt difficult to reach him, I meant psychologically. He had been very polite to us always when we met him up. You see, in this kind of occasions, we won’t be accepted as friends, so we wouldn’t have a chance to make him accepted our favours, either a chance to make him to help us.” [Case 15]

The respondent also said,

“I suppose people are not very eager for gift these days as they have their proper job to sustain their life. They either don’t want to lose their job for any corruption.” [Case 15]

The respondent might be able to build up some sort of personal relationship with the officer, who would place a boundary somehow to protect any possible corruption. We have seen a different type of interpersonal relationship that the respondent built up with an institutional

representative compared with the traditional interpersonal relationship. This will be reasoning in a later section.

Secondly, we also found there are Chinese respondents proactively engaging with the institutional environment and creating their own representation in the existing institutional system. For example, one of the respondents was issued a notice from local government to dispose chemical output through a waste management system. It was ten years ago and the waste management system was a costly mission for most SMEs. Coincidentally, the respondent's father was a member of People's Congress in a local region. So,

“...he went to talk to another member of People's Congress, who served a job in environmental department... the notice for us was withdrawn due to our great contribution to local tax. We were very proud.” [Case 2]

The very strongly and culturally embedded interpersonal relationship worked in this circumstance ten years ago. Social capital based on their 'Guanxi' effectively and easily helped them to deal with the issue. However, three years later, they were requested again by a local authority to improve the waste management as there was chemical hazard detected. This time, the respondent changed to a slightly different strategy,

“He [my father] raised this as a common issue for the chemical firms in our region to a Congress annual meeting. He knew we were not the only one company” [Case 2]

The notice was not enforced, either withdrawn. However, the respondent also said,

“We really had no idea. A good thing is that they were not going to push us again although our people in Congress did not seem to be able to cover us this time.” [Case 2]

Then it was in 2013 that they received another notice.

“We were formally ... informed that there was a request of waste management and no chemical output was allowed to be disposed without environmental friendly technologies. [...] there were quite a few chemical companies closed down.” [Case 2]

The respondent knew that a strategy of lobbying to withdraw the notice was not going to be working. They believed it was a final call otherwise they have to face a penalty or termination.

“We had to move into a special economic zone where we were allowed to output chemical disposal at a lower level as there was a central filter to deal with it.” [Case 2]

In this case, we see the respondent playing as an individual representative by utilising rules to bargain with the local government. The respondent raised it as an issue on behalf of a collective group as they realised that there will be more support from other chemical SMEs. It illustrates that the Chinese SMEs started to participate in development of existing institutional mechanism.

5) Phase V: Institutionalisation of Internal management

We have also observed that the Chinese SMEs confronted institutional change within their own business, particularly for those in a succession of business. They intended to run the business with a different style to what their ancestors did after they took over management roles. For instance, we had a respondent who studied in UK and came back to join his family business afterwards. He had a couple of internal issues with his father,

“Later last year [...] we incidentally found my uncle made fraud receipts in order to claim expenses [...], even worse, we then found out he took 300K cash home [...] So when I found this, I had a conversation privately with my uncle, who was at that time as one board member in our company and responsible for business development...” [Case 14]

The respondent believed this was considerate until his father had a different opinion on a board meeting,

“My father ...came in the meeting, slamming the door, and looked very angry. He said to me at the present of all the board members and colleagues, ‘HJ, you shouldn’t investigate the case, your uncle has done great contributions to the company after all. We need to unite all our family members here. I dare to say, if your uncle left the company, people in other company will laugh at us. That will be a very bad thing for our business’...” [Case 14]

Obviously, the respondent was shocked and told us,

“I really disagree with him, so I said, “We’ve got evidence from the finance office, which is a very serious event...If we could bear with this, then other colleagues may start to copy what he did... What people would think of us?” [Case 14]

He was quite disappointed with what his father reacted,

“He did not listen to me, but said, ‘I am your father, I am the founder of the company... You are still young, and very inexperienced...’ [Case 14]

The respondent was deeply let down. When we asked him what happened afterwards, he said,

“Nothing! I just let it go... because my father is still there.” [Case 14]

However, the respondent also shared with us about his plan, which was independently managed by himself,

“Fortunately, I am able to manage my international team. [...] exclusively reporting to me, so I am able to [...] run the part of business with my authority...more importantly, I told them, ‘I don’t look at how you say, but how you do’. They won’t need to inform me if they were late for work as we have a record system, which will directly report to human resource. We have a process illustrating a process of contacting foreign customers. Everyone will need to understand it well. Alongside the process, there is consequence if they don’t follow. I don’t mean to punish anybody, but to regulate our work... create a system helping everyone to do jobs easily.” [Case 14]

The respondent looked quite positive when he shared this with us,

“Many people in our business don’t care about rules. They relied on their ‘face’; they may ignore business rules...” I am doing this within my team...not in the company yet. It is only a start, [...] difficult and taking time... could be ten, twenty years, but we had kicked it off ...” [Case 14]

Another respondent seemed quite lucky and went into a smooth process within their business. He persuaded his father to recruit staff members as he believed that would be more efficient. He said to us,

“I convinced my father for many times... he was still in his time of ‘one man with a van’. So I had spent almost all my time in the first 3 years to create necessary roles. This was extremely hard because my father just handed over his management to me.” [Case 12]

The respondent felt the company was in a chaos structurally, so he re-arranged it with a much clearer structure,

“I set up an operational team after I took over the role for two years as I felt there were too many people in the manufacturing team. Also, they did not use to online business... I recruited quite a few people for international logistics as this is we aim to follow up with our international markets. We are building our own distribution networks... I also head hunted a new operational director who brought us a new system from an international company...” [Case 12]

The respondent restructured the organisational units and levels by delegating responsibilities, like what he said,

“I set up the rules for employees to follow, so I don’t have to be like my father dealing with everything myself.” [Case 12]

This is how the Chinese SMEs started development of institutional mechanism within business organisations alongside their participation in institutionalisation of external business environment.

6. Discussion

We have presented five phases that the Chinese SMEs have been undergoing with its institutionalised development. In phase I, the respondents did not seem to have a perception of institutional arrangement and settings, regardless formal or informal. They were not aware of any rules and regulations that might affect them even after the business running for quite a while. This is partially because they used to interpersonal relationships from the history. Their business style was substantially based on a ‘simple trading’, which normally had small scale, simple organisational structure and informal presentation. This would also lead them to believe that their business had no need to connect with the formal institutional rules and settings.

Meanwhile, the institutional system in mainland China at that time had very limited resource available to the SMEs. Some of the respondents believed the existing institutional rules and regulations were even a trouble and felt struggled to follow particularly when the respondents found published information contradictive or misled. This also sent out a message that there was no reliable, either trustworthiness from, institutionalised mechanism. In turn, the respondents would not prefer to build up their business networks via institutionalised or organisational approaches, so as to the capability of connecting with institutionalised activities and agents. This is perhaps a feature of the SMEs in an early internationalisation process for the Chinese SMEs.

In phase II, we believe Internet is a significant milestone for the respondents to connect with international market and foreign institutions although it was a very long process. The old generation seemed to have more trust for individual persons than the non-personal instrument. The younger generation taking over the business, particularly for those who had studied overseas, whereas paid more attention to Internet and its related technology.

There had been various obstacles that SMEs had to confront when they were getting Internet to their business, however, this was a point of change to the SME internationalisation process. When the younger generation effectually sent out emails to foreign customers, non-personal instrument were invited to their business communications. This indicates that those Chinese SMEs started to build up connections with a world-wide institution. Through email exchange and massive online information, the Chinese SMEs gained institutionalised resources by all means. The Chinese SMEs therefore started to realise the importance of connecting with institutionalised infrastructure and developed their capability around institutionalised environment. From this point of view, we may say that Internet and its online resources planted seeds of institutionalisation in Chinese SMEs.

In phase III, we found that the respondents had challenges in terms of institutional framework when they intended to approach to the foreign firms. After two decades of inward internationalisation policy in mainland China, the Chinese respondents were eager to discover the differences and catch up with international competitors. However, the Chinese respondents did not seem to have a good knowledge of institutional arrangement in the context of international business. Some Chinese respondents disgraced formal and informal institutional process, particularly when they felt that actually setting up barriers to prevent their approaches to international markets. This negative experience of institutional process and settings indeed spur the Chinese SMEs to penetrate institutionalised mechanism so that they could increase market share.

While other Chinese SMEs thinking of approaches to institutionalised mechanism, we spotted one company that managed to successfully participate in organisational collaboration with a foreign company. That SME engaged with institutional process smoothly and they did not emphasis approaches based on interpersonal relationship. It was the technology breaking the barriers for the SME to engage a collaboration with a foreign customer. They strictly followed the guidance given by the customer to improve technology as this was the only chance that they had to catch up an international collaboration. Therefore, technology straight helped them break into the existing institutional process and build up networks. This indicates that product research and development associated with core technology could help the Chinese SMEs break into originally settled institutional barriers. Core technology might be an essential vehicle carrying capability to lock up with existing institutionalised mechanism.

In phase IV, we suggest a concept of institutional representative, which we use to elaborate an evolutionary process of institutional development for these Chinese SMEs. Institutional representative was originated in the traditional interpersonal relationship although that was employed exclusively by some particular SMEs that had special connections with the governmental or organizational institutions. It was largely based on interpersonal relationship. However, this kind of connection fast collapsed with anti-corruption from the Chinese government. Individuals, formally presenting interpersonal relationship, transferred to represent existing institutional system, although which was still accompanied with relevant

interpersonal relations. The Chinese SMEs therefore would have to build up connection with more institutional context and capability due to their trust with the individuals.

Having going through a transformation from interpersonal relationship to institutional relationship representation, the Chinese SMEs realized the importance of institutional capabilities and resources from institutional mechanism. They therefore intended to build up institutional related networks, as well as take on representations for themselves in the existing institutional system. Self-representation in institutionalized system required understandings of extant institutional mechanism, capability of lobbying rules and regulations and manipulation of individuals related to institutionalized framework. This is a process of building up institutional capability having the Chinese SMEs been spur by foreign companies.

In phase V, we noted that the Chinese SMEs eventually brought institutionalized changes to its internal management. It is more evident in the cases where there was family succession. Having experienced rules and regulations, the Chinese respondents intended to introduce institutional settings to business structures and organizational management. This was emphasized when the respondent brought technical system to attendance of work and process of contacting foreign customers. They built up institutional capability with techniques of ensuring business process to be carried out properly. Institutional capability was indicated in activities such as delegation to form consistent practices and regulated effective behaviors. By doing so, they tended to leave activities based on interpersonal relationship to institutionalized mechanism. This is what we believe an evolutionary process of building up institutional capability among the Chinese SMEs when venturing international markets.

7. Conclusions

In this paper, we presented research findings from a qualitative study of SMEs' institutional capability in mainland China. We offered narratives from 20 SMEs and analysed with a processual approach to understand how the Chinese SMEs engaged with institutional voids in local markets and developed institutional capability. In this paper, we presented five phases of institutional development process that the Chinese SMEs undertook in an early internationalisation process. We suggest that in the first phase, the Chinese SMEs developed institutional capability from a very low level where they had no connection with institutional and organisational settings in local market; in the second phase, the Chinese SMEs took advantage of Internet to absorb institutional concept and capability from foreign companies; in the third phase, they managed to overcome institutional barriers with core technologies; in the fourth phase, the Chinese SMEs created and developed their own institutional mechanism with institutional representative; and in the phase five, they began institutionalisation process within business organisations. This is our major contribution to institutionalisation process in emerging economies.

In this paper, we also proposed a concept of institutional representative, which we use to underline the institutionalisation process in China. We found out that the Chinese SMEs have been unable to leave individual based relationship within its tradition. However, with internationalisation process, the individuals and SMEs both undertook changes in an evolutionary process to engage with institutionalisation and developed relevant capabilities.

This is another theoretical contribution of this paper to the extant literature of institutionalisation studies.

Reference:

Ahlstrom, D. and Bruton, G. (2004). 'Turnaround in Asia: laying the foundation for understanding this unique domain'. *Asia Pacific Journal of Management*, 21, pp. 5–24

Barnes, B. R., Leonidou, L. C., Siu, N. Y. M. and Leonidou, C. N. (2015). 'Interpersonal factors as drivers of quality and performance in Western-Hong Kong interorganizational business relationships', *Journal of International Marketing*, 23, pp. 23-49

Boschma, R. (2005). Proximity and Innovation: A Critical Assessment, *Regional Studies*, 39:1, pp. 61-74

Hoskisson, R., Eden, L., Lau, C-M. and Wright, M. (2000). 'Strategy in emerging economies'. *Academy of Management Journal*, 43, pp. 249–67.

Huber, F. (2013) *Creating a Sustainable Economy: An Institutional and Evolutionary Approach to Environmental Policy*. Edited by Gerardo Marletto, *Economic Geography*, 89, pp. 431-433

Leitch, C. M., McMullan, C. and Harrison, R. T. (2013). The Development of Entrepreneurial Leadership: The Role of Human, Social and Institutional Capital, *British Journal of Management*, 24, pp. 347–366

Makhija, M. and Stewart, A. (2002). 'The effect of national context on perceptions of risk: a comparison of planned versus free-market managers'. *Journal of International Business Studies*, 33, pp. 737–56

May, R., Stewart, W. and Sweo, R. (2000). 'Environmental scanning behavior in a transition economy: evidence from Russia'. *Academy of Management Journal*, 43, pp. 403–28

Mol-Gomez-Vazquez, A. Hernandez-Canovas, G. and Kofeter-Kant, J. (2018). Legal and Institutional Determinants of Factoring in SMEs: Empirical Analysis across 25 European Countries, *Journal of Small Business Management*, 56, pp. 312–329

Nicholson, J. Tsagdis, D. and Brennan, (2013). The structuration of relational space: implications for firms and regional competitiveness, *Industrial Marketing Management*, 42, pp. 372-381

Spicer, A., Kogut, B. and McDermott, G. (2000). 'Entrepreneurship and privatization in Central Europe: the tenuous balance between destruction and creation'. *Academy of Management Review*, 25, pp. 630–49

Su, J., Zhai, Q. and Landstro mc, H. (2015). Entrepreneurship research in China: internationalization or contextualization? *Entrepreneurship & Regional Development*, 27, pp. 1–2, 50–79

Teece, D.J. (2009). *Dynamic capabilities & strategic management: organizing for innovation and growth* Oxford: Oxford University Press.

Tian, Y.A., Nicholson, J.D., Eklinder-Frick, J., & Johanson, M. (2017). The interplay between social capital and international opportunities: A processual study of international 'take-off' episodes in Chinese SMEs. *Industrial Marketing Management*.

Tracey, P., & Phillips, N. (2011). Entrepreneurship in emerging markets: strategies for new venture creation in uncertain institutional contexts. *Management International Review*, 51(1), 23-39

Wan, W. and Hoskisson, R. (2003). 'Home country environments, corporate diversification strategies, and firm performance'. *Academy of Management Journal*, 46, pp. 27-45

White, S. and Linden, G. (2002). 'Organizational and industrial response to market liberalization: the interaction of pace, incentive, and capacity to change'. *Organization Studies*, 23, pp. 917-48

Wright, M., Filatotchev, I., Hoskisson, R. E. and Peng, M. W. (2005). Strategy Research in Emerging Economies: Challenging the Conventional Wisdom, *Journal of Management Studies*, 42:1, pp. 1-33