The Chinese Family Firm as a Multinational Enterprise

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Abstract

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Much of the extant literature on the Chinese Family Firm highlights the unique cultural heritage and social context in which they are embedded as primary determinants of their strategic behaviour. In contrast, few studies have examined the strategic behaviour of Chinese Family Firms from an economic perspective. In this paper, we address this gap in the literature by applying Dunning's eclectic theory of the MNE to the Chinese Family Firm. In doing so, we generate a series of testable propositions. We suggest that although the strategic behaviour of Chinese Family Firms will differ significantly from those of classic Western MNEs, they are nonetheless amenable to interpretation according to Dunning's analytical constructs of ownership (O), internalization (I) and locational (L) advantages. More specifically, we find that like the classic Western MNE, the Chinese Family Firm can be understood as a viable mechanism for capitalizing on particular configurations of OLI advantages in international markets.

Key Words: Chinese Family Business, Personal Capitalism, Family Business Groups, OLI Theory, Multinational Enterprise

Introduction

Away from their ancestral homes, approximately 60 million overseas Chinese, resident primarily in Taiwan, Hong Kong, Singapore, Thailand, Malaysia and Indonesia, have built a vast interconnected system of highly successful businesses (Yeung, 1996; Chen, 2001). One of the central attributes of this Chinese diaspora is the persistence of family control, even in the largest companies (Ip, Lever-Tracy & Tracy, 2000: 13). In the past two decades there has been wide recognition in the sociology and management literatures that the overseas Chinese Family Firm (CFF) represents both a distinct and economically significant organizational form (Hall & Xu, 1990; Weidenbaum & Hughes, 1996; Chen, 2001). While comprising only six percent of the population of Southeast Asia, they control more than 70 percent of the region's corporate wealth (Backman, 1995).

Many of these companies invest internationally, and much of that investment goes to China. Foreign Direct Investment (FDI) in China has increased significantly since the early 1990s, and China is now the second largest host market for international investors. The majority of these funds (over 60%) have come from Hong Kong (including Macao) and Taiwan (Coughlin & Segev, 2000; Wang, 2001), where CFFs are the dominant corporate form. An additional 5% comes from other parts of Southeast Asia (Singapore, Malaysia, Thailand), where ethnic Chinese *(huaqiao)* are also important. However, since much investment in fact enters China *via* Hong Kong, it is likely that the official data overstates the importance of Hong Kong firms (Wong, 2001, p. 171). Whatever their national origin, a number of recent studies indicate that businesses controlled by overseas Chinese provide the majority of FDI in China (Gao, 2000; Guha & Ray, 2000; Coughlin & Segev, 2000).

The international activity of ethnic Chinese firm is not restricted to China. Many of their business groups operate networks of businesses across East and Southeast Asia, and in other parts of the world

(UNCTAD, 1994, Yeung & Olds, 2000). For example, Tzeng (2002) documents the dominant position played by Taiwanese firms in the OEM manufacture of computers and computer components, and describes their subsequent expansion into Silicon Valley. Many of these same firms also operate in China. Similarly, the early development of Hong Kong was in part related to its role as an OEM supplier in the garment industry and electronics industries, much of which has also been moved to China (Reif & Sodini, 1997). Despite their scale and international scope, these enterprises remain family businesses (Redding, 1990; Kao, 1993) insofar as they are typically controlled and managed by a small number of family members and trusted business associates (Carney, 1998; Chen, 2001).

Much of the existing literature on the Chinese Family Firm suggests that it is a unique business institution that reflects Confucian values (Hall & Xu, 1990; Fukuyama, 1995) as well as the institutional structures (Whitley, 1992) and traditional patterns of authority (Hamilton & Biggart, 1988) in their home country. In contrast, few studies have examined the strategic behaviour of Chinese Family Firms from an economic perspective. In this paper, we address this gap in the literature by applying Dunning's (1981) eclectic theory of the MNE to the Chinese Family Firm. In doing so, we demonstrate that while the typical Chinese Family Firm differs from Western firms in important ways, many useful insights regarding their strategic behaviour and distinctive competencies can be generated by considering them in terms of Dunning's paradigm.

Our intent is to complement the more traditional socio-cultural approach to the CFF by introducing a theoretical dimension that has not been previously recognized in published research on this topic. The paper seeks to demonstrate that one aspect of the behaviour exhibited by the Chinese Family Firm – its characteristic pattern of international expansion - can be usefully explored using the existing multinational enterprise theory to frame the various socio-cultural arguments. Consistent with the eclectic theory of the MNE, we argue that the characteristic features of the Chinese Family Firm constitute intangible assets that provide a basis for gaining competitive advantage through international expansion.

One of the most important intangible assets of Chinese Family Firms is tacit managerial knowledge of the traditional Chinese small enterprise management system, which had been virtually eradicated in Communist China (Fan & Li, 2001) while continuing to thrive in the Chinese societies of Hong Kong, Singapore and Taiwan, and in ethnic Chinese enclaves throughout the Southeast Asian region and beyond (Fukuyama, 1995). The heart of traditional Chinese small-enterprise management is its use of distinctive types of human and social capital, including the reliance on networks and relational contracting. In contrast to the shared knowledge of how the system works, which is diffused throughout Chinese economic culture, these intangible assets are highly specific to each individual family enterprise. Thus a major objective of the paper is to explain how the characteristic features of the Chinese Family Firm provide a basis for gaining competitive advantage through international expansion, within the parameters of the eclectic theory of the MNE.

While our approach does not require any adaptation of the eclectic theory *per se*, it does rest on a premise that is not typically explicitly articulated in statements of that theory. This is the implicit assumption that, in practice, the core theoretical constructs of ownership, location and internalization advantages described below are always embedded in specific socio-cultural contexts. The focus of this paper on explaining how these advantages take shape in the context of Chinese economic culture therefore rests on this assumption of social embeddedness (Granovetter, 1985, 1991).

In the following sections, we describe Dunning's theory and its applications. Next, we elaborate more fully on the nature of the Chinese Family Firm, particularly in terms of descriptions from the literature regarding their core competencies, patterns of internationalization and their strategic behaviour.

Subsequently, we bring together the theory of the MNE and the reality of the Chinese Family Firm in order to derive testable propositions. A short discussion of our findings together with some proposals for future research closes the paper.

Theory of the MNE

We adopt Dunning's eclectic theory, because it represents the most general and widely-used framework for analysing the MNE (e.g., Dunning, 1993b; Caves, 1996). This theory, or its variants, is designed to explain why firms from one country engage in value-added activities outside their national boundaries. Dunning himself describes it as a paradigm, and suggests that *"the eclectic paradigm seeks to offer a general framework for determining the extent and pattern of both foreign-owned production undertaken by a country's own enterprises and also that of domestic production owned by foreign enterprises"* (Dunning, 1993b, p. 76). As such it is designed to explain the emergence of and characteristics of MNEs, including their choice of entry mode and the spatial distribution of their activities.

The paradigm suggests that there are three general factors governing the propensity of a firm to engage in international production: Ownership (O) advantages, Locational (L) advantages, and Internalization (I) advantages. It is the configuration of the ownership, location and internalization advantages (OLI) facing a particular firm that determines its capacity to produce abroad. As Dunning (1993a, p. 136) puts it:

"Other things being equal, the greater the ownership advantages of firms of a particular country, the more it pays those firms to create, acquire or add value to those advantages from a foreign location, and the greater the incentive to internalize their markets for those advantages

or the value-added activities arising from them, the higher will be the propensity to engage in outward direct investment."

Ownership Advantages

Ownership (O) advantages refer to the possession of firm-specific assets that provide the firm with a competitive advantage at home and abroad. Ownership advantages arise from the resources and capabilities of the firm, and are in fact comparable to its core competencies (Prahalad & Hamel, 1990). The resources and capabilities of the firm are comprised of its income generating assets, most particularly those that cannot easily be imitated because they are to some degree proprietary. Proprietary assets can be tangible, such as capital equipment, or intangible, such as technology, patents or trademarks. The firm's proprietary assets also include capabilities such as the human resources required to design and market successful new products, or the ability to more effectively manage and organize the production of existing products.

As pointed out by Caves (1996), the possession of such proprietary assets is closely related to product differentiation, in that it causes each firm to face a downward sloping demand curve. Thus, proprietary assets confer on the firm a degree of monopoly power in its domestic market and this market power is often implicitly taken as a necessary condition for international production to occur. However, the general point is that an MNE emerges through the deployment abroad of what are essentially intermediate inputs.

Empirical evidence confirms the importance of proprietary assets (O variables) as a condition for investing abroad, particularly when the investment is horizontal. Moreover, the evidence does tend to point to a relatively small number of variables that are consistently important, namely those related to research and development, and to product differentiation (Caves, 1996, pp. 8-9). Variables such as the ratio of R&D to sales and the ratio of advertising expenditures to sales are typically (although not always) positively associated with multinational activity, the latter most often in consumer goods.

In addition, most studies find a positive relationship between firm size and overseas production activity. The conventional argument is that since foreign investment incurs high fixed costs and relatively high risks, large firms are better able to make large investments (Kimura, 1989; Ozawa, 1991), or that large size is associated with a variety of strategic advantages accruing to large firms, which may give rise to economies of scale or scope at the firm level (Chandler, 1962; Horst, 1972). In a related manner, it has been found that firms with an existing international network achieve network economies that permit further expansion (Hennart & Park, 1994; Belderbos & Sleuwaegen, 1997).

Thus the possession of proprietary assets linked either to technology or to product differentiation, together with large size, appears to be the most powerful O-type determinants of MNE activity. It is true that some studies have revealed, on a less systematic basis, a number of other possible O advantages. These include a variety of intangible and hard-to-measure managerial capabilities such as the more appropriate management styles of Hong Kong and Taiwan companies identified by Schive and Hsueh (1985), or the client-specific knowledge and trust developed in certain service sectors (surveyed in Caves, 1996, pp. 11-13). However, such evidence is usually derived from a specific industry or sector, or from a specific country.

Location-Specific Advantages

The analysis to this point therefore suggests that the MNE is a firm possessing ownership (O) advantages in its domestic market. Given that the firm has the ***capability*** to produce abroad, what are the factors that impel it to ***actually*** produce abroad, and in which countries? These are termed location-specific (L) advantages and comprise such variables as production and transportation costs, resource endowments, the size of markets, infrastructure, government incentives and regulations, and cultural and political differences.

Empirical investigation of the factors determining the location of FDI flows (L advantages) has a fairly long academic history. The UN (UNCTC, 1992) has surveyed this evidence, and a more recent update is found in Globerman and Shapiro (1998). The results obtained thus far reveal some lack of unanimity in terms of purely economic variables. It is clear from all studies that GDP or GDP per capita of both source and host countries are positively correlated with FDI flows. The fact that GDP of both the source and host countries are important suggests that there must in some sense be a match between the economic, strategic and cultural characteristics of the investor and the recipient. Experience in a specific region or country can reduce investment risks (Davidson, 1980) and also allows for cost reductions through learning (Hennart & Park, 1994).

Internalization Advantages

The fundamental characteristic of the MNE is that it engages in overseas production *via* common governance (i.e., ownership) rather than *via* market transactions, such as the sale of proprietary assets or the rights to their use. The advantages that permit firms to transfer their O advantage abroad in this way are termed “I” (internationalization) advantages, because they attempt to explain why firms internalize foreign production rather than rely on market exchange. Internalization advantages provide the incentive to undertake the relevant activities within firm rather than to contract out some or all of them to outside firms. This stage of the argument relies heavily on transaction cost economics (Williamson, 1985). The transaction cost approach suggests that market imperfections create costs that in turn make internalization a more attractive option. Put otherwise, transaction costs associated with market exchange enhance the advantages of hierarchical control.

Markets may impose additional costs when the transaction in question involves a product with public good characteristics (non-rivalrous in consumption and non-excludable) and where buyers and/or sellers have incomplete or asymmetric information, leading to moral hazard and adverse selection problems. In such cases, market transactions are subject to opportunism and bounded rationality, among the most important sources of transaction costs (Williamson, 1985; Teece, 1986). Either or both of these characteristics are likely present in the case of proprietary assets, particularly those involving knowledge (a classic public good) or intangible firm capabilities (Gomes-Casseres, 1989). Moreover, the firm-specific nature of the asset underlying the transaction increases the possibility of post-contractual hold-up. For all these reasons, market exchange is costly and risky relative to hierarchical control, so the MNE emerges as a firm that chooses to transfer its proprietary assets abroad by establishing common ownership and governance of production facilities abroad.

Much of the evidence concerning internalization (I) variables is related to the choice between licensing and FDI decisions (Dunning, 1993b, pp. 167-174). Recent evidence (Anand & Khanna, 2000) suggests non-market transactions are more likely (and licensing less likely) when intellectual property is involved, and when intellectual property rights (IPR) are weakly protected. If licensing does occur, the weaker are IPR the more likely the license will be sold to a related party.

Other studies examine the choice of degree of ownership (100 percent versus joint equity), which is discussed by Caves (1996, pp. 74-82). Strong ownership links such as wholly owned subsidiaries avoid the market failures discussed above, but may incur other organizational costs, may not be permitted by law, and/or may involve significant financial risk. Gatignon & Anderson (1988) find that high levels of R&D are associated with full control of subsidiaries, while Gomes-Casseres (1989) found it to be the case only when the subsidiary was not diversified from the parent. According to Caves

(1996, p. 79), there is agreement that cultural distance between source and home country does tend to favour joint ventures (Kogut & Singh, 1988), while Geringer (1988) suggests that joint ventures are in part motivated by the need to establish good relations with the host country government.

Summary

The eclectic paradigm suggests that the MNE can be understood in terms of ownership, locational and internalization advantages of firms. In essence, the paradigm suggests that most MNEs emerge from the application abroad of proprietary assets developed at home, although some FDI may result from the need to acquire resources and capabilities not available at home. These assets are for the most part related to technology or product differentiation, and the transaction costs associated with their transfer abroad determine the mode by which this is accomplished. The choice of country to which the assets are transferred depends on a variety of locational considerations including cultural proximity.

The generality of the eclectic paradigm emerges from the analysis of the differential nature and impact of the O, L and I variables under a variety of conditions. The nature of the analysis will therefore depend on the way that the O, L and I variables interact in specific circumstances. Dunning has attempted over the years to show how the O, L and I variables could be used and augmented to account for the more cooperative forms of organization now commonly observed (Dunning, 1995), and for Japanese FDI in the US and Europe (Dunning 1993a, Chapter 6). A more recent indication of the generality of the model is found in the 2000 World Investment Report (UNCTAD, 2000, p. 140) where the OLI paradigm is adapted to explain cross-border merger and acquisition activity. The paradigm has therefore proved itself flexible enough to be applied to different circumstances, including the Chinese Family Firm. Before analyzing the Chinese Family Firm in these terms, we briefly elaborate on its nature and characteristics.

The Chinese Family Firm

Family firms and state-owned enterprises are the dominant indigenous forms of business in Asia (Claessens, Djankov and Lang, 1999). Chinese Family Firms share many of the salient features of other Asian family firms, and of family-owned business in general, while manifesting distinctive characteristics that reflect the unique historical and cultural experience of the Chinese people (Carney & Gedajlovic, 2002). *"The fact that a similar pattern of economic behavior emerges whenever governments allow Chinese communities to organize their own affairs suggests that it is in some sense a natural outgrowth of Sinitic culture"* (Fukuyama, 1995, p. 71).

The propensity of Chinese Family Firms to conduct business through myriad informal networks of personal relationships based on kinship reflects the familistic values of Chinese culture (Kao, 1993; Chen, 2001). These values have been codified by Confucianism, which establishes the family as the primary social institution. Without recourse to reliable legal and economic institutions in traditional Chinese culture, people had no alternative but to rely in all matters on the family. Even today it is argued that the individual does not exist in the Western sense and cannot be understood apart from the family context (Fukuyama, 1995). All social interactions including business are carried out *via* interpersonal relationships, primarily within the family network. According to Victor Fung, Chairman of Hong Kong's Prudential Asia, *"For a new partnership, a personal reference from a respected member of the Chinese business community is worth more than any amount of money you could throw on the table"* (Kraar, 1994, p. 92). This heavy reliance on personal connections is deeply embedded in Chinese culture.

> *"A man not thoroughly embedded in a network of kinship cannot be completely trusted because he cannot be dealt with in the normal way. If he behaves improperly, one cannot discuss his behavior with his brother or seek redress from his parents. If one wants to approach him about a delicate matter, one cannot use his uncle as a go-between to prepare the way. Wealth cannot make up for this deficiency any more than it can make up for the loss of arms and legs. Money has no past, no future, and no obligations. Relatives do."* (Wolf, 1968, p. 23)

Family ownership is not only by far the predominant pattern among small Chinese businesses; it is also prevalent among large enterprises (Claessens et al, 1999). Among the more than 55 million overseas Chinese in Asia, businesses controlled by 150 families generate a collective economic output equal to two-thirds the total GNP of China, population 1.1 billion (Cragg, 1996). Even in societies such as Thailand, Indonesia, Malaysia and the Philippines where ethnic Chinese represent a demographic minority, Chinese family Businesses still represent a large proportion of each country's leading businesses (Claessens et al, 1999; Carney & Gedajlovic, 2002)

Though Chinese Family Firms play an important and salient role in many Asian economies, they are undisputedly *the* dominant economic players in Hong Kong. More than half of the total capitalization of the Hong Kong stock market is under the control of just ten families, seven of whom are Chinese (Fukuyama, 1995, p. 74). We examined the 580 firms whose primary stock exchange listing is on the Hang Seng stock exchange, and found that 104 name a family as their largest shareholder and of these 93 are Chinese families. Although they are all listed as the largest shareholders, the magnitude of their ownership stake is wide-ranging: in 9 firms 70-79 percent is held by the controlling family; in 19 firms, 60-69 percent; in 18 firms, 50-59 percent; in 19 firms, 40-49 percent; in 17 firms, 30-39 percent; in 9 firms, 20-29 percent; and in 2 firms, 10-19 percent.

The heaviest concentration of Chinese Family Firms is in the manufacturing sector, or Industrials; however, this is balanced by the combination of Construction with Properties, which are related businesses in Hong Kong. There are 45 firms listed in Industrials (48.38 percent); 35 in Construction Enterprises (37.63 percent); 9 in Properties (9.68); and 1 each (1.08 percent) in Finance; Utilities; Hotels; and Miscellaneous. These classifications are not exclusive. For example, China United Holding, 32.23 percent owned by the Kwok Wai Tak family, is classified under Industrials yet its principal activities include packaging, property holding and development, and securities brokering. China Strategic Holdings, 34.62 percent owned by the Oei Hong Leong family, is classified under Construction Enterprises yet is involved in tires, beer, paper products, consumer goods, chemical products, heavy industrial goods, cables, electronic products, pharmaceutical products, property investment, and trading. Great Eagle Holdings, 50.21 percent owned by the Lo Ying Shek family, is classified under Properties but engages in hotel and restaurant operations, trading, building materials, share investment, management and maintenance services, financing, insurance, and owns hotels in London and Toronto. These examples typify the Chinese Family Firm's characteristic avoidance of industries that require extensive, ongoing coordination of operations such as those involving large-scale complex manufacturing (Yoshihara, 1988), since for the most part they do not have the sophisticated internal organization and decentralized decision making that such industries require (Redding, 1990; Carney, 1998).

The flexibility of the Chinese Family Firm accounts for its prevalence in industries where windows of opportunity open and close quickly, and where start-up costs are relatively low (Limligan, 1986, Chen 1995). The Hong Kong garment industry is a good example. Hong Kong suppliers made their mark not only by their ability to economize on the costs of labor and production, but by their ability to do so very quickly, thereby enabling retailers to respond to changing fashion trends faster than competitors. The ability to mobilize capital on short notice through one's personal network is also a source of timing advantages. This capability is crucial in businesses like real estate, another industry of choice for Hong Kong Chinese (Lasserre & Schutte, 1995).

Representative cases from Hong Kong exemplify the international expansion patterns of the Chinese Family Firm. From trading in gold bullion, Tem Fat Hing Fung Holdings Ltd expanded under chairman Raymond Chan into gold production, jewelry, other metals, property, and financial services, primarily in Malaysia, Hong Kong and China. Novel Enterprises, owned by the Chao Kuang-Piu family, is active in the Hong Kong garment and real estate industries, plus retailing in the UK and US. Luks Industrial, under chairman Luk King-Tin, is involved in plywood, cement, property, television and electronics, in China, Vietnam, Eastern Europe, and the former USSR. International expansion of this type follows business opportunities across industries and national borders and is driven by personal networks rather than portfolio planning (Whitley, 1992). Often this expansion follows kinship lines, within an extended family clan that is united not only by bloodlines, but by a shared dialect and a common origin tracing back to a single region or village in China (Cragg, 1996).

Similar examples can be found outside of Hong Kong. The Charoen Pokphand (CP) Group, a Chinese family owned firm based in Thailand was founded in 1921 by Chinese expatriates, and has grown to become a major agro-industrial conglomerate encompassing 250 companies in 20 countries. Although most of its foreign operations are in Asia, it also has investments in Europe and the United States. On its website (www.cpthailand.com), it claims to be the largest single foreign investor in China.

The Chinese Family Firm as an MNE

The discussion in the previous section indicates that a significant number of Chinese Family Firms are multinational enterprises. In this section, we use Dunning's eclectic paradigm as an organizing tool to systematically analyze the Chinese Family Firm, and to compare it to the American and European MNE. We derive a set of propositions, informed by both the theory of the MNE and the extant literature on the strategic behaviour of Chinese Family Firm. We proceed by considering, in sequence, the O, L and I advantages that most closely characterize the Chinese Family Firm and distinguish them from other MNEs.

Ownership-Specific (O) Advantages of the Chinese Family Firm

The European or American MNE (which we shall refer to as the "classic" MNE) emerged by exploiting abroad a competitive or monopoly advantage acquired at home. As noted above, these advantages were typically based on the possession of proprietary assets, mainly in the area of technology or differentiated products, as well as on economies of size derived from economies of scale and scope. The ability to develop such assets, and to acquire the capital necessary to grow, was fostered by an environment with well-codified laws that sustained market exchanges and protected property rights, as well as by sophisticated financial institutions (Boisot, 1986).

In contrast, the patriarchs who founded the Chinese Family Firm emerged from a country (China) where stable legal, regulatory and institutional arrangements were absent (McVey, 1992; Wang, 2001). In such an environment, the protection of proprietary assets is minimal and it is difficult to raise capital through impersonal financial markets (Khanna & Palepu, 1997). Boisot and Child (1996) suggest that China failed to build a stable codified bureaucratic order, which resulted in *"a preference for interpersonal accommodation -- an orientation to particular individuals and relationships rather than to impersonal rules"* (Boisot & Child, 1996, p. 604). These interpersonal relationships and connections are typically referred to as *guanxi*, which develops as a substitute for reliable legal, contracting financial structures (Xin & Pearce, 1996; Chen, 2001). Of course, such interpersonal relationships are of necessity built on a system of trust, and this favours the development of family ownership and kinship-based relationships. Thus, family ownership and *guanxi* serve as substitutes for formal contracting and legal structures.

Although many (if not most) of the overseas Chinese moved to countries where the rule of law was more reliable, such as Hong Kong, many never completely abandoned the relational system developed in China (e.g. Kao, 1993). Indeed, the very fact that the family remains at the core of the firm supports this idea. As a consequence, many Chinese Family Firm's have developed a core competency in relational contracting, a competency that serves as its basic ownership (O) advantage. Put otherwise, the Chinese Family Firm specializes in doing business in contexts where personal relations (including those with government) and networks are important (Ghemawat & Khanna, 1998; Wang, 2001). Because relational contracting implies the development of distinctive networks of relationships, they can be unique, firm-specific and difficult to replicate, and thus the source of sustainable competitive advantage. The success of the Chinese Family Firm, hence its ability to grow internationally, is therefore not based on the same ownership advantages as characterize the classic European or American MNE. Moreover, these very differences provide CFFs with a competitive advantage relative to traditional MNEs when they compete in markets where relational contracting is important.

These differences in ownership advantages will be reflected in different choices regarding strategies pertaining to scale, scope and organizational structure. We would expect the Chinese Family Firm to avoid activities where intellectual property rights are important (such as branded products and technologies) (Carney & Gedajlovic, 2000). We would also expect that Chinese Family Firms would avoid industries where economies of scale and scope are important. Large-scale production requires large amounts of capital, which in turn requires a reliance on capital markets as well as the inevitable dilution of family control (Chandler, 1990, Kao, 1993). In addition, large-scale production requires complex organizational structures that require expertise that the family does not possess (Redding, 1990).

Proposition 1: *Chinese Family Firms are relatively less well represented in the industries normally associated with classical MNEs (industries that are technology intensive, product differentiated, and/or subject to economies of scale and scope).*

Proposition 2: *Chinese Family Firms are less R&D intensive and less advertising intensive than the average classical MNE.*

Proposition 3: *Chinese Family Firms tend to be smaller than the classical MNE and ownership is more concentrated.*

If Chinese Family Firms do not possess the O-advantages normally associated with the classical MNE, what advantages, if any, do they possess? The ability to do business in an environment where personal relationships, networks, and negotiating and deal-making skills are important is the primary ownership advantage of the Chinese Family Firm (Khanna & Palepu, 1997, Tachiki, 1997). This advantage is based less on technical knowledge and intellectual property, and more on the ability to capitalize on commercial opportunities and "deals" (Chen, 1995). Such opportunities are more likely found in the service industries, most particularly the real estate industry and those related to it (e.g. development, shopping centres, hotels, construction, financing) (Lecraw, 1989). Another likely service cluster of activities will involve the facilitation of trade (import-export), including transportation and finance.

Proposition 4: *Chinese Family Firms are relatively more highly represented in the service industries -- particularly those broadly related to real estate and international trade -- than is the classical MNE.*

This does not imply that Chinese Family Firms will not be found in other industries. However, where this is the case, we would expect that the industries involved would be less technology intensive and would not involve branded products. (See Proposition 1.) Examples would be light manufacturing and food production (Fukuyama, 1995), as well as the manufacture of OEM goods for branded producers, as discussed in the introduction. In these cases, it may be difficult to identify any particular ownership advantage of the type discussed above (Hobday, 2000). Rather, the advantages may be strictly locational, relating to factor prices and resource availability in the host country, as well as to conditions in the home country (Hu, 1995). To the extent that the O-advantages of the Chinese Family Firm are related to home country conditions, we would expect some differences in industrial and firm-specific characteristics. For example, we would not expect the industrial distribution of Taiwanese Chinese Family Firms to be identical to that of Hong Kong or Thai Chinese Family Firms (Carney & Gedajlovic, 2002). For example, the CP Group from Thailand developed a home-based competitive advantage in integrated agricultural and food production, and it has successfully invested abroad in these same industries. At the same time, relative to Hong Kong and Taiwan, Thailand's legal and business infrastructure is less transparent, and as a consequence CP has developed skills in "navigating the corridors of power" (quote taken from the company website, www.cpthailand.com). These skills have allowed it to enter new businesses, often in industries where government regulation is important such as telecommunications. While it is beyond the scope of this paper to explore these differences in detail, we can formulate the following general proposition.

Proposition 5: *The O-advantages of Chinese Family Firms exhibit 'country effects,' reflecting the conditions in their home country. There are therefore both performance differences and differences in industrial distribution among Chinese Family Firms from different countries.*

The O-advantages and ownership structure of the Chinese Family Firm will also be reflected in their strategies and organizational structures. Since their O-advantages are not rooted in any specific technology or brand, but rather in using networks to make "deals," we would expect Chinese Family Firms to follow a less focused strategy than would the classic MNE (Redding, 1990). Moreover, a desire to keep the next generation of family members involved may require that the firm diversify into areas that match their interests or personal competencies, as opposed to those of the firm itself (Wong, 1988, Tam, 1990).

Proposition 6: *Chinese Family Firms undertake relatively more unrelated activities (will be more diversified) than will the classic MNE, other things equal.*

The classic MNE establishes organizational structures to minimize the problems of opportunism and bounded rationality created by the presence of firm-specific assets, and to reflect the strategy that the firm has chosen (Chandler, 1962; Williamson, 1975). The Chinese Family Firm is likely to establish organizational structures to maintain family positions and family control (Whitley, 1992; Kao, 1993, Weidenbaum & Hughes, 1996). The trust relationships required for successful operations will likely place a premium on maintaining family control, both financially and operationally (Carney, 1996; Chen, 2001). The need to maintain tight control will also drive strategic decisions.

Proposition 7: *Chinese Family Firms maintain simple and flat organizational structures relative to that observed in the classic MNE. Reliance on outside experts and expatriates are minimized.*

Location-Specific (L) Advantages of the Chinese Family Firm

The location decisions of the MNE, as discussed above, depend on a variety of economic and socio-political variables. Essentially, the task is to match the ownership advantages of the firm with the immobile resources of a host country. This may involve seeking the largest market or finding the lowest-cost supplier. Other things equal, extant evidence suggests that MNEs tend to avoid regions that are culturally different, or that those cultural differences affect the choice of entry mode and performance **(**Kogut & Singh, 1988; Morosini, Shane and Singh, 1998)**).**

The eclectic paradigm suggests that like any firm, the Chinese Family Firm will attempt to match its locational choices with its O-advantages to some degree. The O-advantages of the Chinese Family Firm suggest that they will place a significant premium on locating abroad in regions that are culturally similar and where they have clear advantages in relation to classic MNEs. More specifically, Chinese Family Firms will be seek to locate operations in economies where codified market-enhancing institutions are weak, and where personal connections are required (Luo & Chen, 1997). While this is likely to be true of many Asian countries, it is particularly true of China, where *"many business transactions in China appear to be settled through negotiation within a system of networked relations based on interpersonal reciprocal obligations (guanxi), with local government being a major player as resource provider, facilitator, and tax collector"* (Boisot & Child, 1996, p. 612).

Proposition 8: *Chinese Family Firms tend to locate within their cultural and business network, that is, within Asia in general and specifically in China. Therefore they are relatively less geographically diversified than the classic MNE.*

The O-advantages possessed by Chinese Family Firms are unique and extremely difficult to imitate (Hu, 1995). It is doubtful whether Western MNEs could easily acquire them. The latter are handicapped not only in terms of language, but are also accustomed to operating in environments with greater reliance on formal markets and contracts (Luo, 1997; Wang, 2001). We would therefore expect that the Chinese Family Firm has a significant advantage *vis a vis* the classic MNE when they compete directly in Asian markets.

Proposition 9: *When Chinese Family Firms and Western MNEs compete directly in Asian markets, Chinese Family Firms are more profitable, other things equal.*

We do not suggest that Chinese Family Firms operate only in Asia. The O-advantages of some Chinese Family Firms may well provide them with some advantage in non-Asian markets (Bartlett & Ghoshal, 2000). In addition, since many Asian economies have been or are potentially susceptible to political or economic risk, it is reasonable to expect that many Chinese Family Firms will also operate outside Asia for reasons related to risk reduction (Kao, 1993). That is, the motive for investment is not only to utilize a firm-specific asset abroad, but also to protect themselves from the risks involved in concentrating resources in Asia (Yoshihara, 1988). The Chinese Family Firm may therefore be prepared to accept a lower rate of return on its investment in return for the risk reduction achieved through diversification. Weidenbaum (1996) suggests that the reliance on networks and contacts sometimes means that the Chinese Family Firm will sometimes miss opportunities to find the lowest-cost suppliers. While this may be true in all locations, it is likely more important when Chinese Family Firms operate outside their primary markets.

Proposition 10: *When Chinese Family Firms compete directly against Western MNEs in non-Asian markets, they are less profitable, other things equal.*

Internalization (I) Advantages of the Chinese Family Firm

The classic MNE exploits its O-advantage abroad by minimizing the relevant transaction costs, other things equal. Since these advantages are largely based on firm-specific proprietary assets, market-based methods of transfer such as licensing are typically eschewed in favour of internalized transfer. Until recently, the internalized transfer was accomplished mainly through wholly- or majority-owned subsidiaries, unless prohibited by law. Recently, voluntary joint ventures have become more common as firms attempt to complement their O-advantages, or acquire new ones.

As described above, the O-advantages of the Chinese Family Firm are not typically rooted in the possession or transfer of proprietary assets (Redding, 1990). Rather, their advantage rests in their ability to do business in relational contexts (Khanna & Palepu, 1997). These competencies are extremely intangible and are not easily transferred abroad by any market or contractual means (Hu, 1995). Consequently, Chinese Family Firms can be expected to internalize O-advantages.

Proposition 11: *Chinese Family Firms attempt to internalize O-advantages and consequently do not typically internationalize their operations through licensing or franchising modes of entry.*

The need to internalize O-advantages, together with the need to maintain family control (Chandler, 1990, Weidenbaum & Hughes, 1996), suggests that Chinese Family Firms will tend to move abroad by establishing wholly- or majority-owned subsidiaries.

Proposition 12: *Chinese Family Firms favour wholly-owned or majority-owned subsidiaries, other things equal.*

However, there are circumstances in which Chinese Family Firms may enter into joint ventures. Legal restrictions on majority ownership, such as those in China, may require that the Chinese Family Firm finds a Chinese partner. In other cases, the Chinese Family Firm may seek to augment its capabilities in certain areas by entering into a joint venture. When the joint venture will operate mainly in Asia, Chinese Family Firms will likely feel most comfortable with a partner that is in some sense part of its network of relationships (Hsing, 1996). However, when the joint venture operates outside of Asia, Chinese Family Firms may place greater weight on acquiring complementary capabilities (Teece, 1981).

Since the typical Chinese Family Firm is relatively weak in the area of technology (Hobday, 1995; Carney & Gedajlovic, 2000), we would expect it to seek out partners in this area.

Proposition 13: *When entering a joint venture in Asia, Chinese Family Firms will choose as partners other Chinese Family Firms as well as firms and government institutions connected to it through guanxi.*

Proposition 14: *When entering a joint venture outside of Asia, Chinese Family Firms will tend to choose partners that augment its capabilities. Most non-Asian partners will be in the high technology sector.*

Summary and Conclusions

In much of the extant literature Chinese Family Firms are treated as uniquely a product of their cultural heritage (Hall & Xu, 1990; Fukuyama, 1995) and their social context (Hamilton & Biggart, 1989; Whitley, 1992). While it is undeniably the case that the organizing principles and strategic behaviour of Chinese Family Firms owe much to their cultural origins and the social structures in which they are embedded, they also clearly economic entities. In this paper, we have shown that the application of an economic perspective can yield new and complementary insights regarding the strategic behaviour and organizing patterns of the Chinese Family Firm.

To this end, we have employed Dunning's theory of the MNE as a heuristic device to identify and describe the different capabilities and strategic assets possessed by Chinese Family Firms, and to compare them with Western MNE's. Our propositions identify many areas of difference between the Chinese Family Firm and the typical Western MNE that cluster around issues pertaining to ownership, governance, organization and strategy. In this regard, the cultural heritage and social context of Chinese Family Firms have undoubtedly led them to develop idiosyncratic business practices that have given rise to a particular set of capabilities. When compared to Western MNE's, these practices and competencies do not provide Chinese Family Firm's with an unambiguous competitive advantage, nor do they encumber them with an absolute comparative disadvantage. Rather our analysis of the Chinese Family Firm from the perspective of Dunning's analytical constructs of ownership (O), internalization (I) and location (L) highlights areas of relative rather than absolute competitive advantage.

In this respect, we find that like the classic MNE, the Chinese Family Firm can be understood as a viable mechanism for safeguarding and capitalizing on particular configurations of OLI advantages. More specifically, while cultural and social factors may give rise to distinctive organizing patterns and thus different sets of capabilities (Bartlett & Ghoshal, 1989; Carney & Gedajlovic, 2001), the exigencies of competitive international markets requires that Chinese Family Firms, like other MNEs, utilize economizing logic to safeguard and exploit these capabilities.

It is beyond the scope of this paper to provide empirical evidence in support of our propositions, but this is a necessary step for future research. However, we believe that our approach provides a useful foundation for the framing of future empirical studies. In particular, many of our propositions require that CFF activities be compared to those of other firms engaged in international production, something that has not typically been done in the literature (an exception is Li, Lam and Fu, 2000).

The economic analysis developed in this paper recognizes and builds on the cultural and societal approaches that dominate the international management literature on Chinese family business. This approach is a logical step in the evolution of scholarly understanding of emerging research topics related to the CFF. However, there is no doubt that wider ranging and more integrative theoretical approaches are required to provide a complete foundation for analyzing the Chinese Family Firm.

Although its immediate objectives are more modest, the present paper takes a step in that direction, by demonstrating that the Chinese Family Firm can be meaningfully examined using previously established conceptual and theoretical frameworks. This approach can be extended in various directions. For example, our analysis is built on the view that CFFs gain competitive advantage by specializing in relational contracting, and are able to leverage these skills into new markets particularly markets where the institutional infrastructure to support market exchange is weak. However, this is a static characterization that does not fully explain why Chinese family business did not abandon the relational system even when they operated in business environments that did develop reliable legal systems and institutions, such as in Hong Kong or Singapore; nor does it predict how they will respond as institutional infrastructures are strengthened in other countries, notably China.

Research in institutional theory suggests that firms are strongly conditioned by environmental conditions at the time of their founding and subsequently evolve on highly path dependent trajectories (Starbuck, 1965; Stinchcombe, 1997; North, 1990). Carney and Gedajlovic (2002) have argued that many CFFs have found it difficult to significantly adapt their traditional business practices to match contemporary business conditions in the most advanced economies of East Asia. Instead, it is argued that many CFFs have responded by co-opting political support in their home countries and by exporting their business models to institutional environments more amenable to their traditional business practices. This suggests that the ownership advantages possessed by CFFs are circumscribed both in terms of time and space (Hu, 1995). Perhaps more importantly, it also highlights that internationalization and political activity can be used by firms in order to extend the duration of their ownership advantages beyond the point where they would otherwise no longer constitute an advantage in home and traditional markets.

There are other established conceptual and theoretical approaches that can contribute to our understanding of the CFF. For example, the importance of political and other external strategies in the evolution of CFFs might benefit from an analysis in terms of stakeholder theory (Friedman & Miles, 2002; Hendry, 2001; Swanson, 1999). The issue of how individual CFFs interact to form integrated networks of organizational activity can be studied in terms of social network theory (Granovetter, 1973; Ireland, Hitt & Vaidyanath, 2002). In all cases, sociological, cultural and political factors are extremely important at each stage in the process of conceptualization, research design, data collection, analysis, and interpretation of results.

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