

Crouching Tiger, Hidden Dragon:

On a State-stewardship View on Chinese Firms' Internationalization

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Abstract

We propose a state-stewardship view as an alternative to the well-established Western-context agency theory to explain China's state-firm-manager relationship and corporate strategy. Under China's unique institutional framework, the state-centric system renders a dominant coercive power from the state to the economic players such as enterprises and their managers. Consequently, the objectives of Chinese enterprises and managers (business elites) are highly politically-oriented. Consequently they do not have inherent conflict of interest with the state, but rather act as responsible "stewards" of the state. Central to our state-stewardship theory are (1) the organizing principles of the state's political system, (2) the dual incentive structures of the managers, and (3) the enforcement mechanisms within and outside the organization. We argue that this state-steward relationship has its long-historical roots in China's institutions: it has been formed since the Communist rule and remained even after China's massive privatization. After the privatization, the state-stewardship has largely replaced the state-ownership as a new way for China's political and business elites to govern the country. The state and elites still remain as the actual controllers behind the scene.

We test our theory on Chinese firms' internationalization, with an emphasis on outward foreign direct investment (OFDI). We find a strong difference between state-owned enterprises (SOEs) and private enterprises in terms of motivations for internationalization. In the export sector which is dominated by private firms, profitability and financial constraints are major concerns. In the OFDI sector in which over 80% are conducted by SOEs, these financial motivations are no longer significant, but the state-stewardship factors – firm's state control status and managers' political connections – play a major role. A steep contrast between the coefficients of state-ownership and of state-stewardship

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demonstrates our argument on the formation of state-steward relationship in China after the economic reform. The economic reform mainly reformed the ownership structure, but actually did NOT reform the personnel at the executive level: the managers are still state appointees – stewards of the state. After the privatization, the state is using fewer shares to control the whole economy and implement political goals in corporate strategy, through maintaining their stewards within the companies.

We contrast our theory with several other theories on explaining international production and investment, such as the comparative advantage theory, the resource-based view, and the traditional OLI paradigm. Compared to these theoretical perspectives, our theory highlights the importance of the path dependence, the historical and institutional embeddedness of the Chinese economy, and their corresponding influences on China's evolution. All these factors come to determine China's global expansion patterns, characterized as a country-level, political-oriented OFDI. Furthermore, we draw economic and welfare implications from our theory for the development of China and the World.

Key words: State-stewardship view, outward foreign direct investment, China, path dependence, historical and institutional embeddedness

JEL Codes: F21, F23, L33