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Luo, Huiying ; Liu, Xiaohui; Wu, Aiqi; Zhong, Xiaotong

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Huiying Luo
School of Management
Zhejiang University
388 Yuhangtang Road, Hangzhou, Zhejiang Province
310058, P. R. China
Email: luohuiying@zju.edu.cn

Xiaohui Liu
Birmingham Business School
University of Birmingham
Edgbaston, Birmingham
B15 2TY, UK
Email: x.liu.1@bham.ac.uk

Aiqi Wu

School of Management
Zhejiang University
388 Yuhangtang Road, Hangzhou, Zhejiang Province
310058, P. R. China
Email: wuaiqi@zju.edu.cn

Xiaotong Zhong
School of Management
Zhejiang University
388 Yuhangtang Road, Hangzhou, Zhejiang Province
310058, P. R. China
Email: zhongxt@zju.edu.cn

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Abstract

This study explores the impact of local protectionism on outward foreign direct investment (OFDI) and how firms respond to local protectionism in a transition economy. We find that local protectionism exerts a negative effect on the OFDI decisions of Chinese privately-owned enterprises (POEs). However, this negative impact is weakened by POEs' corporate philanthropy strategy, whereas corporate political activity reinforces such an impact. This research extends the lens of institutional escapism by highlighting local protectionism as a barrier to OFDI and provides new insights into how firms respond to the subnational environment by adopting various nonmarket strategies.

Keywords: OFDI decisions; subnational governments; local protectionism; corporate philanthropy; corporate political activity; privately-owned enterprises

Introduction

A substantial increase in outward foreign direct investment (OFDI) from emerging economies (EEs) has drawn considerable attention from both academics and policy makers. The literature has recognized that OFDI by EE firms is driven by a variety of factors including firm characteristics, industry conditions and institutional forces (Li, Cui, & Lu, 2017; Liu, Gao, Lu, & Liuliou, 2016; Lu, Liu, & Wang, 2011; Luo & Tung, 2007; 2017; Meyer & Peng, 2016; Xie, Huang, Stevens, & Lebedev, 2019). While some studies have revealed the importance of home-country government support for firms' OFDI decisions (Arregle, Miller, Hitt & Beamish, 2016; Buckley, Clegg, Voss, Cross, Liu, & Zheng, 2018; Gaur, Ma, & Ding, 2018; Lu, Liu, Wright & Filatotchev, 2014; Wan & Hoskisson, 2003), others have found that some EE firms' OFDI is motivated by the desire to escape from an unfavorable domestic environment (Cui & Xu, 2019; Gaur, Kumar, & Singh, 2014; Huang, Xie, Li, & Reddy, 2016; Luo & Tung, 2017; Ma, Ding & Yuan, 2016; Shi, Sun, Yan, & Zhu, 2017). This type of escape OFDI is driven by political instability, policy uncertainty and an over-regulated domestic market (Barnard & Luiz, 2018; Stal & Cuervo-Cazurra, 2011), as well as ownership discrimination (Cuervo-Cazurra, Luo, Ramamurti, & Ang, 2018; Wu & Chen, 2014).

The extant literature assumes that firms have the freedom to escape from the home country successfully, without considering the institutional constraints imposed by the government directly and implicitly (Witt & Lewin, 2007). In particular, this line of inquiry has overlooked the interdependence between firms and subnational governments in transition economies, where firms and governments are intertwined, and subnational government intervention makes escape difficult. This missing aspect is highly relevant to privately-owned enterprises (POEs)

and largely limits our understanding of the heterogeneous role of subnational governments in firm internationalization. According to the institutional escaping view, POEs have a tendency to escape from an unfavorable environment through OFDI (Witt & Lewin, 2007). However, POEs' OFDI only accounts for a small proportion of China's total OFDI, namely 2.9% in 2012 and 6.9% in 2017, respectively. This suggests that POEs may encounter some institutional barriers to undertaking escape OFDI.

Relatedly, local protectionism is a widely adopted administrative instrument by subnational governments in transition economies, which can affect local firms' activities and strategies by controlling local resources (Young, 2000). Such political logic may intensify the dependence of these firms on local resources provided by the government, which reduces POEs' bargaining power and locks them in the focal region. However, few studies have examined the impact of local protectionism on OFDI by POEs. This omission largely constrains our understanding of the complexity of the subnational environment and the unique ways in which subnationalgovernments intervene in OFDI decisions.

Moreover, while extent research has argued that a nonmarket strategy is an effective approach affecting firms' internationalization (Ma et al., 2016; Meyer, et al., 2014), much research in this area has focused on the role of nonmarket strategies in host countries (Marano et al., 2016), including MNEs' corporate social responsibility (CSR) in emerging markets (Ertuna & Tukel, 2010), foreign-country entry modes (Meyer et al., 2014), CSR in export markets (Costa, Lages, & Hortinha, 2015), international diversification (Strike, Gao, & Bansal, 2006), subsidiaries' political strategies (Hillman, Keim, & Schuler, 2004) and corruption activities (Cuervo-Cazurra, 2016). However, little is known about the role of nonmarket

strategies, such as corporate political activity (CPA) and corporate philanthropy, in POEs' international decisions. In particular, there is a lack of research on how nonmarket strategies affect the relationship between the subnational government's intervention and firms' OFDI decisions.

To address the gaps identified above, we examine the following research questions in resource dependence logic (Pfeffer & Salancik, 1978). To what extent would local protectionism instrumented by the subnational government impede POEs' OFDI decisions? Will CPA strategy and corporate philanthropy strategy moderate the relationship between the subnational governments and POEs' OFDI decisions?

This study contributes to the literature on OFDI from transition economy firms in several ways. First, we enrich the institutional escaping lens by taking account of the interdependency between subnational governments and POEs. Subnational governments can set obstacles to POEs' escape OFDI rather than accommodating such investment behaviors. Underpinned by resource dependence theory (RDT), we identify the mechanism through which subnational governments intervene in firms' decisions. Our findings complement the existing literature by capturing the tension between the control exerted by the subnational government and POEs' tendency to escape, thus moving beyond the focus on the antecedents of firms' escaping behaviors (Witt & Lewin, 2007).

Second, this research deepens our understanding of environmental characteristics in transition economies by bringing in the concept of local protectionism to examine escape OFDI. Local protectionism reflects the essential role of a subnational government and represents a unique dimension of subnational government intervention in firm decisions. Examining its

impact enables us to go beyond existing research on the role of the home-country institutional environment by more directly capturing political environmental heterogeneity across regions.

Finally, the study extends the literature on nonmarket strategy to the OFDI decisions of POEs. The extant literature has overlooked the effect of CPA and corporate philanthropy on firms' decision making in the context of local protectionism (Jia & Mayer, 2015). We identify two types of nonmarket strategies as a means of altering the interdependence between POEs and the subnational government, and thus provide new insights into the boundary conditions for escape OFDI.

Research context: local protectionism in subnational China and POEs' OFDI

China, as a transition economy, has experienced continued economic reform and political decentralization. National laws and policies are often proposed by the central government, while the implementation is delegated to the regional administrations (Peng, 2002; Holtbrugge & Berg, 2004). However, the decentralized system can cause inevitable political tournaments and rent-seeking behaviors among officials in different provinces (Young, 2000). The central government evaluates subnational governments primarily according to the regional GDP-enhancing index, and thus subnational officials have a greater incentive to boost the regional economy in general, and promote the growth of local firms in particular (Bai et al., 2004). Local officials can win in the political tournament, and have the opportunity to be promoted, only if the regional economy grows rapidly. Thus, subnational governments tend to impose various administrative requirements on local firms' operations in order to achieve a high growth rate. The political tournament results in local protectionism (Gu, Zhang, Vaz, &

Mukwereza, 2016; Young, 2000).

Local protectionism hampers the free flow of products, labor and capital across regions, resulting in a relatively closed and less competitive subnational market (Rivera-Santos, Rufin, & Kolk, 2012). Meanwhile, local protectionism confines the outflow of local capital by attracting POEs to stay in the region (Bai et al., 2004). On the one hand, subnational governments can offer favored POEs key tangible resources, such as land and real estate, as well as intangible resources, namely localized knowledge, human resources or business opportunities (Li et al., 2003). They can also provide legitimacy for POEs in formal and informal ways, including granting licenses and permission (Wan & Hoskisson， 2003). On the other hand, local governments can control the financial channels and restrict the foreign currency exchanges which are crucial for firm survival and international expansion (Peng, 2002; Wang et al., 2012). Thus, subnational governments can influence regional competition through imposing local protectionism, thereby affecting POEs' decisions (Ioannou & Serafeim, 2012). In the context of local protectionism and the political tournament, POEs and subnational governments build up interdependent relationships based on mutual interests i.e. the 'growth coalition'. However, subnational governments hold more power as they have more control over resources (Casciaro et al., 2005).

It has been noted that subnational governments treat SOEs and POEs differently in many aspects, including firms' OFDI (Buckley et al., 2018; Zhao & Lu, 2016). Private enterprises that survive and develop under the dominance of SOEs are discriminated against by governments in some regions (Bai et al., 2004; Meyer & Thein, 2014). Subnational governments often support SOEs' OFDI by providing resources or preferential administrative

orders to obtain high scores in the political tournament (Palmer & Wiseman, 1999; Arregle et al., 2016). SOEs' internationalization is regarded as an important political achievement by the central government (Cui et al., 2012), whereas POEs' OFDI is usually regarded as capital outflow which may affect the local economy negatively (Li et al., 2003). Thus, POEs' OFDI decisions are more likely to be constrained by local protectionism.

Theoretical background

The fast-growing literature on the internationalization of EE firms has highlighted the impact of the home-country institutional environment on this group of MNEs (Buckley, et al., 2018; Cuervo-Cazura, et al., 2018; Cui and Jiang, 2012; Gaur, Kumar, and Singh, 2014; Lu et al., 2014; Luo, Xue, & Han, 2010; Luo & Tung, 2007; Wan and Hoskisson, 2003; Wang et al., 2012). One stream of the literature has proposed that underdeveloped or incompatible institutions at home push firms to escape through OFDI (Barnard and Luiz, 2018; Huang et al., 2016; Luo and Tung, 2017; Ma, Ding & Yuan, 2016; Shi et al., 2017; Witt & Lewin, 2007). For example, Stoian and Mohr (2015) assert that institutional and regulative voids in the home country, such as corruption and bureaucracy, promote OFDI by serving as a 'pushing hand' encouraging firms to avoid the competitive disadvantages rooted in the institutional environment. Some EMNEs escape home-country institutional voids by investing in tax havens in order to reduce the transparency of investments, leading at times to round-trip investments, aimed at benefiting from the incentives available to foreign investors in the home country (Cuervo-Cazurra et al., 2018). Direct state actions would also encourage large firms to adopt a more diversified strategy and a faster pace in internationalization (Finchelstein, 2017).

In addition, firms may use OFDI as a springboard to gain advanced technology, internationally recognized brands and valuable resources unavailable at home, and achieve desirable performance (Cui and Xu, 2019; Cui et al., 2017; Lu et al., 2011; Luo & Tung, 2007; 2017; Xie, et al., 2019). A more recent paper by Gaur et al. (2018) further examines the complex home-country environments and highlights government supportiveness and industry unfavorableness as potential drivers of the OFDI activities of Chinese firms. However, the existing research has overlooked the existence of a 'pulling hand', which may inhibit firms from undertaking OFDI (Meyer & Nguyen, 2005). More specifically, local protectionism may prevent POEs escaping from the local region through OFDI.

Resource dependence theory

RDT suggests that organizations are embedded in the external environment and depend on powerful external actors (e.g. individuals, firms, groups, governments) for key resources, such as financial capital, raw materials and legitimacy (Oliver, 1991; Pfeffer & Salancik, 1978). Reciprocally, external actors may also depend on the focal organizations for resources, thus creating interdependent relationships (Blumentritt, 2003). Pfeffer and Salancik (1978: p. 40) defined interdependence as a phenomenon that exists whenever one actor does not entirely control all of the conditions necessary for the achievement of an action, or for obtaining the outcome desired from the action. As resources are often distributed unevenly, a power imbalance may exist between the focal organization and the external actors (Casciaro & Piskorski, 2005). If the external actors control more key resources, they have more power over the actions and decisions of the focal organization (Choudhury & Khanna, 2014).

As a crucial resource holder, the government is a key external actor and can provide the focal organizations with monetary and/or physical resources, and information, as well as endorsing their social legitimacy (Choudhury & Khanna, 2014; Hillman et al., 2009). Thus, the government plays a vital role in affecting the extent to which firms gain access to the resources they need for survival and success in both developed countries and transition economies (Jia, 2014; Wang et al., 2012).

Firms' strategic responses to the subnational government

RDT scholars recognize the role of external factors in affecting organizational behavior and, in response, managers can act to reduce environmental uncertainty and counterbalance dependence (Hillman et al., 2009). Pfeffer and Salancik (1978) proposed that firms could minimize dependence by reducing the power of others while attempting to increase their own power. One effective approach to altering the power imbalance would be to restructure the source of a firm's resources in various ways (Xia et al., 2014). For example, organizations could seek alternative sources for their resources, or build up resource coalitions through strategic alliances and mergers, or vertical integration in the focal industry (Hillman et al., 2009).

Based on the logic of RDT, POEs need to develop proactive strategies to ensure access to external resources controlled by subnational governments. More specifically, CPA and corporate philanthropy can be adopted to manage the power imbalance between the government and POEs (Wang, Choi & Li, 2008). CPA is usually used to cope with less-than-ideal political factors and seek support from the political environment so as to obtain access to external resources (Deng, Yan, & Essen, 2018). This strategy is achieved by gaining influence

over political rules and regulations, as well as striving for preferential treatment from governments (Hillman et al., 2004). In such cases, firms obey instructions from the government, and in turn they rely on governments for crucial resources. However, CPA can be a double-edged sword which may strengthen the dependence and power imbalance, and therefore firms may lose their decision-making autonomy (Oliver, 1991; Pfeffer & Salancik, 1978).

Corporate philanthropy enables firms to enhance their reputation and establish close relationships with multiple stakeholders (Godfrey, 2005; Wang et al., 2008). Fiaschi, Giuliani, & Nieri (2017) propose that CSR helps emerging market firms to build legitimacy to overcome home-country liabilities in the context of international business. Adopting the philanthropy strategy, POEs can minimize their dependence on the subnational government and reduce the restrictions associated with local protectionism in the focal region (Wang, et al., 2008). Through engaging with other external stakeholders, firms may find alternative sources of resources and readdress the power imbalance with the government to gain more independence in decision making, including OFDI decisions (Xia et al., 2014). Treating local protectionism as a barrier to POEs' internationalization, we propose that CPA and corporate philanthropy can alter the interdependency between POEs and the subnational government, and hence indirectly affect their OFDI decisions.

Hypothesis development

Local protectionism and POEs' OFDI

RDT proposes that a power imbalance in an interdependent relationship enables the dominant actor to affect the power-disadvantaged one, and its actions (Casciaro & Piskorski, 2005; Choudhury et al., 2014). In a transition economy, especially in China, the government is

the most powerful actor (Young, 2000; Guar et al., 2018), and POEs have to take account of subtle pressure from governments when making strategic decisions (Cui & Xu, 2019). In addition, with the continuing decentralized political reforms in China, there are regional differences in the levels of provincial government control and protectionist policies (Li et al., 2003; Poncet, 2003). Such differences mean that firms locating in different provinces may encounter disparate opportunities and constraints associated with local protectionism for several reasons.

First, foreign exchange control can be used by subnational governments to impose investment restrictions on POEs' OFDI decisions. Before 2001, POEs' OFDI activities needed licenses authorized by the subnational governments, though this regulation was revoked by the central government after China joined the WTO. However, subnational governments still have the right to monitor outflow investment activities, including investment permission, destination, and transaction liquidity (Bai et al., 2004; Luo, Xue, & Han, 2010). Some subnational governments can prevent POEs' OFDI by explicitly using the rules and regulations relating to foreign currency exchanges. For example, POEs are limited in the transfer of money to foreign countries and need to obtain permission from the subnational government. POEs must report outflow investments to the provincial Bureau of Foreign Exchange.

Second, governments may use subtle ways to punish those POEs that seek to invest abroad. For instance, a local government may institute regular checks on a POE's operations and impose fines for minor breaches of regulations, or impose certain administrative orders and inspection requirements. These implicit punishments may undermine a POE's determination to expand internationally. Thus, POEs that originate from a region where local protectionism

is dominant have to take the possible hostile reaction of the local government into consideration. This may deter them from undertaking OFDI. In fact, POEs are more likely to choose a product/business diversification strategy in the focal region rather than international diversification (Li et al., 2014).

Third, under local protectionism, subnational governments provide local firms with favorable policies and key resources, such as industry entry permission and the factors of production, including land and raw materials, as well as some intangible resources, namely localized knowledge, human resources and business opportunities (Wang et al., 2016; Young, 2000). It is common for provinces to develop industrial zones where local firms can obtain preferential treatment, subsidies for R&D activities, and help with recruitment. Firms are shielded from competition with those from other regions because local protectionism often takes the form of informal obstacles that prevent rivals from other regions entering the local market (Bai et al., 2004; Young, 2000). Local protectionism builds up a relatively closed regional business environment for local firms so that they can enjoy the benefits from such protection (Li et al., 2003; Bai et al., 2004). This implies that local firms operating in regions with a high degree of local protection will be less likely to develop the organizational capability needed for OFDI.

Relatedly, to gain support and acquire crucial resources from the subnational government, POEs have to comply with local protection rules implemented by the local government, or face possible adverse consequences. They are obliged to show commitment to the local economy in exchange for local protection and favorable policies (Li et al., 2003; Bai et al., 2004). For instance, subnational governments may ask POEs to promise a specific amount of investment

in exchange for a low-tax policy, or encourage firms to stay in the region by providing low-priced and large-scale land resources (Tan & Meyer, 2010).

Lastly, firms' resources and capabilities originating from local protectionism can be difficult to transfer across a national boundary. If firms intend to explore the international market, the mutually dependent relationship, *guanxi*, and some other non-market capabilities embedded in the local region may lose their value in a host country where firms have to rely on market-based capabilities to compete (Yamakawa et al., 2008). Moreover, firms which rely on non-market capabilities are often less competitive in the international market, especially developed-country markets. Hence, we propose:

Hypothesis 1：Local protectionism has a negative association with the likelihood of OFDI by POEs in a transition economy.

The moderating role of corporate philanthropy

Corporate philanthropy involves the donation of money or gifts to charitable organizations, which connects organizations with the stakeholders more closely (Godfrey, 2005; Mellahi et al., 2016; Wang et al., 2008). It can improve the corporate image and enhance the value of a firm's moral capital (Godfrey, 2005; Porter & Kramer, 2002). It can also help to mitigate the risks of reputational losses and secure critical resources, hence providing insurance-like protection (Williams & Barrett, 2000). In addition, corporate philanthropy enables the focal firm to interact more with the external environment and stakeholders (Wang et al., 2008; Hillman et al., 2009), thus alleviating the focal firm's dependence on the regional government and reducing the impact of local protectionism in several ways.

First, philanthropy helps firms to lessen their resource dependence on the regional government by intensifying their relationship with direct stakeholders, including investors, suppliers and customers (Margolis et al., 2007; Wang & Qian, 2011). McKinsey (2013) noted that stakeholders are increasingly holding firms responsible for the CSR activities of their global business partners. By engaging in philanthropy, firms are more likely to gain positive responses from primary stakeholders. A firm's public image as a responsible company could extend to other aspects of business, such as high standards of product quality and customer services (Adams & Hardwick, 2010). This should, in turn, help a firm gain customer support. Moreover, firms may receive more favorable evaluations from investors, benefit from increased demand, and attract suppliers (Marano et al., 2016; Marquis & Qian, 2014).

POEs with a philanthropic reputation may be able to obtain their much needed resources from other external stakeholders apart from the regional government (Haley, 1991; Zheng, Luo & Maksimov, 2015). The more philanthropic activities a firm undertakes, the more easily it could be identified by stakeholders, and the more resource exchanges could occur with the stakeholders (Hillman, 2009). In particular, MNEs from developed countries are more willing to cooperate with socially responsible enterprises (Marano et al., 2016), therefore widening the range of available resources, including international supply chains, international experiences and international networks. By diversifying the source of the resources they need, POEs become less dependent on the local government for vital resources, which enables them to have more autonomy when making OFDI decisions. For example, we interviewed the CEO and other senior managers of a well-known beverage company in Zhejiang Province. The company created a charity foundation with 10 million yuan in 2009 and built a responsible image in the

eyes of various stakeholders, including DuPont. When the company faced some difficulties in developing new material for a new product, it asked DuPont for help in 2010. The CEO stated that the good reputation of the company facilitated strategic cooperation with DuPont, thus stabilizing the supply of the new material. As a well-established MNE, DuPont brought international management experience to the company, especially their global supply-chain management knowledge, which helped the company seek and integrate resources from all over the world, and build a manufacturing base abroad.

In addition to direct stakeholders, governments may also appreciate firms' philanthropic efforts because philanthropy can assist regional governments in solving some societal problems, and so reduce the governmental burden (Wang & Qian, 2011; Zhou, 2004). Therefore, regional governments tend to encourage such activities and would be more cautious about taking actions to 'punish' POEs participating in philanthropic activities when they seek to undertake OFDI (Qian, Gao, & Tsang, 2015).

We also interviewed an official from a provincial government to gain further insights on this issue. The interviewee stated that there are some yearly philanthropic activities organized by the provincial government, such as the *Hope Project*. The firms that make a donation are on a list of donors and get praised at the end of year by the local government. The firms on the list are more likely to obtain some preferential treatment, and are able to gain access to high-level officials in the provincial government if they need assistance and protection. Moreover, the interviewee pointed out that the government holds an annual charity party or press conference to release the charitable performance of the focal firms to the public. This shows that philanthropic activities can enhance firms' visibility and reputation. Their daily operations

can draw the attention of the public. If those firms suffer from informal harassment, the reputation of the local government could be damaged. Therefore, subnational governments usually choose not to intervene with such firms, but to provide assistance instead. This suggests that firms involved in philanthropic activities may possess more management discretion with regard to OFDI decisions than those without such activities. Taken together, we propose that:

H2：The negative relationship between local protectionism and the likelihood of OFDI will be less pronounced for POEs demonstrating corporate philanthropy.

The moderating role of CPA

Apart from engaging in corporate philanthropy, POEs can pursue an adaption strategy to accommodate local protectionism and reduce environmental uncertainty (Hillman et al., 2009). Using an adaption strategy implies that firms build up political connections with subnational governments (Marquis & Qian, 2014). POEs, as a relatively new organizational form in China, inherently lack legitimacy and political connections (Li & Zhang, 2007). Hence, they have an incentive to engage in CPA through which they create a favorable environment and hence can cope better with latent political risks (Pfeffer & Salancik, 1978; Hillman et al., 2005). While engaging in CPA can enable POEs to gain market entry permits, critical resources and legitimacy, which are important for their survival and success in the focal region, it also can strengthen the POEs' dependency on local protection and reduce their incentive to venture abroad for three main reasons.

First, CPA enables a POE to strengthen its relationship with the local government and help the firm to receive preferential treatment and favorable support (Hillman et al., 1999; Sun et al., 2012). On the basis of local protectionism, the subnational government often sends signals

and information to the local firms with whom the government has a close relationship, including the interpretation of new regulations and changes in the strategic priority of government policies. Such signals may protect the firms from competition with rivals from other regions and create new business opportunities (Zhang et al., 2016). In exchange, POEs need to support the subnational government in achieving its strategic priority (Jia, 2014). In particular, POEs are obliged to deliver politically valuable benefits to the subnational government, such as sustained economic growth and increased employment. This reciprocal relationship may bind the POEs to operate locally as a political obligation (Zhang et al., 2016).

From the viewpoint of subnational officials, POEs can contribute to economic growth and boost local employment; these are key factors in the political career of officials (Young, 2000). Therefore, government officials have an incentive to encourage POEs to stay in the focal region by providing valuable resources and policy support (Bai et al., 2004; Tan, Li, & Xia, 2007). This suggests that when a POE relies on the resources associated with local protectionism, and is locked into a mutually beneficial relationship with a subnational government, it could face the risk of losing some decision-making autonomy (Pfeffer & Salancik, 1978; Jia, 2014). Even strong POEs may be unable to escape due to political obligations to deliver the strategic targets of the subnational government in exchange for resources and preferential treatment.

One important motivation for POEs' OFDI is to escape an unfavorable institutional environment at home and seek competitive advantages abroad (Witt & Lewin, 2007; Sun et al., 2014). However, through CPA, POEs can cultivate a relatively favorable environment at home which may reduce their desire for OFDI, and hence they may choose to concentrate on product/business diversification strategies in the focal region instead (Gaur & Delios, 2015).

Second, CPA may impede the development of market capabilities and limit the international experience which is a driving force for OFDI. If a firm relies on cultivating political connections with the regional government, it may neglect developing necessary market capabilities (Peltzman, 1976; Sun, Mellahi, & Thun, 2010). From RDT, the more attention a firm pays to the government, the less the firm depends on other stakeholders in the industry or the market, such as suppliers and partners (Hillman et al., 2009). When managers heavily rely on political connections, they tend to remain with a domestic focus. There is a trade-off between investing in CPA and market-based capability, and deep political embeddedness may hinder the development of a market-based capability. Thus, rent-seeking CAP may weaken firms' ability to expand internationally (Li, Zhou, & Shao, 2009).

The arguments above are also reflected in our interview with a senior manager of a famous diversified group. The company has been a flourishing clothing company since the early 1990s, and it hoped to build factories in other Southeastern Asian countries in 2010. Over the years, the company built up a robust relationship with the local government by providing a vast amount of taxation and supporting local officials through close political connections. The CEO was a member of National People's Congress. However, the regional government sought to discourage the internationalization plan of the company when they became aware of it at an early stage and, in this case, the provincial government provided land for developing real estate. In the end, the company gave up their international plans and, with continuing support from the regional government, it became a diversified business group in the focal region with business interests in tailoring, real estate and financial investment.

In summary, CPA may reinforce the constraints of local protectionism on a POE's OFDI decisions, as POEs with CAP are more inclined to achieve the subnational government's strategic priority by staying in the focal region. In addition, the advantage derived from CPA tends to be localized which implies that POEs with CPA have less desire to escape from the focal region. Our discussion leads to the following hypothesis:

H3：The negative relationship between local protectionism and the likelihood of OFDI will be more pronounced for POEs with CPA.

Methodology

Sampling and data collection

Our sample was based on the official survey of Chinese POEs in 2012, which was led by the Privately Owned Enterprises Research Project Team (POERPT). Firstly, the team picked a multi-stage stratified random sample of POEs from all of the 34 provinces in China. Then, the data were collected from direct structured interviews with the major founder of each POE in the sample. The survey covered 4,033 firms from 19 industries, based on the Standard Industrial Classification (SIC) categories. After eliminating missing data and invalid observations, the final sample consisted of 3,024 firms across 19 industries and 31 provincial-level regions. They are relatively young firms, with an average of 9 years in business. According to the survey, over 90% of the sample firms operate in and regard the local region as their main market. Their geographical concentration in the focal region makes their OFDI decisions more likely to be affected by the focal subnational government. The survey provided information about the sample firms' characteristics, OFDI decisions, and their founders' backgrounds, as well as political connections. In addition, we used regional-level data on

market fragmentation among 30 provinces (except Tibet) in 2011, extracted from the China Statistical Yearbook, to measure the level of local protectionism. We collected the price index of 9 types of retailing goods from 2009 to 2011 to control for random fluctuation and combined the data at firm-level and region-level to test whether heterogeneity in local protectionism across regions in China influences the OFDI decisions of POEs.

Dependent variables

The dependent variable is a dummy variable which measures whether the sample firms decided to invest abroad or not. The *OFDI decision* is coded 1 for the firms with OFDI activities in 2011, and zero otherwise. As discussed above, the OFDI decision is affected by the characteristics of firms as well as the provincial region where firms originated.

Explanatory variables

At the subnational level, we measured local protectionism by the degree of market fragmentation in a region, based on a commonly used calculation formula, 'Law of One Price' (Wang, 2016). This measurement discards the errors and systematic residuals caused by industry-level characteristics, commodity price, and local resources, which has been used to analyze regional market barriers in previous studies (Parsley & Wei, 1996, 2001). We used the natural logarithm of index of market fragmentation in our estimations.

At the firm level, there are two moderating variables: corporate philanthropy and CPA strategy. Corporate *Philanthropy* is measured by the normalized proportion of philanthropic donations before OFDI activities to industry average in 2011. *CPA* is a dummy variable: if a firm is a member of the subnational Federation of Industry and Commerce (FIC), CPA equals 1 and zero otherwise. As the FIC is a quasi-official organization which serves as a bridge

between the subnational government and POEs, membership of provincial FIC enables POEs to participate in policy making, gain direct access to government officials and lobby on behalf of private sectors to protect POEs' business interests. Thus, the FIC plays an essential role in changing resource interdependency with subnational governments through strengthening the interactions and exchanging information about government policies and the market among its members (Deng & Kennedy, 2010; Jia, 2014).

Control variables

We controlled for some firm characteristics, industry and regional factors which might affect POEs' OFDI strategy. We measured *Firm age* as the length of time since a firm was founded, and *Firm size* using the natural logarithm of the total number of employees. As firm owners exert essential influence on the firm's international decisions, and internationalization is regarded as a risk-taking activity, we controlled for the firm owners' *Gender* which equals 1 if the owner is male (Saeed & Sameer, 2017). We also measured the firm's technology capacity by *R&D intensity* which is the proportion of R&D expenditure in total sales, as technology capability can foster OFDI (Tseng, Tansuhaj, Hallagan, & McCullough, 2007). By engaging in CSR, firms are able to manage stakeholder participation and improve their reputation in a systematic and structured way, therefore we controlled for *CSR reporting* (Marquis, Yin, &Yang, 2017). We also controlled for *Temporary employees* which is the ratio of temporary employees to total employees, because temporary employment mitigates the increasing pressures for lowering costs and risks in the home market (Brewster et al. 1997; Glaister et al., 2014). We controlled for *Foreign ownership* which is the ratio of foreign investment to total capital, because foreign investors could be an important source of knowledge concerning

international markets (Lu et al., 2014). In our dataset, 87% of the sample firms are fully privately owned, and the rest involved in some foreign investment but still controlled by private owners.

Industry is an essential factor which may affect POEs' OFDI decision, and thus we controlled for industry specific effects by including the dummy variables *Industry-Agri* and *Industry-Manu*, which classify industries into agriculture, manufacturing and services. Some firms have been involved in various industries. Therefore, we also controlled for *Industry diversity* to capture the impact of the firms' diversification strategy.

At the subnational level, we controlled for *GDP growth*, which is the increase in value of all final goods and services produced within China in 2011 compared to the previous year in terms of measuring the subnational economic development. The data were collected from the annual national statistical reports of the National Bureau of Statistics. We also controlled for the *'Development of social intermediaries'*, which were collected from the Index of marketization (Fan, 2007). The measure of the development of social intermediaries captures the impact of some aspects of the society apart from economic and political factors.

Estimation methods

The dependent variable is a dummy variable which consists of zero or one, but zero occurs more frequently than value one in our sample. Hence, we adopted rare-event logistic regressions to test our empirical model, which helps to clarify the largely overlooked consequences of rare-event data in the international context and avoids rare-event bias and standard error inconsistency when compared with general logit regression (King & Zeng, 2001).

In order to reduce the potential problem of multicollinearity, the independent variable and moderating variables were mean-centered (Aiken & West, 1994).

Results

Descriptive statistics and the correlation matrix are shown in Table 1. As the mean value of the dependent variable is close to zero, this confirms that our choice of rare-event logit regression is appropriate. We checked for multicollinearity among the explanatory variables by a variance inflation matrix analysis. As the variance inflation factor indices are below 1.8, this indicates that multicollinearity is not a major concern in our model (Neter, Wasserman, & Kutner, 1990).

Insert Tables 1 & 2 about here

Table 2 represents the results of multi-level rare-event logit regression. We report five models, respectively. Model 1 includes the control variables only. In Model 2, we added the independent variable, the index of local protectionism. The results support Hypothesis 1 which assumes local protectionism has a significantly negative association with POEs' OFDI decisions. In Model 3, we entered the variable of corporate philanthropy, which moderates the relationship between OFDI decisions and local protectionism ($p<0.1$), offering support for Hypothesis 2. In Model 4 CPA negatively moderates the relationship between OFDI decisions and the level of local protectionism ($p<0.1$), thus supporting Hypothesis 3. In Model 5 (the full model), which contains all the variables, an increase in the pseudo R^2 has been observed. The results in the full model provide more robust support for all three hypotheses.

Figures 1 and 2 visualize how corporate philanthropy and CPA interact with POEs' OFDI

decisions and local protectionism. As shown in Figure 1, the POEs with more corporate philanthropy activities are more likely to make OFDI decisions, and the likelihood of undertaking OFDI becomes higher when the local protectionism is more pronounced. As the level of local protectionism increases, the slope becomes more positive, which means corporate philanthropy mitigates the negative relationship between local protectionism and the OFDI decision in a subnational region. Similarly, Figure 2 illustrates that the POEs with CPA are less likely to adopt an OFDI strategy, particularly in subnational regions with a higher level of local protectionism, suggesting that the negative relationship between local protectionism and OFDI becomes stronger for the POEs engaging in CPA.

Insert Figures 1 & 2 about here

Discussion

Drawing on resource dependency theory, we examine the extent to which local protectionism affects POEs' OFDI decisions, and POEs' strategic actions to respond to the subnational government. The findings show that POEs' pursuit of OFDI is negatively associated with the degree of local protectionism in a subnational region, indicating that local protection instrumented by the subnational government in the home country impedes POEs' OFDI decisions. The findings reveal a neglected barrier, local protectionism, encountered by these firms.

In addition, we pay special attention to POEs' strategic responses to local protectionism, and find the extent to which the effect of local protectionism on POEs' OFDI decisions is

contingent on POEs' non-market strategies. More specifically, POEs which adopt a corporate philanthropy strategy can lessen their resource dependency on the local government and are more likely to overcome the constraints of local protectionism on their OFDI decisions. One possible reason for this is that firms could build interdependent relationships with other stakeholders in the local market to broaden their source of key resources by engaging in corporate philanthropy. In doing so, POEs can exercise more discretion in decision making and alleviate government control through local protectionism, thus reducing the negative impact of local protectionism on their OFDI decisions. In contrast, POEs with a CPA strategy are less likely to engage in OFDI activity. This is because a CPA strategy tends to strengthen the interdependent relationship with subnational governments. POEs with CPA are obliged to stay in the focal region in order to obtain crucial resources and support from the subnational government. Such a reciprocal relationship constrains POEs' management discretion on decision making. As a result, CPA reinforces the negative impact of local protectionism on OFDI, and POEs adopting a CPA strategy are less likely to undertake escape OFDI. Thus, escape OFDI is not a universal response to the unfavorable or incompatible institutional environment. If firms can take strategic action to alter their relationship with the government and change the adverse institutional environment in their favor, they do not have to look outside the home country.

Contributions

Our study complements existing research on the OFDI originating from transition economy firms in several distinctive ways. First, this research contributes to the literature on the institutional escaping lens by revealing the barriers to escaping through OFDI (Witt & Lewin,

2007; Yamakawa et al., 2008). Existing studies based on the institutional escape lens regard OFDI activities as a strategic response to an unfavorable or incompatible institutional environment, including institutional instability, legal immaturity, and corruption (Child & Marinova, 2014; Luo & Tung, 2007). However, the existing research overlooks the fact that in a transition economy, the subnational government can impose restrictions on firms' international strategies (Huang et al., 2016). Our study reveals the existence of the 'pulling hand' of the subnational government, which restrains POEs from OFDI by implementing local protection policies. Thus, the findings extend the escape view by shedding light on the tension between the subnational governments and POEs' OFDI decisions, and support the recent argument that a poor institutional environment at home hampers POEs' outward internationalization (Young et al., 2014; Sun et al., 2014). From resource dependency logic, the dominant position of subnational governments implies that governments have the power to control POEs' activities through informal and implicit actions, thus inhibiting POEs' OFDI activities. Therefore, our study reveals the dark side of government intervention which makes escape OFDI difficult.

Second, our study enriches the existing literature by capturing the special characteristics of transition economies in which local protectionism is prevalent. Examining local protectionism allows us to analyse a specific institutional constraint that is directly observable across regions in China. Doing so enables us to gain a richer picture of how subnational government intervention directly affects POEs' OFDI decisions. By capturing the impact of local protectionism, our study moves beyond the focus on the effect exerted by the general institutional environment prevalent in the extant literature (Ma et al., 2013; Monaghan,

Gunnigle, & Lavelle, 2014).

Moreover, much research has focused on how the relationship between government and SOEs affects OFDI decisions (Meyer et al., 2005; Cui et al., 2012; Huang et al., 2016) because of the inherent political connections between the two actors. However, we have an incomplete understanding of the political relationship between POEs and subnational governments in a transition economy which are beyond ownership ties. We identify the dominant role of the subnational government in the institutional environment and pay particular attention to local protectionism when analyzing POEs' OFDI decisions in such an environment. A more precise focus on local protectionism is vital as it provides an interconnected lens which enables us to unpack the complex relationship between POEs and subnational governments to reveal the barriers to escape OFDI by transition economy firms.

Existing studies tend to treat the institutional environment as a homogenous external factor which affects firms in the same way (North, 1990; Shi et al., 2017). In contrast, in the logic of local protectionism, firms with different traits and resources get distinct treatment from subnational governments. Thus, examining the impact of local protectionism helps advance our knowledge of the mechanisms through which the government affects POEs' OFDI decisions. Extensive research has focused on government support for OFDI (Arregle, Miller, Hitt, & Beamish, 2016; Gaur et al., 2018; Lu et al., 2014; Wan & Hoskisson, 2003). Our study reveals a unique way in which subnational governments manage regional economies and intervene in POEs' OFDI activity, thus hampering escape OFDI.

Third, this research contributes to our understanding of the strategic actions taken by POEs to alter the level of interdependence and to escape through OFDI. The extant research reveals

some market factors that can alter the pressure from governments, such as market competition, location strategy and entry modes (Huang et al., 2016; Guar et al., 2017; Meyer et al., 2005; Sun et al., 2014), but little is known about nonmarket behaviors which POEs could adopt to cope with the government-business relationship in the context of a transition economy. We find that corporate philanthropy and CPA have differing impacts on the relationship between POEs' internationalization decisions and the subnational governments from the RDT logic. Our study, thus, complements the existing research on market strategy and broadens the scope in which firms interact with subnational governments. We move beyond market strategy by reflecting the unique characteristics of transition economies in which government intervention is prevalent, and where firms need to employ multiple strategies to counterbalance their dependence on subnational governments in order to pursue a long-term strategy, such as OFDI activities.

Managerial implications

Our study has implications for POEs' managers in transition economies who are planning to expand their business into the international market. Our findings illustrate that firms should evaluate both the subnational political environment and the interdependent relationship with the subnational government when considering OFDI activities. If local protectionism in the region is prevalent, firms should be cautious about close links to government as this could lead to a loss of independence. Alternatively, firms could adopt a corporate philanthropy strategy to manage their dependence on the government by building up relationships with other stakeholders. Meanwhile, for those firms which are located in relatively market-oriented regions, managers cannot ignore the function of the subnational government as this could affect

their access to resources (Hillman et al., 2009).

Our study has some implications for subnational governments. First, local protectionism has a negative impact on OFDI decisions. If all levels of government hope to build up a fully functioning market economy in China, they should reduce interference with local business activities and leave more room for POEs. Second, if the goal of government officials is to achieve success in politics, then building up a relatively closed market may not be the best way. Instead, they should devise significant policies to accelerate the development of the local economy, such as by attracting more competitive firms to the region and encouraging firms to internationalize and acquire additional skills in order to achieve improved market capabilities. For the central government, in order to build an environment where POEs can engage in OFDI, local protectionism at the subnational level should be limited.

Limitations and future research

Our study has some limitations which represent interesting avenues for future research. First, we used cross-section data to test our model, which limited our sample size. Although we conducted several interviews to further strengthen our hypotheses, future studies could use a longitudinal dataset to examine the impact of local protectionism on OFDI decisions. Second, we used local protectionism as a proxy for the control mechanism of subnational governments. Future research could use other measurements to capture the relationship between firms and subnational governments.

Third, our measure of corporate philanthropy did not distinguish whether philanthropic activities take place within the focal region or across regions due to the data constraint. Future research could go a step further to examine whether the geographic scope of corporate

philanthropy alters the interdependence between subnational governments and POEs. Relatedly, we only measured one dimension of CPA strategy in terms of POEs' political connection. Such a measure may not fully capture the moderating effect of POEs' CPA strategy on the relationship between local protectionism and POEs' OFDI decisions. Future studies could adopt more fine-grained measurements for POEs' CPA strategy to more fully reveal the complex interplay between local protectionism, CPA and POEs' OFDI decisions. Finally, our sample firms are mainly located in the focal region. Future research could explore whether domestic geographical diversification across regions helps POEs escape from local protectionism.

Conclusion

This study advances our understanding of POEs' OFDI decisions by considering the impact of the subnational political environment. By analyzing a sample of Chinese POEs, we found that local protectionism in the subnational regions in the home country can impede their OFDI decisions. Our findings suggest that enterprises in transition economies should pay more attention to the subnational political environment. Our study also identifies two types of nonmarket strategies and sheds light on how POEs deal with their dependency on the subnational government. Corporate philanthropy and CPA strategies can alter the interdependence between the subnational government and focal firms, thus moderating the relationship between local protectionism and POEs' OFDI decisions. Only by overcoming the implicit and subtle obstacles set by subnational governments can POEs undertake OFDI activities.

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Table 1 Descriptive statistics and correlations

	M	S.D	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
OFDI Decision	0.023	0.150																
Local Protectionism	-7.974	0.692	-0.005 ***															
Philanthropy	0.011	0.053	0.061 ***	-0.074 ***														
CPA	0.416	0.667	-0.065 ***	-0.006	-0.067 ***													
Firm age	9.085	5.200	0.069 ***	0.159 ***	0.001	-0.328 ***												
Firm size	3.769	1.732	0.111 ***	0.070 ***	0.016	-0.488 ***	0.414 ***											
Exporting	0.367	2.894	0.218 ***	0.094 ***	-0.015	-9.119 ***	0.178 ***	0.280 ***										
Industry-Manu	0.072	0.258	0.047 ***	0.090 ***	-0.030*	-0.094 ***	0.179 ***	0.343 ***	0.212 ***									
Industry-Agri	0.498	0.500	0.031 *	-0.076 ***	0.005	-0.076 ***	-0.014	0.042 ***	-0.277 ***	-0.003 *								
R&D intensity	0.088	1.941	0.023	-0.006	0.003	0.016	0.000	-0.036 **	0.034 **	-0.007	0.065 ***							
CSR Reporting	1.949	0.220	-0.071 ***	0.039 **	-0.120 ***	0.059 ***	-0.021	-0.128 ***	-0.030 *	-0.025	0.003	-0.039 **						
Temporary Employees	21.74	29.777	0.003	-0.026 *	-0.002	-0.036 **	0.031 **	0.109 ***	0.027	0.024	-0.002	-0.061 ***	0.006					
Foreign Ownership	2.743	0.784	0.017	0.024	-0.056 ***	-0.063 ***	0.028 *	0.183 ***	-0.018	0.060 ***	-0.004	-0.027 *	0.026 *	0.072 *				
Gender	1.161	0.367	-0.012	-0.004	0.004	0.107 ***	-0.098 ***	-0.185 ***	-0.127 ***	-0.014	0.037 **	0.028 *	-0.022	-0.049 ***	0.003			
Industry diversity	1.377	0.667	0.089 ***	-0.013	0.058 ***	-0.133 ***	0.058 ***	0.097 ***	-0.057 ***	0.144 ***	-0.014	-0.057 ***	0.026	-0.047 ***	-0.025	0.092 ***		
Development of social Intermediaries	5.979	4.099	0.024	0.207 ***	-0.048 ***	-0.046 ***	0.234 ***	0.158 ***	0.153 ***	-0.109 ***	-0.010	0.022 *	-0.013	-0.045 ***	-0.041 ***	0.170 ***	0.132	
GDP growth	11.62	1.98	-0.040 **	-0.490 ***	0.019	0.005	-0.165 ***	-0.107 ***	-0.061 ***	0.072 ***	0.004	0.026	0.012	0.004	0.032 **	-0.632 ***	-0.126 ***	0.041

Table 2 Relogit results: the impact of local protectionism on POE's outward foreign direct investment decision

	whetherinter	whetherinter	whetherinter	whetherinter	whetherinter
Firm age	0.033	0.029	0.033	0.026	0.031
	[0.026]	[0.026]	[0.026]	[0.027]	[0.026]
Firm size	0.264***	0.255***	0.243***	0.219**	0.214**
	[0.091]	[0.094]	[0.092]	[0.099]	[0.098]
Industry-manu	0.262	0.195	0.211	0.239	0.242
	[0.305]	[0.306]	[0.312]	[0.307]	[0.313]
Industry-agri	0.824*	0.784*	0.856*	0.787*	0.862*
	[0.436]	[0.443]	[0.449]	[0.441]	[0.446]
R&D intensity	0.736*	0.786**	0.549	0.734*	0.496
	[0.396]	[0.372]	[0.388]	[0.377]	[0.399]
Exporting	1.774***	1.692***	1.776***	1.700***	1.778***
	[0.351]	[0.350]	[0.349]	[0.354]	[0.352]
CSR reporting	-1.064***	-1.093***	-1.026***	-1.104***	-1.021***
	[0.363]	[0.357]	[0.365]	[0.349]	[0.358]
Temporary employees	0.000***	0.000**	0.000***	0.000**	0.000**
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Foreign Ownership	-0.317	-0.296*	-0.248	-0.287	-0.227
	[0.194]	[0.182]	[0.183]	[0.182]	[0.182]
Owner gender	0.241	0.303	0.279	0.344	0.317
	[0.376]	[0.373]	[0.378]	[0.369]	[0.373]
Industry diversity	0.474***	0.496***	0.474***	0.502***	0.476***
	[0.168]	[0.175]	[0.175]	[0.179]	[0.178]
Development of	-0.039	0.115*	0.112*	0.123*	0.119*
social intermediaries	[0.041]	[0.064]	[0.064]	[0.063]	[0.064]
GDP increase	-0.195**	-0.207**	-0.187*	-0.212**	-0.190**
	[0.085]	[0.097]	[0.097]	[0.093]	[0.093]
Local		-1.186***	-1.107***	-0.827**	-0.642**
Protectionism		[0.313]	[0.311]	[0.346]	[0.367]
Local ProtectionismX			2.484**		2.859*
Philanthropy			[1.196]		[1.474]
Philanthropy			4.749***		5.034***
			[0.932]		[1.104]
Local ProtectionismX				-0.513*	-0.563**
CPA				[0.274]	[0.296]
CPA				-0.275	-0.245
				[0.172]	[0.171]
$\chi 2$	55.84***	70.65***	76.43***	76.48***	77.29***
Pseudo R^2	0.092	0.114	0.123	0.124	0.131
N	3024	3024	3024	3024	3024

Standard errors in brackets

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Figure 1 The moderation effect of corporate philanthropy on the relationship between the degree of local protectionism and firms' OFDI decisions

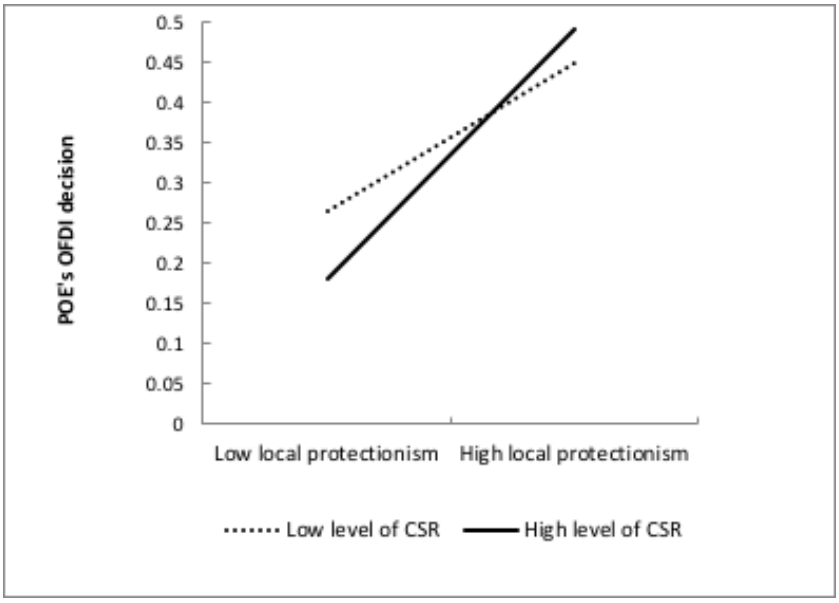

Figure 2 The moderation effect of CPA on the relationship between the degree of local protectionism and firms' OFDI decisions