

Institutional System Development for Outward Foreign Direct Investment in China and Russia

Abstract

This paper examines outward foreign direct investment (OFDI) institutional formation and entrepreneurship in China and Russia since the start of market-oriented economic reform. We study the impact of change on regularity and continuity in the OFDI institutional development, its stages and the role of institutional entrepreneurs. The OFDI institutional system in the two countries is found to be dominated by the state and its agencies as the principal institutional entrepreneurs. We posit that the formation of an OFDI institutional system and its regularity and continuity requires alignment of state policy with cultural-cognitive behavior. The paper ends with theoretical discussion and addresses managerial implications concerning the role of institutions in supporting the international expansion of firms from China and Russia via OFDI.

Keywords: Outward foreign direct investment, institutional system, institutional entrepreneurs, China, Russia.

Introduction

The outward foreign direct investment (OFDI) from the big emerging market countries of Brazil, Russia, India, and China (BRIC) has risen prominently over the past few years. It represents the ascent and evolution of a new set of

corporate players (Aykut & Ratha, 2004; Goldstein, 2007; Kumar, 2008). Among the BRICs, Russia tops the ranking with an OFDI stock of US\$160 billion in 2006, China followed with US\$78 billion (Deutsche Bank Research 2008). Russian OFDI has been dominated by companies owned or supported by the government (Prihodko *et al.*, 2008), and the bulk of China's OFDI is made by the country's large companies administered by Central Government ministries and agencies.

In contrast to past practice, governments have become more engaged in regulating and supporting OFDI. An UNCTAD survey conducted in 2006 found out that OFDI regulation was strengthening in many emerging market countries, including China and Russia. Government OFDI policies reflect a country's stage of development, its comparative advantages, geopolitical position, industrial structure and overall development objectives (WIR, 2006). Institutional arrangements in an emerging economy have become to play an important role in determining the OFDI of domestic firms (Peng, 2002; Wright *et al.*, 2005). As suggested by Aggarwal and Agmon (1990) and Buckley *et al.* (2007), while firms have to face strict administrative processes and procedures laid down by governments for OFDI approval, home institutions also support emerging market firms to compensate for ownership and locational disadvantages when investing overseas. Thus the OFDI strategy of emerging market firms is embedded in their home country institutional setting and regulated, enforced and controlled by the home government (Scott, 2002).

China and Russia have undergone considerable moves beyond and away from their socialist institutional arrangements. The high degree of state control of the Chinese economy (Luo *et al.*, 2010) accounts for the decisive role played by the Chinese government in defining firm OFDI engagement. While in the 1990s the Russian government chose not to be involved in the OFDI process, since 2000 state control has become stringent and exercised via direct asset ownership and regulation (Karavaev, 2002; Prihodko *et al.*, 2008). This paper examines the economic transformation of China and Russia in view of the challenges it posed to governments in their effort to create institutional systems for OFDI and the role of regularity and continuity in reducing uncertainty (Williamson, 1975). Regularity here is used in the sense of providing an adequate regulatory structure for OFDI. The paper explores the role of the process and result of change in the formation of a new OFDI institutional system (DiMaggio, 1991; Scott & Christensen, 1995). Moreover, we associate OFDI institution building with institutional entrepreneurship, which incorporates individuals or organizations that introduce, establish and develop new institutional norms and rules (DiMaggio, 1988; North, 1990) redefining OFDI behavior.

The present research contributes towards filling a gap in the existing literature through a study of the role of change and institutional entrepreneurship in the formation and evolution of the OFDI institutions in Russia and China. The paper proceeds with an analysis of the theoretical perspectives that inform its conceptualization and the research questions it

addresses. This is followed by an examination of the impact of changes in the wider environment on OFDI institutional building and the role of institutional entrepreneurship. Theoretical contributions based on the analysis of the development of emerging market OFDI institutional systems in China and Russia are subsequently discussed.

Theoretical Perspectives

An organizational field, hereafter used interchangeably with the term institutional field (Lawrence *et al.*, 2002), comprises institutions that are formed on the basis of issues shared by its constituents (Hoffman, 1999). Critical events bring about change in the institutional field undermining existing institutional systems and challenging ‘the validity of a long-standing tradition or established activity’ (Oliver, 1992:567). Change is driven by institutional entrepreneurs (DiMaggio, 1988) who are individual and organizational strategic actors that either design institutions (Hoffman, 1999; Streeck & Thelen, 2005) or are required to comply with the laws and regulations installed within the field. These actors interact with and influence each other to develop and enact institutional rules, mechanisms and practices (Child *et al.*, 2007). Consequently, the formation of an institutional system with its individual and organizational actors instigates the emergence of forces that emphasize regularity and continuity in the development of the field.

The Role of Change in the Formation and Development of Institutions

While institutional theorists agree on the importance and role of an institutional system, the new institutional paradigms seem to differ in their understanding of institutions (Campbell, 2004). Some institutional theories emphasize strategic equilibrium (Bates *et al.*, 1998), others view institutions as formal and informal rules and procedures that define behavior (North, 1990; Thelen & Steinmo, 1992), whereas a third group in recognizing formal rules also emphasizes the informal cognitive frameworks which conjointly generate regularity of behavior by enabling, guiding and motivating it (Jepperson, 1991; Greif, 2004). Despite any differences, all of them reinforce regularity and continuity as common attributes or the *raison d'être* of the existence of institutions.

Nevertheless, institutional theorists argue that stability, regularity and continuity pre-suppose change, which can be incremental and evolutionary, or disruptive and revolutionary. Evolutionary changes are ongoing, non-disruptive and accumulating over extended periods of time. These changes are based on social learning in the process of which “self-reflective actors gradually adjust their institutions in ways that are constrained by already given institutional practices, rules, routines, and cognitive schema” (Campbell, 2004:34). Revolutionary changes are often defined as a punctuated equilibrium, or a punctuated evolution that is preceded by long periods of stability, or incremental evolution which is then cut short by a crisis. A disruptive crisis brings existing institutional frameworks into disarray that can be brought back to regularity and stability only if a new set of institutional

arrangements emerges and becomes a source of stability (Blyth, 2002). Crises are often associated with unsettled and unclear situations in which decision makers find it difficult to develop clear programs for institutional change based on their interests because the latter are difficult to define considering the widespread uncertainties (Marcussen, 2000). At such times, institutional entrepreneurs have to generate new ideas in order to drive forward change processes and institutional building. Thus crises are perceived as triggers of institutional shifts in economic governance (Campbell *et al.*, 1991). Institutional change is easy to delineate from institutional stability but often it is difficult to distinguish evolutionary from disruptive change. Institutional regularity and continuity is disrupted by change which subsequently tends to bring stability in the long run. However, this drive towards stability does not always pre-suppose continuity. For example, after a disruptive change such as that at the beginning of the 1990s in Russia, building new political and economic institutions has become a major challenge as it has not ensured continuity concerning old and new institutional structures and processes (Elster *et al.*, 1998).

While general perspectives on the role of change in institutional development have been studied in organization theory and mostly in developed economy contexts, little is known about the role change plays in the development of the OFDI institutional field in transformation economies. This gives rise to the following research question:

Q1 How has change in the wider environment impacted the development of the OFDI institutional field in Russia and China?

Development of an Institutional System

The process of institutional definition or structuration exhibits contextual variations, generally associated with stages of institutional development. In a study of professional accounting services in Canada, Greenwood *et al.* (2002) identified six stages of institutional formation, i.e., (1) precipitating jolts, which destabilize established practices; (2) deinstitutionalization that is characterized with entry of new actors who disturb the socially constructed consensus by introducing new ideas and thus the possibility of change (Thornton 1995); (3) preinstitutionalization, associated with the development of new rules and practices; (4) theorization, which includes the development of abstract categories simplifying the new practices; (5) diffusion that creates social consensus in organizational communities; and (5) re-institutionalization when the rules and ideas become taken-for-granted. By comparison, Child *et al.* (2007) when examining the formation of the organizational field of environmental protection in China categorized four stages, i.e., enlightenment, when authorities experienced pressures to move beyond the institutional status quo; regulatory endorsement, professionalization, and social responsibility. The common ground between the different stage models is the existence of critical events such as 1989 (Tiananmen) in China and both 1991 and 1998 in Russia that undermine the status-quo and lead to the appearance of

institutional entrepreneurs initiating new institutions. This in turn leads to the creation of new laws and regulations that are gradually translated into practices and norms of behavior, which are subsequently diffused within organizational communities.

The major task of institutional entrepreneurs is to construct the key elements of the institutional system, comprising of regulative, normative and cultural-cognitive pillars (Scott, 1995). A regulative pillar is built by policies, laws and regulations that define the rules that must be followed by organizations. A normative pillar creates a code for organizational behavior based on procedures, standards, conventions, and training and education programs. A cultural-cognitive pillar embodies elements that define “the frameworks through which meaning is made” (Scott, 1995:40). Thus institutional entrepreneurs build a three pillar institutional system that may vary across countries as it involves and affects different interest groups, including government agencies and communities. Hence, the development of the OFDI institutional system is likely to differ between countries also because (1) the three pillars are not necessarily constructed at the same time and (2) the time order of their development may vary between countries. This leads to the following question:

Q2 How have the OFDI institutional systems of Russia and China developed and how do they differ?

Importance of Institutional Entrepreneurs

Institutional entrepreneurs are the variety of actors, also referred to as field makers, rule makers, strategic actors, powerful agents and institutional designers (Hoffman, 1999; Scott, 1995; Streeck & Thelen, 2005), who initiate the emergence of an issue and facilitate the development of an institutional system. They can be associated with government agencies, industry and professional associations, organizations and communities. For example, Greenwood *et al.* (2002) note the importance of regulatory agencies and professional associations in the transformation of accounting as an institutionalized field. Institutional entrepreneurs are united by a common issue, but Hoffman (1999) suggests that their purpose may differ. The composition and role of these actors may also change as issues that bring them together evolve over time.

Institutional theory has viewed the role of the government as a key rule-maker. The significance of government policies has been emphasized since the government secures the framework of regularity and continuity on which the economy is built. Thus Lewis (1955) suggests that countries cannot make economic progress without the positive stimulus from governments because they create an explicit regulatory system that enables and governs exchange behavior. Moreover, institutional political economists argue that the government acts as a rule-maker who sets the imperatives and limitations determining the behavior of organizations (Boddewyn, 1988; Boddewyn & Brewer, 1994), whereas the latter inform and impact government decision-making. Streeck (1992) suggests that the understanding of these relations

necessitates that organizations play the role of political actors who participate in the creation of institutions. The range of institutional entrepreneurs and the role of the government in the development of an institutional system are likely to depend on the specific institutional arrangements and the strength of the government as a rule-maker. For instance, Child *et al.* (2007) suggest that in many emerging economies, institutional change is government-driven. Similarly, governments can define the regulations for OFDI, thus motivating or impeding OFDI activities based on the asymmetric distribution of wealth. These reflections inform the following research question:

Q3 Who are the institutional entrepreneurs in the evolution of the OFDI institutions in Russia and China and what is their role?

Role of Change in the Formation of OFDI Institutional System

The role of change in the development of an OFDI institutional system has to be analyzed within the context of change in the wider environment of China and Russia. This is necessary as institutional theorists argue that all major changes could be seen as exogenously generated and generally, an institutional field is initiated by changes in the wider environment. Political economists argue that such a change is predominantly associated with a critical juncture of political rather than cognitive or normative forces, thus a major institutional change emanates from a shift in the political balance of power (Collier & Collier, 1991). In line with Streeck & Thelen (2005), we classify the change processes as incremental or abrupt and the results of change as leading either

to continuity or discontinuity (see Figure 1). An abrupt change process results in discontinuity when it is characterized by a breakdown and replacement of institutions. In other words, it leads to a displacement in which previous forms, models and schemas are replaced by new ones. By comparison, the process following an abrupt change may be characterized by trajectory activities aimed at survival and return to stability that lead to regularity and continuity. The process of incremental change that represents reproduction by adaptation brings about regularity and continuity, whereas incremental change, which is associated with activities enabling gradual transformation, leads to discontinuity.

[Figure 1 in here]

Prior to the Cultural Revolution in China (1966-1976), institutional development was an incremental process, the results of which ensured regularity and continuity, i.e. reproduction by adaptation (see Figure 2). The critical juncture that led to the Cultural Revolution was a fight for power based on different platforms of ideas for economic development where some incumbent party leaders and government officials were ousted whereas the institutional system was preserved. The activities in this institutional transformation process undermined the normative and cultural-cognitive pillars of institutions. They brought about the collapse of the national economy and crippled the cultural and educational system. This process disrupted the status-quo and led to a crisis, a critical juncture that initiated a change process representing survival and return. The latter reinstated the normative and

cultural-cognitive pillars of institutions and strengthened the regulative pillar giving exclusive prerogatives to the Communist Party. Thus official assessment of the impact of the Cultural Revolution stipulated that China had to be governed by a strong party institution, in which decisions were made collectively and according to the rule of law, and in which the public had limited input. Subsequently, this gave rise to an incremental change process that ensured reproduction by adaptation and resulted in regularity and continuity.

The formation of an institutional field takes place within the limitations of the change processes in the wider environment. The return to power of Deng Xiaoping and the announcement of the “Open Door” policy precipitated the start of OFDI from China in 1982. The initiation of the OFDI institutional field in China started in the change period of survival and return (1976-1992). The latter ensured regularity and continuity when the normative and cultural-cognitive pillars of institutions were reinstated and the Chinese Communist Party and government strengthened their position as the most powerful institutional regulators. The initiation of the OFDI institutional field began as a top-down process with stringent regulations and strict limitations directly imposed by the government. The initiation of the regulative framework for OFDI was of evolutionary nature in the context of the changes in the wider environment. In the period after 1992, China experienced incremental change that ensured regularity and continuity by the implementation of liberal policies prevailing over bureaucracy. The incremental change led to further

development of the regulative, normative and cultural-cognitive pillars of OFDI institutions, although the major emphasis was on the regulative pillar. The building of institutions was under state-led economic restructuring, when new institutions were formed to serve the OFDI of companies with different ownership structure. The government-ensured stability in the wider environment expanded the activities in the OFDI change process resulting in the evolution of OFDI institutions. Thus in 1995, OFDI officially became part of China's economic development policy. The incremental change in the wider environment and the shift from "Open Door" to "Go Abroad" (later "Go Global") policy has enabled the diffusion of rules, norms and practices.

[Figure 2 in here]

Before the *Perestroika* period (1987-1991) in Russia, institutional development was incremental and it led to continuity, i.e. reproduction by adaptation (see Figure 3). A continuous economic slowdown coupled with exogenous political pressure acted as a critical juncture, which disrupted the *status quo* of political, economic and social ideas and triggered the *Perestroika* process. *Perestroika* was a change process introduced as a way to revive the ailing Soviet economy based on major political and economic reforms. The activities in this period represented gradual transformation that undermined all three pillars of institutions in Russia. Thus the process was incremental through gradual transformation leading to discontinuity. Most importantly, the regulative institutional pillar was severely undermined and the whole institutional structure became unstable. Consequently, the process of change

eventually caused instability, which led to the critical juncture of the unsuccessful *coup-d'état* (“*putch*”) in August 1991. As a result, a new period of abrupt change was instigated, representing breakdown and replacement. This change process that was based on a new set of ideas radically undermined the three pillars of institutions and stripped the existing institutions of their functions, which meant that the institutional structure continued to exist *de jure* but *de facto* institutions did not perform their functions. In effect, anarchy and chaos in the political, economic and social spheres came to rule causing discontinuity. The trajectory activities gave birth to omnipotent oligarchs who functioned outside the regulative, normative and cultural-cognitive institutional pillars. Subsequently, the chaos led to a new critical juncture that was expressed in the economic collapse of 1998. It was accompanied by a major political crisis bringing about a new political leader. A new process of change was initiated that reinstated the normative and cultural-cognitive pillars of institutions, followed by the strengthening of the regulative pillar. The process of change was abrupt. It was characterized by survival and return ensuring regularity and continuity. In the course of the change, a critical juncture was marked by the government’s decision on a new economic and geopolitical strategy. Trajectory activities for its implementation have led to incremental change representing reproduction by adaptation reinforcing regularity and continuity.

The process of OFDI from the former USSR was government directed and executed within the economic interests of the former Council for Mutual

Economic Assistance (CMEA). OFDI was based on the principles of the international division of labor and specialization, and took the form of government investment in the creation of productive assets in CMEA countries. The incremental change process of reproduction by adaptation supported the growth of this investment mostly in the 1970s and 1980s. However, an institutional field of OFDI did not develop as the investments were made solely and exclusively by the government. The process of gradual transformation started by *Perestroika* led to the emergence of entities based on some participation of private capital. This required the initiation of an OFDI organizational field, which began in 1989 with the Decree of the Council of Ministers on the Development of Economic Activities by Soviet Organizations Abroad. The uncertainty caused by the gradual transformation and the weakening of the regulatory institutional pillar created irregularity and discontinuity that led to continuously weakening control of OFDI activities. Consequently, a large amount of capital escaped overseas but statistics failed to produce reliable evidence. The capital flight intensified with the process of radical and systemic undermining of the three institutional pillars. As institutions were stripped of their functions, the regulatory pillar could no longer enforce OFDI regulation. Thus the chaos in the wider environment at the time of abrupt change hindered the functioning and further development of the OFDI institutional field. The survival and return change from the beginning of 2000 had a positive effect on the emerging OFDI institutional field. By re-examining the ownership structure of the economy and identifying

key strategic economic priorities, the government re-instated its position as a key regulator bringing greater stability, regularity, and continuity. The strengthening of the regulative pillar in the wider environment led to an incremental development of institutions defining the rules, norms and cultural-cognitive aspects of OFDI. The evolution has been facilitated by the incremental changes of reproduction and adaptation that create regularity and continuity.

[Figure 3 in here]

OFDI Institutional System Formation

Following the method for the study of institutional formation and evolution suggested by Lieberman (2001) the data was organized in a historical chronology in order to identify analytically useful periods. Subsequently, the critical events and trajectory activities that enabled the evolution of OFDI institutional systems in China and Russia were distinguished. Critical events are major newsworthy developments, such as new legislation or new policy (Hoffman, 1999), that drive institutional formation to move from one stage to another. Publicly available sources of information were used to spot the critical events. Trajectory activities were identified following the method applied by Child *et al.* (2007). They include subsequent activities of institutional entrepreneurs that support institutional development within the boundary of each stage. These encompass drafting and revising relevant laws, regulations and policies, training, and public campaigns on OFDI. Using a

number of official sources and publications listed in the Appendix, 856 and 574 activities concerning OFDI were identified in China and Russia respectively. They consist of official elaboration of laws, rules and policies, official decisions, educational programs, research and publication activities, and public announcements. Content analysis was applied to all indentified activities using Neuendorf (2002), based on separate coding by two of the authors who are bilingual in English and Russian and two independent researchers who are bilingual in English and Mandarin, with an initial agreement of 92.8% and 87.9% respectively. The classification and coding of the Chinese data were also discussed in detail between the two independent researchers and the two authors. The coding classification used the six categories of trajectory activities suggested by Child *et al.* (2007) (see Tables 1A and 1B). Category 1 was taken to concern the building of a regulative pillar, categories 2–5 the building of a normative pillar, and category 6 the cognitive pillar of institutional building in the respective countries.

[Table 1A in here]

[Table 1 B in here]

Three stages in OFDI institutional development were indentified in China by examining the occurrence of critical events and were labeled as follows: (1) Pre-institutionalization (2), Regulatory Endorsement, (3) Theorization and Diffusion. In Russia, we delineated only the first two of these stages. *T*-tests were applied to see whether the incidence of activities to build the three institutional pillars listed in Tables 1A and 1B differed between each adjacent

stage. Stage 1 in both China (1984-1990) and Russia (1987-2002), was found to be significantly different in comparison with Stage 2, which in China was 1991-2000 and in Russia 2003-present for both the number of laws, rules and regulations, and the number of activities in category 1 associated with building a regulative pillar system ($p<.001$, one-tail test). Similarly, the value of t for the differences between Stages 1 and 2 in the two countries was also significant for the sum of categories 2–5, indicating construction of a normative pillar ($p<.05$). Differences in the incidence of activities between Stages 2 and 3 in China were statistically significant.

The analysis points out that although similar stages in the formation of institutions concerning OFDI in the two countries have been identified, the major difference lies in the intensity and extent of development of the three institutional pillars in terms of breadth and depth. For example, the regulative pillar in the Regulatory Endorsement stage in Russia includes fewer laws and regulations with a limited scope that are also scarce in details clarifying their implementation. Moreover, the regulatory pillar in China embraces a more varied range of state institutions that contribute to the interpretation and translation of the regulations. The scale of the normative pillar building is much greater and with a richer content for the same stage in China compared to Russia. The broader scope and scale of regulatory endorsement in China has gradually created conditions for diffusing OFDI rules, norms and procedures thus increasing the scope of the field and initiating decentralization in policy implementation. Consequently, in 2006 the first regulation for OFDI of

privately owned enterprises was drafted and later approved; measures for capital support of small and medium-sized enterprises to encourage their OFDI were introduced; Foreign Economic Relation and Trade offices in each province or municipality have been included into the approval process of small OFDI projects (for investment of up to US\$30 million). Thus, as suggested by Bach *et al.* (2006) since 2001 the Chinese Central Government finalized the shift from direct intervention into OFDI decision-making to a role that controls and impacts OFDI through policy and a broad network of organizational bodies and structures.

By contrast, the OFDI process in Russia has been driven by companies (Bulatov, 2001) while the Russian Federal Government gives approval based on regulations and procedures, which have been in place since the 1990s when the government opposed OFDI. There is no overall government policy for OFDI for the range of state-owned and private firms. Nevertheless, strategic national priorities for OFDI have emerged post-2003. OFDI activities of national institutions are selective, giving preferential treatment to individual companies identified as national champions. For instance, in 2007 Lukoil signed an individual contract with the Ministry of Economic Development of Russia that could enable it get access to new OFDI business projects (Prihodko *et al.*, 2008). Moreover, the government provides indirect guarantees for OFDI of companies operating in strategic economic sectors that are defined by the state.

Thus the OFDI institutional development has been directed and managed by the government in the two countries. However, the process of OFDI institutional formation is more advanced and thorough in China allowing greater diffusion of rules, norms and practices. By contrast, Russia is still in need of a better developed regulatory, normative and cognitive institutional system providing for more encompassing activities.

Role of Institutional Entrepreneurs

Institutional entrepreneurs initiate, establish and legitimize an institutional field. Hereafter, we examine the role of the individuals and organizations that have set up, developed and legitimized the institutional field of OFDI in China and Russia.

Jowitt suggests that the post-communist societies should be viewed as turbulent environments in which existing institutional boundaries and identities are challenged. He notes that “leaders will matter more than institutions” (Jowitt, 1991:15) as they will decide the distribution of political power and define directions and forms of innovative institutional building. He also points out that the contextual specifics play an important role in determining leaders’ role in the course of change. Moreover, he proposes that Chinese leaders of reform have had “confidence in their political and ideological purpose” (p. 14) which was not a feature of Russian leadership. The policy foundations for the OFDI institutional field in China were laid down by Deng Xiaoping who instigated the “Open Door” policy. He initiated

the beginning of an innovative institutional structure needed for the implementation of the Chinese new economic policy. His ideas were translated into meaningful institutional solutions by the government and its regulatory agencies. The critical role of regulatory agencies in enabling the formation and reproduction of shared meanings at the ‘theorization’ stage of institutional field formation has been recognized by Greenwood *et al.* (2002). Thus the OFDI institutional field has emerged as an essential component of the new institutional framework. The main OFDI institutional entrepreneurs have been the Chinese Communist Party and the Chinese government, although the specific field-makers outside the government system varied in the different stages of field formation. The major field-maker has been the State Council that regulates, develops policies, and plans the overall OFDI in the long run. It has been supported by branch ministries promoting and managing OFDI (e.g., Ministry of Commerce, Ministry of Finance). The Ministry of Commerce drafts OFDI policy and regulations, develops large OFDI projects in non-financial sectors, conducts negotiations for securing OFDI projects, guarantees alignment of economic and trade laws impacting all FDI activities. Other institutional entrepreneurs also play part in developing shared meanings. The People’s Bank of China regulates OFDI through monetary and foreign exchange policies. The State Administration of Foreign Exchange reviews the certification of investors, foreign exchange risk and source of investment funds; develops guidance for granting credit for overseas processing and assembly. The State Development and Reform Commission sets China’s

economic and industrial policies and defines the role of OFDI in its realization. The State-Owned Assets Supervision and Administration Commission determine the OFDI activities of the country's state-owned enterprises. The OFDI rule-makers have gradually evolved with the increasing role of OFDI in the overall economic development policies. Following the announcement of the "Go Abroad" policy, the State Development Planning Commission became responsible for state development and reform; Departments of Foreign Economic Cooperation, Policy Research Development, Foreign Economic Relations and Trade, International Trade and Economic Affairs emerged as new institutional entrepreneurs. Professional organizations, sector associations (e.g., All China Federation of Industry and Commerce, China Entrepreneur Association) and firms, mostly those who belong to the group of National Champions, have started to inform government policies on OFDI and translate the details of OFDI institutional rules and norms of behavior.

The OFDI institutional field formation in Russia has also been using a top-down approach. It has been driven by individual entrepreneurs with political power dominating the presidential institution. In line with Jowitt's (1991) analysis, the Russian presidents have acted as key rule-makers. They have the power to rule by decrees and to approve or overturn laws developed by the state legislative bodies. For example, the Presidential Decree of President Gorbachev of November 15, 1991 liberalized the international economic activities, including OFDI, of firms on the territory of Russia.

Another example is the Presidential Decree that was later adopted as Russian Federal Law on July 9, 1999. This Law regulates foreign investment in and from the Russian Federation. Presidents have also defined new norms and cognitive attitudes towards OFDI. Thus, President Putin used his political influence in targeted meetings with European counterparts to secure OFDI transactions for Russian firms. Among the OFDI institutional entrepreneurs, the Russian government is the key one. In the period 1987-2003, it considered OFDI to be an undesirable or even harmful activity for the economy (Prihodko *et al.*, 2008). Since 2003 the government has changed its attitude and started assisting and facilitating OFDI by large Russian firms, mainly through mergers and acquisitions. From 2005, the government has provided political and diplomatic assistance and lobbying activities for the implementation of OFDI projects by Russian firms. Other major OFDI institutional entrepreneurs include the Ministry of Economic Development, which coordinates OFDI activities and has initiated the development of a new OFDI regulatory system; Ministry of Natural Resources regulates and facilitates OFDI of companies from this economic sector; Russian Central Bank regulates OFDI through monetary and fiscal policies. The OFDI institutional field in Russia has been dominated by federal government institutions. Some professional organizations have recently emerged as OFDI institutional entrepreneurs. The Russian Union of Industrialists and Entrepreneurs has taken an active position in facilitating and encouraging OFDI. Similarly, the International Council on Collaboration and Investment offers support for the realization of OFDI

projects. The Russian International Centre has started to provide information to firms on OFDI opportunities and processes. The National Centre for Government-Private Business Relationships facilitates the government in directing and regulating OFDI by private Russian firms.

Discussion

Institutional theorists note the importance of regularity and continuity for institutional development. They presuppose evolutionary change causing gradual institutional transformation (Campbell, 2004). Evolutionary change in institutional development arises from social learning which is embedded in the existing institutional practices, norms, rules and cognitive schema. Our analysis shows that in the case of China the initiation and development of the regulative, normative and cultural-cognitive pillars of the OFDI institutional system stem from the regularity and continuity in the wider environment. Change in the wider environment in Russia in the process of transition towards and implementation of *Perestroika* and then throughout the period of Yeltsin's presidency was associated with discontinuity. The latter disrupted the regularity and continuity in the wider environment and henceforth hampered the development of the OFDI institutional system, most seriously affecting its regulative pillar. These considerations suggest:

Proposition 1 Regularity and continuity in the wider political environment warrant continuity in the development of the institutional system of OFDI whereas discontinuity undermines OFDI institutional building.

In both China and Russia the formation of the OFDI regulative pillar has been initiated and implemented top-down with the government and its agencies being the major institutional entrepreneurs. The evolution and recent changes in China's economic restructuring policy have led to decentralization of the process of OFDI approval and implementation via the inclusion of provincial government authorities and local State Administration of Foreign Exchange (SAFE) institutions in the decision-making processes. However, OFDI direction and control still remain in the hands of the Central Government whereas policy implementation relies heavily upon administrative regulations (Blanchard & Shleifer, 2000). In Russia the central regulation of the OFDI process has been consistent since 2003 continuously strengthening and expanding the regulative pillar of OFDI (Prihodko *et al.*, 2008). Moreover, rules and norms of behavior have been gradually tightened up concentrating more institutional building power in the Federal Government. Hence, we suggest:

Proposition 2 Direction, control and assistance of OFDI in post-socialist economies remain with the state government as a major OFDI institutional entrepreneur, irrespective of the degree of decentralization of the process of OFDI approval and implementation.

The evolution of OFDI institutions in China and Russia displays common characteristics that could be relevant to other emerging market countries. In such contexts institutional formation tends to materialize as a top-down process initiated, guided and controlled by the state. The primary role of the

state is embedded in the political heritage of these countries. In large countries, the strong centripetal forces tend to slow down institutional formation and policy endorsement at the local level. In the case of China the uninterrupted top-down process aligned with state policy has enabled the systematic and consistent adoption of OFDI laws and regulations as well as their ongoing clarification. The top-down process of OFDI institutional development in China instigated slow but steady emergence of the normative and cultural-cognitive institutional pillars. By comparison the institutional arrangements in Russia have also been top-down. The formation of the regulative pillar was initiated by the Federal Government, but in the first stage of OFDI institutional development it was undermined by a clash between the state OFDI policy enforcement and the dominant cultural-cognitive behavioral patterns that led to flight of capital in spite of existing regulations (Witt & Lewin, 2007). It was only in the second stage that the regulative pillar was significantly strengthened, which boosted the formation of the normative pillar leading to gradual alignment of OFDI cultural-cognitive behavior with the state policy. Ultimately the centripetal forces enabled the OFDI regulatory endorsement in Russia. Following the above analysis we suggest:

Proposition 3 The formation of an OFDI institutional system requires alignment of state policy with cultural-cognitive behavior.

A major task of institutional entrepreneurs is to create the basic institutional components of the regulative and normative institutional pillars through which the new order is respectively normalized and enforced (Greenwood *et al.*,

2002). Construction of the regulative and normative pillars of OFDI has gradually involved a wider range of institutional entrepreneurs. In China, field-makers expanded to include not only the State Council and ministries, which were the established policy-making authorities, but also newly formed government agencies and industry associations. The regulation of OFDI through rules concerning foreign exchange has intensified since 2003 when the existing regulation was expanded to include a number of regulations concerning foreign exchange administration rating, foreign exchange administration stimulation, measures for the usage of foreign exchange, and a set of rules regulating the source and application of foreign exchange for OFDI activities (Luo *et al.* 2010). The newly formed OFDI government agencies have recently initiated a set of regulations to oversee the performance of OFDI projects by developing rules, standards and procedures for annual assessment, and incorporating rules and procedures for an OFDI statistical and information system. The process of change of the Central Government role to a more directive and controlling role has resulted in a series of regulations involving more local government institutional entrepreneurs. The diffusion of OFDI concepts has attracted more participants as the awareness of OFDI opportunities and challenges increased strengthening the cognitive pillar. In addition, Chinese companies involved in OFDI started to participate in institutional entrepreneurship offering technical expertise to governmental agencies. Thus the scope and dynamics of OFDI regulative and normative pillar development have increased. In Russia, the government has recently

placed a key priority on the development of the regulative system of OFDI in line with the current state strategy for economic development. Thus in 2007, the Ministry of Economic Development drafted a system of laws including mechanisms for OFDI involvement of Russian firms and their relationships with the banking system. The technical expertise of Russian firms and the banks involved in financing OFDI activities has informed the drafting of the rules. In 2008, the *State Duma* approved a new law for the strategic role of Russian OFDI drawing on the input of government agencies, the Russian Central Bank, the Union of Industrialists and Entrepreneurs, the National Centre for Government-Private Business Relationships, and respective academic institutions. Moreover, the Ministry of Economic Development has begun to put together and coordinate a set of laws and measures for the development of the OFDI regulative system informed and supported by eighty inter-governmental commissions that define priorities and principles for OFDI collaboration. Consequently, we suggest:

Proposition 4. The wider the range of institutional entrepreneurs, the stronger the development of the OFDI regulative and normative pillars.

Conclusion

The present study has explored the development of the OFDI institutional system in China and Russia drawing upon political economy theory and institutional theory strengthening the notion that institutions play a key role in the process of OFDI from emerging countries assisting firms from such

economies in compensating for their initial disadvantages (Child & Rodrigues, 2005). Following Streeck and Thelen's classification of change processes and results (Streeck & Thelen, 2005), we studied the impact of changes in the wider environment on the continuity or discontinuity of the OFDI institutional building process in the two countries. Subsequently, using critical events and trajectory activities the analysis identified the stages in the formation of the OFDI institutional system in view of the regulative, normative and cultural-cognitive pillars. Thereafter, the research focused on the nature and role of the key institutional entrepreneurs in developing the OFDI institutional field. The combined attention to changes in the wider environment, critical events and stages, and institutional entrepreneurs offers a more complete analysis of OFDI institutional field formation processes and outcomes in emerging market economies. By the same token, the limitations of this study offer avenues for future research. For example, further studies can not only identify the critical events that have led to the transition from one stage to the next, but it may explore in a greater detail the cycles of events and trajectory activities within each stage and identify the roles of various institutional entrepreneurs in initiating and developing different institutional components. In the two countries the joint impacts of government policy and institutional support structures have boosted the development of OFDI activities by home firms.

The development of institutional structure in both China and Russia has assisted the expansion of OFDI activities of firms in both counties. In China where the institutional structure supporting OFDI is more advanced

than in Russia the government provides companies with financial support, risk safeguarding and simplification of approval processes among others (Luo *et al.*, 2010). By comparison in Russia there is a process of intensive further development of OFDI supporting institutions and the process is less advanced. The Russian government does not provide financial help to companies attempting OFDI rather it facilitates the process of financially strong Russian firms to succeed abroad.

As the international business literature acknowledges that the relationships between home government and multinational firms are largely neglected this study has attempted to fill-in the existing gap.

Further research can encompass in-depth interviews with rule-makers and rule-takers who could shed more light on the specifics of institutional entrepreneurship in the two countries, which would extend the understanding beyond the information offered by the documentary data. This may prove a useful and exciting study thread to follow due to the intricacy of the relationships between rule-makers and rule-takers in the two studied contexts. Our study also calls attention to the question whether China and Russia are unique cases among the emerging market countries in view of the top-down government-led OFDI institutional system formation and the nature of institutional entrepreneurs involved in the process. Thus including into the research other large emerging economies in which OFDI plays a significant role in the internationalization of their businesses will be of interest because institutional structures vary among these economies it can be expected that the

government policies and institutional specifics impact OFDI activities differently. Such a research will enrich the understanding of the internationalization of firms from emerging economies based on deeper understanding of the role of government and institutions in emerging economies.

References:

- Aggarwal, R., & Agmon, T. (1990). The International success of developing country firms: Role of government-directed comparative advantage. *Management International Review*, 30(2), 163-180.
- Aykut, D., & Ratha D. (2004). South-south FDI flows: How big are they? *Transnational Corporations*, 13(1), 149–177.
- Bach, D., Newman, A., & Weber, S. (2006). The institutional implications of China's fledgling regulatory state: From product maker to rule maker. *New Political Economy*, 11(4), 499-518.
- Bates, R., Greif, R., Levy, M., Rosenthal, J.-L., & Weingast, B. (1998). *Analytic narratives*. Princeton: Princeton University Press.
- Blanchard, O., & Shleifer A. (2000). Federalism with and without political centralization: China versus Russia. *NBER Working Paper* No. 7616, March, Cambridge, MA: National Bureau of Economic Research.
- Blyth, M. (2002). *Great transformations: Economic ideas and institutional change in the twentieth century*. New York: Cambridge University Press.

- Boddewyn, J. (1988). Political aspects of MNE theory. *Journal of International Business Studies*, 19(3), 341-363.
- Boddewyn, J., & Brewer, T. (1994). International business political behavior: New theoretical directions. *Academy of Management Review*, 19(1), 119-143.
- Buckley, P., Clegg, J., Cross, A., Liu, X., Voss, H., & Zheng, P. (2007). The determinants of Chinese outward foreign direct investment. *Journal of International Business Studies*, 38(4), 499-518.
- Bulatov, A. (2001). Russian direct investment abroad: History, motives, finance, control and planning. *Economics of Planning*, 34(3), 179-194.
- Campbell, J. (2004). *Institutional change and globalization*. Princeton and Oxford: Princeton University Press.
- Campbell, J., Hollingsworth, J., & Lindberg, L. (Eds.), (1991). *Governance and the American economy*. New York: Cambridge University Press.
- Child, J., Lu, Y., & Tsai, T. (2007). Institutional entrepreneurship in building an environmental protection system for the People's Republic of China, *Organization studies*. 28, 1013-1034.
- Child, J., & Rodrigues, S. (2005). Internationalization of Chinese firm: A Case for theoretical extension. *Management and Organization Review*, 1(3), 381-410.
- Collier, R., & Collier, D. (1991). *Shaping the political arena*. Princeton, NJ: Princeton University Press.

- Deutsche Bank Research (2008). *Russia's outward investment*, Frankfurt am Main, April 30.
- DiMaggio, P. (1988). Interest and agency in institutional theory, in L. Zucker (Ed.) *Institutional patterns and organizations: Culture and environments*. Cambridge, MA: Ballinger Publishing Co., 3–21.
- DiMaggio, P. (1991). Constructing an organizational field as a professional project: US art museums, 1920–1940, in W. Powell and P. DiMaggio (Eds.) *The new institutionalism in organizational analysis*. 267–292, Chicago: University of Chicago Press.
- Elster, J., Offe, C., & Preuss, U. (1998). *Institutional design in post-Communist societies: Rebuilding the ship at sea*, New York: Cambridge University Press.
- Goldstein A. (2007). *Multinational companies from emerging economies: Composition, conceptualization and direction in the global economy*. Basingstoke: Palgrave Macmillan.
- Greif, A. (2004). *Institutions: Theory and history*, Cambridge University Press.
- Greenwood, R., Suddaby, R., & Hinings, C. (2002). Theorizing change: The role of personal associations in the transformation of institutionalized fields. *Academy of Management Journal*, 45(1), 58-80.
- Hoffman, A. (1999). Institutional evolution and change: Environmentalism and the US, chemical industry'. *Academy of Management Journal*, 42, 351–371.

- Jepperson, R. (1999). Institutions, institutional effects and institutionalism, in
Powel, W., & Di Maggio, P. (Eds.) *The new institutionalism in
organizational analysis*. Chicago: University of Chicago Press, 143-163.
- Jowitt, K. (1991). After Leninism: The new world disorder, *Journal of
democracy*, 2(1), 11-20.
- Karavaev, V. (1992). Government regulation of foreign investment: Russian
realities and world experience. *Problems of theory and practice of
management*, 2, 16-27, (in Russian).
- Kumar, N., (2008). Internationalization of Indian enterprises: Patterns,
strategies, ownership advantages and implications. *Asian Economic
Policy Review*, 3(2), 242–261.
- Lawrence, T., Hardy, C., & Phillips, N., (2002). Institutional effects of
interorganizational collaboration: The emergence of proto-institutions.
Academy of Management Journal, 45(1), 281-290.
- Lewis, A., (1955). *The Theory of economic growth*. London: George Allen and
Unwin.
- Lieberman, E. (2001). Causal inference in historical institutional analysis: A
specification of periodization strategies. *Comparative political studies*,
34, 1011-1035.
- Luo, Y., Xue, Q., & Han, B. (2010). How emerging market governments
promote outward FDI: Experience from China. *Journal of World
Business*, 45, 2010, 68-79.

- Marcussen, M. (2000). *Ideas and elites: The social construction of economic and monetary union*, Aalborg: Aalborg University Press.
- Neuendorf, K., (2002). *The content analysis guidebook*. Thousand Oaks, CA: Sage.
- North, D. (1990). *Institutions, institutional change and economic performance*, Cambridge: Cambridge University Press.
- Oliver, C. (1992). The antecedents of deinstitutionalization. *Organization studies*, 13, pp. 563–588.
- Peng, M. (2002). Towards an institution-based view of business strategy, *Asia-Pacific Journal of Management*. 19(2/3), 251-267.
- Prihodko, S., Pahomov, A., & Volovik, N. (2008). *Russian foreign direct investment: Major trends and consequences for the national economy*, Moscow: Institute of the Economy in Transition, (in Russian).
- Scott, W. (1995). *Institutions and organizations*, Thousand Oaks, California: Sage.
- Scott, W., & Christensen, S. (1995). Conclusion: Crafting a wider lens, in W. Scott and S. Christensen (Eds.) *The institutional construction of organizations: International and longitudinal studies*. 302–313, Thousand Oaks, CA: Sage.
- Streeck, W., (1992). *Social institutions and economic Performance: Studies of industrial relations in advanced capitalist economies*. London: Sage.
- Streeck, W., & Thelen, K. (2005). Introduction: Institutional change in advanced political economies. In Streeck, W. and Thelen, K. (Eds.)

- Beyond continuity: Institutional change in advanced political economies*,
Oxford: Oxford University Press, 1-39.
- Thelen, K., & Steinmo, S. (1992). Historical institutionalism in comparative politics. In Steinmo, S., Thelen, K., & Longstreth, F. (Eds.) *Structuring politics: Historical institutionalism in comparative analysis*, New York: Cambridge University Press, 1-32.
- Thornton, P. (1995). Accounting for acquisition waves: Evidence from the U.S. publishing industry. In Scott, W., & Ghristensen S. (Eds.) *The institutional construction of organization*, Thousand Oaks, GA: Sage.
- Williamson, O., (1975). *Markets and hierarchies*. New York, NY: Free Press.
- Witt, M., & Lewin A. (2007). Outward foreign direct investment as escape response to home country institutional constraints. *Journal of International Business Studies*, 38(4), 579-594.
- World Investment Report* (2006). FDI from developing countries and transition economies: implications for development. New York and Geneva, UNCTAD.
- Wright, M., Filatotchev, I., Hoskisson, R., & Peng, M. (2005). Strategy research in emerging economies: Challenging the conventional wisdom. *Journal of Management Studies*, 42(1), 1-33.

Appendix:

РИА Новости 18/09/2008: Внешние инвестиции России и Китая: Пятый российско-китайский инвестиционный форум в Пекине, full record of the

meeting, www.visualrian.ru; РИА Новости Частно - государственная экспансия за рубеж, 08/02/2008; Центральный банк Российской Федерации, www.cbr.ru; Чистый ввоз/вывоз капитала частным сектором в 2009 году и I квартале 2010 года, ЦБРФ; “Бюллетен банковской статистики” 2010, ЦБРФ; Министерство экономического развития Российской Федерации, www.economy.gov.ru/minec; Основные меры по улучшению инвестиционного климата в Российской Федерации, определенные на совещании Президента Российской Федерации Д. А. Медведева, 2 февраля 2010 г., www.economy.gov.ru/minec/activity/sections/investmentPolicy/doc201002101210; Минприроды России, www.mnr.gov.ru/part/?pid=15; Российский союз промышленников и предпринимателей, www.rspp.ru; www.rian.ru/analytics/20080208/98715870.html; www.interfaks.ru; Олег Митяев, Частно - государственная экспансия за рубеж, РИА Новости 08/02/2008; Известия, www.izvestia.ru; Институт государства и права Российской академии наук, Лучко М. Прямые иностранные инвестиции: движение и значение. Экономист, 2003, № 3.; Ведомости, www.vedomosti.ru; Ministry of Commerce, the People’s Republic of China, www.mofcom.gov.cn; Investment Service Platform China, www.fdi.com.cn/app?page=IndexLawEn&service=page; www.china.org.cn/?&ext_id=; China Daily, www.chinadaily.com.cn, National Development and Reform Commission of China, www.ndrc.gov.cn.

		Result of Change	
		<i>Continuity</i>	<i>Discontinuity</i>
Process of Change	<i>Incremental</i>	Reproduction by adaptation	Gradual transformation
	<i>Abrupt</i>	Survival and return	Breakdown and replacement

Figure 1 Types of Institutional Change Processes and Results

Source: Streeck & Thelen (2005:9)

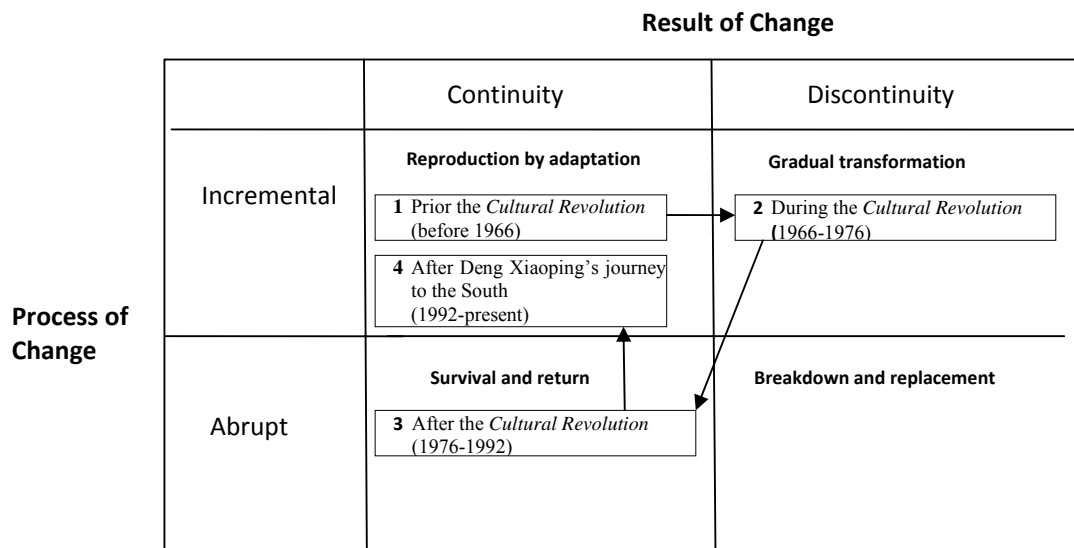


Figure 2 Types of Institutional Change Processes and Results in China

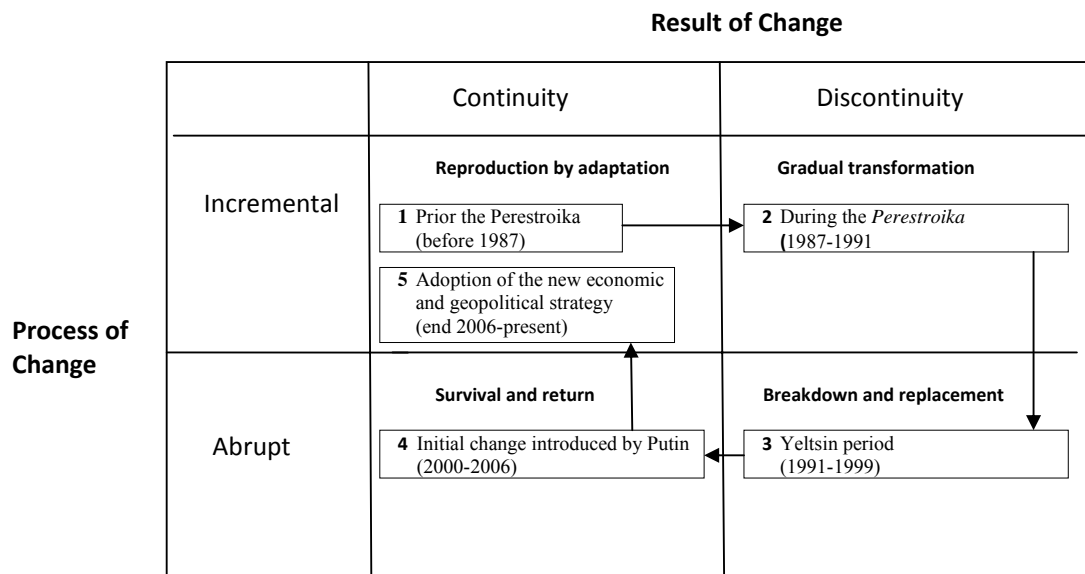


Figure 3 Types of Institutional Change Processes and Results in Russia

Table 1 A. Institutional Entrepreneurial Activities in China's OFDI Field Formation

	Stage 1 1984-1990		Stage 2 1991-2000		Stage 3 2001-2009	
	Number	Annual Mean (SD)	Number	Annual Mean (SD)	Number	Annual Mean (SD)
Number of new laws, rules and regulations	32	3.21 (4.51)	63	5.34 (3.28)	119	11.33 (2.97)
Activities coded into six categories of institutional pillar building:						
<i>Regulative</i>	16	1.62 (1.08)	37	3.36 (2.48)	96	6.67 (3.36)
1. Supporting the formulation of laws, regulations and standards*						
<i>Normative</i>	12	1.02 (1.26)	45	3.29 (2.67)	69	11.28 (3.08)
2. Diffusing official values and beliefs on OFDI						
3. Representing official commitment and allocation of resources to OFDI projects	10	1.02 (1.18)	25	3.31 (3.89)	82	5.12 (3.21)
4. Communicating and exchanging expertise and knowledge between organizations involved in OFDI.	23	2.71 (4.26)	72	6.12 (3.28)	112	10.91 (6.18)
5. Participation in investment treaties	18	2.91 (3.73)	27	4.19 (3.27)	93	19.07 (9.36)
<i>Cognitive</i>	6	0.39 (0.69)	26	3.97 (3.16)	87	9.97 (5.48)
6. Building social awareness, appreciation and aspiration towards greater involvement in OFDI.						

*The number of laws, rules and regulations differs from the number of activities in category 1 (supporting the making of laws, etc.) because one activity could lead to the promulgation or revision of a number of laws, rules and regulations at the same time, or because some activities did not result in new laws, rules or regulations.

NB Stage 3 in China continues presently.

Table 1 B Institutional Entrepreneurial Activities in Russia's OFDI Field Formation

	Stage 1 1987-2003		Stage 2 2003-2009	
	Number	Annual Mean (SD)	Number	Annual Mean (SD)
Number of new laws, rules and regulations	26	2.17 (1.98)	53	4.74 (5.29)
Activities coded into six categories of institutional pillar building:				
<i>Regulative</i>	31	2.98	138	12.96
1. Supporting the formulation of laws, regulations and standards*		(2.17)		(6.97)
<i>Normative</i>	11	1.03	29	4.97
2. Diffusing official values and beliefs on OFDI		(1.32)		(1.96)
3. Representing official commitment and allocation of resources to OFDI projects	15	1.39 (2.68)	97	9.67 (5.98)
4. Communicating and exchanging expertise and knowledge between organizations involved in OFDI.	7	0.67 (0.92)	39	3.71 (2.68)
5. Participation in investment treaties	28	3.26 (10.19)	89	8.31 (5.12)
<i>Cognitive</i>	12	1.08	78	8.68
6. Building social awareness, appreciation and aspiration towards greater involvement in OFDI.		(2.11)		(4.31)

*The number of laws, rules and regulations differs from the number of activities in category 1 (supporting the making of laws, etc.) because one activity could lead to the promulgation or revision of a number of laws, rules and regulations at the same time, or because some activities did not result in new laws, rules or regulations.
NB Stage 2 in Russia continues presently.