



The effects of social capital and organizational innovativeness in different institutional contexts

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Abstract

This paper examines how social capital and organizational innovativeness influence business performance through their separate, indirect, or interactive effects, and how these effects differ across the institutional contexts of a transition economy and a market economy. In line with institutional theory, our findings show that the effects of social capital are more extensive and probably more malignant in a transition economy than in a market economy. Furthermore, different types of organizational innovativeness, as corporate culture, can be cultivated by different forms of social capital in different institutional contexts. The implications for institutional theory and social capital theory, and the managerial implications, are discussed.

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INTRODUCTION

The effects of social capital and innovativeness on business performance at the organizational level, and how these effects differ across institutional contexts, are important yet relatively unexplored topics. Social capital is grounded in social theory, which emphasizes friendship and mutual obligation (Field, 2003). Organizational innovativeness is grounded in the literature of the marketing concept, which emphasizes market competition and a corporate culture that gives priority to customer satisfaction over the interests of other players (Deshpande, Farley, & Webster, 1993; Hurley & Hult, 1998). Strategies based on innovativeness assume economic rationality, rather than soft, “irrational” assumptions concerning friendship and mutual obligation. The different business philosophies underlying social capital and organizational innovativeness appear to be associated with different institutional contexts, the former being more frequently adopted in transition economies, and the latter in market economies (Peng, 2002, 2003). However, to date there is little research that goes beyond this general assertion. But such a general assertion may be an oversimplification that might mislead the international business practitioner to believe that all types of personal relationship are

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equally useful in transition economies but should not be used in market economies.

In this paper, we attempt to fill this research gap by examining how different types of social capital and different types of organizational innovativeness are related to one another and are more or less important in transition economies or market economies. We use institutional theory as a framework for understanding the complicated effects covered by this research question. We review the literature on social capital and organizational innovativeness. Then, we provide an analysis of the two institutional contexts and propose hypotheses regarding these effects. A brief case study will be added to substantiate the business models we propose. We tested our hypotheses by conducting an empirical study in mainland China (a transition economy) and Hong Kong (a liberal market economy). Our research contributes to institutional theory by conducting a much-needed comparative study on institutional effects (Scott, 2001). It also contributes to social capital theory by assessing the different benefits of social capital to business performance. We found that the institutional context of a transition economy tends to breed the more malignant form of social capital, and that of a market economy tends to breed the more benign form of social capital. Finally, our research provides international business practitioners with a road map for effective relationship management in different institutional contexts.

BACKGROUND

Conceptual Distinctions

A corporate culture reflects how an organization competes (e.g., Deshpande et al., 1993; Hurley & Hult, 1998). Organizational innovativeness is one such corporate culture. We follow Mytelka (1999) and conceptualize innovativeness broadly as an organization's tendency to master, implement, and develop processes or products new to the organization, although the processes or products may not be new to its local or foreign competitors. The distinction between administrative innovativeness and product-related innovativeness is based on the distinction between administrative innovation and technical innovation (Damanpour, Szabat, & Evan, 1989; Han, Kim, & Srivastava, 1998). Administrative innovativeness encourages changes in organizational structure, administrative processes, and strategic goals. Thus it overlaps with the constructs of process management (Benner & Tushman, 2003)

and innovative management (West & Anderson, 1996). Examples include new management processes (e.g., total quality management), new organizational designs (e.g., from seniority-based to performance-based wage systems), new markets, and new strategic focuses (e.g., from OEM to brand building). By contrast, product-related innovativeness is a corporate culture that encourages the invention of new and improved products, by means of new product designs or adding new functions.

Regarding the conceptualization of social capital, we follow Park and Luo (2001) and Peng and Luo (2000) and focus on the informal personal relationships, known as "guanxi" in Chinese, that managers have with other individuals. Guanxi is built on trust and cooperation, and maintained by implicit rules of reciprocity and social obligations (Hitt, Lee, & Yucel, 2002; Park & Luo, 2001). These informal personal relationships constitute the social capital of the firm at the organizational level. Strategic management research in transition economies distinguishes between guanxi with government officials and guanxi with managers at other business firms (Li & Atuahene-Gima, 2001; Park & Luo, 2001; Peng & Luo, 2000). Relationships with the former group are vertical, between subordinate and superior, while those with the latter group are horizontal, between peer and peer (Adler & Kwon, 2002). Government officials and political leaders provide knowledge about rules and policies, while managers at other firms provide knowledge and resources about new product features, technical advances, and sophisticated manufacturing or product technologies (Hitt, Ahlstrom, Dacin, Levittas, & Svobodina, 2004; Thun, 2006).

Benefits of Organizational Innovativeness and Social Capital

Figure 1 illustrates the benefits conferred by organizational innovativeness and social capital. A body of literature has been written on the benefits of innovation (Benner & Tushman, 2003; Han et al., 1998; Mytelka, 1999). The predominant proposition is that innovativeness directly enhances competitiveness and performance. The effects of social capital are more varied, and include solidarity, information, and social influence benefits (Adler & Kwon, 2002).

Solidarity benefit. In Bourdieu's (1984, 1986) view, social capital functions to maintain inequality through a network of mutual acquaintance and recognition. Network members enjoy benefits that

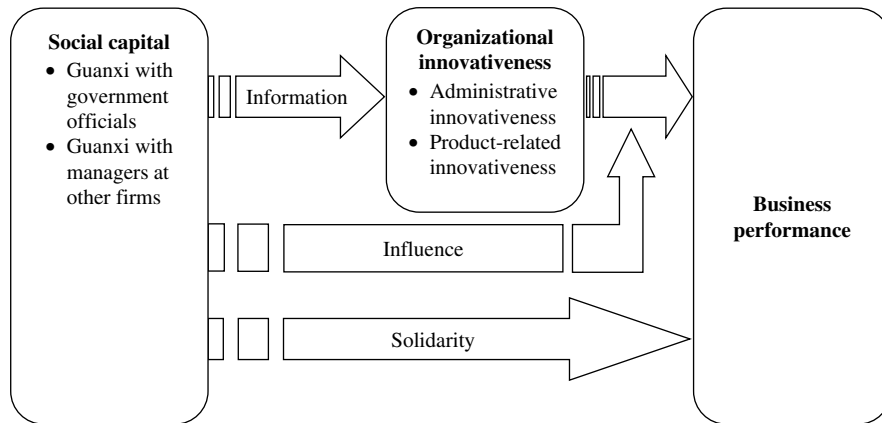


Figure 1 Three benefits of social capital in relation to organizational innovativeness.

non-members do not. Thus social capital is like a “club good”, serving to maintain the privileges and status of the club members (Field, 2003). Benefits are given by one member to another to increase cohesion (Gabbay, 1997). This kind of benefit, known as solidarity benefit (Adler & Kwon, 2002; Sandefur & Laumann, 1998), confers exclusive opportunities, such as convenient access to resources and business contracts (Davies, Leung, Luk, & Wong, 1995; Nahapiet & Ghoshal, 1998), regardless of the virtues or capabilities of the recipient.

Information benefit for organizational innovativeness.

Unlike Bourdieu (1984, 1986), Coleman (1988) and Putnam (2000) focus on the benefit of social capital for the development of intellectual capital. At the organizational level, social capital enhances organizational innovativeness by facilitating the flow of information (Adler & Kwon, 2002; Ahuja, 2000; Nahapiet & Ghoshal, 1998; Sandefur & Laumann, 1998). Thus organizational innovativeness mediates the link between social capital and business performance. Compared with solidarity benefit, information benefit of social capital creates less social inequality and produces fewer negative effects on the wider society (Field, 2003).

Social influence benefit on organizational innovativeness. Finally, effective implementation of innovations may need critical productive resources or cooperation from business partners. Social capital provides a firm with critical productive resources or cooperation so that it can transform its innovative ideas into profit (Adler & Kwon, 2002; Nahapiet & Ghoshal, 1998; Pfeffer & Salancik, 1978; Sandefur &

Laumann, 1998). In this way, social capital positively moderates the innovativeness–performance link.

Institutional Context and Strategic Effectiveness

The basic premise of the present paper is that the institutional context (market versus transition economies) moderates the effects of social capital and organizational innovativeness. Institutional theory suggests that different firms operating in the same institutional context tend to behave similarly (DiMaggio & Powell, 1983). The institutional context specifies the formal and informal “rules of the game” (North, 1990). It determines what strategies work best, and induces firms to choose this set of effective strategies. As a result, the institutional context leads to convergence of firm behaviors. In the following, we focus on a comparison of the two broadly different institutional contexts of market economies and transition economies.

Market economies. Economies differ to the extent that non-market institutions, particularly the government, are involved in the coordination of the behaviors of the economic actors (e.g., Friedman & Friedman, 1990/1979; Scott, 2001; Vig, 1985). At one end of the spectrum is the command economy, in which the government has complete control over all economic behaviors, and at the other end is the perfect market economy, in which intervention by non-market institutions is non-existent. In reality, these two extremes do not exist, and virtually all economies are located somewhere between these two poles. Even among developed market economies, differences exist with respect to

the amount of non-market influences from the state and other interest groups (Marks, 1985). Hall and Soskice's (2001) varieties of capitalism approach focuses on the formal, impersonal, non-governmental and non-market institutional structures such as industrial associations and labor unions. These are networks built on relational contracting (Thorelli, 1986). Hall and Soskice further distinguish between the coordinated market economies (e.g., Germany and Japan) and the liberal market economies (e.g., the US and the UK), the former being more heavily coordinated by these non-market institutional structures. Overall, government interventions are much less common in market economies than in planned or transition economies.

The most liberal market economy in the world is probably Hong Kong, which has been praised by Friedman and Friedman (1990/1979) as the best exemplar of a free market economy. For 13 consecutive years Hong Kong has ranked as the freest economy since the Heritage Foundation introduced the Index of Economic Freedom in 1995 (Wikipedia, 2007). Non-market, non-governmental structures such as industrial associations and labor unions are neither prevalent nor powerful. Government involvement in economic activities remains restrained. Laws, while clearly written and consistently enforced, are kept to a minimum, primarily targeting such opportunistic behaviors as misrepresentation of transaction-relevant information, failure to carry out agreed-upon contracts, defrauding, corruption, and graft. Although far from being a perfect market, given these institutional arrangements, Hong Kong's primary challenge to economic actors is market competition. The uncertainties businesses face are market uncertainties. Basically, firms engage in arm's length market transactions and compete with respect to the price and quality of their products and services.

Transition economies. Close to the other end of the spectrum of political economies are command economies and transition economies. Most of the command economies that currently still exist are not influential in the global economy. Transition economies, those that are transforming from a command to a market economy, are much more active players. The major problem resulting from central planning is operational inefficiency (Nee, 1992). Therefore the primary goal of market reform of transition economies is efficiency enhancement.

The transition may take the "big bang" approach or the "gradualist" approach. Russia and the former

Eastern European communist countries chose the "big bang" approach, removing the communist parties from their governments in one fell swoop (Buck, Filatotchev, Nolan, & Wright, 2000). China and some South-East Asian communist countries have adopted the "gradualist" approach. The communist parties remain in power and are responsible for gradual market reforms according to their agendas (Naughton, 1996). Irrespective of the approach taken, government involvement remains heavy in transition economies (Boisot & Child, 1988; Buck et al., 2000; Child & Tse, 2001; Kornai, 1992; Puffer & McCarthy, 2007; Thun, 2006; Walder, 1995). For example, insider privatization of former state-owned enterprises in Russia allows the state to maintain influence in these firms (Buck et al., 2000). Heavy government involvement means that the uncertainties businesses face are institutional uncertainties instead of market uncertainties (e.g., Lin, Cai, & Li, 1998; O'Connor, Deng, & Luo, 2006; Puffer & McCarthy, 2007). The state plays an active role in promoting "priority projects" or "pillar industries" (Lin et al., 1998; Thun, 2006), creating a protected environment to limit market uncertainties (Boisot & Child, 1988). Yet changes in state policies can be unpredictable, creating institutional uncertainties.

Another common feature of transition economies is the emphasis on informal personal relationships. Although Boisot and Child (1988, 1996) argued that the reliance on informal relationships is peculiar to Chinese culture, research shows that firms in other transition economies, including Hungary (Whitley, Henderson, Czaban, & Lengyel, 1996) and Russia (Hitt et al., 2004; Puffer & McCarthy, 2007), also rely on trust in informal relations to do business. Whitley et al. (1996) attributed this reliance to the distrust developed during the central planning era of formal institutions, whereas Peng (2002, 2003; Peng & Luo, 2000) attributed it to institutional voids: that is, the lack of formal market-supporting institutions, such as a transparent legal system and non-corrupt law-enforcing bodies.

China is the largest and the fastest-growing transition economy in the world (Child & Tse, 2001), and it appears to be having more success than its Eastern European counterparts with its reforms (Boisot & Child, 1996; Buck et al., 2000; Walder, 1995). Decentralization of power from the central government to local governments is arguably the most critical success factor. Decentralization aligns local governments' own interests with business success under their jurisdictions (Thun, 2006; Walder, 1995). Business success in the locality creates

financial and political capital for the local government. Local officials are therefore motivated to promote, protect, and participate in local businesses. These attempts are facilitated by the Chinese cultural values of obedience and local feudalism (Boisot & Child, 1988, 1996; Buck et al., 2000). A workforce that is obedient provides room for local officials and local business leaders to experiment with innovative management methods. For example, Chinese firms were able to attract foreign investors by letting them “cherry-pick” the best assets and human capital, while such an arrangement was resisted by Russian workers (Buck et al., 2000). A question regarding China is whether it will eventually develop into a true market economy or end up as so-called “network capitalism”, which remains relationship-based rather than rule-based (Boisot & Child, 1996). Next, we will discuss how these institutional factors affect the effects shown in Figure 1.

HYPOTHESES DEVELOPMENT

Benefits of Organizational Innovativeness

To achieve the goal of efficiency enhancement, economies in transition often choose “catch-up strategies” – the imitation and adaptation of administrative or product-related technologies that are already well developed elsewhere (Child & Tse, 2001; Mytelka, 1999). Catch-up strategies, compared with “keep-up strategies” and “get-ahead” strategies, are more appropriate because the technologies being adapted are already proven to work, are incremental in the sense that the needed capabilities can be built step by step, and are readily available through purchasing or licensing.

Administrative innovativeness. In transition economies, firms are at the early stage of development in terms of capability-building and efficiency enhancement. To catch up with foreign competitors, they tend to be engaged more in low-cost production than in differentiating themselves through product innovation (Mytelka, 1999). For example, China has been doing well in labor-intensive, low-cost, and low value-added manufacturing, and this is how it has come to be known as the “world’s factory” (Zhang, 2006). Administrative innovativeness aims at improving operational efficiency by cost reduction (Benner & Tushman, 2003). As such, it matches the basic developmental need of firms in transition economies. Thus administrative innovativeness has a stronger effect there than in market economies.

Hypothesis 1: The positive effect of administrative innovativeness on business performance is stronger in a transition economy than in a market economy.

Product-related innovativeness. In contrast, firms in market economies are no longer competing on the basis of cost. They tend to take the “keep-up” or “get-ahead” approaches to innovation (Mytelka, 1999). This is because capability-building and efficiency enhancement are no longer their concerns. Product innovation rather than low-cost production helps them differentiate themselves. Thus:

Hypothesis 2: The positive effect of product-related innovativeness on business performance is stronger in a market economy than in a transition economy.

Information Benefit of Social Capital for Organizational Innovativeness

Boisot and Child’s (1988, 1996) typology of economic structures seems to suggest that informal personal relationships, or *guanxi*, are found only in fiefs and clans but not in bureaucracies and markets. Taking into account the arguments of social capital theory (e.g., Adler & Kwon, 2002; Nahapiet & Ghoshal, 1998), we propose that informal personal relationships, or *guanxi*, matter in *both* market and transition economies, but in different manners.

Guanxi with government officials. As a legacy of central planning, government officials in transition economies remain as a source of information for firms (Thun, 2006). Combined with the decentralization of power and local protectionism in China (Walder, 1995), local government officials have been quite innovative in their experiments with different regulatory measures such as local content requirements, tax rates, stock systems, and bankruptcy laws (Thun, 2006). They also actively take part in business planning, playing the roles of advocate and adviser to local firms (Thun, 2006). They give suggestions to local firms about how to take advantage of the institutional framework and reduce costs, hoping to enhance local prosperity. For example, Thun (2006: 163) quoted a Guangdong Province Vice-Governor as saying, “We must make every use of the favorable conditions provided by the ‘exemptional policy’... We should try to convert some domestic investment projects and find a foreign linkage for them so they enjoy the ‘exemptional’ policies.” Their suggestions can also be related to

such matters as merger and acquisition of ailing state enterprises (Paine, 2001a), new forms of human resources management (Warner, 1995), and new methods of financial management such as using the “gray” market (Thun, 2006). Although different localities vary with respect to the content of their ideas (Thun, 2006), the role of local government officials as planners is consistent. The same administrative process may not work equally well in all institutional frameworks at the local level. Therefore suggestions given by local officials are valuable guidelines for coping with the institutional uncertainties at this level. Firms having *guanxi* with local government officials will enjoy this benefit. Yet, limited by their own expertise, government officials are likely to be able to provide information only about administrative innovativeness, but not about product-related innovativeness. On the other hand, government officials of a free market economy do not confer this information benefit because of their non-interventionist tradition. Therefore:

Hypothesis 3: *Guanxi* with government officials positively affects administrative innovativeness in a transition economy but not in a market economy.

Guanxi with managers at other firms. As stated in Hypothesis 2, product-related innovativeness is the dominant strategy in market economies. Firms in a market economy are more likely than their counterparts in a transition economy to take the “keep-up” or “get-ahead” approaches to innovation (Mytelka, 1999). Compared with “catching up”, “keeping up” and “getting ahead” are uncertain, risky, and expensive. For example, expenditures on R&D in search of radical innovations are usually large and might be futile. Also, the external market of radical innovations probably does not exist. As a result, neither hierarchy (i.e., to make internally) nor market (i.e., to buy from the market) are satisfactory solutions. The formal inter-firm networks of the coordinated market economies are not particularly helpful either, because these networks are more conducive to incremental innovations than to radical innovations (Hall & Soskice, 2001). This dilemma is quite common to firms in a liberal market economy such as Hong Kong. To maintain product-related innovativeness, firms need state-of-the-art information about new technology and new product features. Social capital theory argues that firms can obtain and share this information via informal personal relationships among themselves

(e.g., Nahapiet & Ghoshal, 1998; Tsai & Ghoshal, 1998). Informal personal relationships are more flexible and unobtrusive than the formal non-market institutional structures of the coordinated market economies, and would be more beneficial to the development of radical innovations. In transition economies, firms are less eager to expend their social capital in strengthening their product-related innovativeness, because product innovations are not the dominant strategy in that institutional context. Thus:

Hypothesis 4: *Guanxi* with managers at other firms positively affects product-related innovativeness in a market economy but not in a transition economy.

Influence Benefit of Social Capital on Innovation
Implementation of innovative strategies requires productive resources, including financial, human, and technological capital. Social capital may be a source of these resources.

Guanxi with managers at other firms. The central planning era has left in many transition economies the legacy of inefficient allocation of productive resources and the shortage economy (Lin et al., 1998; Nee, 1992). Even today, their markets for productive resources are not yet mature, and firms cannot easily acquire the needed resources by purchase (Heritage Foundation, 2007; Nee, 1992; Warner, 1995). In China, firms have used informal personal relationships to cope with these difficulties (Boisot & Child, 1996; Child & Tse, 2001). Some firms may be fortunate enough to possess some of the needed resources in abundance at some points in time. Personal relationships built on trust ensure that the firms in the network efficiently redistribute their productive resources among themselves. Since the dominant innovative strategy in a transition economy is administrative innovativeness, the productive resources relevant to administrative innovations may include the financial and technological capital needed to shift to a new product line (e.g., the case of Guangdong Galanz reported by Sull & Wong, 2005) or to license a technology (e.g., the case of Haier reported by Li & Chen, 2006), and the human capital needed for the smooth running of a new management process (e.g., Warner, 1995). Thus:

Hypothesis 5: *Guanxi* with managers at other firms enhances the positive effect of



administrative innovativeness on business performance in a transition economy.

In market economies, the markets of financial capital and factor resources are mature. Firms have relatively little difficulties acquiring the resources needed for the implementation of their product-related innovations. Therefore no hypothesis is proposed about the influence benefit of guanxi with other managers in a market economy.

Guanxi with government officials. The role of government officials in helping firms implement innovations is less clear. In a transition economy, the government is still in command of most factor resources. To obtain these resources directly from government officials, firms usually have to pay a hefty “management fee” (Nee, 1992; Sun, 2004), which hurts financial performance (Luo, 2002). Even if corruption is not involved, local governments consider the businesses in their jurisdiction as their primary source of revenue (Walder, 1995). If firms rely on governments for resources, they are expected to return the favor. For example, a firm that is undergoing organizational restructuring may obtain financial and human capital from government officials to help carry out the change. In return, it may have to surrender employment control rights to government officials, and the organizational restructuring may end up being less successful because of the officials’ direct involvement (e.g., O’Connor, Deng, & Luo, 2006). Boisot and Child (1988) also pointed out the negative impacts of the direct involvement of government officials in the firm’s daily operations: for example, personalized interference and the using up of scarce managerial time in meetings and banquets. Therefore the influence benefit of guanxi with government officials is likely to be offset by its costs.

In a market economy, by its very nature, government involvement in daily operations is rare and oftentimes prohibited. The influence benefit of guanxi with government officials, if any, would be negligible. Therefore no hypothesis is proposed about the influence benefit of guanxi with government officials in either transition or market economies.

Solidarity Benefit of Social Capital

Solidarity benefit refers to the favors given directly on the basis of personal relationships, regardless of

the content and quality of the recipient firm’s business strategies.

Guanxi with managers at other firms. Favoritism nourished by informal personal relationships is common during the economic transition of China (e.g., Boisot & Child, 1988, 1996; Xin & Pearce, 1996). As a remark quoted by Boisot and Child (1988: 524) put it, “Only a face-to-face relationship will clinch the deal.” According to Boisot and Child, the dominant economic structures of China are fief and/or network capitalism, and the logic of these structures is to capitalize on networks of guanxi. While favored by Boisot and Child (1988, 1996), a cultural explanation cannot account for the widespread use of informal personal relationships in other transition economies. Other researchers argue that guanxi becomes important because of the institutional voids of the economies in transition (e.g., Park & Luo, 2001; Peng, 2003; Peng & Luo, 2000; Xin & Pearce, 1996). Economies undergoing market reforms generally fail to establish market-supporting institutions in a timely manner, resulting in institutional uncertainties (Lin et al., 1998) and rampant corruption (Sun, 2004). The principles governing economic activities have changed, while legal frameworks lag behind. For example, after 30 years of market reform in China, private property rights law are yet to be made (deLisle, 2004). Also, a group of judges of the Shenzhen Intermediate People’s Court have recently been jailed because of their own corruption, but the sentences they received are said to be way too lenient in view of the severity of their crimes (Chow, 2007). The legal system is not something that can be relied on. Formal contracts or agreements are not taken seriously. Against this background of institutional voids, economic actors have to rely on implicit personal relationships to clinch deals and protect their interests. An informal personal network is like a voluntary self-help group. Trust built on guanxi results in a direct exchange of favors within the network. Therefore:

Hypothesis 6: Guanxi with managers at other firms has a direct positive effect on business performance in a transition economy but not in a market economy.

In a market economy, on the other hand, companies tend to rely on formal contracts instead of relationships in the pursuit of profitable

transactions (Peng, 2002, 2003). Thus the solidarity benefit of social capital would be negligible.

Guanxi with government officials. Finally, *guanxi* with government officials does not necessarily bring a solidarity benefit in either transition or market economies (e.g., Li & Atuahene-Gima, 2001; Park & Luo, 2001; Peng & Luo, 2000). In a transition economy, as with the influence benefit accrued from government officials, the costs of the solidarity benefit can more than offset the benefit (Luo, 2002). In a market economy with market-supporting institutions, formal constraints and rules stipulate how government resources are allocated. Favoritism is usually prohibited, and officials cannot reward firms on the basis of *guanxi*. Therefore no hypothesis is proposed about the solidarity benefit of *guanxi* with government officials in either transition or market economies.

Summary of Hypotheses

Figure 2 is based on the general model of Figure 1 and adapted for the two institutional contexts. Figure 2b resembles other business models developed in the West, such as that of Tsai and Ghoshal (1998). Figure 2a is relatively novel. A real case involving the Haier Group might shed more light on it. Other well-known Chinese manufacturers, such as Guangdong Galanz and the Legend Group, have gone through paths similar to that of Haier (Lu, 2000; Sull & Wong, 2005; Zeng & Williamson, 2003).

Much has been written about Haier (e.g., Li & Chen, 2006; Paine, 2001a–c; Sull & Wong, 2005; Yan & Hu, 2002). It was China's top electronics

original equipment manufacturer in 2002 (Tarr, 2003), and is regarded by the government as a flagship corporation that hopefully can establish the country's overall international competitiveness (Zeng & Williamson, 2003). There are numerous reasons behind Haier's success, but the most widely cited ones are all related to its administrative innovations. First, a "culture center" has been set up to imbue newcomers, including firms newly acquired by Haier, with the "Haier enterprise culture" of self-discipline and individual accountability. Second, a process management method called "OEC" (everyone everyday has overall control and is clear on everything) has been invented to enhance process quality. Third, it has developed the "capturing the stunned fish" principle of acquiring other ailing state enterprises. Fourth, it has a flexible hierarchy that allows top-down decision-making and bottom-up participation to coexist and interact. Furthermore, it has chosen the strategy of global brand building before exploiting the domestic Chinese market.

Consistent with the model shown in Figure 2a, *guanxi* with government officials has played an active role in the gestation of Haier's administrative innovations, whereas *guanxi* with managers at other firms has helped the implementation of its administrative innovations. Government officials have provided ideas. How successfully the firm implements the ideas depends on its relationships with business partners. Zhang Ruimin, founder and CEO of Haier, was himself a government official when he took over the factory that subsequently evolved into Haier. The very idea of reforming the ailing factory came from government officials.

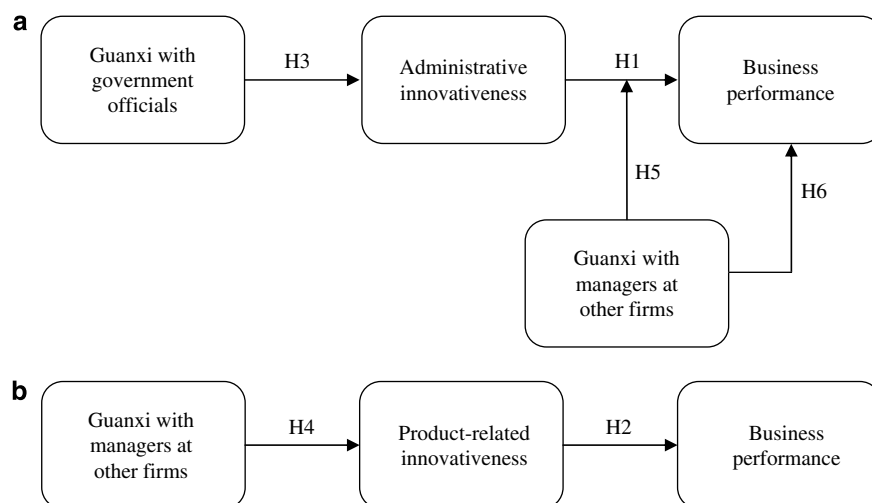


Figure 2 (a) Business model of a transition economy; (b) business model of a market economy.

Many of its subsequent merger and acquisition decisions were also initiated by government officials. Its global strategy is in line with the government's plan of building international competitiveness. To implement its process management methods, Haier has benefited from the help of its business partners, especially in the transfer of technical know-how. In the production process, Haier faced problems of quality with parts provided by local suppliers. To maintain the quality of the firm's products, Zhang managed to secure a supply of high-quality parts from non-local suppliers. The firm's strategy of global brand-building also needs the cooperation of its overseas distributors in foreign markets. However, it is less clear from the published case studies how Haier has enjoyed the solidarity benefit of social capital. At present, Haier is so successful that it hardly needs this type of benefit. Having briefly discussed the case of Haier, we will now report our quantitative comparative study.

METHOD

Design and Sampling

We chose mainland China and Hong Kong as proxies for transition economies and market economies respectively. These two economies permit meaningful comparisons, because the former is the largest transition economy whereas the latter is the freest market economy. They share the same national culture (Hui & Luk, 1997), and managers have the same ethnic background. Yet the two economies have drastically different institutional contexts, as mentioned above. This allows us to rule out cultural explanations and attribute the differences between the two economies to institutional effects (see the discussion of Peng, 2002).

The transition economy of mainland China. Mainland China had a planned economy between 1949 and 1978. Since 1978, it has been transforming into a more market-driven system. Yet this transition is far from complete. The government still attempts to direct production via administrative measures. Many industries are still heavily regulated, but legal frameworks remain weak (Heritage Foundation, 2007).

The market economy of Hong Kong. For more than a century, Hong Kong had a market economy under British rule. After Hong Kong was handed over to mainland China in 1997, it retained its market eco-

nomy. According to the 2006 Index of Economic Freedom, Hong Kong ranked number one among the 157 economies surveyed (Heritage Foundation, 2007). China ranked number 119. Another indicator of the level of institutional support is the corruption perception index (Luo, 2002). Among the 91 economies surveyed, Hong Kong was one of the cleanest, ranking 14, whereas mainland China ranked 57 (Transparency International, 2001). Hong Kong is among the least corrupt economies in the world, reflecting the effectiveness of its formal market-supporting institutions.

Data Collection Procedure

The data collection procedure we used was the same as that of Greenley and Foxall (1997, 1998). We collected data from manufacturing companies in a variety of industries located in the three most important commercial cities of mainland China: Beijing, Shanghai, and Guangzhou. With the help of a renowned research company in Hong Kong, we randomly selected 700 manufacturing companies, of which 188 were in Beijing, 268 were in Shanghai, and 244 were in Guangzhou, from the 1999/2000 Dunn and Bradstreet directory of domestic Chinese companies (Dun & Bradstreet Information Services, 1999). Using the key informant approach (Phillips, 1981), we mailed our questionnaires to the top administrator of each company. A telephone follow-up was conducted within 2 weeks to make sure that it was the top administrator (general or deputy-general manager) who provided the information. In many instances, the research company sent representatives to meet the top administrator of the company to explain how the data would be used, to answer any queries, and to collect the finished questionnaires. These steps have been used in past studies on Chinese management, and are deemed to be effective in overcoming the single response bias (Luk, Yau, Tse, Sin, & Chow, 2005). Eventually, 189 usable questionnaires were returned, representing an effective response rate of 27%. Of the 189 responding companies, 64 were located in Beijing, 75 in Shanghai, and 50 in Guangzhou. With regard to industry type, 58 (30.7%) of the participating companies manufactured consumer durable goods, 39 (20.6%) manufactured fast-moving consumer goods, and 92 (48.7%) manufactured capital industrial equipment and components. With regard to ownership structure, 42 (22.2%) were state-owned, 81 (42.9%) were private, and 66 (34.9%) were collective firms

(for a discussion of the three types of ownership see Nee, 1992).

The same data collection procedure was used in Hong Kong. We randomly selected 700 manufacturing companies from the 1999/2000 Dunn and Bradstreet directory of local Hong Kong companies. The companies returned 203 usable questionnaires, a 29% response rate. Of the participating companies, 58 (28.6%) manufactured consumer durable goods, 35 (17.2%) manufactured fast-moving consumer goods, and 110 (54.2%) manufactured capital industrial equipment and components. All the Hong Kong companies were private.

A response rate of under 30% is not uncommon in strategic management research (e.g., Greenley & Foxall, 1997, 1998; Griffith & Harvey, 2001; Marsh & Stock, 2006), and a response rate of 31% is considered to be satisfactory by Uhlenbruck (2004). Very, Lubatkin, Calori, and Veiga (1997) suggested that the response rate in a mail survey is affected by culture. Lee (2005) received only 54 responses from 350 Hong Kong manufacturers, a response rate of 15.4%. Schlevogt (2002) indicated that response rates in Chinese societies can be below 2%. Our response rates from Chinese societies were close to 30% and were deemed to be acceptable.

We conducted a *t*-test on the mean differences between early and late respondents with regard to firm characteristics (firm size and age) and the six

key variables (organizational innovativeness, guanxi, and firm performance). Those who returned the questionnaires within the first 2 weeks (i.e., before we sent out our reminder) were considered early respondents because they could be assumed to be more interested in responding to the survey (Armstrong & Overton, 1977). Those who returned the questionnaires after receiving the reminder were considered late respondents, and they might be more reluctant to respond. There were 69 early respondents in China and 82 in Hong Kong. However, no significant differences were found between the two groups ($p > 0.10$). Therefore non-response bias was unlikely to be a problem in our study.

Measures

Organizational innovativeness. Table 1 presents the items measuring the six key variables. Administrative innovativeness was measured with West and Anderson's (1996) measure of innovative management. Responses to these items were made on a five-point Likert scale, where 1 stood for "Strongly disagree" and 5 stood for "Strongly agree". The measures of product-related innovativeness were taken from Hooley, Broderick, and Möller's (1998) scale of competitive positioning. Responses to these items were made on a five-point Likert scale, where

Table 1 Results of confirmatory factor analyses of the six key constructs

Constructs and measurement items	Standardized factor loadings	
	Mainland China (N=179)	Hong Kong (N=184)
<i>Administrative innovativeness</i>		
China: $\alpha=0.82$, AVE=0.70, HSV=0.09		
Hong Kong: $\alpha=0.90$, AVE=0.80, HSV=0.12		
1. We are more innovative than our competitors in deciding what methods to use to achieve our targets and objectives	0.62	0.80
2. We are more innovative than our competitors in initiating new procedures or systems	0.79	0.88
3. We are more innovative than our competitors in developing new ways of achieving our targets and objectives	0.85	0.84
4. We are more innovative than our competitors in initiating changes in the job contents and work methods of our staff	0.69	0.86
<i>Product-related innovativeness</i>		
China: $\alpha=0.74$, AVE=0.66, HSV=0.09		
Hong Kong: $\alpha=0.71$, AVE=0.59, HSV=0.18		
1. The degree of innovation in our products and services	0.71	0.78
2. The uniqueness of our products and services	0.96	0.79
3. The degree of customization to individual customer requirements	0.46	0.36

Table 1 Continued

Constructs and measurement items	Standardized factor loadings	
	Mainland China (N=179)	Hong Kong (N=184)
<i>Guanxi with managers at other firms</i>		
China: $\alpha=0.70$, AVE=0.67, HSV=0.25		
Hong Kong: $\alpha=0.81$, AVE=0.53, HSV=0.09		
1. Good personal guanxi with key suppliers	0.59	0.71
2. Good personal guanxi with key buyers/customers	0.80	0.92
3. Good personal guanxi with key distributors	0.62	0.54
<i>Guanxi with government officials</i>		
China: $\alpha=0.81$, AVE=0.81, HSV=0.25		
Hong Kong: $\alpha=0.92$, AVE=0.74, HSV=0.09		
1. Good personal guanxi with relevant key government officials	0.85	0.91
2. Good personal guanxi with officials in relevant business bureaus (e.g., Commerce and Industry Bureau, Trade and Industry Dept.)	0.83	0.90
<i>Financial and market performance</i>		
China: $\alpha=0.89$, AVE=0.81, HSV=0.44		
Hong Kong: $\alpha=0.91$, AVE=0.72, HSV=0.43		
1. Overall profit levels achieved	0.81	0.82
2. Profit margins achieved	0.80	0.84
3. Return on investment	0.80	0.84
4. Sales volume achieved	0.84	0.75
5. Market share achieved	0.78	0.72
6. Shareholder satisfaction with financial performance	0.72	0.79
<i>Corporate social performance</i>		
China: $\alpha=0.83$, AVE=0.70, HSV=0.44		
Hong Kong: $\alpha=0.83$, AVE=0.69, HSV=0.43		
1. Levels of customer satisfaction achieved	0.57	0.66
2. Levels of customer loyalty achieved	0.78	0.64
3. Levels of employee satisfaction with their jobs	0.79	0.75
4. Levels of employee retention	0.78	0.72
5. Providing employment and income locally	0.72	0.77

Measurement model, model fit indices:

China data alone: $\chi^2(215)=314.91$, $p<0.001$, $\chi^2/\text{d.f.}=1.46$, RMSEA=0.05, GFI=0.87, CFI=0.95.

Hong Kong data alone: $\chi^2(215)=297.16$, $p<0.001$, $\chi^2/\text{d.f.}=1.38$, RMSEA=0.05, GFI=0.88, CFI=0.96.

Multiple group analyses model fit indices:

Model A (six key constructs; same factor structure across China and Hong Kong): $\chi^2(430)=612.07$, $p<0.001$, $\chi^2/\text{d.f.}=1.42$, RMSEA=0.04, GFI=0.87, CFI=0.96.

Model B (six key constructs; same factor structure and equal factor loadings across China and Hong Kong): $\chi^2(447)=637.72$, $p<0.001$, $\chi^2/\text{d.f.}=1.43$, RMSEA=0.04, GFI=0.87, CFI=0.95.

Note. AVE=average variance extracted; HSV=highest shared variance with other constructs. All factor loadings are significant at the 0.01 level.

1 stood for "Much lower than competitors" and 5 stood for "Much higher than competitors".

Guanxi. Measures of the two forms of social capital (guanxi with government officials and guanxi with other managers) were adapted from Park and Luo (2001) and Peng and Luo (2000). Their items were originally designed for use in mainland China. We

made a few adaptations so that the items could be used in both Hong Kong and mainland China. We came up with five items, three for measuring guanxi with managers at other firms and two for measuring guanxi with relevant government officials. The respondents indicated whether they and their managers had good and strong personal guanxi with the individuals, as specified in the

items, on a five-point Likert scale, where 1 stood for "Strongly disagree" and 5 stood for "Strongly agree".

Business performance. Business performance was measured with 11 items adapted from Greenley and Foxall (1997, 1998). The respondents were asked to compare themselves with their main competitors in the last financial year, and to respond on a five-point Likert scale, where 1 stood for "Much worse than competitors" and 5 stood for "Much better than competitors". These 11 items covered two major areas of business performance: financial and market performance, and corporate social performance. While financial and market performance has been widely used in past research (e.g., Park & Luo, 2001), corporate social performance is relatively new. Defining company performance in terms of financial and market performance reflects only the perspective of the shareholders. The perspectives of other relevant stakeholders should also be taken into account (Chakravarthy, 1986; Clarkson, 1995). Assessing both areas of performance gives a more comprehensive view of the company's strengths. According to Clarkson (1995), corporate social responsibility includes the promotion of customer and employee welfare. The items measuring corporate social performance were designed with reference to this responsibility.

These subjective performance measures helped us avoid the problems associated with objective performance measures in transition economies, including non-standard financial reporting, failure in the enforcement of financial reporting legislation, inflation or devaluation of local currencies, and widespread use of barter (Hoskisson, Eden, Lau, & Wright, 2000). However, there might have been the risk of common method bias. Nevertheless, our hypotheses are concerned with interaction effects, which common method bias can scarcely explain (e.g., Luk et al., 2005). Whenever possible, we also tried to obtain from the respondent the firm's profit before tax in the last financial year. Only 72 respondents from China and 71 respondents from Hong Kong were willing to give us this figure.

Control variables. Following Peng and Luo (2000), we included industry type, ownership type, firm size, and industry growth rate as control variables. Two dummies were created to code industry type. The first dummy (Industry Type 1) contrasts consumer durable goods (1) with fast-moving consumer goods plus industrial goods (0). The second

dummy (Industry Type 2) contrasts fast-moving consumer goods (1) with consumer durable goods plus industrial goods (0). Although our classification of the manufacturers into three types is not as fine-grained as the SIC, it was sufficient for our research because the hypothesized effects were not likely to vary across different types of manufacturing. For example, the effects of product/service quality, ties with managers at other firms and ties with government officials were quite similar in the manufacturing and service sectors (Peng & Luo, 2000), two sectors that are supposed to be widely discrepant. Similarly, in Wiklund and Shepherd (2003), the effects of entrepreneurial orientation, which includes innovativeness, were constant whether the sector was manufacturing, retailing, or service. Different types of manufacturing are arguably more homogeneous than are manufacturing and service. Thus the effects of type of manufacturing in our study should be negligible. Moreover, the variance due to industry type could be partially captured by another control variable, industry growth rate (Peng & Luo, 2000).

Regarding ownership type, we followed Park and Luo (2001) and combined the collective and private companies into one group of non-state-owned companies, because the distinctions between these two types were blurred (Nee, 1992). The respondents were asked to estimate the number of employees in their companies by choosing one of seven options: "Less than 20", "20–99", "100–299", "300–499", "500–999", "1000–4999", and "More than 5000". These seven options were coded as 1 to 7 respectively. Manufacturers in mainland China ($M=4.59$, $s.d.=2.12$) were significantly larger than those in Hong Kong ($M=2.59$, $s.d.=2.30$); $t(390)=8.96$, $p<0.001$. To measure industry growth rate, we followed Luk et al. (2005) and asked the respondents to indicate whether their main industries were (1) newly emerging, (2) established but growing, (3) mature, showing little signs of change, or (4) declining. A higher value on this scale reflects a higher level of maturity and a slower rate of growth. The Hong Kong manufacturers considered their industries to be more mature (Hong Kong: $M=2.95$, $s.d.=0.76$; China: $M=2.44$, $s.d.=0.67$; $t(390)=6.99$, $p<0.001$), reflecting the longer history of industrial development in Hong Kong.

Measuring institutional contexts. Seven items were included to ascertain whether the respondents perceived their institutional contexts in the way we expected. We designed two items to measure the

emphasis on relational networks: "In our marketing, great emphasis is placed on building long-term relationships with key suppliers", and "In our marketing, great emphasis is placed on building long-term relationships with other organizations and institutions that influence buyers' purchasing decisions". Five items were taken from Greenley and Foxall (1997, 1998) to measure the level of market competition: "Customers are increasingly demanding better quality and reliability in the products and services they buy", "Customer wants, needs, and expectations are changing rapidly", "New products and services are coming to market more quickly than in the past", "Competition is now global rather than just domestic", and "There is a significant threat that new firms will enter the market". The respondents were required to indicate how much they agreed with these statements on a five-point Likert scale, where 1 stood for "Strongly disagree" and 5 stood for "Strongly agree".

The back-translation procedure was used to prepare the Chinese version of the questionnaire items. The questionnaires administered in mainland China were printed in simplified Chinese characters, and the questionnaires administered in Hong Kong were printed in traditional Chinese characters. Otherwise, the two versions were the same.

Scale Dimensionality, Validity, and Reliability

We followed Anderson and Gerbing's (1988) two-step approach to examine the validity of the six key variables measured by the items listed in Table 1. First, we ran exploratory factor analyses (EFA) on all the items shown in Table 1 and checked the threat of common method variance using the Harman one-factor test (Podsakoff & Organ, 1986). Six factors emerged with eigenvalues over unity, together accounting for 69.05% of the total variance. The first factor accounted for 30.34% of the total variance in the unrotated solution. Grouping of the items was exactly in line with our expectation. We then repeated the EFA without the 11 performance items. Four factors emerged, accounting for 72.46% of the total variance. The first factor accounted for 29.92% of the total variance in the unrotated solution. Grouping of the items remained unchanged. Since one general factor could not explain the majority of the total variance, the threat of common-method variance was not serious.

As the second step, we performed a series of confirmatory factor analyses (CFA). The results of

the CFAs and the standardized factor loadings associated with the items are displayed in Table 1. All Cronbach alphas were acceptable, ranging from 0.70 to 0.92, and all average variances extracted (AVE) exceeded 0.50. The measurement model fitted both the China data and the Hong Kong data (see Table 1). Then we ran two multiple group analyses, one with the constraint of invariance of factor structure (Model A) and the other with the constraints of invariance of factor structure as well as invariance of factor loadings (Model B) across the two data sets, to examine the extent to which the measurement model holds simultaneously in China and Hong Kong. Model B did not lead to significant deterioration compared with Model A (increase in $\chi^2=25.65$, increase in d.f.=17, n.s.). Thus the factor structure and the factor loadings were the same in the two samples. Table 1 also shows that the highest shared variance that each scale had was always smaller than its AVE, attesting to the discriminant validity of the scales.

RESULTS

The zero-order correlations among the six key variables, profit before tax, the control variables, and their descriptive statistics are displayed in Table 2. Ownership type (state-owned versus non-state-owned) is not significantly correlated with any of the performance variables, and was omitted from the subsequent multiple group analyses.

Ascertaining the Institutional Contexts

The two items measuring emphasis on relational networks were averaged to form a composite score and the five items measuring level of market competition were averaged to form another composite score. As expected, mainland China ($M=4.08$, $s.d.=0.52$) scored significantly higher than Hong Kong ($M=3.76$, $s.d.=0.63$; $t(389)=5.40$, $p<0.001$) on the emphasis on relational networks, whereas Hong Kong ($M=4.07$, $s.d.=0.51$) scored significantly higher than mainland China ($M=3.95$, $s.d.=0.49$; $t(390)=2.29$, $p<0.05$) on the level of market competition.

Hypothesis Testing

Modeling the direct effects on performance only. We used simultaneous multiple group path analysis with structural equation modeling to test Hypotheses 1, 2, 3, 4, and 6. Starting with Model B (the measurement model that imposed invariance of factor structure and invariance of factor loadings

Table 2 Correlation matrices and descriptive statistics

	(1) Finan Perf	(2) Socia Perf	(3) Profit	(4) Admin Innova	(5) Product Innova	(6) Managers	(7) Officials	(8) SOE	(9) Size	(10) Industry Growth	(11) Industry Type 1	(12) Industry Type 2
Mean	3.65	3.69	1926.47	3.67	3.63	3.91	3.45	—	4.59	2.44	—	—
s.d.	0.60	0.57	4161.73	0.59	0.65	0.51	0.69	—	2.12	0.67	—	—
(1)		0.60** (179)	0.24* (72)	0.19* (183)	0.20** (183)	0.18* (183)	0.24** (183)	−0.06 (183)	0.15* (183)	−0.16* (183)	−0.04 (188)	−0.04 (188)
(2)	0.59** (184)		0.07 (72)	0.16* (180)	0.20** (180)	0.25** (180)	0.27** (180)	−0.10 (180)	0.03 (180)	−0.12 (180)	0.02 (185)	−0.01 (185)
(3)	0.18 (67)	0.01 (69)		0.17 (72)	−0.06 (72)	0.00 (72)	0.10 (72)	−0.13 (72)	0.44** (72)	0.13 (72)	−0.11 (72)	−0.16 (72)
(4)	0.22** (189)	0.18* (191)	−0.04 (71)		0.23** (184)	−0.07 (184)	0.14 (184)	0.01 (184)	−0.08 (184)	−0.02 (180)	0.09 (184)	0.06 (184)
(5)	0.25** (189)	0.35** (191)	0.14 (71)	0.26** (196)		0.10 (184)	0.05 (184)	−0.21** (184)	0.01 (184)	−0.01 (184)	−0.02 (189)	0.03 (189)
(6)	0.10 (189)	0.18* (191)	−0.02 (71)	0.12 (196)	0.25** (196)		0.44** (184)	−0.02 (184)	−0.01 (184)	0.08 (184)	0.01 (189)	−0.00 (189)
(7)	0.21** (189)	0.21** (191)	0.25* (71)	0.20** (196)	0.19** (196)	0.42** (196)		0.09 (184)	0.11 (184)	−0.01 (184)	−0.05 (189)	0.15* (189)
(8)	— (189)	— (191)	— (71)	— (196)	— (196)	— (196)	— (196)		0.14 (184)	0.12 (184)	0.00 (189)	0.16* (189)
(9)	0.12 (189)	−0.004 (191)	0.27* (71)	−0.05 (196)	−0.09 (196)	0.05 (196)	0.15* (196)	— (196)		0.01 (184)	−0.01 (189)	−0.09 (189)
(10)	−0.28** (189)	−0.15* (191)	−0.03 (71)	−0.11 (196)	0.02 (196)	−0.14* (196)	−0.22** (196)	— (196)	−0.17* (196)		−0.07 (189)	0.03 (189)
(11)	−0.04 (195)	0.04 (197)	−0.05 (71)	−0.03 (197)	−0.03 (202)	−0.04 (203)	0.03 (203)	— (203)	−0.12 (203)	−0.02 (203)		−0.34** (189)
(12)	0.03 (195)	0.01 (197)	0.09 (71)	0.10 (197)	0.08 (202)	−0.02 (203)	−0.10 (203)	— (203)	0.14* (203)	0.06 (203)	−0.29** (203)	
Mean	3.06	3.26	822.48	3.63	3.41	3.54	2.33	—	2.59	2.95	—	—
s.d.	0.68	0.55	1816.63	0.70	0.59	0.84	1.20	—	2.30	0.76	—	—

Note. The mainland China sample is above and the Hong Kong sample is below the diagonal. Sample sizes are in brackets. Finan Perf=Financial and Market Performance; Socia Perf=corporate social performance; Profit=profit before tax (in unit of 10,000 local currency: Renminbi for the mainland China sample and Hong Kong dollar for the Hong Kong sample); Admin Innova=administrative innovativeness; Product Innova=product-related innovativeness; Managers=guanxi with other managers; Officials=guanxi with government officials; SOE=ownership type (1=state-owned and 0=non-state-owned); Size=firm size; Industry Growth=industry growth rate; Industry Type 1=consumer durables (1) vs all others (0); industry type 2=fast-moving consumer goods (1) vs all others (0).

*p<0.05, **p<0.01, two-tailed tests.

across the two economies), we estimated a model (Model C) in which the two latent performance variables were simultaneously regressed onto the control variables (except ownership type), the two latent innovativeness variables, and the two latent social capital variables ($\chi^2=896.30$, d.f.=583, $p<0.001$, $\chi^2/\text{d.f.}=1.54$, RMSEA=0.04, GFI=0.85, CFI=0.93).

Modeling the effects of social capital on innovativeness. To model innovativeness as the link between social capital and performance, we next constructed Model D by adding to Model C the four effects of social capital on innovativeness ($\chi^2=941.94$, d.f.=601, $p<0.001$, $\chi^2/\text{d.f.}=1.57$, RMSEA=

0.04, GFI=0.85, CFI=0.92). Table 3 shows the unstandardized structural coefficients for each path of Model D. Model D fits the data less well than Model C (χ^2 change=45.64, d.f. change=18, $p<0.01$) because some of the added effects are not significant (i.e., Path 17 and Path 20 in both economies, Path 18 in Hong Kong, and Path 19 in China). To test which paths in Table 3 are significantly different in the two economies, we used the data-analytic strategy recommended by Jaccard and Wan (1996). If constraining the structural coefficients of a path to be equal across the two economies results in a significant deterioration in overall model fit (i.e., χ^2 increase ≥ 3.84 for one degree of freedom at the 0.05 level), the

Table 3 Results of path analysis by structural equation modeling (Model D)

Paths	Mainland China (N=179)		Hong Kong (N=184)	
	Structural coefficients	t	Structural coefficients	t
<i>Effects on business performance</i>				
1. Industry growth rate→Financial and market performance	−0.18	−2.93**	−0.20	−3.04**
2. Firm size→Financial and market performance	0.04	1.88	0.03	1.38
3. Industry type 1→Financial and market performance	−0.11	−1.17	−0.02	−0.23
4. Industry type 2→Financial and market performance	−0.12	−1.10	0.02	0.12
5. Administrative innovativeness→Financial and market performance	0.25 (H1)	2.57**	0.14	1.61
6. Product-related innovativeness→Financial and market performance ^a	0.17	2.41*	0.44 (H2)	4.25**
7. Guanxi with other managers→Financial and market performance ^b	0.32 (H6)	1.95*	−0.07	−0.81
8. Guanxi with government officials→Financial and market performance	0.13	1.34	0.05	1.05
R ² for Financial and market performance	26.0%		26.4%	
9. Industry growth rate→Corporate social performance	−0.09	−1.98*	−0.04	−1.02
10. Firm size→Corporate social performance	0.00	0.27	0.01	0.50
11. Industry type 1→Corporate social performance	−0.03	−0.36	0.03	0.43
12. Industry type 2→Corporate social performance	−0.05	−0.59	−0.05	−0.62
13. Administrative innovativeness→Corporate social performance	0.15 (H1)	2.18*	0.10	2.00*
14. Product-related innovativeness→Corporate social performance ^a	0.09	1.76	0.26 (H2)	4.27**
15. Guanxi with other managers→Corporate social performance ^a	0.32 (H6)	2.59**	0.03	0.53
16. Guanxi with government officials→Corporate social performance	0.08	1.15	0.01	0.22
R ² for Corporate social performance	24.2%		26.7%	
<i>Effects on organizational innovativeness</i>				
17. Guanxi with other managers→Administrative innovativeness	−0.24	−1.58	0.10	1.17
18. Guanxi with government officials→Administrative innovativeness	0.22 (H3)	2.58**	0.07	1.62
R ² for Administrative innovativeness	6.4%		3.8%	
19. Guanxi with other managers→Product-related innovativeness	0.20	0.97	0.23 (H4)	2.56**
20. Guanxi with government officials→Product-related innovativeness	0.02	0.15	0.09	1.86
R ² for Product-related innovativeness	1.6%		11.4%	

Note. The hypothesis numbers are shown to the right of the relevant structural coefficients. The structural coefficients are unstandardized.

* $p < 0.05$, ** $p < 0.01$, two-tailed tests.

^aThe path has significantly different values in the two economies, $p < 0.05$.

^b $p = 0.06$.

magnitudes of the path in the two economies are different. The sizes of the significant effects reported below range from 0.19 to 0.43, which according to Cohen's (1988) standards are small to medium. Effect sizes in this range are reasonable because successful business performance depends on many factors. We have selectively focused on only a small subset of those factors.

Effects of innovativeness on performance. Consistent with Hypothesis 1, Path 5 (administrative innovativeness→financial and market performance) and Path 13 (administrative innovativeness→corporate social performance) are significant in China but not in Hong Kong. Standardized effect

sizes of Path 5 and Path 13 in China are 0.21 and 0.19, respectively, and in Hong Kong are 0.12 and 0.16, respectively. However, the strengths of these two paths are not significantly different across the two economies (χ^2 increases=0.67 and 0.39 for Path 5 and Path 13, respectively). Consistent with Hypothesis 2, Path 6 (product-related innovativeness→financial and market performance) and Path 14 (product-related innovativeness→corporate social performance) are significantly stronger in Hong Kong than in China. It should be noted that Path 6 is also significant in China. Standardized effect sizes of Path 6 and Path 14 in Hong Kong are 0.38 and 0.43, respectively, and in China are 0.19 and 0.15, respectively. The strengths of these two

paths are significantly different across the two economies (χ^2 increases=4.20 and 4.36 for Path 6 and Path 14, respectively).

Solidarity benefit of social capital. Consistent with Hypothesis 6, Path 7 (guanxi with other managers $\rightarrow$ financial and market performance) and Path 15 (guanxi with other managers $\rightarrow$ corporate social performance) are significant in China but not in Hong Kong. Standardized effect sizes of Path 7 and Path 15 in China are 0.19 and 0.29, respectively, and in Hong Kong are 0.04 and 0.17, respectively. The difference of the magnitudes of Path 7 is marginally significant across the two economies (χ^2 increase=3.43, $p=0.06$). The strength of Path 15 is significantly different across the two economies (χ^2 increase=4.18).

Information benefit of social capital for innovativeness. Hypotheses 3 and 4 are concerned with the effects of social capital on organizational innovativeness. The lower section of Table 3 presents the relevant results. Consistent with Hypothesis 3, Path 18 (guanxi with government officials $\rightarrow$ administrative innovativeness) is significant in China but not in Hong Kong. The standardized effect size of Path 18 in China is 0.29, and in Hong Kong is 0.14. However, the strength of this path is not significantly different across the two economies (χ^2 increase=2.46). Consistent with Hypothesis 4, Path 19 (guanxi with other managers $\rightarrow$ product-related innovativeness) is significant in Hong Kong but not in China. The standardized effect size of Path 19 in Hong Kong is 0.24, and in China is 0.12. However, the strength of this path is not significantly different across the two economies (χ^2 increase=0.02).

Influence benefit of social capital for innovativeness. Hypothesis 5 involves the interactions between two continuous variables. To test it, we followed Jaccard and Wan's (1996) advice and used traditional moderated regression analysis. We used the composite scores of the six key variables, and mean-centered the independent variables. Two moderated regression analyses were performed: one on financial and market performance and the other on corporate social performance. Table 4 presents the results of these two moderated regression analyses. All variance inflation factors are below 3.5, indicating no threat of multicollinearity. The focus of the analyses was on the three-way interactions among guanxi with managers at other firms, organizational

innovativeness, and institutional context. Therefore we entered all main effects and two-way interactions in the first step, and the relevant three-way interactions in the second step. Consistent with Hypothesis 5, the additional variance explained by the three-way interaction among guanxi with managers at other firms, administrative innovativeness, and institutional context is significant for both dependent variables.

To interpret the significant three-way interactions that are consistent with Hypothesis 5, we substituted the values of zero and one into the dummy variable of institutional context to represent Hong Kong and China, respectively. With respect to financial and market performance, the regression weights of the two-way interaction between administrative innovativeness and guanxi with managers at other firms become -0.01 ($\beta=-0.01$, $t=-0.13$, n.s.) for Hong Kong and 0.41 ($\beta=0.27$, $t=2.59$, $p<0.01$) for China. The amounts of variance accounted for by this two-way interaction are 0% in Hong Kong and 3.8% in China. With respect to corporate social performance, the regression weights are -0.02 ($\beta=-0.01$, $t=-0.23$, n.s.) for Hong Kong and 0.43 ($\beta=0.33$, $t=3.14$, $p<0.01$) for China. The two-way interaction accounts for only 0.1% of the variance in Hong Kong, but 4.7% in China. Next, we applied Aiken and West's (1991) plotting technique plus the simple slope analysis to probe the three-way interaction. The relationship between administrative innovativeness and financial and market performance was plotted in Figure 3 at high (one s.d. above mean) and low (one s.d. below mean) levels of guanxi with managers at other firms separately for China and Hong Kong. Simple slope analysis shows that the relationship is significant only in China on condition that guanxi with managers at other firms is good: $\beta=0.31$, $t=2.80$, $p<0.01$. A similar pattern is evident in Figure 4. Simple slope analysis shows that the effect of administrative innovativeness on corporate social performance is significant only in China on condition that good guanxi with managers at other firms is good: $\beta=0.38$, $t=3.38$, $p<0.001$. Thus Hypothesis 5 was supported.

Profit before tax as dependent variable. The above analyses were repeated with profit before tax as the dependent variable. The patterns of the results were similar to those reported above, although the levels of statistical significance were much lower than before owing to the reduced sample sizes.

Table 4 Results of moderated regression analyses for testing Hypothesis 5

Variables	Financial and market performance (N=372)		Corporate social performance (N=371)	
	Model 1	Model 2	Model 3	Model 4
Constant	3.17**	3.17**	3.32**	3.33**
<i>Step 1</i>				
Ownership type	−0.04	−0.08	−0.09	−0.13
Firm size	0.04*	0.04*	0.00	0.00
Industry growth rate	−0.20**	−0.22**	−0.10**	−0.13**
Industry type 1	−0.05	−0.05	0.04	0.05
Industry type 2	−0.04	−0.02	−0.01	0.01
Administrative innovativeness	0.17*	0.15*	0.06	0.05
Product-related innovativeness	0.32**	0.32**	0.32**	0.32**
Guanxi with other managers	−0.05	−0.03	0.03	0.03
Guanxi with government officials	0.06	0.05	0.02	0.03
Guanxi with other managers × administrative innovativeness	0.07	−0.01	−0.03	−0.03
Guanxi with other managers × product-related innovativeness	0.09	0.15	0.07	0.08
Guanxi with government officials × administrative innovativeness	0.05	0.05	0.08	−0.02
Guanxi with government officials × product-related innovativeness	0.10	0.10	0.01	−0.03
Institutional context	0.29**	0.32**	0.22**	0.23**
Administrative innovativeness × institutional context	−0.06	−0.09	0.06	0.00
Product-related innovativeness × institutional context	−0.27*	−0.27*	−0.25*	−0.28*
Guanxi with other managers × institutional context	0.21	0.16	0.08	0.07
Guanxi with government officials × institutional context	0.05	0.03	0.20	0.13
<i>Step 2</i>				
Guanxi with other managers × administrative innovativeness × institutional context		0.41*		0.45**
Guanxi with other managers × product-related innovativeness × institutional context		−0.17		0.09
Model statistics: R^2 of equation	0.33	0.34	0.26	0.28
ΔR^2	0.33	0.01	0.26	0.02
d.f.s of ΔR^2	18,353	2,351	18,352	2,350
ΔF	9.56**	3.04*	6.93**	4.79**

Note. Ownership type was dummy-coded such that 0 stood for non-state-owned companies and 1 stood for state-owned enterprises. Institutional context was dummy-coded such that 0 stood for Hong Kong and 1 stood for mainland China. All independent variables except institutional context were mean-centered.

* $p < 0.05$, ** $p < 0.01$, two-tailed tests.

DISCUSSION

Our hypotheses are generally supported by the data. Although the effects are of small to medium sizes, the overall pattern of the effects is impressive. The effects of social capital are more pervasive in a transition economy than in a market economy. In this general picture, we have additionally uncovered how different forms of social capital and different types of organizational innovativeness interact to support business performance in the two institutional contexts. In the market economy of Hong Kong, competitiveness is driven primarily by product-related innovativeness, which in turn is enhanced by guanxi with managers at other firms.

The picture is more complicated in the transition economy of China. The drivers of business performance include both administrative innovativeness and product-related innovativeness. Guanxi with government officials enhances administrative innovativeness, while guanxi with managers at other firms enhances the effectiveness of administrative innovativeness. Having good guanxi with managers at other firms also directly enhances business performance in the transition economy. This more complicated picture in China can be attributed to the institutional factors of

- (1) inefficiency in operation and allocation of productive resources;

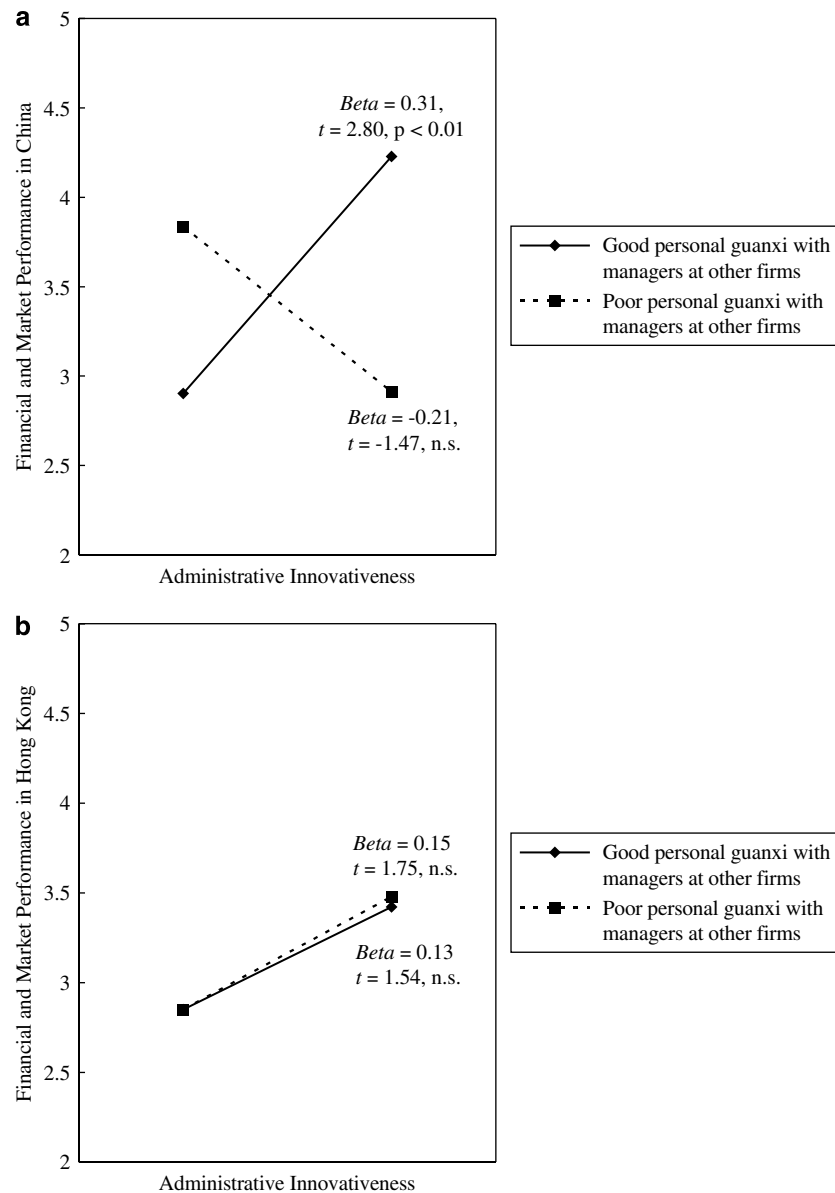


Figure 3 Interaction effect between administrative innovativeness and guanxi with managers at other firms on financial and market performance: (a) mainland China; (b) Hong Kong.

- (2) government involvement in business planning; and
- (3) institutional voids.

These factors are the legacy of its central planning era.

Implications for Social Capital Theory

In this research, we focus on the informal social capital of guanxi. Past studies on social capital in the West focused largely on formal interfirm networks (e.g., Ahuja, 2000; Geletkanycz & Hambrick,

1997; Hall & Soskice, 2001). Informal personal relationships have received far less attention. In neoclassical economics, it might be argued that informal personal relationships should not be formed in a market economy because they are irrational and compromise market efficiency. The spirit of the antitrust law in the US appears to be consistent with this argument. However, informal personal relationships matter in reality, including in the freest market economy in the world. It is erroneous to assume that market mechanisms would automatically exclude all informal personal

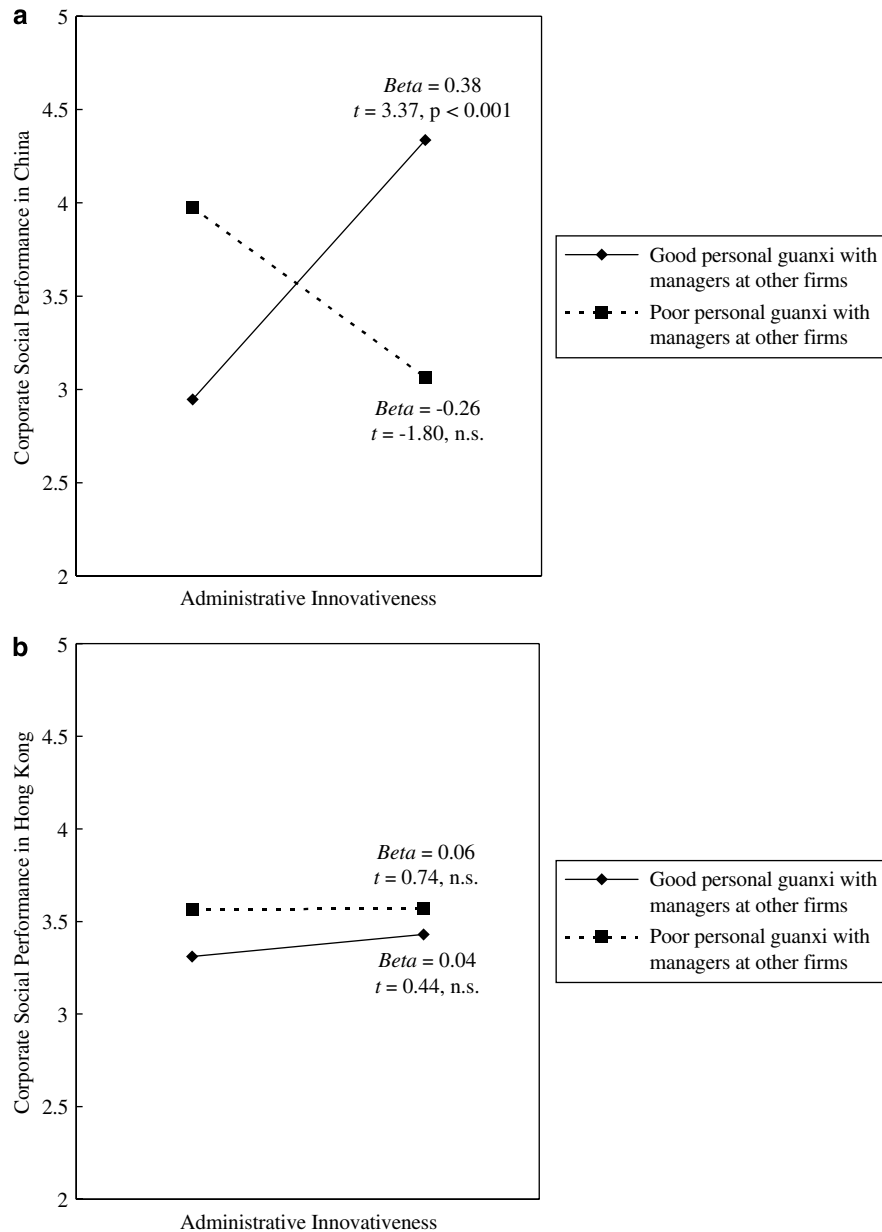


Figure 4 Interaction effect between administrative innovativeness and guanxi with managers at other firms on corporate social performance: (a) mainland China; (b) Hong Kong.

relationships from the market. Our research calls for a formal treatment of informal personal relationships under the social capital theoretical framework. The more appropriate questions to ask are: How does the institutional context shape the use of informal personal relationships? How do informal personal relationships complement or clash with formal interfirm contractual relationships?

The pattern of the effects of guanxi with managers at other firms is intriguing. In a market

economy, informal social capital only provides the information benefit leading to product-related innovativeness, a benefit that is more consistent with the views of Coleman (1988) and Putnam (2000). Social capital as a source of information is benign. It can enhance the overall efficiency or effectiveness of the firms using it, and may benefit the society at large by facilitating the development of innovative products and services. Therefore this use of social capital is permissible under the

National Cooperative Research Act of 1984 (Parkhe, 1991). Our research shows that informal *guanxi* is an option when neither market nor hierarchy can effectively reduce transaction costs. This would be especially true for the development of radical innovations that are highly uncertain and costly. Informal personal relationships are flexible and unobtrusive, and may provide facilitative effects that are economically efficient.

In a transition economy, informal *guanxi* with managers at other firms provides the solidarity benefit that directly enhances performance and the influence benefit that strengthens the innovativeness–performance link. These two benefits are consistent with Bourdieu's (1984, 1986) view of social capital as a “club good”. Both are based on preferential treatments that favor the “ingroupers” regardless of their capabilities. Social capital as a “club good” is malignant because it cultivates particularized trust and creates social inequality that can be harmful to members of the wider society (Field, 2003).

The relationship between *guanxi* with government officials and administrative innovativeness reflects the legacy of the central planning era, but it may also be the driver that has contributed to China's international competitiveness in the last two decades (e.g., Buck et al., 2000; Walder, 1995). Perhaps the government officials are themselves driven by their economic interests and are motivated to promote economic prosperity under their jurisdictions (e.g., Thun, 2006; Walder, 1995). Government involvement is common, and perhaps essential, in the early stage of economic development (Mytelka, 1999). However, whether in the long run government involvement benefits the country as a whole is a complicated question. It depends on the skills and moral integrity of the government officials, as well as on the quality and content of their involvement (Mytelka, 1999). Without the control of formal regulations, government involvement may easily turn into favoritism and corruption (e.g., Sun, 2004). Given these observations, the next question is why a particular institutional context breeds the benign or the malignant effects of social capital.

Implications for Institutional Theory

Peng (2002, 2003) put forward the general proposition that relationship-based strategies are more prevalent in a transition economy than in a market economy. Our research goes one step further and shows that the institutional context of a market

economy tends to breed the more benign form of social capital, whereas that of a transition economy tends to breed the more malignant form of social capital. In Hong Kong, market competition is maintained by the openness of its markets (both factor and consumer) and the complementary market-supporting institutions (e.g., laws against corruption, property rights laws, transparent accounting standards, rules of financial disclosure, and independent law-enforcing bodies). Furthermore, there are formal regulations and informal norms that prevent government officials from interfering with the legal operations of firms. These appear to be sufficient conditions for limiting the use of social capital in the benign zone. Put simply, market competition and market-supporting institutions are favorable to ethical business practices. If formal rules are effectively implemented to rule out corruption, informal *guanxi* with managers at other firms could exist without hurting overall competitiveness.

By the same token, the malignant effects of social capital in transition economies may be attributed to their institutional voids. These institutional voids are due to the absence of market openness as well as the absence of market-supporting institutions. There is also a lack of adequate constraints on the behaviors of government officials. The implication is that policymakers in transition economies should fill the institutional voids. Of course, this is easier said than done because policymakers are limited by their own path dependencies.

To account for the emphasis on informal personal relationships in transition economies, Boisot and Child (1988, 1996) and Hitt et al. (2002) favored the cultural explanation. However, the transition economies they studied have widely different cultural backgrounds, yet are similarly reliant on informal social capital. Our study of two economies with the same cultural background has identified different patterns in the use of informal social capital. Thus culture seems to be less able than institutional context to explain variations in the use of informal social capital. Yet we acknowledge that culture and institutional context are to a certain extent related. An institutional context is shaped by many factors, including culture, geographical location, living standards, the political system, ideological development, technological advances, foreign relations, and the global-level institutional context that determines how countries behave. Some of these factors are under the control of some people, but many are beyond the



voluntary control of any actor. For example, the market economy of Hong Kong is the result of Chinese culture, historical events that occurred some 170 years ago, and the current international political landscape. Culture seems to be only a small part of the story.

What is the future of transition economies? Will they all converge to the same form of market economy after institutional changes? A complete convergence seems to be unlikely. Variations exist even among capitalist countries (Hall & Soskice, 2001). According to Boisot and Child (1996) China, limited by its path dependency, is transforming from a fief to a clan rather than to a market economy. The clan, a type of network capitalism, is also different from coordinated market economies to the extent that implicit personal relationships rather than formal relational contracting are used as the guiding principle. However, judging from the experience of Hong Kong, we suspect that the stickiness of tradition and path dependence is not unbreakable. Twists and turns in institutional changes have been brought about by external forces. Market competition imposed by international trade and supranational bodies such as the WTO might in the long run lead to the establishment of more efficient market mechanisms in China. On the other hand, firms from market economies are having an increasingly extensive and intensive presence in transition economies. It is possible that they will adopt some of the characteristics of transition economies and thus make heavier use of informal personal relationships.

Managerial Implications

Market orientation has been found to be a driver of administrative and technical innovations (Han et al., 1998). Our findings suggest that other stakeholders, such as business partners in a market economy and government officials in a transition economy, can also provide useful information for innovativeness. Managers at other firms and government officials serve different functions, and so *guanxi* with both groups is uniquely useful, highlighting the benefits of a heterogeneous social network. According to the concept of information non-redundancy (McEvily & Zaheer, 1999), the information provided by government officials is different from that provided by managers at other firms. However, in a transition economy, *guanxi* with government officials as a social capital should be used with caution. Manufacturers should refrain from engaging in corrupt activities, otherwise

organizational competitiveness can be hurt (Luo, 2002). It seems to be better to maintain a certain distance from government officials, and to treat them only as consultants with regard to new institutional changes and to how management processes can be innovated in response to these institutional changes.

Administrative innovativeness is more important in a transition economy than in a market economy, whereas product-related innovativeness is more important in a market economy than in a transition economy. We have found that product-related innovativeness is also a significant driver of business performance in the transition economy of China. Therefore, with the “catch-up” strategies of innovation (Mytelka, 1999), firms should simultaneously embrace administrative and product innovations. Our study has not identified the driver of product-related innovativeness in a transition economy. Perhaps administrative innovativeness also contributes to incremental product innovations (Benner & Tushman, 2003). Future research should explore this possibility.

Limitations and Future Research

One limitation of our research is that only one transition economy and one market economy were studied. Fortunately, as noted by Peng (2003), the characteristics of the transition economy of mainland China can be found in other transition economies such as Russia or the Eastern European countries. Future research may include other transition and market economies to replicate our findings. Second, future research should study how culture interacts with the institutional context to influence the benefits afforded by social capital. Certain industry- or market-level institutional forces may also have important impacts on the benefits of social capital. For example, as Peng and Luo (2000) hypothesized, interpersonal relationships may be more important in service industries than in manufacturing industries. Future research should further explore these issues. A finer-grained classification of industry types should also be used so that industry-level institutional forces can be discerned more easily. Finally, although our research design – a typical cross-sectional survey research design – is appropriate for comparative management research (Deshpande & Webster, 1989), future research could incorporate a longitudinal design so as to gain more insights into the dynamic nature of the business processes involved.

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