Private firms in China: Building legitimacy in an emerging economy

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ABSTRACT

Firms are legitimated by their environments if they survive and prosper. But firms can also proactively build legitimacy to enhance their long-term growth prospects. This is vital for private firms based on emerging economies given the weak protection for private property. This article examines ways in which private firms in China build legitimacy for themselves and their industries. Through field interviews with firm founders and top managers in China various legitimization strategies and the conditions under which they can be used are examined. The authors also conducted follow-up interviews in Taiwan to investigate legitimacy-building strategies there. Though more advanced, Taiwan's economy shares many cultural traditions with Mainland China, and it presents firms with similar legitimacy-related challenges. Interviews with managers of multinationals operating in China were also conducted to determine what they are learning from the legitimization strategies of the indigenous Chinese firms.

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1. Introduction

Global firms today face a host of challenging environments as they do business in the emerging economies of the world. One of the key issues that such firms face is how to establish their legitimacy, or right to exist, in a given market (Ahlstrom & Bruton, 2001; Stillman, 1974). The local firms based on these emerging economies regularly face such problems. These firms have developed a number of legitimacy-building strategies to help them cope with the challenging and sometimes chaotic environments in emerging economies. To better understand the many approaches used to build legitimacy in an emerging economy, we interviewed firm principals and founders from China's growing private sector. In addition, senior managers of global firms operating in China were interviewed to determine which strategies they were able to adopt from the local Chinese firms. To further substantiate these findings subsequent interviews in Taiwan were conducted. Although more developed and amenable to private property, Taiwan shares the same cultural traditions as Mainland China. Firms in Taiwan reported they face a number of comparable legitimacy-building challenges.

Legitimacy represents a legal and societal judgment of the norms, appropriateness, image, and legal standing of an organization (Aldrich & Fiol, 1994; Suchman, 1995; Rindova & Fombrun, 1999). Legitimacy can help a firm survive and avoid significant interference from outside parties in its environment (Zimmerman & Zeitz, 2002), something that can be a particular problem in emerging economies (Ahlstrom & Bruton, 2001; Bai, Lu, & Tao, 2006). In addition, enterprises that have achieved a level of legitimacy can more easily obtain access to resources and markets needed to prosper (Dowling & Pfeffer, 1975). It is not always easy for firms to build legitimacy for themselves and the type of industry they are in as new firms, technologies, and organizational forms are not automatically accepted by markets and local constituencies (Stinchcombe, 1965). Lacking the support conferred

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by legitimacy, a firm’s ability to conduct business can be significantly hampered by governments, banks, and other organized groups or simply by market indifference (Suchman, 1995; Tsang, 1996).

Much prior research has viewed legitimacy retrospectively. The survival of an organization suggests that legitimacy must either have already been present for that organization (or its industry), or was achieved primarily through sheer numbers of similar organizations entering a market (Zimmerman & Zeit, 2002). Prior research on legitimacy has also typically focused on established organizations in developed economies, where private enterprise is well accepted. It is commonly assumed that the environment conferred legitimacy based on firm survival, profitability, and the supplying of valued inputs (e.g. Baum & Singh, 1994). This view tends to downplay the role that an individual firm may have in establishing its own legitimacy.

Securing legitimacy for a new firm or business model is difficult enough in developed economies where private enterprise is well accepted and property rights secure. In emerging economies, legitimacy can even be more difficult to obtain (Wright et al., 2005). Private enterprise has little history or legitimacy in many emerging economies (Soto, 2000). Though there is variation in emerging economies such as Russia and China (Wright et al., 2005), the legitimacy of private business cannot be assumed (Peng, 2000; Soto, 2000). Instead the growing presence of private ownership during economic transitions has maintained an uneasy coexistence with a residual statist ideology (Peng, 2003). Observed a former senior government official in China:

“There’s nothing to keep the [Chinese] Government from taking those private assets back …... One year things are open and everyone can prosper; the next year the Government decides to collect everything for the state.” Cao Si-yuan, senior adviser to former People’s Republic of China General Secretary Zhao Ziyang (South China Morning Post, June 16, 1999: p. 1).

It is true the support for private enterprise is increasing in emerging economies such as China and Russia. However, the past opposition to private property continues to have a major impact since the ownership of property in China can sometimes be unclear (Delios, Wu, & Zhou, 2006; Huang, 2005; Wank, 1999). For example, many private businesses in China were founded during the early reform period before it was legal to possess private property. These firms have none of the required documentation technically legitimizing their operations. Other more recently founded private firms started when it was legal to have private property but bypassed many of the various bureaucratic regulations for such businesses, sometimes mixing assets of state and private entities as the firms grew. The fear held by these private enterprises, including several in our sample, is that if the government challenges the firms’ right to exist, their assets can be appropriated and they can even be driven out of business. In the absence of stable legal arrangements legitimacy building becomes crucial for the private firms in China. Thus, in facing residual hostility in China, and what is often unclear legal status private enterprises can help to legitimize their commercial activities through image building, networking, and developing close connections with the government, particularly the local legal regime and power structure (Ahlstrom, Young, Nair, & Law, 2003; Peng & Luo, 2000; Tung & Worm, 2001; Tung, 2002).

Our point of departure with past work is to understand how private firms in a major emerging economy build legitimacy for themselves, their industry, and even their entire (private) sector and to examine how multinational firms are learning from these actions. This article extends previous work on tactics used by firms in emerging economies to secure legitimacy (Ahlstrom & Bruton, 2001; Kumar, Rangan, & Rufin, 2005; Tsang, 1996; Tung & Worm, 2001) by developing a hierarchy of the strategies that private firms in China are using to build legitimacy. These strategies range from individual firm action to collective actions by networks of firms, sometimes in concert with the government. While private firms in China, along with some in Taiwan are used to ground this study to establish clarity about legitimacy building, these strategies are potentially relevant to various enterprises in many emerging economies such as those of Eastern Europe and Latin America, as well foreign firms that need to learn and employ the same strategies when they enter those markets (Kumar et al., 2005).

2. A traditional view of firm legitimacy

The term legitimacy commonly refers to the right to exist and perform an activity in a certain way (Suchman, 1995). The legitimacy of firms in an industry has historically been viewed from a macro level where the industry both seeks and is impacted by socio-political and cognitive approval from society and its institutions (Aldrich & Fiol, 1994). Socio-political legitimacy stems from the approval of the general public, key opinion leaders, or government officials. Cognitive approval is based on the spread of knowledge and general acceptance of an enterprise and its activities and some acceptance from the culture at large. Lacking legitimacy, the ability of organizations to pursue their goals and accumulate resources is reduced (Dowling & Pfeffer, 1975; Suchman, 1995; Tsang, 1996).

When the founders of any new venture seek legitimacy for their activities (and those of their industry), the social context in which they operate encourages different strategies to establish or build legitimacy in both a sociopolitical and cognitive sense (Aldrich & Fiol, 1994). Ultimately, legitimacy confers the right to exist on an individual organization and its activities (e.g. Stillman, 1974). Some industry sectors have not managed this process well. For example, the for profit hospital sector in the U.S. still has a great deal of trouble convincing the public that they put the patients’ interest first and not...
behind those of the stockholders. News reports on television in the U.S. regularly run shows on healthcare problems that the news outlet is convinced was caused by for profit medicine. But it is not the nature of the healthcare industry that is the issue but the ability of the organization and its industry to attend to its own legitimacy. In other countries such as Thailand and Singapore, the for profit hospital sector is thriving, and has achieved a high degree of legitimacy in that region with the public and the media (e.g. Cochrane, 2006). This is due in no small part to the work of these hospitals in the legitimizing their activities with the government, medical profession, and local media.

Institutional theorists have helped to illuminate and frame these legitimacy-building approaches by pointing out that organizational structures, procedures, and personnel may be used to build and demonstrate an organization’s acceptability to key constituencies (DiMaggio & Powell, 1983; Oliver, 1991). Though there is some disagreement on how to organize various institutional forces (Hirsch & Lounsbury, 1997), Scott’s (2001) well-accepted formulation provides three types of institutions under the terms normative, cognitive, and regulatory. Each of these institutional pillars can affect firm legitimacy and are thought to be particularly important to understand in emerging economies (Peng & Zhou, 2005).

The normative and cognitive institutional pillars are quite resilient and less subject to change than are the regulatory pillars (Scott, 2001). These institutional elements are socially constructed over time and come to be “perceived as objective and external to the actors: not as man-made but a natural and factual order” (Scott, 1995: p. xvii). While both normative and cognitive institutional pillars draw on culture there are differences in the two. The normative pillar represents actions that organizations and individuals ought to take; normative pillars are the standards of behaviour and commercial conventions of different professions, occupations and organizational fields. A normative evaluation of legitimacy concerns whether the organization’s activities are proper and consistent with influential groups and societal norms (Suchman, 1995). The cognitive institutional pillar is represented by the scripts, schemas and taken-for-granted elements that influence individuals in a particular socio-cultural context. A cognitive evaluation of legitimacy concerns the congruence between an organization and its cultural environment (Meyer & Scott, 1983). Regulatory institutional pillars are described by laws, regulations, and their enforcement. Such institutions include the sanctions, laws and political power that regulate individual and organizational action (Scott, 2001). Regulatory structures are relatively rational, negotiated arrangements to exchange problems that can change readily (North, 1990). Regulatory legitimacy occurs when laws and regulations are passed that recognize and help to safeguard the legal right of the industry to exist.

3. Emerging economies

Emerging economies differ from those of more developed market economies (Wright et al., 2005). Interpreting firm actions in such economies cannot assume to be analyzed by simply taking models from mature economies and applying them in such environments (Clark & Soulsby, 1999). In part this is due to the fact that emerging economies are not institutionally well developed and alternative mechanisms are often necessary to govern economic activity (Boisot & Child, 1996; Peng, 2000). To illustrate, laws to support the fulfillment of contracts are poorly developed and enforced in many emerging economies so alternative, often less formal mechanisms must be pursued to ensure that such contracts are fulfilled (Ahlstrom et al., 2003; Peng & Heath, 1996; Tung, 2002; Tung & Worm, 2001).

Until the 1980s China’s central government played a role in nearly all aspects of the economy. With the economic reform of the economy initiated in 1978, China began to move toward a more market-oriented economy while retaining a number of elements of state control (Pei, 2006). Since that time the central government has sought to devolve regulatory oversight to local and provincial authorities (Boisot & Child, 1988). By the late 1990s, private property had been legalized to coexist with the state-owned segment of the economy. Beijing sought its reforms without significantly disturbing the country’s socialist political system (Scott, 2002). Yet there also remain many influential party cadres who remain suspicious of market reform and private property ownership (The Economist, 2004). In addition, private property still lacks the full legal status and protection that state assets and state-linked enterprises have (Huang, 2005). This has resulted in ideological conflict, with some in the government attuned to the market economy and others still emphasizing a very active role for government in the day-to-day affairs of businesses (Pei, 2006; Wank, 1999).

Many private enterprises have emerged since the start of the economic reforms of the late 1970s. State enterprises can be owned or controlled by different government departments, by the military (though the government has been moving the military out of commerce), by provinces, or by local cities and villages, and private enterprises can have a very unclear, mixed ownership structure (Delios et al., 2006; Huang, 2005). Some state-owned and state-linked enterprises have become private-owned enterprises in practice if not in name. Because of their murky legal status, owners of these private enterprises can suddenly be accused of ‘stealing’ state’s properties. For example, some entrepreneurs started their businesses by paying local officials or bank offers to gain special consideration to operate their firms or separate newly accumulated resources from the state-owned parent firm. Under those circumstances, it is not unusual for successful entrepreneurs to be prosecuted years later for their earlier “illegal” behaviors in creating a private enterprise.
To prosper in such an environment where the rights of private enterprise still remain in question and interference in company activities is quite common, firms have been observed using specific strategies individually and collectively that seek to establish their legitimacy and manage the present influence of the government officials in China (Ahlstrom & Bruton, 2001; Tsang, 1996; Tung & Worm, 2001). The specific means used to build legitimacy in China’s emerging economy will next be examined.

4. The study

To explore and categorize the numerous legitimacy-building strategies used by private firms in China, this study used a modified version of an interview questionnaire first utilized by Ahlstrom and Bruton (2001). As is common with sensitive data about firm policies and strategies in China, it is generally best to obtain this information through face-to-face interviews. The interviews ranged between one and two hours with the majority taking a little more than an hour.

4.1. The sample

We initially contacted 20 private enterprises in Mainland China for the study. These firms were located with the help of knowledgeable consultants and academics in China. A list of 28 firms was provided and the top 20 in terms of profitability were selected, 16 of which agreed to be interviewed.6 The nature of ownership in Chinese firms can be quite complex (Delios et al., 2006). For example, Lenovo now owns IBM’s microcomputer unit and is one of the largest PC firms in the world. However, Lenovo is still 27% owned by the Chinese Academy of Sciences. Therefore, relying on the intimate knowledge of experts who have a clear understanding of the ownership structure of the firms was felt to be crucial to ensure we were actually studying private firms (Delios et al., 2006). The researchers also initially identified in a similar manner six firms in Taiwan; four of which agreed to the interviews. Ten of the 20 Mainland Chinese firms also provided us with the names and contacts of their main foreign alliance partners situated in China so we could also understand what foreign firms coming to China were learning from their Mainland Chinese partners about legitimacy building. Six of those 10 foreign firms also subsequently agreed to be interviewed; thus a total of 26 (out of 36 firms contacted) were interviewed representing a response rate of 72%.

The interviews were conducted in various southern Chinese cities as well as the Taiwanese cities of Taipei and Kaohsiung. The interviews lasted approximately 90 min. The interviews were principally conducted in English except when the interviewee did not speak English well. In that case the interviews were conducted in Mandarin Chinese and translated into English. One of the co-authors is a native Chinese speaker and conducted the translations. The six international firms with operations in China included U.S. firms (three), a Hong Kong firm (two) and a U.K. firm (one).7

All of those interviewed in the 26 firms occupied a senior management position such as managing director (roughly equivalent to CEO in North America), vice president of business development or a department head such as head of human resources or communications. All had significant responsibility for contact with those outside the firm. Of the 20 Chinese and Taiwanese firms interviewed, 12 firms were in light manufacturing, 2 in heavy manufacturing, and 6 in services. The sample of six foreign firms included four manufacturing and two service firms. All of the Chinese and Taiwanese firms employed between 100 and 2000 employees and the sample was balanced between private firms founded within the past three years and firms that were founded in the 1990s. The foreign firms were all well-known multinationals.

4.2. Data gathering

The semi-structured interview methodology used to explore legitimacy-building activities in China allowed for both structure and some spontaneous discussion of problems and solutions not fully identified by prior research. This, in turn, allowed for follow-up questions on the topic and the development recommendations grounded in practice (Eisenhardt, 1989). We approached the data gathering and analysis of the interview data in a manner consistent with replication logic (Eisenhardt, 1989). That is, the initial questions that guided the building of this understanding were based on the nine basic categories of legitimacy identified largely from previous work (Suchman, 1995; Zimmerman & Zeit, 2002). The managers were asked about the nature of their firms’ relationship with regulatory authorities, key government officials, and the judiciary in the region. They were also asked questions about several common legitimacy-building activities in China, such as the nature of guanxi and how it was actually used, and the specific types of charitable activities pursued and why. Also examined were the nature of the alliances pursued and firms’ association with key organizations such as major state-
owned enterprises there, as well as insight on any certification the firm already held. Finally, the nature of the firms’ interaction with government officials through associations and loose cooperative bases was discussed.

The insights provided by each interviewee were compared with what is known about legitimacy from previous research. After each interview, the model of legitimacy strategies was adapted incrementally, based on the new information provided and then discussed with the next interviewee for validation and additional comment (Eisenhardt, 1989). We reviewed our interview notes carefully until we identified a group of legitimacy-building approaches that represented and summarized the data. This replication logic assists in taking multiple cases to build an understanding of a relatively new domain and in supplying direct application of the information (Eisenhardt, 1989; Finkelstein, 2003).

4.3. Validity

In analyzing the data provided by interviews and several archival sources we worked to minimize the confirmatory evidence bias. To reduce the potential problem of over-selecting evidence that would simply confirm our initial expectations, we subjected the analysis to five tests to improve validity (Hensley & Griffin, 1986; Huberman & Miles, 2002). First, we required examples from at least two of our interviewed firms to give an illustration of a legitimacy-building strategy. Examples from the business literature are presented to clarify certain concepts, but these were not counted as examples for validity purposes. Second, one example could not be applied as evidence for more than 1 legitimacy-building strategy; new and distinct (and multiple) examples had to be found to populate the 12 legitimacy-building strategies. Third, evidence from an indigenous firm about a particular type of legitimacy building was not used if its validity was questioned by another indigenous firm. Where a significant disagreement arose, such as two firms supplying one type of strategy and others disagreeing, we have reported this and did not include this as a possible strategy. Fourth, information that did not fit or was in dispute was also reported with explanation. Finally, although primary information sources are the main source of this study, secondary sources were later sought to provide further confirmation and illustration of the strategies employed (e.g. Tung & Worm, 2001; Sull, 2005; Tsang, 1996) and these are also reported along with summaries from the interviews as well as selected quotes for illustration purposes.

5. Legitimacy-building strategies in China

Prior to the limited legalization of private property in recent years, the less than legitimate status of private firms in China resulted in widespread abuses with no outlet for private firms to protest or to seek legal redress (Clarke, 1991; Gold, Guthrie, & Wank, 2002; Wank, 1996). Thus, while the constitution of China now allows private enterprise, many important officials still do not approve of their right to freely conduct business. Even for officials more accepting of private property, they question the ownership of organization’s productive assets and possible overlaps with state assets (Jiang & Hall, 1996; The Economist, 2004). In fact, several heated debates related to the protection of private property appeared in leading Chinese newspapers and magazines in 2006. As a result, the government’s original plan to pass new laws in the National People’s Congress protecting private property was postponed in March 2006. There are many articles questioning “privileges” given to private property and complaints about the increasing income disparity and conspicuous consumption on China’s news blogs. In response, China’s president Hu Jintao started his promotion of “the harmonious society” in 2005 in part, to mitigate the general public’s growing resentment of the enormous wealth generated by some private businesspeople. Additional protection for private property and clarification of the division between state and private assets was put on hold.

Our results suggest that firms in China need not passively wait for the private sector to grow in size and political influence; rather they have some options in selecting strategies to improve their organizational legitimacy. Building on past work (e.g. Ahlstrom & Bruton, 2001; Suchman, 1995; Tsang, 1996), our interviews revealed four types of legitimacy-building strategies being used in China under various conditions: (a) selecting (new) environments in pursuit of an audience that will be supportive; (b) conforming to the dictates of constituents within the organization’s current environment; (c) manipulating the environment by creating new audiences and new legitimating beliefs; and (d) creating new environments in which they can function. Private enterprises in China were able to use these legitimacy strategies both separately and concurrently. Additionally, the interviews suggested that these four strategies need increasing levels of effort for implementation and thus may be useful under different circumstances. The results suggested that each of the four general strategies used to build legitimacy can be divided by three different implementation approaches available based on the three institutional pillars (normative, cognitive, and regulatory) of the firms’ environments.

5.1. Strategy 1—selection of environments

Individual firms may find that selection of an appropriate environment is the simplest legitimacy-building strategy to undertake. Thus private firms reported they were sometimes able to select a setting where the acceptance of their activities is already established. These localities approve many projects without much difficulty; firms generally agreed there was less interference in their activities in these regions. This makes an environment selection strategy relatively easiest to pursue if that option is available.

5.1.1. Normative selection

A firm can establish its legitimacy through its selected environment by arguing that its activity is beneficial to the area, for example, by providing employment or by bringing in new technology (Suchman, 1995). Such legitimacy can be significant for firms in China. For example, in western China, there is high unemployment and poverty. Private
enterprises often build their legitimacy by selecting to expand or locate in those areas. A related option not readily available in most developed economies but utilized by private firms in China is the takeover of ailing state-owned enterprises (SOEs). By doing this, the private firm can bring new resources and know how to help the SOE stay in business and prosper. For example, the Hope Group, a large private animal feed and food processor in China, in conjunction with several other private firms started the “Poverty-Fighting Brilliant Project” in order to establish factories in remote rural areas. The Hope Group also took over a number of troubled state firms in poorer regions. In addition to improving the economic climate in those areas, Hope received extensive favorable media coverage and built up its reputation with local governments and markets—something that can be very challenging to do given the local nature of commerce in China (Au & Li, 1998; Solinger, 1989).

About half of the firms interviewed reported that they were thinking of purchasing the assets of troubled state enterprises, and several had already made significant purchases. Although they generally stated that there may have been better deals available, they believed that helping a local government by taking over a troubled SOE would prove beneficial to them in the long run. One telecommunication equipment firm in China reported that they turned down a buyout offer from a major foreign buyer because they would have been unable to take over a troubled state firm in northeast China. They stated that the purchase placed them in good stead with not only a major provincial government but also won them some public praise from the central government for working to build China’s economy.

Several firms noted that takeovers of troubled SOE assets must be done very carefully otherwise a firm may be saddled with one or more very difficult partners, obsolete equipment, and too many employees and obligations. But successfully managing a purchase can build solid obligations with local governments, not just individual officials. For example, well-known Chinese beverage producer Wahaha successfully took over and operated a major state factory near its hometown of Hangzhou in eastern China partly as a favor to local municipal officials that did not want to continue to subsidize it. That successful acquisition not only helped Wahaha meet its goal of connecting with local officials, but it also earned the firm national attention as one of the first private firms to acquire and effectively operate a larger state enterprise (Sull, 2005). This led government officials from around China to offer Wahaha the opportunity to take over failing state factories in their regions, for which they were able to negotiate favorable terms (Sull, 2005).

5.1.2. Cognitive selection

Legitimacy in a selected environment requires that an organization identify an environment where it can attract or associate with potentially friendly audiences (Ashforth & Gibbs, 1990; Suchman, 1995). In China, many contracting relations established following economic liberalization were based on relations that existed before China’s 1949 revolution. It has been found that large numbers of commercial transactions in the large eastern Chinese city of Wuhan have been conducted through such decade-long relations (Solinger, 1989). Private firms have reported selecting an area in China where their managers’ significant long-standing relations or clan ties confer some initial legitimacy. The firm’s legitimacy can be further strengthened in these situations through reciprocal relation-building by conducting exchanges and networking activities including gift-giving and banquets to build relationships with key individuals in that region (Peng & Luo, 2000; Xin and Pearce, 1996).

5.1.3. Regulatory selection

Regulatory legitimacy will be achieved in the selected environment if the enterprise enters a setting where a certification they already possess is required. A difficult problem for organizations and consumers alike in emerging economies is determining whether a product has the characteristics that the firm producing it says it has. For example, in recent years many organizations in China have sought ISO 9000 certification (Ahlstrom & Bruton, 2001). This certification is required by many firms and government agencies in China to be considered as a possible supplier. The certification indicates the firm’s status as a quality manufacturer. Other China specific awards, such as the “Gold Medal” quality award, and other service quality and safety awards play a similar legitimacy-building function. They get a great deal of publicity in China in the general press and indicate both to consumers, prospective employees and organizations that the business is a qualified producer or service supplier and fulfills the product and safety regulations set by the Chinese government and large state-linked firms.

Firms may also select a regulatory climate more favorable to private enterprise outside of Mainland China. Several Mainland Chinese firms in our sample had been able to locate some key activities to Hong Kong, thus improving their financing options. Even firms that do not become Hong Kong listed firms may set up shell companies in favorable locations such as Bermuda and in the Caribbean, to facilitate financing and to protect hard currency. For example, appliance manufacturer Haier has such an operation which allows the firm to place its hard currency earned abroad in banks with favorable interest rates allowing them easy access to the money.

5.2. Strategy 2—conforming to current environment

If a firm is not able to select a more favorable institutional environment in which to base and conduct much business due to constraints on its location or movement, it may be able to conform more effectively to the institutional environment of its existing environment in which it operates. In this setting, a firm can take actions that allow it to meet the dictates of the local constituents in order to build legitimacy. It is important to note that conforming strategies are typically individual firm strategies.

5.2.1. Normative conformance

Procedures, structures, and personnel can signal to key constituencies that an organization belongs and conforms to certain rules (Ashforth & Gibbs, 1990; Suchman, 1995). In China, private firms often seek to develop alliances with
organizations that have greater legitimacy by adopting their procedures and structures. For example, the right of private enterprises in China to exist and freely conduct business, manage their own human resources and earn profits is not widely accepted, but the right of foreign firms to do those things is. Foreign firms are viewed as bring in advanced technology and management techniques to the country, as well as a reputation for quality products. Thus, it is felt that aligning with a foreign firm can provide positive reputational benefits that help confer legitimacy (Hitt, Ahlstrom, Dacin, Levitas, & Svobodina, 2004; Tsang, 1996).

Exercising normative conformance to the demands of a local environment is often done through establishing guanxi or connections with important individuals. Guanxi is regularly mentioned as something firms doing business in China must have (Peng & Luo, 2000; Yeung & Tung, 1996) or develop (Ahlstrom, Bruton, & Lui, 2000). Hiring or working closely with local respected advisors that are in good standing with the government, party cadres, local village committees, and the judiciary can help to confer legitimacy, particularly during disputes over firm resources, land ownership, employment issues, payment of tax and commercial and legal issues (Hung, 2004).

Connections with key individuals are still quite important in China particularly for firms entering a new market or region (Tung & Worm, 2001). They are less durable an asset than having obligations from a government body through a purchase of SOE assets or by hiring a large number of unemployed in one region. Guanxi with key officials and other connected individuals in China will continue to be an important source of legitimacy, though perhaps less important and durable than in the past (c.f. Peng & Zhou, 2005).

5.2.2. Cognitive conformance

Institutional theorists have observed that organizations in uncertain environments often pursue legitimacy by associating themselves with well-understood and accepted entities (DiMaggio & Powell, 1983; Deephouse, 1996). In China, some private enterprises try to not look like a successful private business and instead seek to look like a state-linked firm (Ahlstrom et al., 2000; Tsang, 1996). This provides evidence of their fulfilling of the socialist market mandate important in China (Au & Li, 1998; Tsang, 1996). One such method still used in parts of China is to register as a township or village collective firm with the agreement of the local government. These “concealed” private firms, sometimes included with a group of firms known as “red hat firms” (so-called because governments or state officials are brought in as investors)—can be insulated from some governmental interference (Tsang, 1996). The extent to which private firms are concealed as collectives or partially owned state firms varies with the political climate, laws, and institutional traditions of different provinces (Huang, 2005).

In the eastern provinces of Fujian and Zhejiang, large numbers of private firms were able to register as collectives to avoid stifling regulations (Wank, 1996) and many have remained registered in that way (Huang, 2005). In contrast, Guangdong province, adjacent to Hong Kong, has a long history of private enterprise and concealment is not commonly reported there. Our interviews suggested that concealment is still being used, sometimes in an unofficial, clandestine way through payments and favors to government regulators and their families.

The interviews further illuminated an unusual facet of business in China. If a company has high-level government officers pay a visit, the company may be more favored by local officials when they learn of those central and provincial government visits. This is why it is common for Mainland Chinese firms to have pictures of high government officials visiting the firm on display in the lobby of the firm headquarters. Sometimes promotional company videos are made featuring central government officials’ visits to the firm. Interviews revealed that firms believe they will receive preferential treatment, particularly in terms of bank loans and government support, if they can demonstrate connections with top officials and principles of important state enterprises.

5.2.3. Regulatory conformance

In developed economies the rules and regulations are relatively clear and generally uniform. But for new industries the ability to interact with key officials can provide insights as to what rules and regulations are the most critical, and the expected future direction of the laws and regulations. In emerging economies rules and regulations and their enforcement are less clear and more capricious than in mature economies. It is possible for various levels of government to have competing and contradictory rules. Thus, private firms in emerging economies must deal with unpredictable government officials at various levels that are able to interpret (and reinterpret) regulations to extract resources from them (Gold et al., 2002; Tung & Worm, 2001; Wank, 1996). The lack of status and legal protection of private firms leaves them vulnerable to much interference from government officials and the judiciary (Ahlstrom et al., 2003; Peng & Luo, 2000).

Guanxi with certain officials can provide a firm some protection from ambiguities in the law (Peng & Luo, 2000; Tung & Worm, 2001). For example, if there is a relationship with the managers of a firm, officials and judges frequently will interpret the rules and regulations from the perspective of the firm. The relationship provides the opening for the regulator or government official to be educated as to the needs and nature of the firm. Thus, if there is a relationship, the firm does not have to conform to the regulators perhaps unusual interpretation of the laws or regulations. Instead, there is the opportunity for the firm to shape the regulations to the firms needs. This may not be an option for many private firms, since they may not have had time to build guanxi (Xin & Pearce, 1996). To deal with such coercion, private firms may try to co-opt influential local officials to ensure that their interests align with those of the firm. One means to obtain guanxi with government

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8 Although the local government can be very good in helping firms get established and growing, private firms find they can also be quite intrusive. Government shareholders may be passive at first, but once a company succeeds, significant interference can follow; very good companies such as appliance makers Kelon and Haier and several telecom firms have been hurt by government interference (The Economist, 2005).
units is to have them as shareholders who contribute lands, capital or some other assets. This investment allows the government officers to have one or more board seats.\footnote{The legality of these options varies somewhat around China, but offering direct and indirect benefits to key officials such as special consideration to the friends and relatives of the official (as opposed to bribes, which are illegal and watched very carefully) are commonly used in spite of concerns from the central government.}

Another method to avoid the vagueness of the laws and regulations in China is to give partial ownership of the private firm to senior local cadres in exchange for political protection and favors.\footnote{The legality of this option varies around China and thus must be used judiciously.} For example, Liu (1992) reported that owners of private firms in Wenzhou in Eastern China gave firm shares to senior cadres in exchange for protection from government interference. Similarly, Tan (1999) described a private firm’s formal profit sharing with city officials in Hainan province. A second co-opting method is to hire key officials or their relatives (Ahlstrom et al., 2000). Such individuals usually keep their government jobs and are given an office at the firm to share in certain human resource and strategic decisions in accordance with government mandates.

Some interviews reported that in China’s northern provinces, this was rather common. In China’s Shanxi province for example, where mines are a major industry, it was reported that a number of officials and Party cadres are significant shareholders of these coal-mining companies. They felt it was no coincidence that the coal mines’ safety regulations are not well enforced. After public outcry of frequent mine disasters, the central government has prohibited government or party officers to be mining firms’ shareholders. In spite of laws and decrees, the defiance of the central government’s orders is quite common and our interviews reported that this practice clandestinely continues. Thus firms achieve legitimacy with key stakeholders in their area, albeit with a negative outcome of possibly compromising mine safety.

5.3. Strategy 3—manipulate existing environment

If private firms are not able to locate in more favorable regions, and if they find it difficult to conform to the normative, regulatory and cognitive demands of their local environment, they may have to positively manipulate their environments by proactively shaping the opinions of their constituents in their existing environments. This type of image management is more difficult and time consuming and can entail aggressive promotion of the business or its procedures to regulatory bodies, policymakers and society in general (DiMaggio, 1988; Fligstein, 1997; Garud & Ahlstrom, 1997; Van de Ven & Guard, 1994). Typically this can best occur when several firms join together to shape the environment. Such collective action is typically difficult to undertake (Olson, 1965) but can also create significant environmental change favorable to a firm.

5.3.1. Normative manipulation

Interfirm linkages, such as trade associations, play a key role in organizing activities that establish an industry’s legitimacy in mature economies (Aldrich & Staber, 1988). In China, the role of trade associations may be even more important. In more developed economies, trade associations augment the existing voice of individual firms—facilitating the voice that individuals in private firms already have. However, in China when trade associations represent private industry to government agencies, they may be the only voice that the private firm or individuals have. For example, the Young Factory Directors & Managers Association is a national association founded in 1985 (Ahlstrom & Bruton, 2001). A central function of the group is to disseminate information and promote activities through lecturers and meetings with municipal, provincial and national officials. This helps to create a degree of official understanding and sanction for activities of private firms and the problems they face (Wank, 1996).

Recalled one founder of a private leather goods manufacturer.

Even when we were small, we joined the associations of tanners [leather trade group]. Most of the small firms in our business were joining in spite of the cost. We felt we needed help in promoting product and environment standards and manufacturing safety. Otherwise new, privately held firms in our business, and I guess in many business in China, can get accused of not caring for workers or the community. It is not true, we do care, and trade associations help us promote a positive image.

In fact, all trade associations are organized and monitored by the Communist party and play some semi-official functions. Through these associations, firms can establish a communication channel with officials. Some firm owners might be selected as representatives at the city, provincial or national level.

5.3.2. Cognitive manipulation

Establishing legitimacy through manipulation from the perspective of the cognitive perspective of institutional theory may require collective action among firms and is particularly challenging to undertake (Olson, 1965). Examples of this strategy include collective lobbying of officials, advertising, event sponsorship, and scientific research (Dunbar & Wasilewski, 1985; Hinings & Greenwood, 1988). In China, one way cognitive legitimacy has been built is through the collective action of firms joining together to promote the education of officials on the nature of private enterprise. An example is the visit by Deng Xiaoping’s 1992 tour to China’s southeastern provinces. During this tour he visited many of the best performing private firms and international joint ventures in the region. He also made numerous speeches and spoke to party officials, worker committees and local governments. Numerous organizations cooperated in this effort to ensure the best face of market reforms was put forward and that the directives that ensued from it were favorable to business. Deng’s statements and speeches from that famous trip have been regularly invoked by entrepreneurs and other reformists to legitimize private enterprise (Ahlstrom & Bruton, 2001).

The result was building far greater acceptance of private enterprise, along with more availability of capital, as a necessary part of China’s development and an opening of
the economy (Ahlstrom & Bruton, 2001; Sull, 2005). Private firms savvy enough to directly and publicly associate with Deng’s southern tour were able to build significant reputation and recognition from both the government and the public (Walder, 1995). They would do so by posting photos of Deng or his entourage prominently in their lobbies along with statements or articles from that time validating their activities. Deng’s slogans from that time still appear on billboards and in firm advertisements, particularly in south China as a subtle reminder of his wishes and encouragement of private enterprise. When confronted with challenges to their freedom to conduct business, private firms in our sample mentioned that they have invoked Deng’s “mandate” to justify their actions and position in society—government officials do not want to appear to oppose Deng’s positions about the reforms and private enterprise. Cooperation in China for cognitive legitimation is limited, but it can be powerful and leave a lasting effect.

5.3.3. Regulatory manipulation

In mature economies organizations may employ charitable giving to promote a positive view of the firm within society (Galskiewicz, 1991). If an industry has a poor public image there can be a perception that they must be in violation of existing rules and regulations in order to exist. This perception can lead to strict enforcement of existing laws and regulations or the generation of new laws and regulations to control the firm. In China the enforcement of laws and regulations can be rather arbitrary and subject to a number of pressures outside of the direct legal and judicial proceedings. For example, judges in China most respond to pressure from local governments or the Chinese Communist Party (CCP). If any disagreement exists between the CCP and the law in question, judges will generally try to follow the party policies. Although China’s constitution stipulates that political parties, the armed forces, and state organs must abide by the constitution and the law, judges and other officials must consider party policies and the views and needs of local governments in the adjudication and enforcement of the law.

Therefore, many private firms in favourably manipulating the cognitive milieu of their environments, try to emphasize that their actions (or those of all firms in their sector) are aligned with local government rules and regulations as well as CCP imperatives for developing China. As a result, charitable giving for local developmental purposes by private firms is common and visibly promoted. For example, the Hope Group printed and donated to the government 17 million copies of a well-known ethics textbook used by all junior high school students in its home province of Sichuan (Au & Li, 1998).

Most of the private firms interviewed reported they provided such charity to local governments or acted on their behalf in a very public manner, such as donating supplies, building schools and community centers. Several private firms mentioned that they regularly meet with local officials to discuss local development issues including lending out parts of their workforce to help landscape local grounds or plant trees by the roadside. Whereas firms used to be assessed fees for this sort of activity (Boisot & Child, 1988), and sometimes still are, private firms reported being quite proactive in this area to show how they are in accordance with regulations and the formal developmental goals of their regions. Foreign firms interviewed similarly recalled that they followed the example and recommendations of their alliance partners and worked to make themselves aware of and align themselves with local government goals, often through visible charitable giving and increasingly, sporting event sponsorship and contributing to local sports facilities.

5.4. Strategy 4—creating the environment

The fourth form of legitimacy strategy is environment creation. This perhaps requires the greatest effort of firms but with solid payoffs. Firms may not be able to locate in existing favorable environments but instead must work to create new environments to legitimize their operations (Zimmerman & Zeitz, 2002). In this setting the firms locate new domains of operations that lack existing scripts, rules, norms, values, and models (Aldrich & Fiol, 1994). They then create the framework for those domains. In emerging economies, each time a private firm acts as a pioneer in its field it is establishing the framework for that industry and the basis of legitimacy for those that come after it (Anderson & Zeithaml, 1984). For example, when a firm introduces the first laser eye surgery center standards are being established for that domain in that region.

5.4.1. Normative creation

Each time firms are able to establish a new industry in an emerging economy they may be introducing significant change to the social context of that sector. This social context becomes the standard that individuals will use to judge that industry’s behavior. The turbulent nature of these markets can results in new product introductions quickly changing throughout the market an entire domain. The appliance market in China has developed primarily in the last two decades. Prior to 1990 few refrigerators, air conditioners or microwave ovens were purchased in China. These goods were out of the financial reach of many organizations and most consumers. Since the start of economic reforms, demand for these goods rose considerably. But the disposable income of most Chinese citizens is such that they could not afford the more expensive imports (Sull, 2005). Additionally, there are special needs in the Chinese market. Most apartments in China are small, with small kitchens; refrigerators are often placed in a living room or front room (people may also do this to demonstrate their good taste). Thus, a refrigerator needs to be styled as a piece of furniture for a living area as opposed to the white boxes that typifies most refrigerators from the U.S. (Bruton, Lan, & Lu, 2000).
During the initial stages of economic liberalization there were hundreds of appliance firms but general quality was not good (Sull, 2005). As a result, firms sought to establish quality and innovativeness standards in the industry. Initially there was little advertising of goods in China as economic reform began. These efforts typically occurred through informal methods and broad acceptance of quality control and customer service standards as opposed to formal regulations. To illustrate, Haier is one of China’s largest manufacturer of appliances, such as refrigerators and air conditioners, and a pioneer in developing products for the Chinese market. The population in China early in the reform process was not positive to advertising; the attitude was why would you need to advertise if you had a good product? Thus, initially advertising did little good and may have harmed a firm’s reputation. Therefore, Haier sought to build in the public’s mind what the standard of such appliances should be. They did this through widely shared stories and articles in newspapers as well as telling and retelling the well-known story of the firm’s chairman, Zhang Ruimin, breaking a poor quality appliance just off the assembly line with a sledgehammer (the sledgehammer is still on display at Haier headquarters) (Wu, 2003). The resulting shift in perceptions of the standard for appliances significantly challenged the established method of doing business in the industry and lead to substantial advances in quality. Beverage maker Wahaha employed a similar approach in the beverage industry by working to establish standards and educating the public about the real nutritional value of its enriched drinks—something difficult to do in a chaotic market with few established standards for product quality and performance (Sull, 2005).

5.4.2. Cognitive creation

When a firm creates a new domain in an emerging field it creates the standards and dimensions that of how that industry, or the domain that industry is part of, fits into society. The cognitive creation approach is typically broader than creation of normative standards in the industry in that the industry is striving for its activities to be taken-for-granted by the market. In China, holidays and occasions such as Christmas, Valentine’s Day, and Mother’s Day are starting to be observed in the cities. These holidays were “introduced” to the general public largely by private firms that wanted to promote their products associated with these holidays. Borrowing from the greeting card firms that promote occasions to sell more cards, firms in south China firm that exported plastic Christmas trees to the West started to promote Christmas in China in the 1990s, first to other firms and then to consumers. They did this by giving away trees and decorations to businesses and hotels in major cities China. Shopping malls started to run Christmas and other holiday promotions. The result is that today several holidays that are not indigenous to China are increasingly promoted there. These firms in promoting the holiday largely established what many individuals in China thought the holiday and the goods used in it should be and established themselves as the early-moving firms in Christmas-related markets.

Cognitive legitimacy creation for a new business or market entrant is a step that should not be ignored. In China, many new businesses are extensively discussed on the Internet and in the press, which can help them gain legitimacy (or can be a hindrance if the firm missteps). The interviews revealed the story of a new business of “renting a filial [loyal] son” that older people can hire to assist them and provide them some company. In spite of its early popularity, there was a lot of controversy over this service. People feared that this business contributed to the destruction of traditional Chinese values such as true filial piety from the sons. Though some argued these fears were greatly overblown, the entrepreneur closed his new business after just a few weeks of operation, in spite of early success. The entrepreneur was unable to counter the negative press about his firm and build legitimacy for his service. There was talk that the personal assistant business may re-emerge, albeit without the filial piety angle.

5.4.3. Regulatory creation

Private firms can sometimes help to write the rules and regulations for that industry as the government becomes aware of the industry. Our interviewees supported the argument that regulatory creation occurs today in China, particularly in many technical areas. The government wants to regulate these domains but it does not have the technical expertise in the government to do so. Therefore, it is not uncommon for the government to consult with leading businesses in a domain. For example, in the telecommunications domain there are many private firms that have emerged to pursue new technologies. The government works with these firms in concerns such as encryption to establish the regulations for the domain. Two private firms in the telecommunications field reported that they are working with local governments to establish standards that meet worldwide and not just local criteria. Although they may be able to profit more from the adoption of idiosyncratic local standards, they argued that this would be bad in the long run as it would isolate local equipment makers from developments overseas.

6. Legitimacy building in Taiwan

Taiwan shares similar traditional Chinese culture with China, that is, a similar cognitive institutional structure (House, Hanges, Javidan, Dorfman, & Gupta, 2004). Taiwan is also classified by the World Bank as an emerging economy although it is viewed as less turbulent than that of China. Thus, it would not be unreasonable to assume that many legitimacy strategies are similar in Taiwan and China. As a result, Taiwan offers the opportunity to substantiate the findings on China and to also understand how these efforts on legitimacy building are likely to evolve over time as China’s economy matures. The results will be presented in terms of the four strategies highlighted above for China. Those areas of agreement and differences will be highlighted.

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13 Today the attitude toward advertising has changed with extensive advertising occurring in all media forms.
6.1. Strategy 1—selection of environments

Taiwan is a relatively small island. The travel time on the new high-speed train from Taipei in the north to Kaohsiung in the south is only about 90 min. As a result the ability to pick locations that offer the potential to impact normative or cognitive institutions is very limited. However, Taiwan firms in a manner very similar to Chinese firms seek to meet clients’ request for certain accredited procedures such as ISO or quality assurance programs.

6.2. Strategy 2—conforming to current environment

It was highlighted in the discussion of normative and regulatory institutions in China and the strategy of conforming to the current environment that guanxi is important. Such relationship building is also important in Taiwan. However, the relative importance is of guanxi is different in Taiwan. In China, every business wanted relationships with a wide range of government entities. But in Taiwan, the need for relationships is more specific to the type of business the entrepreneurial firm pursues. For example, if businesses are export-oriented, guanxi with government officials might not be so important, whereas firms from the China sample stated that good relations with the customs department are essential. Guanxi in Taiwan proved much more important for firms that are domestic-market oriented, which concurs with resources dependency theory (Pfeffer & Salancik, 1978) as domestic markets are more heavily regulated by the government.

It was highlighted that the means to impact cognitive institutions through the strategy of conforming to the environment was to associate with given government firms or entities in China. There is similar use of the strategy in Taiwan although most typically the Taiwan entrepreneurial firms seek to associate with high profile international firms rather than the government. Such firms help to legitimize the Taiwan firm as a global competitor. This perception encourages not only respect for the firm but also to lessen government interference since the island is so dependent on exports by there is a high premium places on such firms.

6.3. Strategy 3—manipulate existing environment

It was highlighted in the discussion of China that the strategy of manipulating the environment can impact the normative institutions through associations. Such associations are also critical in Taiwan and in fact are often more critical. For example, trade associations play a much more significant role in Taiwan than in China. These trade associations can influence regulations, push government to implement favourable policies, and regulate their members’ business activities. Similarly, in Taiwan entrepreneurs seek to impact the cognitive institutions through sponsoring of activities and research.

Taiwanese firms use corporate philanthropy in a different manner than do entrepreneurs in China in an effort to impact regulatory institutions. Mainland Chinese entrepreneurial firms often make donations or purchase SOEs in order to establish good relations with the local government rather than for general image building purposes. Taiwan firms use philanthropy to build an image and support with the public. In large measure this is because Taiwan business people view the government differently than do those in China. Businessmen in Taiwan seldom participate in politics directly. For historical reasons, most of Taiwanese businessmen have traditionally shied away from politics. There are two principal political parties in Taiwan. If the private entrepreneurs can build support with the public no matter which party is in control of the government they feel they will be more likely to receive fair treatment. In contrast, in a one-party state such as China, building relationships with that party becomes the crucial factor. In part this difference in approaches is also supported by the fact that Taiwan has much better private property protection than does Mainland China.

6.4. Strategy 4—creating the environment

Taiwanese entrepreneurs also use the strategy of creating the environment. In a manner similar to China entrepreneurs in Taiwan will seek to develop a new industry and establish the expectations of that industry and the rules governing the industry in a manner favourable to them. Thus the normative and regulatory institutions are impacted in a manner similar to China. One manner that does differ is in the cognitive institutions. Taiwan entrepreneurs like to demonstrate show that they are indeed well-managed companies and up-to-date with cutting edge knowledge. This is view is consistent with the issue noted before that Taiwan firms like to be perceived as a world class global competitors. Therefore, Taiwan firms like to demonstrate the benefit of what they do and how it is used in a business. A typical example is Taiwan Semiconductor Manufacturing Company (TSMC) which sees itself as a global firm. They sponsor management training seminars and regional business conferences to demonstrate their cognitive legitimacy through positive association with modern business practice.

There is one important difference that emerged after our interviews with Taiwan businesspeople about legitimacy creation. In creating the environment, Taiwanese firms approached the issue somewhat differently than in Mainland China. In China, frugality is often seen as a sign that the firm is not doing well, and firms seek to demonstrate their success and generosity visibly to clients, partner firms and the government through somewhat lavish spending and gift-giving. In contrast, Taiwanese firms are more likely to try to show they are careful, frugal stewards. As an example, Stan Shih, founder of Acer used to always drive by himself. Finally his employees insisted that for security he should hire a driver. Taiwanese employees might share one hotel rooms when on business trip in order to save money. Careful corporate stewardship has become an expected norm among Taiwanese businesspeople. Thus, the Taiwan firms approach creating an environment favourably to them in a slightly different manner than do Chinese firms.
7. International firms and legitimacy

It can be seen in examining Taiwan that most of the same legitimacy strategies are in place. The major differences concern the role of government and the greater security of private property in Taiwan. Yet many idiosyncratic practices surrounding building legitimacy through guanxi, charity, and gift giving remain in place. In examining the other international firms it was clear that the international firms were trying to learn from their Chinese partners. For example, two of the foreign firms in the sample specifically reported that they were watching the activities of their Chinese partners carefully to learn what they do in this regard while the others reported more general copying of their legitimacy-building activity.

Two major legitimacy lessons appeared to have been learned by the international firms. First lesson learned was that the role of the government in establishing legitimacy is significant. These relationships by the international firms were frequently taking a deeper form than might be thought of for international firms. For example, two firms were thinking about buying out the more valuable divisions of SOEs with the help of private equity firms. Another firm mentioned that they would be doing a favor for the government of a major southern province by taking over a troubled diversified SOE and that this would help them in getting business from the provinces' other state-owned or state-linked firms. None of these purchases had occurred as yet but they demonstrate that the international firms understanding of the role of the government. This does not mean that these firms would waste their funds to make the government happy. Instead they were looking for mutually beneficial arrangements. For example, one senior manager from a U.S. telecommunications firm noted:

There have been so many appalling stories about [western] firms throwing money down the drain in China, particularly on bad firm purchases. I know of one company that bought into several SOEs in a variety of inland locations in China. They ran themselves ragged just watching over those acquisitions. Since they weren't able to keep a close eye on their investments, some of the SOEs started pulling all kinds of financial shenanigans and using the firm's brand name to sell their own products out of the backdoor of the factory and so forth. And that foreign buyer never did get any real benefit from the provincial governments or Beijing for their purchases. We have learned, partly from our [local] partner that we would need to do very careful due diligence and keep a close watch on any SOE we might take over by placing our own financial person and middle management in there. We are looking carefully at some SOEs for acquisition purposes, but very carefully, and only in places where we can benefit from establishing ourselves further ... while being able to keep a close watch on their activities.

The second lesson learned by the international firms is that building legitimacy is a broad-based activity. While not pursuing all of the various legitimacy-building strategies most international firms reported pursuing some of them. This is in contrast to many of the first movers into China. These firms often felt they could build a relationship with a single individual – often a government official in Beijing – and that this would bring them legitimacy. That quickly proved to not be the case as several firms in our sample discovered. Commented one foreign manufacturer on this account:

We have learned by watching the ups and downs of local firms that guanxi with government officials can be very helpful, but you should be careful to not depend on your connections too much. Sometimes a problem goes too high up for an official to fix. Also Beijing and other local governments tend to rotate officials more these days, so you can lose your guanxi capital quickly if you're not careful. One of our alliance partners, a local factory, had an important sponsor that helped him out for years. That official got in caught in a bribery scandal, and our alliance was tainted by the association. Without its sponsor downtown, that local firm ran into trouble. Only now are they starting to sort things out [several years later]. The moral is to get to know a lot of people, but also build up your local reputation and credits steadily.

Thus, rather than relying on a single relationship international firms reported they are attempting to build a broader based approach to their legitimacy in China, sometimes in response to what local joint venture partners had advised them to do. Having connections with the central government may not be enough to get things done out in China's provinces, something that a number of studies have confirmed (e.g. Ahlstrom et al., 2000; Chan, 2003).

8. Discussion

In past work, researchers have often concluded that business and industries that survived and grew had achieved legitimacy. This perspective does not call attention to how firms can act to shape legitimacy. It is possible for firms to build legitimacy, and it is indeed a very important activity for firms in emerging economies with uncertain property rights. This extension of the theoretical understanding of legitimacy by incorporating this institutional entrepreneurship is a major contribution of this paper.

Firms can create new norms, values, beliefs, expectations, models, patterns of behavior, networks, or frames of reference consistent with an organization's identity and current practice, and then getting others to accept these norms, and values (Aldrich & Fiol, 1994; DiMaggio, 1988; Suchman, 1995). Thus, the firm or industry can be limited by the status of its legitimacy but its need for legitimacy also creates opportunities for what Etzioni calls such institutional entrepreneurs – "the shock troops of innovation" (1987: p. 179) – whereby a new venture or grouping of firms creates or changes scripts, rules, norms, values, and laws that may lead to changes in how society views the firm or its industry. That legitimacy or its lack thereof,
This article contributes to theory and practice on legitimacy by providing a framework for legitimacy building in an emerging economy as shown in Table 1 (Table 1 summarizes the four types of strategies and the three institutional pillars). Mature market economies are generally accepting of private enterprise in most industries. But in emerging economies, the environment is radically different than that faced by private firms in mature economies. The four strategies that can be used to build legitimacy in three different parts of the institutional environment suggest an inventory of 12 types of actions that private firms take in the challenging environment of China’s emerging economy. These strategies can be seen as relevant not only to those domestic firms in China but also entrepreneurial private firms in emergent economies such as Taiwan or international firms active in China.

These strategies can be viewed in a hierarchy according to the difficulty in their utilization, and the interviews suggested that the easier ones were in fact more commonly used. For example, selection of a favorable environment is the easiest strategy to undertake if the firm is able to readily move or start up in a more favorable operating venue. If that is not feasible, then if a firm can conform to its local environment and may be able to establish legitimacy through influential individuals with whom the firm is allied. While the first two strategies are normally undertaken by single firms, the third and fourth strategies are best conducted through collective action among multiple firms. Firms may have to work together to manipulate their environment by joining together to create an image or understanding of the industry. This is particularly difficult when firms have to work to create a new environment with regulations, norms and cognitive elements that include enlisting government, media and popular culture support for its actions but the payoff from achieving this can be significant.

This research raises additional points about the indigenous or emic practices (Harris, 1979) developed in an emerging economy and their potential value to foreign firms. Although China’s economy has been developing rapidly, the formal legal environment has been progressing more slowly. Private enterprise has gained some legal standing, but its long-term status is still somewhat uncertain. The evidence from the firms in China demonstrated a hierarchy of legitimacy strategies that help firms to navigate the uncertain setting; strategies that reflect the idiosyncratic environment. For example, the importance of guanxi and maintaining good connections with key stakeholders in the region in which a firm is doing business cannot be overstated. Several interviewees in both China and Taiwan reminded us that guanxi is not likely to get a firm new business, but it can help protect the firm against excessive interference by the government or other influential individuals and secure the firm’s position in the local market.

Although firms more often chose simple legitimization strategies that do not require collective action (e.g., selection and conformance), they sometimes chose the more difficult manipulation and creation strategies. Yet regardless of the strategy chosen, we found that the normative component of the environment was nearly always included in the firms’ legitimacy approaches and the interviews revealed that these were considered particularly important. The Chinese firms stated that establishing norms of behavior within their industry for a variety of functions ranging from quality control, to customer service, to salaries, bonuses and labor relations were important parts of building legitimacy within the community, and even across China and overseas, and they reported spending as relatively large amount of time on this. This sometimes necessitated working with other firms in their industry through associations to establish needed standards and codes, but private firms reported that they were paying attention to this.

Interestingly, in spite of Taiwan’s development, firms there also reported practicing many of the Mainland Chinese firms’ legitimacy strategies, albeit with some subtle differences. For example, guanxi continues to be
important in Taiwan to build business and establish good commercial and governmental relations. The pattern of that reliance on relationships is somewhat different as Taiwan has evolved into a fairly robust democracy in recent years. However, the institution remains important in so many ways. In fact looking at issues such as the role of business associations and how firms move collectively to lobby the government for benefits or action in some areas suggest guanxi’s continuing importance in a variety of areas. Taiwanese managers also agreed with the hierarchy of legitimacy-building strategies for China. The importance of working with the more informal normative and cognitive institutions will likely continue to be a dominant feature of doing business in Greater China. The foreign firms in our sample concurred that informal institutions are particularly salient in establishing oneself and building legitimacy in China. Several further commented that they intended to pay close attention to this by hiring local consultants and middle managers that have some connections and an understanding of helping the firm legitimize its activities, particularly within the community in which the foreign firm is situated.

The findings here have implications for not only China but also for other emerging markets. The number of private enterprises is expected to continue to grow not only in China but also in other emerging economies such as those of Eastern Europe, Latin America, and India (Bruton & Rubanik, 1997; Hisrich & Grachev, 1993; Kumar & Thacker-Kumar, 1996; Peng & Heath, 1996). The details of the strategic behavior that private firms exhibit in each of these countries may differ somewhat due to variation in their respective institutional environments suggesting the value of understanding emic approaches to management, particularly in emerging economies (Hitt et al., 2004; Tsui & Lau, 2002). The legitimacy-building methods being used in China were found to be quite familiar and useful to the managers interviewed in Taiwan. While there were differences, particularly based on the less intrusive role of government in Taiwan, these findings suggest the durability of legitimacy-building strategies and their value to all firms in Greater China. These legitimacy-building approaches were also learned by foreign alliance partners of the firms in our study and proved valuable as they entered and sought to navigate China’s markets.

Legitimacy is a crucial issue for private firms in China and in many emerging economies. These firms’ approach to building legitimacy for themselves, their industries, and the entire private sector is central to the growth and success of private enterprise there. Foreign firms coming to China can also learn from the creative and distinctive tactics used by indigenous private firms in China in building legitimacy and securing their station in a rapidly growing emerging economy.

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