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**AN INVESTIGATION OF CHINESE EXPORT  
TRADING COMPANIES:  
INTEGRATING INSTITUTIONAL  
PERSPECTIVE INTO TRANSACTION COSTS  
ANALYSIS**

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2015

## **Declaration**

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## **Papers based on this thesis**

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## **Abstract**

Trading companies have played and continue to play significant and strategic roles in international trade, supporting the export of manufacturers and the import of purchasing companies. The transaction costs economics, indicated that the role of trading companies is reducing the transaction costs during export. However, the rise of transition economies, such as China, which has become one of the most important players in international trade, leads to two gaps in existing studies. First, the trading companies from these countries and regions have been kept as a “black box”, compared with relative numerous studies on developed countries. Second, the local institutions, which are considered as main determinants on business models in transition economies, are most likely to affect the transaction costs during export, and trading companies’ characteristics and their methods of reducing transaction costs.

Therefore, the aims of this study were to explore these institution-related transaction costs in China’s export market, and how Chinese ETCs operate one more efficient indirect export market compared with one direct market between domestic manufacturers and foreign buyers. Correspondingly, the main research questions were: 1) what are the institutions, which generate transaction costs for domestic manufacturers and foreign buyers, in China’s export market? And 2) how do Chinese exporting trading companies respond to such institution-related costs as an intermediary between domestic manufacturers and foreign buyers.

A qualitative multiple-case approach was chosen. Six Chinese ETCs were selected, with their export processes as embedded units. The main sources of data included semi-conducted interviews and in-depth field observation. In addition, secondary data, such as newspapers, industrial reports, also contributed to the context of the cases.

With one integrative analytical framework, this study identified a couple of institutional constraints in China’s export markets, including the bureaucratic

procedures and administrative approvals, inefficient legal system and informal contract obligation, and long-term OEM trading methods. These institutions were involved in the whole procedure of export transaction, from the manufacturing by domestic manufacturers to the purchase by the foreign buyers and generated additional transaction costs in different steps, ranging from search, negotiation, to enforcement.

Even though the transaction costs were greatly increased because of the export-related institutional constraints, the findings further reveal that Chinese ETCs can reduce these institution-related transaction costs by a series of effective methods, such as acquirement of knowledge on administrative procedures, collection of information on production, vertical integration, offering supplementary functions for dysfunctional domestic manufacturers and so on. The relevant explanations are twofold. As explained in traditional economic theories, Chinese ETCs' also relied on economies of scale to reduce institution-related transaction costs. Moreover, Chinese ETCs adopted some approaches affiliated to export-related institutions, such as long-term reselling system and monopoly of export authority in history in China's export market, and this is the first time that institutional perspective were applied to explain the transaction behaviour of trading companies.

To sum up, this study extends our understanding of Chinese export trading companies and export-related institutions in China's export market, enhances traditional transaction costs analysis on trading companies by adding the perspective from foreign buyers, and integrates institutional perspective into transaction costs analysis to better explain ETCs' business model in transition economies. Last but not least, the findings in this study are also helpful for practitioners and policy-makers from transition economies in order to improve their export performance and local export-related institutional arrangements.

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# **Chapter 1 Introduction**

## **1.1 Background to the study**

According to the WTO's International Trade Statistics 2012, China, with a total of \$1898 billion in exports and making up 10.4% of global exporting trade, became the top largest exporter, with a growth rate what is more of 20%. This attractive outcome is attributed to 30-years' economic reform and export-oriented developmental pattern (Child, 2009). In China's Statistical Yearbook (SSB, 2011) of the same year, 44.07% of this huge sum of exports comes from local manufacturers in China, rather than foreign-funded enterprises. However, many researchers argue that local manufacturers from these developing countries, like China, are suffering from many competitive disadvantages for their export strategy at the level of firms, industries and institutional infrastructure (Gao, Murray, Kotabe, & Lu, 2009). Therefore, the question is how do these local manufacturers achieve such success in exporting?

Trading companies could provide the answer. The limited literature points out that the export volume operated by trading companies in China made up 94.4% of the activity before 1986 due to their possession of monopolistic export authority, and then reduced to 34% in 2000 after the gradually easing of access to export authority (Yao & Chen, 2001). Nonetheless this means that the trading companies still largely dominate and support China's local exports. However, their business model and characteristics, particularly their methods for facilitating domestic exports, remain unknown.

## **1.2 Importance of trading companies in export**

Trading companies are the earliest and most efficient facilitators for supporting local export (Jones, 2002a; Perry, 1992a). The most famous Japanese General Trading companies (JGTCs) are identified as the key determinant for Japan's previous success in an export-oriented economy. The nine largest JGTCs almost make up half of Japan's total exports from the 1970s to 1990s (Kojima and Ozawa 1984; Jones 1996). Meanwhile other various trading companies also play a similarly significant

role in local exports in US, EU and worldwide (Balabanis and Baker 1993; Jones 1998; Peng 1998). For instance, it is estimated that European export intermediaries (main forms of trading companies in EU) made up 25-60% of exports in different European countries in the 1990s (Balabanis & Baker, 1993b).

Being the “merchant” between domestic manufacturers and foreign buyers, trading companies are playing a significant role in international trade (Jones, 1998b), supporting manufacturers’ exports (Peng & Ilinitch, 1998) and foreign companies’ imports (Quintens, Matthyssens, & Faes, 2005). They help domestic manufacturers, especially small and medium sized enterprises (SMEs), to search for and negotiate with foreign buyers (Peng, 1998). They offer various services and supports to facilitate exporting. Small export intermediaries normally can offer several specialized export services according to different demands from clients, such as export documentation, packaging and marking, international market research, advertising and promotion, freight forwarding and so on, which are classified as transaction-creating services and physical fulfilment services (Balabanis, 2005). Large trading companies are able to provide more comprehensive and complex export services, such as “one-stop” export services (Shao & Herbig, 1993) and export finance services (Kojima & Ozawa, 1984; Sheard, 1989). In addition, these trading companies are able to flexibly operate different trading methods, including reselling, brokering and 3<sup>rd</sup>-countries trade, according different situations (Casson, 1998).

In short, trading companies have played and continue to play significant and strategic roles in international trade by offering various methods and services effectively and efficiently. Therefore studies on trading companies are important for academic understanding and practice improvements.

### **1.3 The significance of this study**

#### ***1.3.1 Practical significance***

Transition economies are defined as some countries and regions where formal and informal institutions are comprehensively and fundamentally changing, particularly from central planning to market-based economic reforms (Peng, 2003, p275). They contain around 30 countries (IMF, 2000), and affect the lives of at least 1.65 billion people (Roland, 2004, p17). These countries and regions have been emerging as the most important group in current international trade. The three largest transition economies, China, Germany (former East Germany) and Russia, are respectively listed first, third, and ninth as leading exporters and making up a total of 21.4% of exports worldwide, according WTO's International Trade Statistics 2012 (WTO, 2012). And other relatively smaller transition economies, including Poland (27<sup>th</sup>), Czech (30<sup>th</sup>), Hungary (38<sup>th</sup>) and Vietnam (40<sup>th</sup>), also have rather good exporting power (WTO, 2012).

However, trading companies from these transition economies have been ignored by academics for a long time. Compared with their practical contributions to international trade, the lack of the knowledge on trading companies from these economies is becoming more obvious. Moreover, one original study in this field also offers potential for more relevant academic studies. One original study on unfamiliar economic phenomena always offers one platform for more relevant studies. In the field of trading companies, such a situation is extremely true. According to literature reviews in this study, it is indicated that several original studies always lead to a mushrooming of subsequent ones focused on certain underdeveloped sorts of trading companies. The Japanese GTCs is one typical example. There are almost no relevant studies on Japanese GTCs before 1980s, though they have dominated Japan's international trade since the 17<sup>th</sup> century (Yoshihara, 1982). After several Japanese researchers' pioneering contributions in the 1980s (Kojima & Ozawa, 1984; Yoshihara, 1982; Yoshino & Lifson, 1986), extensive subsequent research was undertaken on Japanese general trading companies (Amine, Cavusgil, & Weinstein, 1986; Dicken & Miyamachi, 1998; Jones, 1996; Kim, 1986; Meyer-Ohle, 2004; Roehl, 1998; Sarathy, 1985; Sheard, 1989). Therefore, this study, as one original study on trading companies in these transition economies is expected as to be an icebreaker in this field.

Furthermore, the update of relevant knowledge on trading companies in these economies is also significant for practitioners in this field. The interviews with the practitioners from domestic manufacturers and foreign buyers, and even from trading companies in this study, indicate the urgent demand for such knowledge. Specifically, these practitioners from domestic manufacturers and foreign buyers seem to have no clear plans as to when and how to use trading companies' assistance during their export/import businesses in China. In addition, as the lack of clear recognition of their roles in exporting and logistics for the efficient processing of export transactions, the practitioners from Chinese trading companies are also confronted with many troubles, and fail to improve export performance. The continuous downturn in the global economy worsens this situation for these practitioners. Therefore, this study will be of benefit to current and would-be practitioners involved in exports in China and other transition economies.

### ***1.3.2 Theoretical challenge***

In contrast to developed economies with stable and matured institutions, transition economies unavoidably experience a special period of mixed institutions (Nee, 1992), where institutional voids (Miller, Lee, Chang, & Le Breton-Miller, 2009), uncertainty of institutional change (Child & Tse, 2001), misalignment between institutional supply and firm demand (Witt & Lewin, 2007), and reactions between this institutional environment and organizations (Peng, 2003) jointly construct a distinctive institutional environment. Therefore, the institutional perspective becomes a relatively suitable and mainstream approach in extant studies on transition economies (Meyer & Peng, 2005; Peng, 2003, 2005; Peng & Heath, 1996; Peng & Khoury, 2008; Peng, Sun, Pinkham, & Chen, 2009; Peng, Wang, & Jiang, 2008). As a result, two theoretical challenges related to institutional perspectives have emerged in this study. Firstly, the concepts, terminology and classifications related to institutional perspectives in these studies, are disorganized, ambiguous and overlapping. Such problems seem to be inherited from higher-level institutional research. Scott (2008) has found that institutional research in social science, economics and political studies shows large discrepancies and conflicts, and are

lacking in a general framework. Therefore, this study is looking forward to clarifying such conflict and developing one universal institutional perspective framework for studies on transition economies.

Furthermore, such an institutional environment definitely and considerably impacts on domestic and international firms in these transition economies, and further on extant theoretical studies, which are normally developed in western countries with more matured institutions (Child & Tse, 2001; Meyer & Peng, 2005). As Peng stated, these extant theories need modification when they apply to transition economies, like China (Peng, 2006). Specifically, transaction costs economics (TCE) which is the most important and dominant theory in the field of trading companies, has been argued to be largely influenced by local institutions in these transition economies (Meyer, 2001a; Meyer & Peng, 2005). Thus, this study is confronted with another theoretical challenge of seeking one suitable approach to integrate the institutional perspective into extant theories in this field, given each of them is able only to partially explain Chinese trading companies.

Last but not least, there is one theoretical challenge in extant TCE analyses on trading companies. TCE is the dominant theory in the field of trading companies due to its powerful explanation of trading companies' existence and business (Casson, 1998). It clearly indicates the transaction-costs-economizing role of trading companies during international trade. However, the extant TCE analysis on trading overlooks the perspective from the foreign buyer, which is reported as one important stakeholder during export transactions by many export-related articles (Perdue & Summers, 1991; Quintens et al., 2005). Therefore, this study is faced with the challenge of modifying such deficiencies in extant studies.

#### **1.4 Research aims and research questions**

The main purpose of this study through consideration of multiple case studies is the development of one comprehensive understanding of Chinese export trading companies, relevant institutions in China's export market and their interaction with

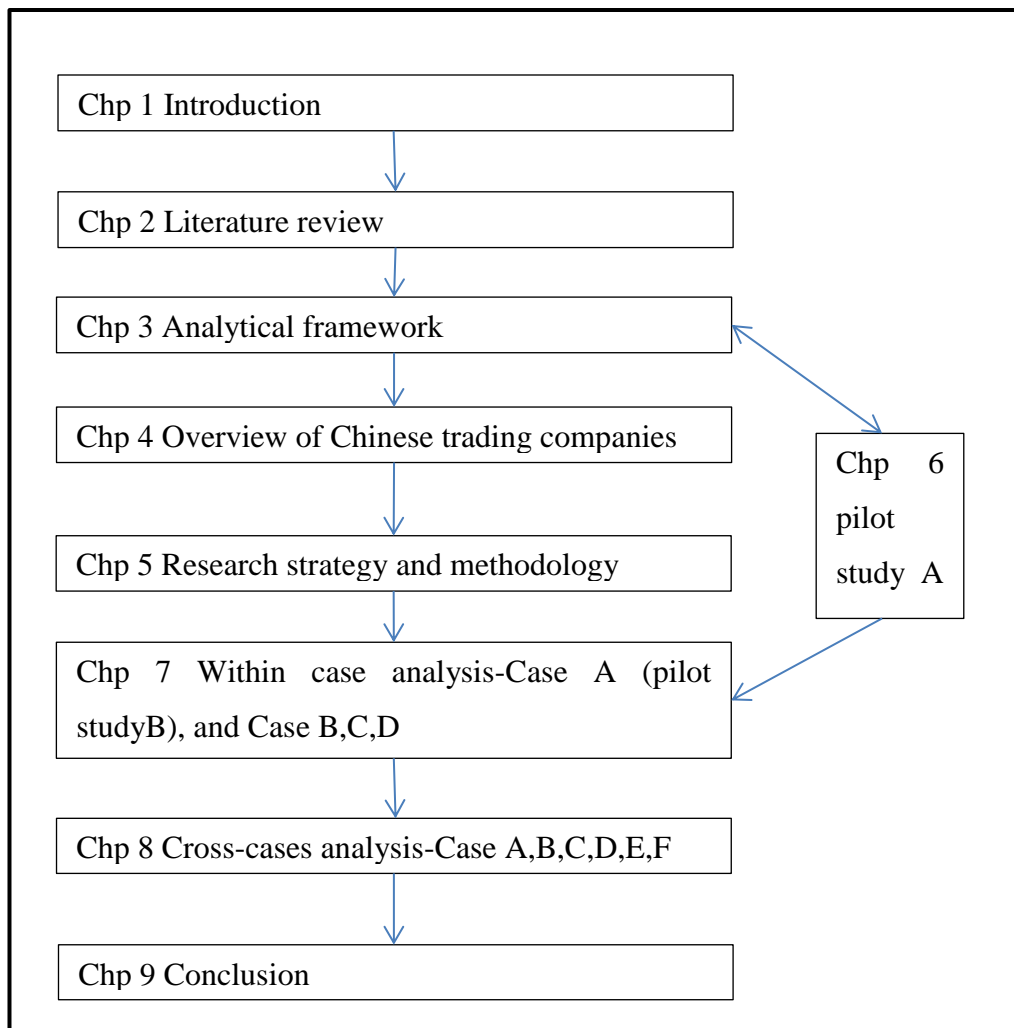
each other together with the interaction between ETCs and institutions, from both an institutional perspective and a transaction costs economics perspective. Specifically, two objectives and relevant questions arise as follows:

Firstly, this study aims to explore and investigate the export-related institutions, which generate costs for domestic manufacturers and foreign buyers in exporting activities in China. Second, it aims to explore and investigate Chinese ETCs' responses to such institution-related transaction costs as an intermediate between domestic manufacturers and foreign buyers. Therefore, two research questions are: 1) what are the institutions, which generate transaction costs for domestic manufacturers and foreign buyers, in China's export market? And how do Chinese exporting trading companies respond to such institution-related costs as an intermediate between domestic manufacturers and foreign buyers.

## **1.5 Structure of the thesis**

The general structure of the thesis is shown in figure 1-1. Following the introduction in Chapter one, Chapter two presents an overview of trading companies in extant literature, including their history, characteristics and methods for facilitating exports as reflected in three main countries and areas, and three related theories. Based on the literature review, the deficiencies in these studies and research questions are listed. Then one new analytical framework is developed in Chapter three, based on the TCE and institutional perspective in international business, in order to guide the subsequent explanation of institutional constraints in China's export market and Chinese ETCs. Chapter four is an overview of the history of Chinese trading companies since 1949. This chapter offers one original introduction of unknown Chinese trading companies. Within it, the main developmental periods, significant events, and relevant institutions are described in detail. In Chapter five, a detailed research strategy and methodology is designed to make logical links between the evidence and research questions in this study. It concludes with the philosophical stance in this study, the justification for the use of qualitative case studies, and the detailed case study design. Chapter six is the first part of the pilot study (pilot study A), which offers a chance to pre-test the previous integrative framework, and to

specify the institutional constraints on China's export market. Then the main within case analysis takes place in Chapter seven. Four different cases are selectively presented out of a total six cases (the details of the last two cases are presented in appendix 3 to save space). The first case is a pilot case study (Pilot study B). Moreover, the Chapter eight offers cross-cases analysis to further generate patterns between China's export-related institutions and ETCs in this study. Finally the Chapter nine concludes this study.



**Figure 1-1 Thesis structure.**





## **Chapter 2 Literature review**

### **2.1 Introduction**

This chapter aims to identify the gaps and research questions from extant literatures. In section 2.2 an overview of trading companies worldwide is provided, especially their methods for facilitating exports. Also the research objective (the export role of trading companies) and the first gap in the literature are identified. Then several main theoretical analyses/models, particularly from the perspective of transaction costs economics, are reviewed in section 2.3. As a result, the second and third gaps in the literature, and two further research questions are identified.

### **2.2 Overview of trading companies worldwide**

Trading companies are the earliest economic organizations involved in international trade (Perry, 1992a), and can be traced back to “colonial time” (Jones, 2002b, p2). As the “merchant” between domestic manufacturers and foreign buyers (both of whom lack the resources to transact directly), trading companies have played and continue to play significant and strategic roles in past and current global business (Jones, 1998b). Most importantly, they are international trade facilitators and mediators through marketing, distributing and selling products overseas for manufacturers and through searching for and organizing supplies for buyers. They offer clients a series of trading services, such as export documentation, freight forwarding, warehousing, etc (Balabanis, 2005). At the same time, they are also trade initiators and generators (Balabanis & Baker, 1993a), as they proactively search for or design competitive products, and potential markets, negotiate with manufacturers and buyers, and enforce the export transactions. In addition to traditional trade, some trading companies widely participate in other business activities, which could be trade-related, like shipping and manufacturing, or trade-unrelated, like FDI and finance. Corresponding to such diversified functions, these trading companies vary in terms of characteristics and business modes. For instance, the sizes of trading companies are quite different from each other, ranging from individual middlemen to large general trading companies (Perry, 1992a, p2). The most successful ones, such

as the Japanese general trading companies with their successful diversification strategies, became leading companies in the Japanese and the global economy over a long period of time, while others, notwithstanding varied forms worldwide, also greatly facilitate international trade.

In a word, trading companies have complex backgrounds, and diversified characteristics and functions. Therefore, this section initially aims to explore two basic questions: what kind of trading companies and what kind of function of trading companies will be studied in this study? To answer these questions, I have sought out extant literatures on trading companies from the fields of international business, business history, international marketing and strategy. I hope to clarify three confusing points in this field: the typology of trading companies; the main function/roles of trading companies in international business; and the main mechanisms of trading companies for achieving such functions (to facilitate exporting) from extant literatures. At the end, one gap will be illustrated after the review of the empirical studies.

### ***2.2.1 Typology of trading companies***

Given that they appear in various forms, the typology of ‘trading companies’ are always amorphous and difficult to perceive (Amine, 1987; Jones, 2002b, p1; Peng, 1998; Perry, 1992a). They are called different names in different countries, such as export trading companies, export management companies, export intermediaries, trading agents (shown in Table 2-1). Jones (1998b) concluded several reasons for such a situation. First of all, trading companies can be brokers or resellers with different risk-taking capability, and the difference is that resellers purchase and then resell products (Casson, 1998). In the U.S., for instance, the trading companies that take title to products are termed export trading companies (ETCs), while the others without doing so, are termed export management companies (EMCs) (Peng & York, 2001; Perry, 1992a). In the same way, Balabanis (2001) European export intermediates (EIs) are divided into merchants-EIs and agent-EIs. Yet the boundary between these two groups has been ambiguous, as their areas of work overlap in practice (Perry, 1992a, p18). Thus some scholars have used more universal term, like

international trade intermediaries (ITIs) (Perry, 1990, 1992a, b) and export intermediaries (Peng, 1998), to bypass the difficulty of differentiating trading companies in practice. In addition, the fact that trading companies undertake varied functions increases the difficulty of distinguishing between these companies, since they might be categorised in other ways if they are highly participative in other businesses beyond trade (Jones, 1998a). Casson (1998) classified trading companies into pure trading companies with simple trading functions and hybrid trading companies when they undertake other functions. These functions are not always exclusive and fixed, and even represent an evolutionary path in the development of trading companies (Visvabharathy, 1984). For instance, one trading company might start out from exporting, and then turn to or diversify into importing, manufacturing and other functions (Amine, 1987). In this way a pure trading company is transformed into to a hybrid trading company with its own productive function. In extreme cases, they can change into another company. Jones (1998a) illustrated how “Shell” transferred from being trading companies into an oil company. Thirdly, trading companies vary according to their specialised products or export regions. Since some trading companies only specialize in some products and markets, Sarathy (1985) distinguished them as special trading companies (STCs), compared with GTCs that have numerous products and global markets. Finally, diverse trading companies presented as independent entities or affiliated enterprises in a large group (like sogo shosha in Japanese MNEs) also contribute to this implicit situation (Jones, 2002b). In spite of these differences, “trade” and “export” became the most common key terms in these types, as they had been the most significant characteristics and business for these companies (Balabanis, 2005).

**Table 2-1 Typology of trading companies.**

Name of trading companies		Criteria
ITIS/ EIs		Taking title of products
Broker	Reseller	
EMS	ETC	
Agent-EIs	Merchants-EIs	
Pure trading companies	Hybrid trading companies	Functions
STCs	GTCs	

### ***2.2.2 Roles of trading companies***

Trading companies have received massive attention from academic, practical and political fields due to their significant in international business. As these trading companies have multiple roles, their main businesses are usually classified into trading businesses, such as export, and non-trading businesses such as FDI. These roles will be specified below.

### **2.2.2.1 Facilitating International trade**

The first important role of trading companies is to facilitate international trade, including export, import and complex trade (such as third-country trade). As core businesses of trading companies, such trading functions exist in almost all trading companies mentioned in the last section. Among these trading businesses, export is the most important and common role of trading companies. By bridging different political, economic and cultural environments, trading companies link domestic manufacturers and foreign buyers by offering professional exporting services and information. This holds absolutely true and obvious for supporting and enhancing exports from small and medium size manufacturing companies that lack exporting capabilities and are more vulnerable to export barriers than large ones (Balabanis & Baker, 1993b). In this case, trading companies usually undertake two major groups of activities: physical-fulfilment and transaction-creating (Balabanis & Baker, 1993a). In the former one, trading companies usually help manufacturers to process export documents, to arrange shipping with the freight forwarder, to apply for quotes and licences to officials, to deal with payment and financial issues with domestic and international banks, etc. In the latter one, they undertake a series of activities to increase trading opportunities, such as advertising and promotion, international market research and so on (Balabanis, 2000).

Second, some trading companies also play dramatic roles in import business, the other side of international trade. Similarly, they can offer a series of import-related services to facilitate foreign manufacturers and domestic buyers. Or they can, when importing some products such as raw materials, natural resources and high-tech equipment, support their export, where these imported materials are used to create

export products. In particular, these importing services are quite important for the manufacturers and countries, which lack these resources and capabilities to purchase them independently. In practice, JGTCs played an important role in the import of materials and equipment, which offer essential inputs for relatively weak domestic manufacturers. At some peak times, such as the 1970s, these JGTCs accounted for half of the imports into Japan (Kojima & Ozawa, 1984).

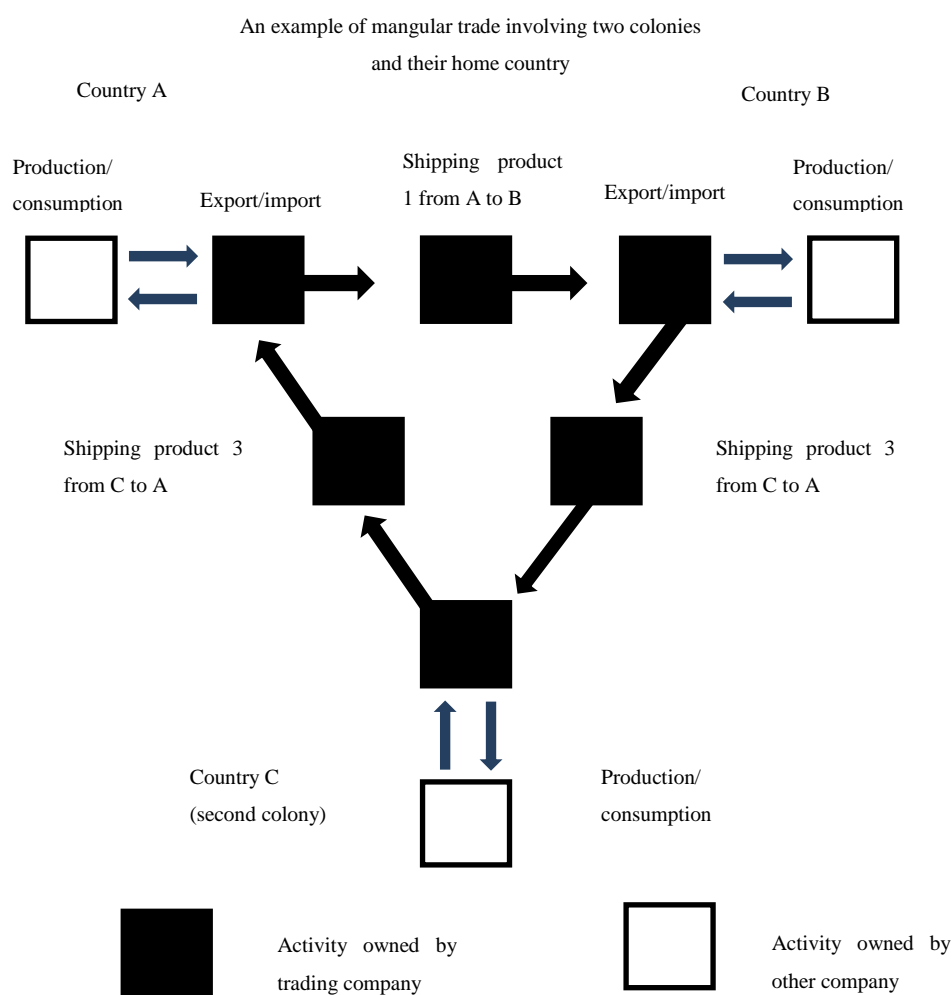
Thirdly, some trading companies also participate in more complex international trade, like third-country trade, etc. Third-country trade, also called offshore trade, refers to trade that does not involve the home country of a trader as a buyer and a supplier (Yoshino & Lifson, 1986, p77). Casson (Casson, 1998) has illustrated how trading companies extend simple bilateral trade into complex multilateral trade, like third-country trade, in multiple countries and products (Shown in Figure 2-1). This kind of international trade is also important for some trading companies. For instance, third-country trade processed through Mitsui, one major JGTC, once made up 30 % of its total sales. And most of these JGTCs undertook extensive third-country trade from the 1970s onwards (see the Table 2-2) (Yoshino & Lifson, 1986, p77-78).

Additionally, trading companies also indirectly facilitated international trade by offering a series of trade-related, trade-supporting and trade-complementary services, such as shipping, export credit, export insurance, etc. They also organized production of tradeable products, and coordinated with different organizations within the production system. Sometimes, they completed some key units on their own throughout the whole supply chain. Thus trading companies fit into the physical functions in trade, and create trading opportunities.

**Table 2-2 Third-country trade as a percentage of total sales.**

	1973	1978	1983	1984
Mitsubishi	6.2	6.1	8.9	11.7
Mitsui	6.3	1.9	14.8	16.0
C.Itoh	6.3	12.0	15.1	17.7
Marubeni	5.1	13.3	15.7	16.9
Sumitomo	9.9	5.2	8.2	11.5
Nissho-Iwai	10.1	9.9	22.5	21.1

Source: (Yoshino & Lifson, 1986, p78).



[Figure: Geographical diversification: the use of multiple connected routes to support multinational trade](#)

**Figure 2-1 An example of mangular trade involving two colonies and their home country.**

Source: (Casson, 1998)

### **2.2.2.2 Facilitating Foreign Direct Investment (FDI)**

The second role of trading companies is to facilitate FDI, which are normally trading companies' non-trading businesses. This role is normally found in large trading companies, like GTCs in Japan and Europe CTCs, and can be exemplified in two

main ways. First, the trading companies help other business partners' FDI by offering consulting services. It mainly relies on their information and experience, which have been accumulated from previous international businesses. Second, some trading companies also undertook FDI on their own account. For instance, the JGTCs participated extensively in FDI overseas, such as mining, manufacturing, real estate, etc (Kojima & Ozawa, 1984). Jones (Jones, 2002a) also reports that early British trading companies made up a significant component of the British FDI in the 19<sup>th</sup> century. These trading companies started with trade and related activities, and then diversified into other non-trading functions, such as plantations and mining.

The motivations for trading companies' participating in FDI are varied. Jones (Jones, 2002a) believes that British trading companies' FDI activities could be for the pursuit of new profitable opportunities and to make up for the inadequate business supportive functions in underdeveloped/developing countries. Kojima et al. argue that Japanese GTCs' FDI activities show twofold motivation. The FDI in developing countries are commonly resource-seeking FDI, while those in developed countries, like the US, (mainly in manufacturing) aim to bypass some export barriers or strategic objectives (Kojima & Ozawa, 1984; Sarathy, 1985).

### **2.2.2.3 Other functions**

Historically, trading companies also have participated extensively in other non-trading businesses, apart from FDI. But such non-trading businesses usually aim to support their trading business. For instance, Jones (Jones, 2002a, p26) reported that early multinational trading companies had to undertake many "complementary businesses needed for their trading business", like financing and insurance, especially when their trade extended to underdeveloped countries. Yoshino & Lifson (Yoshino & Lifson, 1986) also indicate that most of non-trading businesses, such as warehousing, shipping, finance, manufacturing, and mining, undertaken by JGTCs are developed to support their core trading business. For instance, these warehousing and shipping functions directly facilitate JGTCs' trading services, while the finance and manufacturing businesses are intended to make up for some drawbacks and to



increase the efficiency of domestic production systems in Japan, thereby benefitting JGTCs' exports.

### ***2.2.3 The trading companies' history, characteristics and approaches to facilitate export***

The main role of trading companies is that of exporting in international business. The next question is how they facilitate exports, since they show dramatic variance according to different countries and regions in relation to such a question. In this part, I will illustrate different trading companies' history, characteristics and methods for facilitating exports, from three main regions and countries, which are covered by almost all existing literatures.

#### **2.2.3.1 European Countries**

##### **2.2.3.1.1 History of trading companies in Europe-Chartered trading companies and Exporting Intermediaries**

European trading companies are normally considered to start from "chartered trading companies" (CTCs). For a long time, from the 16th to 18th centuries, these European CTCs experienced unparalleled ascendancy in the global economy (Jones, 1996). These CTCs were then the most successful large multinational enterprises, such as the English and Dutch East India companies (the two largest), and the Hudson's Bay Company (the smallest one). They had a monopoly of trading charters in specific regions and products issued by home governments, which then became entry barriers for private traders, and also ensured their exclusive returns from high risk long-distance trade and other investments overseas at that time (Carlos & Nicholas, 1996). They handled most of the international trade between their home countries (Europe was then the centre of international trade) and their colonies in developing countries, such as Asia, India, America, and Africa. Examples include the export of textiles from the UK, the import of local resources from Africa, such as gold, ivory and even slaves, and the trade in opium from India to China (Jones, 2002a). They normally owned one head office in Europe, and numerous forts, factories and plantations worldwide, kept long-term contracts with lots of foreign suppliers, and other

middlemen, all of which constructed global trading networks (Carlos & Nicholas, 1996).

Most of the CTCs faded out from international trade by the mid-19th century for many reasons, including the dismissal of government monopolies, the rise of MNEs which preferred owned distribution, and institutional and technological change (Balabanis & Baker, 1993a). At the same time, the new generation of private trading companies, like Jardine Matheson (based in HK) and Inchcape, had gradually emerged and replaced CTCs' position in trade between Europe and the rest of the world. These trading companies started from individual merchants or merchant partnerships, and focused on certain local products and foreign markets during the early 1800s. Their businesses initially started from simple import/export and broker jobs based on one main export and entrepot hub either in the home countries or postcolonial regions. Then they developed relatively small business networks into several main regions (normally previous colonies) around the world by operating agency relationship with business partners overseas.

As the founders and employees of these new trading companies came from previous CTCs, or some of these trading companies had previously been the agency houses for previous CTCs, the business modes and characteristics of these trading companies were quite similar to previous CTCs during 1800s. For instance, they were deeply involved in international trade and other businesses in former colonies, participated in shipping and insurance, undertook massive investments overseas and third-country trade. After continuous "re-invention" and modification to their business modes from the 19th through to the 21st centuries, including corporate organizational structure, core markets and products, level and scale of diversification. In this way, some of them survived the fluctuations of international and domestic environments and the threats of integration by manufacturers, evolving into successful general trading companies with less diversification. For instance, "Inchcape operated in forty-four countries and marketed the products of 2,750 manufacturers. Apart from general merchandising, its activities included shipping, travel agents, port operators, timber sawmills, tea producers, commodity dealing,

and local manufacturing, though 40 per cent of its profits were derived from automobile distribution, and 60 per cent came from Hong Kong, Malaysia, and Singapore”. In general, these large European trading companies are not as large as the Japanese GTCs in terms of size, scale, performance, importance and influence (Jones, 2002a) .

In modern Europe, the trading companies are commonly small-sized and specialized in some products and regions. Balabanis & Baker (1993b) calculated that 90% of European TCs now only have 9 to 20 staff. These European TCs normally concentrate on the trade of certain industrial products. They could be merchants, who take title of products, and agents, who work on behalf of principals (manufacturers or buyers) without taking title of products (Balabanis, 2000). They are willing to establish agency relationships with other domestic TCs in order to increase trading opportunities, instead of establishing many subsidiaries in their home countries. Their relationships with manufacturers are neither long-term nor close. In addition, unlike early CTCs, who diversified both upstream and downstream, these small TCs are likely to offer more specialized agency services for clients, buyers and manufacturers (Balabanis & Baker, 1993a). They are usually specialized in several services, and even have to collaborate with other facilitators, like freight forwarder and insurance companies, in order to complete the entire export task. Meanwhile, they pay more attention to collaboration with other members, such as manufacturers, in the same export channel (Balabanis, 1998). In two surveys, Balabanis (Balabanis, 2000, 2005) listed two major groups of services: transaction-creating and physical fulfilment, which are shown in Table 2-3, offered by British export intermediaries, and indicated that the EIs usually offer some combination of these services as a consequence of some internal and external limitations.

**Table 2-3 Services offered by British export intermediaries.**

<b>transaction-creating services</b>	<b>physical fulfilment services</b>
International market research	Export documentation
Product research and design	Provision of cost, insurance and freight quotes
Development of marketing strategies and plans	Export packaging and marking
Advertising and promotion	Warehousing
Selection of foreign distributors	Freight forwarding
Training of distributors' staff	Quality control of exported goods
After sales services	Financing and credit of export transactions

Although the emergence of modern MNEs and the decline of trade capitalism have weakened these European TCs, they still play a very important role in im-/ex-orting in the EC, especially in supporting SMEs' im-/ex-orting. Balabanis&Baker (1993b) indicated that these TCs on average make up more than one quarter of exports and almost half of the imports in the EC.

#### **2.2.3.1.2 European CTCs and EIs' approaches to facilitate export**

The early trading companies in Europe, such as CTCs, played the most important role in the international trade between European countries and the rest of the world. First of all, they acted as pioneers for considerably extending European trade to worldwide before the 19<sup>th</sup> century. These CTCs initially exported European products into the rest of the world, especially into those new and undeveloped markets, such as Latin America, Asia and Africa, which are unknown and full of risk for most of other companies in Western Europe due to their distinct cultures and poor communication links (Carlos & Nicholas, 1996). Therefore a great deal of local tradable products were found and brought back to Europe by them (Balabanis & Baker, 1993a). At the same time, the global trading networks were constructed by these trading companies and their business partners overseas to facilitate numerous third-country trading ventures (Jones, 2002a). Thus these early trading companies largely increased trading opportunities through continuously expanding foreign markets and tradable products.

In addition, these CTCs also facilitated international trade by offering trade-complementary services on their own, such as financing, shipping, insurance and even manufacturing. This was particularly important for trade in underdeveloped countries as they emerged and became important markets for industrialized European countries whilst at the same time lacked these complementary businesses and infrastructures (Jones, 2002a).

Thirdly, CTCs and their successors reduced the risk and increased the efficiency of undertaking international trade before the 19<sup>th</sup> century, based on their creative mechanisms for handling high numbers of recurrent transactions, processing a great deal of trading information systematically, and reducing private opportunism inside owned trading organizations. International trade carried a great deal of political and economic risk and uncertainty from the environment, and similarly high private opportunism inside trading companies prior to the time before the 19<sup>th</sup> century, due both to distance (physical and culture) and inadequate information (Carlos & Nicholas, 1988, 1996; Jones, 2003). Correspondingly, these trading companies effectively reduced these risk and uncertainty, and reduced transaction costs in international trade. Through a series of creative ways of organizing businesses, such as massive vertical integration through the whole supply chain, efficient hierarchies of salaried managers, comprehensive and timely trade reporting and recording systems operation on their global trading networks, these trading companies replaced inefficient external markets with owned administrative hierarchies and more efficient external contracts (spot market, long-term contracts, and vertical integration), and then enhanced trading efficiency (Carlos & Nicholas, 1988, 1996).

With the withdrawal of CTCs from the stage of history, a great number of small and specialized export intermediaries (9-20 employees in term of size) continue to play an important role in international trade. They now make up 25-60% export in different European countries (Balabanis & Baker, 1993b). These small trading companies or export intermediaries continue to facilitate export, but in different ways, which means they are more specialized and collaborative. First, though they do not undertake as diversified trade and non-trade functions as the early European CTCs did, these EIs are able to offer more professional export service for clients, including buyers and manufacturers. It is extremely important in an advanced export market. According to Balabanis's description of the services offered by British EIs, it is obvious that the whole trading companies sector constructed by various EIs, facilitates the export more efficiently and specialized by offering the various service-mix for clients with different requirements (Balabanis, 2000, 2005). At the same time, as they do not dominate the whole export channel; EIs are more likely pursue

the close collaboration with other units, like manufacturers, on the export channel (Balabanis, 1998). In the end, these diversified, flexible, and compatible services offered by various trading companies, plus other facilitators, construct one more efficient export collaborative network.

### **2.2.3.2 Japan**

#### **2.2.3.2.1 History of trading companies in Japan-Japanese General Trading Companies**

The Japanese General Trading Companies (JGTCs), the total number of which could only be fewer than 16 (Shao & Herbig, 1993), have dominated Japan's international trade since the 17th century, though there are also great numbers of small trading companies and specialized trading companies in Japan (Sarathy, 1985; Shao & Herbig, 1993; Yoshihara, 1982). These JGTCs are considered to be the most important economic organizations in both Japan and the world, given their significant contributions to the domestic economy, international trade and business in Japan (Kojima & Ozawa, 1984; Yoshihara, 1982, p6; Young, 1974), and their considerable influence on the global economy (Amine et al., 1986; Daniel C. Bello, 1985; Herbig & Shao, 1997; Kim, 1986). It is estimated that the JGTCs made up 10% of global trade in the 1990s (Shao & Herbig, 1993). Earlier studies calculated that the nine largest JGTCs almost made up half of Japan's import and export and around 30% of the GNP during the 1970s (Kojima & Ozawa, 1984). Another study by Jones (1996) indicated that these nine GTCs still accounted for 76% of imports and 43% of exports in 1991 in Japan.

These JGTCs have a long history, and some of them can be traced back to the 17th century. But their rise as an important economic organization in Japan started from the early Meiji period (1868-1912), when the Japanese government began the reforms leading towards industrialization and modernization. Therefore, the history of JGTCs parallels the modernization of Japan. Due to the increase of international trade in Japan after the Meiji restoration, several Japanese trading companies, such as Mitsui Busan (now Mitsui Co.) and Mitsubishi Shoji (now Mitsubishi Corporation), quickly grew up as the main indigenous trading institutions and replaced the then

dominant place of foreign traders in Japanese international trade. Due to the weak industrial foundation in Japan, JGTCs undertook multiple roles during the international trading process. For instance, before WWII, Mitsui took charge of not only the import of spinning machinery and raw cotton, but also the export of cotton products (MITSUI, 2011). Therefore, these trading companies gradually expanded their affiliates, such as suppliers and banks, to most regions of Japan, and developed into the famous Zaibatsu groups, which were family-based industrial and financial conglomerates in the pre-war period in Japan (Kojima & Ozawa, 1984; Yoshino & Lifson, 1986, p9-36)

After WWII, the Occupation Authorities attempted to dissolve the previous Zaibatsu groups (large holding companies). Under this policy, the JGTCs, including previous and current ones, were broken up into many companies. But with the gradual discontinuation of the “dissolution” to Zaibatsu due to political, economic and cultural reasons, JGTCs quickly self-restored and became the sales and procurement agents for the new generation of Japanese business groups. These JGTCs turned out to be the most important institutions for Japan's post-war economic recovery (Kojima & Ozawa, 1984; Yoshino & Lifson, 1986).

The 1960s and 1970s, Japan's economy experienced a period of super-growth, and witnessed the JGTCs' rapid growth and expansion. With its prompt industrialization and export-oriented economic policy, Japan became globally the largest importer and exporter. Nine of the largest JGTCs almost made up half of Japan's total imports and exports and around 30% of the GNP during 1970s. The import products of the JGTCs mainly focused on overseas resources and raw materials for domestic production, while the export products developed initially from steel, chemicals and textiles, which were the most competitive products in Japan during the early ages of industrialization, to hundreds and thousands of various items, the process of which was described as “from noodles to satellites” (Dicken & Miyamachi, 1998; Kojima & Ozawa, 1984; Yoshino & Lifson, 1986, p9-36).

With the oil crisis and the slowing down of the growth of Japan from the middle of 1970s, the JGTCs entered into a “wintry period” with many problems, such as a

receding domestic economic, strong currency and hence the decline of domestic exports, manufactures' own distribution channel, etc. (Marubeni, 2012). Under these circumstances, the JGTCs changed their strategies. They entered into more complex contracts and projects: for instance plant export, international constructions, third country trade (Yoshino & Lifson, 1986; Young, 1979). Moreover, they also undertook many unrelated businesses, such as real estate, retailing, power industry, for new businesses opportunities, which became important sources of profit for JGTCs from 1980s. The trend of diversification in non-trade businesses became more dramatic during 1990s. Many JGTCs, like Mitsui and Itochu, invested in resources overseas (MITSUI, 2011). Marubeni and Itochu jointly established Marubeni-Itochu Steel INC in 2001(Itochu, 2012). All these developments further extended JGTCs' business empire, starting from traditional trade, expanding into broader areas, and eventually turning these large trading companies into MNEs, like the western ones, up to the present day.

#### **2.2.3.2.2 JGTCs' approaches to facilitate export**

JGTCs have multiple options for facilitating export. First of all, the JGTCs are able to process numerous products based on their considerable global trading networks. The considerable level of diversification in both product and market is the key characteristic of the JGTCs (Cho, 1984). The products processed by JGTCs were extremely varied, ranging "from noodles to satellites" (Dicken & Miyamachi, 1998). Their auxiliary trading companies and regional offices were all over the world, which established their global trading networks (Kojima & Ozawa, 1984). In 1973, at least 5000 employees were employed in 800 offices overseas (Young, 1974). Huge amounts of information on markets, trade, and even politics and culture were gathered through these networks. Apart from offering support to other business activities, this activity smoothed out any information asymmetry, thereby reducing uncertainty and risks of international trade (Kojima & Ozawa, 1984). For instance, Mitsubishi owned 232 offices overseas, which communicated at least 30,000 pieces of information every day (Shao & Herbig, 1993).



In turn, their clients, manufacturers and purchasers, could enjoy the more efficient distribution system offered by JGTCs with lower costs. By only transacting with one GTC, a manufacturer might sell one item to many purchasers from different markets, while one purchaser could buy several products from different manufacturers at one time. In addition, these extensive trading networks also facilitated third-country trade (Kojima & Ozawa, 1984; Young, 1974). Thus, JGTCs indeed achieved economies of scale, largely reduced cost per transaction for their clients, and created more trading opportunities, including third-country trade (Yoshino & Lifson, 1986).

Second, JGTCs were able to offer clients a “one-stop” service by integrating a series of export-supporting services, including export documentation, warehousing, freight forwarding, shipping, offering letters of credit and insurances, and so forth (Shao & Herbig, 1993). These services obviously extended beyond those offered by simple trading companies or other independent exporting facilitators, like freight forwarders, shippers and banks, which only offered single service. These were attributed to JGTCs’ diversified functions, and capabilities of coordinating with other related organizations. In turn, their clients, notably the SMEs, benefited from these efficient distribution channels and other services, at a low cost.

Third, as organizers/coordinators of production systems, JGTCs reduced the obstacles during production and exporting, as well as any resulting uncertainty from other units in whole production systems, enabling domestic manufacturers to focus on their specialized role in production, and further increase trading opportunities (Kojima & Ozawa, 1984; Yoshino & Lifson, 1986). Unlike pure trading companies, JGTCs organized and coordinated whole production and sale systems, apart from simply buyout products from manufacturers or agency for manufacturers. According to different products, JGTCs may be involved in several different stages of production, such as purchase of raw materials, sale of products, logistics, finance, marketing and so on (Yoshino & Lifson, 1986). These organizational and management functions undertaken by JGTCs largely supported inexperienced domestic manufacturers and supplemented the relatively weaker business systems at that time in Japan. As Kojima & Ozawa report, whether in the Meiji or the post-war period, domestic manufacturers and business systems were not strong enough to

support the economic and political requirements of rapid industrialization and the "export-or perish" ethos (Kojima & Ozawa, 1984, p21).

In turn, JGTCs, as the most experienced and advanced large business organizations, at least in the international trade of Japan, quickly developed production systems and competitive products by importing technology, equipment and raw materials, offering business information, organizing and coordinating production of semi-finished or finished products, representing market intermediaries and so forth. In this way, JGTCs considerably increased trading opportunities and the amount of tradable products for those weaker manufacturers and subcontractors, enhancing the competitive advantage of Japanese products in international trade.

In addition, these organization also worked effectively reducing the uncertainty of the whole production system and risks for each unit in system (Sheard, 1989). Due to the fluctuation of the markets of raw materials and finished products, together with the high investments in equipment, political risks overseas, exchange risks, and so on, the involvement in exports lead to high fixed costs and resulted in high risks and uncertainty for manufacturers, particularly for SMEs. The JGTCs effectively reduced these risks and uncertainty by their global trading networks, massive information resource about markets, accumulated experience, great financing capability, and linkages with the members in business groups. At the same time, domestic manufacturers were able to reduce fixed costs, focus on production, and enjoy lower transaction costs for each export transaction, regardless of inputs and sale. In conclusion, by organizing whole production system, JGTCs achieved economies of scope, and reduced the total costs and sub costs for each unit (Yoshino & Lifson, 1986).

As main exporting supplements, the financial functions and services of JGTCs are worth mentioning separately due to their significance and uniqueness to export activity. The financial functions had become another main feature of JGTCs, which were therefore called "quasi-bankers" or "quasi-insurance agencies" for the Japanese economy and trade (Kojima & Ozawa, 1984; Sheard, 1989). These financial services

contained “the extension of ordinary trade credit, advance payments, short-and long-term loans, loan guarantees, and even leasing of properties and equipment” and so on, which considerably furthered the trade (Yoshino & Lifson, 1986, p50). Due to their large scale and linkages with banks, it is relatively easier for JGTCs to obtain financial support from banking systems in Japan (Roehl, 1983, 1998). Then these financial capitals were used to finance trade-intermediating activities through short-and long-term loans, to developed suppliers by equity investment (Kojima & Ozawa, 1984, p24-25), and finally to support intermediate product markets (inputs) for domestic manufacturers’ export (Sheard, 1989) (Such process is illustrated in the Figure2-2 in details).

These financial credit and investments were based on their information and experience on export process, international markets, partner enterprises, products and industries, etc. Thus JGTCs efficiently leveraged their information and experience to finance export (Shao & Herbig, 1993). In return, JGTCs obtain the trading rights of the products from these domestic manufacturers (Kojima & Ozawa, 1984; Yoshino & Lifson, 1986). In the end, by directly financing export procedure and indirectly offering credits to production, JGTCs substantially helped domestic manufacturers and suppliers, notably the SMEs, which struggled to get financial support from the banking system in Japan, and further international trade through their coordination and organization.

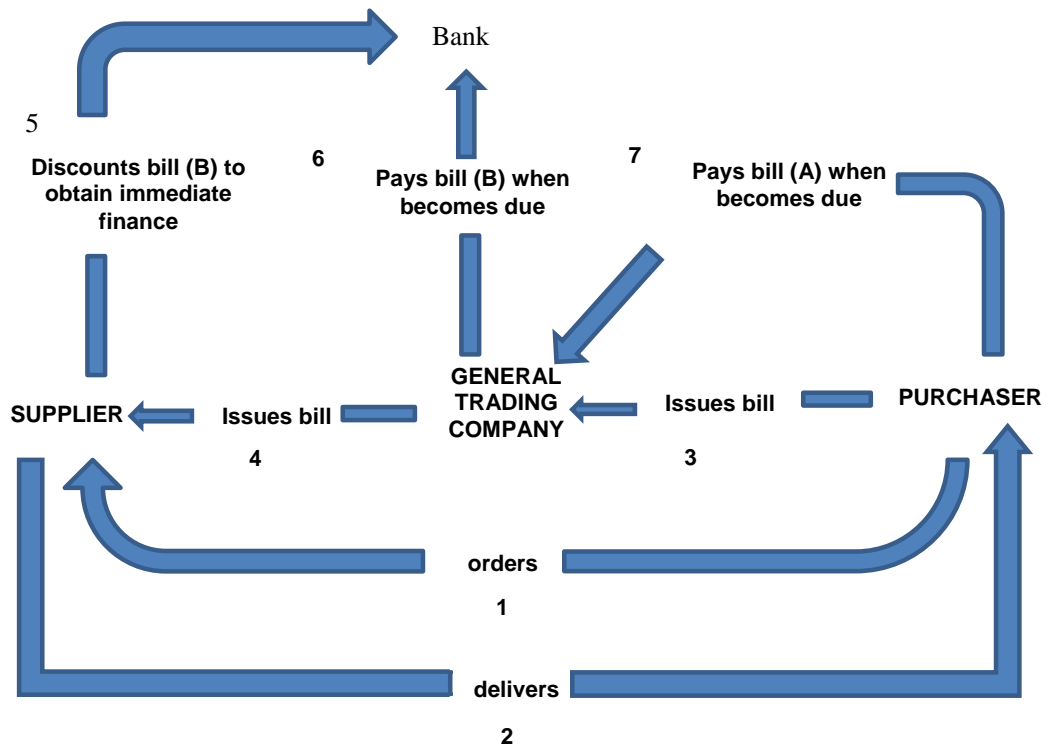


FIG 1. The role of the general trading company as a trade intermediary in interfirm transactions. Figures indicate the temporal sequence of events. Source: Compiled on the basis of company interviews. Sheard illustrated how JGTCs provided and arranged trade credit among suppliers, purchasers and banks, with the assistance of their "inside" information and organizer position of such trades, and therefore facilitated whole transaction among suppliers and manufacturers, and diversify the interfirm risks (of trade credit).

**Figure 2-2 The role of the general trading company as a trade intermediary in interfirm transactions.**

Source: (Sheard, 1989)

### **2.2.3.3 US**

#### **2.2.3.3.1 History of trading companies in the U.S. - Exporting Intermediaries**

Before the 20th century the Yankee traders were the earliest trading companies in US. They replaced previous European trading companies, which dominated the international trade of America during the colonial period. Due to European trading companies' monopoly of existing markets at that time, such as India, these American trading companies initiated their trade from certain new markets, such as the Pacific Northwest, Far East and Latin America. Then their geographic scope gradually extended to the rest of the world, even back to Europe. Their characteristics were similar to early European traders (Peng, 1998, p30-32) . From 1900, however, the international trade had gradually been dominated by the emerging MNEs, which

relied on their in-house FDI distribution channel, while most American small- and medium-sized manufacturers only concentrated on domestic consumers. Thus fewer tasks were remained for the trading companies. Unlike the prosperous development of JGTCs at the same period in Japan, these trading companies had a minimal influence on and development in the American economy (Peng, 1998, p30-32).

The boom in modern trading companies in the US started from 1982, when the American Export Trading Company Act (AETC) of 1982 was issued. In order to increase exports, the AECT of 1982 loosened the anti-trust laws and encouraged financial institutions' participation in exporting. This initiative in essence attempted to establish large JGTC-like "exporting intermediary organizations" in US by combining manufacturers (especially SMEs), export trading companies and banks (offering financial support for export). However, the emerging trust-like trading companies such as Sears, General Electric, and Control Data, quickly faded out of market after 1982 (Peng, 1998, p41), due to the lack of institutional background of the JGTCs (Amine et al., 1986; Herbig & Shao, 1997; Peng, 1998, p32).

After that, the American trading companies developed into pure export intermediaries from the 1990s, called export management companies (EMC) and export trading companies (ETC). Their number is great, as Perry stated the number could be up to four thousand (Perry, 1992a, p2-3). They are small-sized companies with limited product lines (Perry, 1992a). Despite the lack of a large-scale survey, there were two empirical investigations on International Trade Intermediaries (ITI) in the US by Perry (1990, 1992b) and on Export Intermediaries (EIs) in the US by Peng (1998), which represented the scale of modern American trading companies in terms of the number of employees, sales amount, and product diversification. In Perry's survey, 33/35 ITIs owned fewer than 50 employees, and 20/35 handled less than \$10 million in sales (Perry, 1992b), and in Peng's postal survey, 163/195 owned fewer than 50 employees, and 132/195 recorded less than \$10 million in sales (Peng, 1998, p114). According to Perry's survey (Perry, 1992b), 2/3 ITIs undertook moderately diversified product lines (6 product categories made up 200%, as "several" firms handled a number of product categories simultaneously", which meant that one firm

handled 2 product categories on average). Similarly, a total of 300% in 8 dealing areas means slightly diversified areas.

#### **2.2.3.3.2 American EIs' approaches to facilitate export**

The trading companies did not play an important role in most of the US international trade history, even after the issue of a supportive policy by government in 1982. It reflected that the dominance of large MNEs in the US economy minimized the importance of independent trading companies within the international trade (Peng, 1998). But the American EIs, such as EMCs and ETCs, became one of the most efficient export channels for domestic manufacturers, particularly the SMEs (Peng, 1998; Peng & Ilinitch, 1998; Peng & York, 2001).

Similar to European EIs, American EIs also offer various brokerage services related to international trade for manufacturers, such as a search for new markets and buyers, negotiation with buyers, and enforcement of the contracts. In some cases, they also offer reselling functions, by taking title of some products from the manufacturers, and then reselling them to potential buyers. These flexible services are important for domestic SMEs with limited exporting resources and capabilities and for the companies at the initial period of export involvement. For instance, the reselling methods reduce manufacturers' risk and monitoring costs (Peng, 1998). These services are largely contributed to through their knowledge of international markets, experience of export processes and financial capital (Peng, 1998). However, their businesses mainly focus on certain products, markets and relatively specialized functions in whole export process, referred to as a "specialist" or niche strategy (Peng, Hill, & Wang, 2000; Peng & Ilinitch, 1998). Thus these American trading companies are a group of trading facilitators with various specialized capabilities in the field of international trade. The domestic manufacturers are able to choose the most suitable one as their distribution channel (Peng, 1998).

**Table 2-4 Overview of trading companies worldwide.**

<b>Name</b>	<b>Country</b>	<b>Characteristics</b>	<b>Authors</b>
General Trading Companies (GTCs) (Sogo Shosha in Japanese)	Japan and Korea	Conglomerate-like trading organizations with numerous product lines, domestic and foreign subsidiaries, and diversified businesses.	(Cho, 1984; Dicken & Miyamachi, 1998; Kojima & Ozawa, 1984; Roehl, 1982; Sheard, 1989; Yoshihara, 1982; Yoshino & Lifson, 1986; Young, 1979)
Export Management Companies (EMCs)	U.S.	“Uniquely American institutions” which transitionally serve as manufacturers’ distributors, normally small and undercapitalized(Perry, 1992a)	(Howard & Maskulka, 1988; Williamson & Bello, 1984)
Export Trading Companies (ETCs)	U.S.	The new formation of trading companies after the Export Trading Companies Acts of 1982, therefore called ETCA. Some of them acquired GTCs’ characteristics, such as the involvement of manufacturers and banks, say MNC-ETCs and Bank-ETCs	(Amine, 1987; Amine & Cavusgil, 1987; Amine et al., 1986; Howard & Maskulka, 1988)
American International Trade Intermediaries(ITIs)	U.S.	Including “EMCs, AETCs and ACT-firms-In other words, to all indirect international trade vehicles that engage in international marketing activities on behalf of US manufacturers and that make up the US industry of international trade intermediation” (Perry, 1992a, p19)	(Perry, 1990, 1992a, b)
Export intermediaries (EIs)	U.S.	Export intermediaries are agents whose resources and capabilities help lower export-related transaction costs for their manufacturing clients(i.e. principals)(Peng, 1998, p75). Generally including “EMCs, ETCs and other intermediary firms that are involved in facilitating U.S. exports.”(Peng, 1998, p18)	(Peng, 1998; Peng et al., 2000; Peng, Ilinitch, & Hill, 1998; Peng & Ilinitch, 1998; Peng & York, 2001)
Special Trading Companies(STCs)	U.S.	In contrast to GTCs, they have “specialized product lines, often requiring sophisticated distribution and after-sales service; not bulk commodities” (Sarathy, 1985)	(Sarathy, 1985)
Chartered trading companies (CTCs)	ECs	The early trading companies in ECs during 16 <sup>th</sup> -18 <sup>th</sup> . They are normally large, trading products between home countries and colonies, with a government monopoly charter, such as the English and Dutch East India companies.	(Carlos, 1992; Carlos & Nicholas, 1988, 1996; Jones, 1998a, 2002a)
European International Trade Intermediary (ITIs)	ECs	“A class of intermediaries(ie., agents or merchants) whose main business is to (re)sell domestic products to overseas markets(Balabanis, 1998)”	(Balabanis, 1998)
British Export	UK	Including export merchants and export agents. The former “take title to their	(Balabanis, 2000, 2001, 2005)

Intermediaries		goods, buying and selling at their own risk”, while the latter do not. Both of them act on behalf of their suppliers(Balabanis, 2000).	
European Companies	Trading ECs	The surviving large trading companies and numerous small trading companies in ECs. The former inherited from CTCs, but have continuously “re-invented” their business mode till recently, and developed into a handful of GTC-like European multinational trading companies with relatively less diversification. But the later ones vary from each other, and like American EIs	(Balabanis & Baker, 1993a, b; Jones, 2002a)
Multinational Companies (MTCs)	Trading Global	The firms “that engage in trade intermediation between countries, and own assets in more than one country(Jones, 2002b, p1)” . Generally including all large trading companies in history, like CTCs in ECs and JGTCs	(Casson, 1998; Jones, 1996, 1998a, 2002b; Jones, 2003)



#### ***2.2.4 Summary of the overview of trading companies worldwide-first gap***

In general, trading companies show considerable variance in term of typology, characteristics and roles in extant literatures (the details is shown in Table 2-4 overview of trading companies worldwide).

First of all, most of the studies indicate that international trade, especially exporting businesses, represents the most significant characteristic and function of these companies (Balabanis, 2005; Balabanis & Baker, 1993a, b; Jones, 1998a, 2002a; Peng, 1998). As Balabanis & Baker stated “The trade of products manufactured by other firms” is always the main function of trading companies (Balabanis & Baker, 1993b). Therefore the *export trading companies (ETCs)* and their exporting businesses became the target in this study.

Then, the reviews lead to one gap in extant literatures: the lack of information about the trading companies from transition economies. Compared with relatively numerous literatures about trading companies from developed countries, research on trading companies from transition economies is rare. But these transition economies, such as China, have become the most important players in international trade. To take China as example, in 2011, China, with \$1898 billion export total, marking up 10.4% of global exporting trade, became the first largest exporter, while the growth rate is 20 % as well (WTO, 2012). And other main transition economies, such as Germany (former East Germany) and Russia, are also leading exportes in global trade. Considering their importance in global trade, therefore, one original study on trading companies from these countries and regions is demanded.

In addition, two main reasons indicate that such study become more important as it is different from previous studies on trading companies. On one hand, the review of literatures has indicated that trading companies’ characteristics and methods for facilitating export show considerable differences according to countries, especially their background institutional factors (Balabanis & Baker, 1993a; Peng, 1998, p28). On the other hand, many studies have stated the reality that the business model and

institutional environment, in particular exporters' characteristics and exporting channels, are different in these transition economies (Child, 2009; Child & Tse, 2001; Das, 1994; Peng, 2005; Tesfom, Lutz, & Ghauri, 2004). Thus these distinctions from transition economies, plus the heterogeneity of trading companies make one original study on trading companies from one transition economy more significant.

Last, the history reflects that the trading companies, their trading business at least, always experience diminishing trends with the development of institutions. Such phenomenon implies that the previous institutions create the opportunity for prosperity of trading companies, which are swept away with institutional change. As Balabanis (1991) indicates, the GTCs can only vigorously develop in the environment with inadequate resources, including institutions. Balabanis & Baker (1993a) further explain that the "highly munificent environments (refers to the availability of environmental resources to support growth) encourage firms to use other modes to enter foreign markets".

The prosperity of Chartered Trading Companies (CTCs) is partially resulted from then unsupported institutional environment in colonies, which create high risk and the system of trading charters to counter such risk (Carlos & Nicholas, 1988, 1996). Then the improving institutions reduces the difficulties and risk to allow small companies to participate in international trade, and finally dismantles CTCs' monopolies (Jones, 2002b). Those remaining CTCs, like Jardines and Swires, have to "reinvention" themselves in emerging markets, such as East and South East Asia (Jones, 1998, p16; 2002a), where institutional environment is still weak. In addition, the developmental path of Japanese GTCs also supports such explanation. Generally speaking, GTCs initially develop from trading business, then through other trade-related activities and finally to diversified business conglomerate (Amine, 1987; Kim, 1986). Such developmental path implies that GTCs diversification strategy towards more advanced business is one solution facing with improved domestic institutions, which enables domestic manufacturers to finish export on their own. Finally, the history of trading companies in the U.S. also supports our statement. The relatively

less importance of trading companies for export in US proves that the relatively more efficient institutions discourage the development of trading companies.

## **2.3 Theoretical literatures on trading companies**

The transaction costs economics (TCE) is the most dominant theory in the field of trading companies, apart from a few application of the resource-based view (RBV), in existing literatures. In this section, hence, the TCE is mainly reviewed. At the end, the critics of these theoretical analyses are set out.

### ***2.3.1 Transaction costs economics approach***

The TCE is the most important theory on the topic of TCs, as it has been applied and systematically discussed in the field of International Business (Hennart, 2010). As Casson (1998) states, there is no neoclassical theory for trading companies before the emergence of transaction cost theory, as the transaction between workers and consumers or among the consumers can happen directly without costs.

#### **2.3.1.1 Transaction costs economics**

As the founder of transaction costs economics, Coase initially indicates the existence of transaction costs in his seminal work on *the nature of the firm* in 1937 (Dietrich, 1994, p15). In it, Coase (1937) indicates the emergence of the firm arising from the costs of marketing transactions, and that firm's make-or-buy decision (or the boundary of the firm) depends on the comparison between the costs of organizing the transaction within the firm and the costs of accomplishing the same transaction through an exchange on the market or the costs of running it in another firm. He further stated that 1) the transaction costs are the costs of using the price mechanism; 2) the market organizes transactions by contracting, while the firm does so by authority; 3) the market and firm can substitute for each other (Coase, 1937, 1960). The origin of the firm comes from the substitution of markets and reduction of the transaction costs. Afterwards, Williamson (1979, 1985, 1988, 1996) further systematically build up TCE as a paradigm for analysing economic organizations by synergizing relative theories of economics, law and organizations. He concludes several important issues in TCE. First, *bounded rationality* and *opportunism* are two basic behavioural assumptions. The former, coming from Simon's (1961, p.xxiv)

“intendedly rational, but only limitedly so”, indicates the inevitable and incomplete contract. The latter reflects the necessity of ex ante screening of agents and ex post governance. Second, following Commons (1932)’s approach, the *transaction* becomes the basic unit of analysis. The purpose of economic organization is economizing on transaction costs. Third, any transaction can be oriented to contracting. *Frequency, uncertainty and asset specificity* construct three dimensions (asset specificity is the most important) of the transaction or contracting, and jointly determine different contracts and correspondingly different governance structures. The last point is the *comparative approach* (economizing transaction costs) to different transactions and governance structures (firm, market and hybrid modes). The above construct constitutes the paradigm of the TCE. Among these characteristics, *bounded rationality, opportunism, frequency, uncertainty and asset specificity* mainly determine the level of transaction costs. Therefore, the next sector provides a detailed explanation and description of these five aspects.

#### **2.3.1.1.1 Bounded rationality**

As one of the important behavioural assumptions, bounded rationality is the cognitive assumption on which transaction cost economics relies (Williamson, 1985, p45). It refers to “behaviour that is intendedly rational but only limitedly so; it is a condition of limited cognitive competence to receive, store, retrieve, and process information. All complex contracts are unavoidably incomplete because of bounds on rationality” (Williamson, 1996, p377). The assumption of “economic man”, or perfect individual rationality, from classical economic theory, refers to “all decision makers possess consistent and stable preferences-whether they are consumers, entrepreneurs, or bureaucrats “. In other words, it is “possible to conceive of an ideal case in which individuals display purposeful, rational behaviour of a very high order” (Furubotn & Richter, 2005, p3-4). Nevertheless, bounded rationality, as “imperfect individual rationality” (Furubotn & Richter, 2005), is “a semi strong form of rationality in which economic actors are assumed to be intendedly rational, but only limitedly so” (Williamson, 1985, p45). In other words, transaction costs economists admit both the rationality that humans’ pursuing maximizing utility rooted in

classical economics, and particularly emphasize the limits on such rationality. (Williamson, 1975, 1985, 1996).

Bounded rationality mainly contains the limits of neurophysiological approach and language. The physical limits are often displayed in the form of “rate and storage limits on the powers of individuals to receive, store, retrieve, and process information without error”. Then language limits refer to “the inability of individuals to articulate their knowledge or feelings by the use of words, numbers, or graphics in ways which permit them to be understood by others” (Williamson, 1975).

The major problem is that bounded rationality leads to incomplete contracting, and subsequently governance structure and resulting transaction costs. Bounded rationality makes it impossible to generate “comprehensive *ex ante* contracting”, and “all contracts within the feasible set are incomplete”. As a result, the *ex post* governance of contracts, such as gapfilling, dispute settlement and adaptation, will play more significant role in contracting. These *ex post* governances represent varying and sophisticated contracting structures, or governance structures in Williamson’s transaction costs economics, which incurs main transaction costs (Williamson, 1996).

Particularly, environmental uncertainty introduced in later section enables bounded rationality to become more obvious and outstanding, and *vice versa*. Without the bounded rationality, uncertainty’s extent will not influence contracting methods and all contracting will end up with contingent contracting. Under a relative simple environment, conversely, bounds on rationality become useless and so do the trade-off of comparative governance structures between markets and hierarchies (Williamson, 1975, p22-23).

#### **2.3.1.1.2 Opportunism**

As second behavioural assumption, opportunism is “self-interest seeking with guile”, and it refers to, broadly speaking, “the incomplete or distorted disclosure of information, especially to calculated efforts to mislead, distort, disguise, obfuscate,

or otherwise confuse” (Williamson, 1985, p46-47). It is different from “simple self-interest seeking, accordance to which individuals play a game with fixed rules that they reliably obey” (Williamson, 1996, p378). Opportunism behaviours may take place *ex ante* transaction, including *adverse selection*, and *ex post* transaction, such as *moral hazard*. Correspondingly, the *ex ante* screening of agents and *ex post* governance, all of which incur transaction costs, become inevitable. Williamson believes that the cooperative modes of economic organization in neoclassic economics, where “trust and good intentions are generously imputed to the membership is too ideal” (Williamson, 1985, p46-47).

Opportunism is as important as bounded rationality. Incomplete contracts led by bounded rationality would be accepted and reliant if economic agents were wholly trust-worthy (Furubotn & Richter, 2005, p5). In the case without opportunism behaviours, *ex ante* planning become unnecessary, and transaction partners will jointly act towards profit-maximization if unanticipated events happen. A general clause for potential problems in contracts is to issue *ex ante* insistence: “I agree candidly to disclose all relevant information and thereafter to propose and cooperate in joint profit-maximizing courses of action during the contract execution interval, the benefits of which gains will be divided without dispute according to the sharing ratio herein provided.” (Williamson, 1985, p48)

Moreover, the opportunism assumption also relies on bounded rationality. If economic agents are able to design appropriate safeguards in advance, *ex post* opportunism will not affect transactions, then *ex post* governance structures will not be as important as in practice (Williamson, 1985, p49).

#### **2.3.1.1.3 Specificity**

Among five main determinants on transaction costs discussed in this section, asset specificity is the most important and most distinctive for transaction costs economics (Williamson, 1996, p45). Asset specificity refers to “a specialized investment that cannot be redeployed to alternative uses or by alternative users except at a loss of productive value.” Specific assets play an important role in transaction costs analysis.

It becomes inevitable for transactions as it is able to considerably reduce production costs or increase revenue. However, it also leads to “bilateral (or, sometimes, multilateral) dependency”, which require more complicated contact relations and resulting governance structures (Williamson, 1996, p26, p377).

Asset specificity mainly contain six types: (1) site specificity, which refers to the situation that successive stages/stations, such as buyers and sellers, are located in close proximity to each other, in order to minimize inventory and transportation costs; (2) physical asset specificity, which refers to “one or both parties to the transaction make investments in equipment and machinery that involve design characteristics specific to the transaction and which have lower values in alternative uses”. One example is the specialized dies that are required to produce a component; (3) human capital specificity, which is “a consequence of learning-by-doing, investment, transfer of skills specific to a particular relationship”; (4) brand name capital; (5) dedicated assets, which indicate the “general investments that would not take place but for the prospect of selling a significant amount of product to a particular customer. If the contract is terminated prematurely, it would leave the supplier with significant excess capacity”; and (6) temporal specificity, which “is akin to technological nonseparability and can be thought of as a type of site specificity in which timely responsiveness by on-site human assets is vital has been added.” (Furubotn & Richter, 2005, p142; Williamson, 1985, p95 ; 1996, p105)

In general, these specific assets strengthen the reliance on trading partners. Such reliance is increasingly enhanced along with the degree of specificity and the value of specific assets, as opportunistic behaviours from trading partners will considerably threaten continuous partnership and vast previous investments on specific assets, which would be less used in other transactions. In other words, the specific assets increase firms’ costs on marketing transactions. As a result, the alternative solutions and governance structures, such as hierarchies and/or other hybrid forms, become more complicated and costly. Therefore, specific assets play an important role in transaction costs analyses, especially those on the case of firms’ vertical integration (Williamson, 1975, 1985, 1996).

#### **2.3.1.1.4 Frequency**

Transaction frequency is another important dimension of transactions. The greater the frequency is, the more widely spread the fixed costs of establishing a nonmarket governance system is (Furubotn & Richter, 2005, p372). As stated in previous part, the governance structures involved in transactions with investment of specific assets require specialized design. Following the same logic of assumption of scale/scope economies, the higher frequency of transactions will reduce the costs of establishing such specialized governance structures. As a result, firms tend to internalize transactions with higher frequency. For instance, recurrent market transactions would be left in-house, as they will incur trading partners' repeatable bargaining costs (Williamson, 1985).

#### **2.3.1.1.5 Uncertainty**

Uncertainty is the third important dimensional element which considerably influences transactions and contracting. Tackling uncertainty is the core problems for economics organization, as the decrease of uncertainty can create mutual gains (Williamson, 1985, p57; 1996, p60). Williamson (1975, p23) indicates that uncertainty is a circumstance, "in which event it is very costly, perhaps impossible, to describe the complete decision tree." Similarly, North (1990, p126) defines uncertainty as "a condition wherein one cannot ascertain the probability of an event and therefore cannot arrive at a way of insuring against such an occurrence."

In general, uncertainty comes from two aspects: individual behaviour and environment. Koopmans (1957, p147) classifies uncertainty as primary and secondary kinds, with perspective causes of state-contingency and lack of communication. Then Williamson absorbs and extends Koopmans's secondary uncertainty into "behavioural uncertainty" by adding opportunism behaviours characterized by "strategic features", such as strategic nondisclosure, disguise, or distortion of information. Such strategic features inevitably take place when parties are joined in a condition of bilateral dependency. (Williamson, 1975, p24; 1985, p56-59; 1996, p60-61) In other words, the behavioural uncertainty generated by



opportunism will exist in transactions involved in different parties. In response, the ease on such uncertainty requires sophisticated governance structures with transaction costs.

Compared with behavioural uncertainty, the uncertain environment also leads to increase of transaction costs and is in fact more important. Williamson (1985, p59) stated that the behavioural uncertainty will not affect transactions, if exogenous disturbances are non-existent. The reason is that trading partners will not adapt the changes and attempt to alter contracts and the original terms will be insisted. It is the existence of uncertain environment that needs trading partners for adaptation after transactions, increases difficulties on contract enforcement. As a result, complicated and costly governance structures to ease such uncertainty turn out to be inevitable (Williamson, 1985, p59-60).

In addition, the transactions including specific assets will be more vulnerable to uncertainty, as the investment in specific assets increases difficulties of freely changing trading partners (Williamson, 1985, p60).

### **2.3.1.2 Theoretical explanations of trading companies from transaction costs economics**

The TCE is one of the most important theories in international business (Foss & Roemer, 2010; Hennart, 2010). Such a situation has been taking place in the studies of international trade and trading company. Casson (1998) states that international trade incurs numerous transactions and contracting issues among sellers, buyers and intermediaries, large risks and uncertainty, great information asymmetry due to different time zones, location and culture. All of them are related to the transaction costs, and certainly offer TCE the potential experimental field. In terms of trading companies, transaction cost economics explains their rationale in a practical economic world with “friction”. Under the TCE, the existence of trading companies in international trade relies on whether it can lower the transaction costs and create

transaction efficiency in international trade. It answers two questions on trading companies in extent literatures: to identify the different kinds of transaction costs, which are reduced by trading companies during international trade, and to explain how they reduce these various transaction costs.

However, such transaction costs-minimizing activities vary among extant literatures on trading companies, especially from three main destinations: EU, US and Japan. The next section will respectively review these different transaction costs-minimizing activities according to these three regions.

#### **2.3.1.2.1 TCE on European CTCs**

Carlos and Nicholas (Carlos, 1992; Carlos & Nicholas, 1988, 1996) have analysed CTCs by using TCEs. They reveal two main transaction costs in international trade that are liable to being reduced by the CTCs. The first one was raised by risk and uncertainty related to the lack of knowledge, information and experience on foreign markets and the underdeveloped technology used in international trade. International trade contained a great deal political and economic risks and uncertainty from the environment, during the time preceding the 19<sup>th</sup> century, both owing to distance (physical and culture) and inadequate information on foreign markets. (Carlos & Nicholas, 1988, 1996; Jones, 2003). This situation became more serious considering the then main trading destinations were all in the new world, like Asia and America. These kinds of international trade from/to these areas were called long-distance trade, which are the main domain of CTCs. Therefore, all of these raise great transaction costs on external markets of international trade for individual traders.

The second one was agency costs generated by the opportunism of the manager and other employees (like overseas agents), by asymmetric information and uncertainty inside the trading companies. In the CTCs' administrative organization, the headquarter offices were usually located in one European city, while numerous salaried managers conducted concrete work independently overseas. This organizational structure is compatible with their diversified business activities,

massive transactions and global trading network. However, the headquarters of CTCs, with asymmetric information, were confronted with the difficulty of monitoring at a distance any opportunism on the part of overseas managers. Then the principal-agent relationship between headquarters and its managers in the CTCs generated high agent costs (Carlos, 1992; Carlos & Nicholas, 1988).

In turn, the CTCs effectively reduced these two main transaction costs in then international trade. First of all, these CTCs replace the external market with their internal managerial hierarchy, which incurs lower transaction costs. The volume of transactions processed through the CTCs was high due to their large size, vertically integrated business and global networks. When transactions are frequent and recurrent, “the teams of salaried managers can coordinate the flow of goods and information more cheaply than the market”, as the latter were highly imperfect and costly for the lack of information on market, and supply and demand, at that time. (Carlos & Nicholas, 1988, 1996). In this case, CTCs, which are considered as “a nexus of internal contracts (between owners and managers and between managers and overseas agents)”, replace a series of “external contracts (including spot market, long-term contracts, and vertical integration) for the purchase and sale of intermediate and final goods and services” in international trade in order to economize on transaction costs (Carlos & Nicholas, 1996).

In addition, CTCs also devise a series of internal managerial mechanisms to manage to solve agency problems from managers overseas. For instance, some elaborately-structured contracts, like incentive salary structures, compensation mechanisms and efficiency wages terms, used by CTCs with their managers effectively improve the moral hazard and adverse selection, which are two main agency problems inside CTCs (Carlos, 1992). Furthermore, some regulations, like oaths, were issued to avoid private trade by managers; the internal auditing mechanisms, like checking the amount between the order list and actual delivery, inventory list, return orders, and internal surveys, were also effective methods for evaluating and monitoring managers' performance.

#### **2.3.1.2.2 TCE on Japanese GTCs**

To the best of my knowledge, Roeh initially applied TCE to the analysis of JGTCs trading companies. During his studies on JGTCs (Roehl, 1983, 1998; Roehl, Chee, & Cho, 1984), the transaction costs, which can be reduced by JGTCs, initially come from the trading industry, according to the product characteristics and diversified characteristics of JGTCs. Initially JGTCs usually choose the exported products, which incur lower transaction costs through their trading mechanism. He indicates that the products handled by JGTCs are usually standardized, in a large volume and recurrently transacted, such as JGTCs are able to achieve economies of scale through reducing the costs of each transaction of these products. In particular, the standardized products, with simple characteristics, require less idiosyncratic investment on trading structure design and quality control systems in order to avoid opportunistic behaviour, and therefore achieve scale of economies on transactions earlier compared with complex products. Similarly, the products with a large volume of or repetitive trading can also spread the cost of per transaction.

JGTCs also reduce the uncertainty of recurrent transaction, or long term transaction, for manufacturers, as JGTCs behave less opportunistically under such transactions in the marketplace. In these transactions, JGTCs are likely to invest transaction-specific capital, as their aims are to pursue commission by completing transactions. Second, the overall costs of trading some products, like steel, will be decreased, when JGTCs participate in different stages of production, because they reduce the opportunistic behaviours, with regard to like quality, timing of delivery, etc., in each exchange among different tiers of the production cycle. In the same way, JGTCs' trade-related functions, like warehousing, shipping, etc, are also explained. The large volume of transactions and market information make these functions less risky, while transaction orientation allows JGTCs to make substantial transaction-specific investment.

In addition, he also believes that the information cost and mechanism to reduce information costs is another main problem for JGTCs. First, the information-gathering is one main function of the JGTCs (Kojima & Ozawa, 1984; Young, 1974). These kinds of information on foreign markets, international trade, domestic firms,

related industries, etc. are collected through their huge investment on information-gathering structures, like global business networks. The characteristic of public good of this information, however, makes the difficulty and diseconomy of trading them in the external market. In turn, JGTCs effectively reduce these information costs by sharing, transferring and trading the information among their clients within same industrial group. The GTCs' non-transaction functions, like financing, are well explained in this way. For instance, by long-term trading commitment, JGTCs obtain important information on certain manufacturers, which are lax but necessary for banks to offer credit. But JGTCs are able to offer these manufacturers financial support, while they relatively earlier obtain banks' credit due to their large size and close connection with banks. In this way, they achieve their function of "quasi-bankers" (Kojima & Ozawa, 1984).

#### **2.3.1.2.3 TCE on American IEs**

Peng et al (Peng, 1998; Peng & Ilinitich, 1998; Peng & York, 2001; Peng, Zhou, & York, 2006; Trabold, 2002) established a TEC-based model with assistance from agency theory and RBV, to explain modern American EI's performance. First of all, EIs' performance relies on their efforts to help manufacturers to minimize export-related transaction costs, given that manufacturers can choose direct or indirect export entry mode. Second, the agency theory describes the principal-agent relationship between manufacturers and EIs, and the resulting agency costs for principals (manufacturers) to employ agents (EIs). Only if the agency costs are less than transaction costs, EIs can be the effective export channel choice for manufacturers. Finally, the involvement of RBV further highlights "export intermediaries' performance depends on their possession of *valuable, unique, and hard-to-imitate resources* which help minimize their clients' transaction and agency costs" (Peng & York, 2001). Therefore, this model concluded that EIs' performance stems from their abilities to lower client firms' searching, negotiation and monitoring/enforcement costs. These three abilities are operationalized into four testable hypotheses: h1, h2, h3, h4. (Shown in table 2-5)

**Table 2-5 The perspective of Peng et al integrated model is shown below.**

Definit	Export intermediaries are agents whose resources and capabilities help lower
---------	--

ion	export-related transaction costs for their manufacturing clients(i.e. principals)
Assu mptio n 1	Manufacturers tend to use direct, integrated channels when export-related transaction costs are less than agency costs brought by export intermediaries.
Assu mptio n 2	Manufacturers tend to use export intermediaries when export-related transaction costs are more than agency costs brought by export intermediaries.
Assu mptio n 3	Export intermediaries have the incentive to improve their organizational resources and capabilities to order improve the odds of being selected by manufacturers.
Propo sition 1	The greater their ability to lower export-related transaction costs for manufacturers, the stronger the export intermediary's performance.
Propo sition 2	The more credible the threats imposed by manufacturers and/or the stronger the incentives provided by manufacturers, the stronger the export intermediary's performance.
Propo sition 3	The stronger the valuable, unique, and hard-to-imitate resources and capabilities possessed by the export intermediary, the stronger its performance.
Hypot hesis 1	The more knowledgeable it is about foreign markets and export processes, the more likely the export intermediary, the stronger its performance.
Hypot hesis 2	The greater its ability to undertake export-related negotiations, the more likely the export intermediary will be successful.
Hypot hesis 3	The better its ability to take title to the goods, the more likely the export intermediary will be successful.
Hypot hesis 4	The more willing it is to specialize in commodity products, the more likely the export intermediary will be successful.

Source: adopted from (Peng, 1998, p75)

Therefore, it was found that three main transaction costs, which can be reduced by modern American EIs, are searching, negotiation and monitoring/enforcement costs respectively according export process. First, the lack of information, experience and knowledge of foreign markets and export practice generate difficulty and high costs of finding potential buyers for tradable products. Second, international negotiations have the reputation of being time-consuming and costly, and therefore require specialized personnel. When they happen between unfamiliar partners from different countries, the potential hazard and risks, and mutual adaptation jointly create higher costs in export negotiations. Third, the relationship between American manufacturers

and EIs is described as the principal-agent relationship. Under this, the EIs will perform opportunistically, conflicting with the manufacturers' interests. In the end, the resulting agent costs, or manufacturers' monitoring costs of EIs' performance will rise during exporting agency process.

In turn, the American EIs show a series of capabilities to reduce these transaction costs. The EI's knowledge and information on foreign markets, experience of export, and special connections with certain countries enable them efficiently find potential foreign buyers and reduce searching costs in export. Moreover, the specialized personnel in EIs with negotiation experience and specialized skills, like fluency in foreign languages and understanding of foreign cultures, together with their networks overseas, jointly ease the difficulties in international negotiation. Then when the EIs are able to take title of tradable products, or choose the ones, like commodity products and low-tech products, which require less transaction-specific investment from manufacturers to monitor agents' activities, the relative transaction costs are also lower.

### **2.3.1.3 Summary of TCE analysis on trading companies-second and third gaps**

The TCE will explain the significance of trading companies in international business. Due to uncertainty, complications and information absence, the resulting various transaction costs create difficulty and reduce the efficiency of international trade and business. The trading companies, as the intermediaries for linking different players involved in these businesses, effectively reduce these transaction costs, and facilitate international trade.

The extent TCE analyses on trading companies mainly answer two questions: *1, what kinds of transaction costs during international trade can be economized by trading companies? ; 2, how can they reduce these transaction costs?*

From the three TCE analyses, it is found that the kinds of transaction costs and the means by which trading companies can reduce these transaction costs are different from each other. It confirms our previous discussion on trading companies' different characteristics and mechanisms for facilitating export found in the empirical literatures. Given the economic explanation of the role of trading companies in economizing transaction costs, the distinct characteristics and functions of trading companies are used to reduce the different transaction costs. This situation alerts this study to the potential discrepancy between the sorts of transaction costs, and mechanisms by which Chinese trading companies can reduce them.

However, these three TCE analyses are confronted with different limitations. Carlos and Nicholas' TCE analysis on CTCs has the difficulty of explaining modern trading companies with the disappearance of TCTs, advances in technology and improvement of information in international trade. For instance, the popularity of the internet largely reduces the information absence and asymmetry, and resulting uncertainty; the utility of modern financial tools decrease the risk related to international trade. Therefore, those resulting risks and uncertainty would not be the main sources of transaction costs for modern international trade. In addition, the TCTs and their internal organization structures have been replaced by those modern trading companies and more efficient administrative hierarchies with less agent trouble inside the trading companies respectively. For instance, neither American EIs nor Japanese GTCs use similar corporate structures with headquarter office and numerous salaried managers overseas.

Roeh's TCE analysis focuses on JGTCs, and there is a lack of generalization to other trading companies. This difficulty mainly results from the considerable difference between JGTCs and other trading companies. For instance, Peng et al (Peng, 1998; Peng & York, 2001) empirically tested American EIs' performance and trading products, and found a lower correlation between performance and commodity products, which are argued as JGTCs' main products in Roeh's TCE analysis.



Peng's model on American EIs mainly concentrates on the simple exporting agent service, and fails to include many other export-related services, like trading credit, and non-trade functions, like manufacturing, which are usually undertaken by trading companies as well. This is because this model focuses on the agent's role in trading companies, rather than main reseller role.

More importantly, three kinds of TCE analysis only focus on manufacturers and trading companies, and *fail to pay enough attention to other players, especially foreign buyers or importers, involved in international trade*, which is also the second gap from extant literatures. The foreign buyers or importers are usually considered as an equally important stakeholder in the practice of export and import (Perdue & Summers, 1991; Quintens et al., 2005). Some studies, mainly from the marketing perspective, have mentioned these buyers' significance to trading companies' service offerings (Balabanis, 2000). In fact, the use of intermediaries or trading companies is a common method for international purchasers, particularly where buyers are small, engaging in simple or lower-purchasing-risk products or unfamiliar markets. One study of American purchasers (Ciancarelli, 1999) reports at least 13% of them use the trading companies during international purchases (Quintens et al., 2005). Thus it is hard to make the decision to employ trading companies without a purchasers' stake.

This ignorance could come from the traditional assumption of "agent relationship" between manufacturers and trading companies. For instance, in the Peng et al model, the manufacturers and serving trading companies are defined as principals and agent respectively under the agency theory. However, the manufacturer can be the agent as well, while the intermediary is a principal in practice (Balabanis, 1998). In this situation, the manufacturers can behave opportunistically as well as EIs acting in previously assumed situations (Chintakananda, York, O'Neill, & Peng, 2009). In some literatures on RBV analysis, some capabilities of trading companies, such as the capabilities for searching for and monitoring qualified suppliers (Feenstra & Hanson, 2004), also indicates the opposite principal-agent relation. Therefore the principal-agent relationship in this model could be problematic.

Last but not least, the studies in the international business and strategy indicates the analyses are generally from three basic perspective, namely firm perspective, industrial perspective and institutional perspective (Peng, 2006; Peng & Khoury, 2008; Peng et al., 2009; Peng et al., 2008). The existing TCE analyses on trading companies are mainly from first two perspectives, and *miss the analysis from an institutional perspective, which is the third gap in this study*. Specifically, the scholars focus on the transaction costs from firm perspective, like CTCs' agent costs, JGTCs' information costs, American EIs' searching, negotiation and monitoring costs, and from industrial perspective, like the costs related international markets, tradable products, relationship between manufacturers and trading companies. The recent literatures have already highlighted institution-related transaction costs. For instance, Orr & Scott (2008) found huge institution-related transaction costs in international projects. They believe that these "institutional transaction costs" differ from the traditional understanding of transaction costs, and are ignored but very important for international business. Furthermore, many studies have emphasized that the studies on transition economies need more attention from an institutional perspective, as the business is considerably influenced by local institutions (Meyer & Peng, 2005; Peng et al., 2008). Thus this study on trading companies from developing countries obviously needs additional concerns from the institutional perspective.

## **2.4 Gaps and research questions in this study**

Following the literature review, three research gaps are identified:

1. While most studies are about the trading companies from developed countries, less attention is paid to the transition economies, like China, which has become one of the most important players in international trade.
2. The extant literatures using TCE analysis, which is considered the most significant theory on trading companies, fail to pay enough attention to other players involved in international trade, especially foreign buyers or importers.
3. These literatures using TCE analysis ignore concerns from an institutional perspective, which have been proved the most important determinant for the study of business in transition economies.

Finally, according to these three gaps in the extant literatures on trading companies, the research questions in this study are:

- 1) What are the institutions, which generate transaction costs for domestic manufacturers and foreign buyers, in China's export market?
- 2) How do Chinese exporting trading companies respond to such institution-related costs as an intermediate between domestic manufacturers and foreign buyers?

## **2.5 Chapter summary**

This Chapter reviews the main literatures in the field of trading companies. It initially introduces the different trading companies worldwide, including typology, their roles in international business, and their history, characteristics and approaches to facilitate export in three main countries and regions. Then one detailed review is undertaken on theoretical literatures on trading companies, which contains introduction of theory, empirical explanation on trading companies and critiques on extant studies. Among of them, the TCE, as core theory on trading companies, is mainly discussed, while RBV, as supplementary theory, is briefly analysed. In the end, three gaps are identified from extant literatures. Correspondingly, two research questions are raised.

## **Chapter 3 An integrative analytical framework of trading company**

This chapter aims to develop corresponding analytical frameworks for the purpose of exploring such questions, in order to response to the gaps and research questions developed in Chapter 2. Therefore, this chapter is organized around the institutional perspective and integration of an institutional perspective and transaction costs economics analysis. In section 3.1, the institutions and institutional theories are introduced as the foundation of an institutional perspective on business study. Then, the characteristics of institutions in transition economies are stated in 3.2 to highlight the distinct institutions related to the location of this study, China. Afterwards, the section 3.3 reviews and discusses one workable institutional perspective, which is suitable for the business study on transition economies. Finally, one new integrative framework, which will guide this study, is developed in section 3.4, by combining transaction costs economics analysis and the institutional perspective. In the end, the section 3.5 summarizes this chapter.

### **3.1 Institutions**

#### ***3.1.1 Why use institutional perspective in this study?***

The institutional perspective, has been dominant in recent literatures in international business(Peng et al., 2008), as the lens through which IB's traditional characteristics for studying transactions across different nations, and certainly in distinct institutions (Henisz & Swaminathan, 2008). The studies on transition economies require more attention from the institutional perspective, because existing theories in IB emerged from western countries with sound marketing institutions (Peng, 2001, 2006). Moreover, China, as one of the most representatives among transition economies (Hoskisson, Eden, Lau, & Wright, 2000), needs special consideration from an institutional perspective (Child, 2009; Peng, 2005).

#### ***3.1.2 What are institutions?***

North (1990, p3-4) indicates "institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction".

These institutions contain formal rules, such as political, judicial and economic rules, and informal ones, like cultures, customs, traditions, and codes of conducts, which “come from socially transmitted information”. (North, 1990, p37) Likewise, from the sociological perspective, Scott (Scott, 2008, p48) defines as “institutions are comprised of regulative, normative and cultural-cognitive elements that, together with associated activities and resources, provide stability and meaning to social life”.

The extant research on institutions mainly refers to three mainstream fields: economics, political science and sociology. There are many different viewpoints in each field (Scott, 2008). Scott’s study on institutions, the book, *Institutions and Organizations* offer some review the their viewpoints on institutions and relavent theory (Scott, 2008). This study brifly concludes these viewpoints according Scott’s work (shown in the table 3-2). From this review, it is found that these institutionalists focus on different perspectives of institutions, particularly when they come from three distinct main academic fields. As Yiu & Makino claim, the institutional theories in economics and sociology seem to present divergence: the former is based on efficiency criteria, while the sociological perspective focuses on the “legitimacy” criteria (Yiu & Makino, 2002). Certainly there are some overlapping parts, especially with regard to the new institutionalism parts. For instance, the rational choice theory in new institutionalism in political science is close to the new institutionalism in economics (Scott, 2008, p33). In addition, Peng (Peng, 2006) states that there are few difference between North’s formal and informal classification on institutions, and Scott’s regulative, normative and cognitive pillars (shown in Table 3-1). In short, the researches on institutions in general remain undecided about which school to favour, given the differences between them.

**Table 3-1 The classification on institutions.**

Dimensions of Institutions		
Degree of Formality (North, 1990)	Examples	Supportive Pillars (Scott, 1995)
Formal institutions	Law	Regulative (coercive)
	Regulations	
	Rules	
Informal institutions	Norms	Normative
	Cultures	Cognitive
	Ethics	

Source: (Peng, 2006; Peng et al., 2009)

**Table 3-2 General summary of different scholars and their standpoints on institutions and relevant theories.**

	Main standpoints in academics	Scholars	studies
Early institutional theory in Economics	Individual's behaviour is limited by habits and conventions, rather than by hypothesis of the rational man in neoclassical economics	Thorstein Veblen	The Theory of the Leisure Class, 1899
	The transaction, as the mechanism and rule of conduct, limits individual and firms' behaviours. Therefore, the reset of transaction as the analytical unit introduces the institutions to economic analysis	John Commons	Institutional Economics, 1934;
New institutionalism in Economics	The transaction costs exist and are important in economics.  Institutions, trading mechanisms and market mechanisms, influence the economic transactions.  The institutions are changing and have the characteristics of path dependence.	Ronald Coase	The nature of the firm, 1937; The problem of social cost, 1960; etc
		Oliver Williamson	Markets and hierarchies: analysis and antitrust implications, 1975; The Economic Institutions of Capitalism: Firms Markets, Relational Contracting, 1985; The mechanisms of governance, 1996; etc
		Douglass North	Institutions, institutional change and economic performance, 1990; Institutional change and American economic growth, 1971; etc
Early institutional theory in political science	These studies focus on the detailed explanation (mainly configurative description) of specific formal legal systems, rules and procedures, without the standpoints of characteristics of changing institutions.  These studies are mainly nontheoretical.	John William Burgess	Reconstruction and the Constitution 1866-1876, 1902
		Woodrow Wilson	The State and Federal Governments of the United States: A Brief Manual for School and Colleges, 1889
		Westel Woodbury Willoughby	An examination of the nature of the state: A study in political philosophy..1896; The American constitutional system: an introduction to the study of the American state. 1919
New institutionalism in political science	These studies belong to historical institutionalism.  They believe that institutions conclude "both formal structures and informal rules and procedures that structure conduct"	March and Olsen (1984, 1989), Krasner (1988), Hall (1986),	March and Olsen (1984, 1989), Krasner (1988), Hall (1986), Skocpol (1985)

	(Thelen and Steinmo 1992:2).  In these studies, political systems are not the result of rational choice, but of the unexpected and bounded choice. In addition, history is underdetermined and context-dependent	Skocpol (1985)	
	These studies belong to rational choice theory, where institutions are governance or rule systems: "Institutions represent rationally constructed edifices established by individuals seeking to promote or protect their interests"	Terry Moe, Kenneth Shepsle, Barry Weingast	
Early institutional theory in sociology	"Spencer (1876, 1896, 1910) viewed society as an organic system evolving through time. Adaptation of the system to its context was achieved via the functions of specialized "organs" structured as institutional subsystems."	Herbert Spencer	Spencer (1876, 1896, 1910)
	For Sumner (1906: 53), "an institution consists of a concept (idea, notion, doctrine, interest) and a structure." The "concept" defines the purposes or functions of the institution, whereas the "structure" embodies the idea of the institution and furnishes the instrumentalities through which the idea is put into action. Societal evolution progresses from individual activities to folkways, to mores, to full-fledged institutions. Such institutions are "crescive"—evolving slowly through instinctive efforts over long periods of time—although institutions can also be "enacted"—the products of rational intention and invention."	William Graham Sumner	Folkways, 1906
	Institutions are "a set of interwoven folkways, mores and laws built around one or more functions." And the conception of institutions as functionally specialized arenas.	Kingsley Davis	Human Society, 1949
	The relation between individuals and institutions is interdependent. For instance, the institutions are constructed through interaction among individuals	Thomas Cooley,	Social organization, 1902/1956
		Everett Hughes	The ecological aspects of institutions, 1936
	Institutions, like capitalism, contain the activities and social structures, including the beliefs, norms, power relations and so on	Karl Marx	Economic and Philosophic Manuscripts of 1844, 1844/1972; The German Ideology, 1845/1972; etc
	Institutions, as symbolic systems, "although a product of human interaction, are experienced by individuals as	Emile Durkheim	The Rules of Sociological Method, 1901/1950; etc



	objective”		
	Institutions, as cultural rules, including customs, rules and legal system, “define social structures and govern social behavior, including economic structures and behavior.”	Max Weber	the theory of social and economic organization, 1924/1947; etc
New institutionalism in sociology	“The systems approach tends to regard behaviour as a reflection of the characteristics of a social system containing a series of impersonal processes which are external to the actors and constrain them. In emphasising that action derives from the meanings that men attach to their own and each other’s acts, the action frame of reference argues that man is constrained by the way in which he socially constructs his reality.” (Silverman 1983: 141)	David Silverman	The Theory of Organisations, 1983
	Pierre, initially indicates the concept of social field, which means social arenas governed by distinctive values and approaches.	Pierre Bourdieu	Pierre Bourdieu,
	In these studies, institutions are “complexes of culture rules”, which support organisations.	John Meyer and Brain Rowan	John Meyer and Brain Rowan, 1977
	These two studies indicate three main mechanisms (coercive, mimetic, and normative) of institutions’ influence on organizational fields. As a result, organizations show isomorphism, which is one main contribution.  They also initially identify the organization “field” or sector as an analytical level.  In addition, the introduction of “imprinting” effects of institutions is also the contribution in thesetwo studies	DiMaggio and Powell, Meyer and Scott	DiMaggio and Powell, 1983 Meyer and Scott, 1983

Source: adopted from (Scott, 2008)

### ***3.1.3 Institutional theories in this study?***

This study mainly uses two arguments from the extant researches on institutions. First of all, the institutions influence transactions and the level of transaction costs. North claims that “institutions provide the structure for exchange that (together with the technology employed) determines the cost of transacting and the cost of transformation.” (North, 1990, p34) Coase (1998) also states that “the costs of exchange depend on the institutions of a country: its legal system, its political system, its social system, its educational system, its culture, and so on”. Apparently, institutions impinge on the transaction costs in two ways: to raise and reduce them. On one hand, most institutions researched are capable of reducing uncertainty and transaction costs (North, 1990, p6). On the other hand, others, like “rules that restrict entry, require useless inspections, raise information costs, or make property rights less secure”, actually increase transaction costs (North, 1990, p61). Finally “because that market is imperfect, institutions everywhere are a mixed bag composed of those that lower costs and those that raise them.” (North, 1990, p61). Therefore, this study believes that *local institutions will influence the level of transaction costs in China’s export markets.*

More specifically, such influence will be shown as institutional effects on main characteristics of transaction costs in this study, say *bounded rationality, opportunism, frequency, uncertainty and asset specificity*. Many studies have proved that certain institutions enhance or reduce these characteristics. For instance, Williamson (1996, p268) highlights that social culture, one informal institutions, is introduced in economic organizations for mitigation of *opportunism*. North (1990, p58-59) is also explicit on that the ineffective judicial systems in developing countries, including obscure legal framework and uncertain behaviours of agents, such as lawyers and arbitrators, increase *uncertainty*. As this study mainly study institutions in transition economies, more detailed discussion on the influence of specific institutions on these characteristics of transaction costs in these countries will be presented in later part of this chapter. Section 2.3.1.1 Transaction costs economics discussed that these five characteristics determine the level of transaction

costs. Therefore, this study argues that certain local institutions, by impacting these characteristics, will influence the level of transaction costs in China's export markets.

Second, such influences on transaction costs are variable for different organizations in the same institutional environment. As North indicates, "institutional constraints include both what individuals are prohibited from doing and, sometimes, under what conditions some individuals are permitted to undertake certain activities." (North, 1990, p4). In other words, the institutions constrain certain trading partners, and facilitate other transactions at the same time. Such an argument also appears in the institutional theory from sociology. Scott (2008, p52) indicates that some regulations (or formal institutions) also "enable social actors and action, conferring licenses, special powers, and benefits to some types of actors". Therefore, the institutions, including the institutional changes, exert varying effects on organizations in term of their forms and position in the institutional environment. This argument has also received support from the literatures in international business. Peng (Peng, 2003), and Meyer & Nguyen (2005) claim that the institutional effects on different firms, such as local firms, foreign firms, SMEs and MNEs, are different.

Although these two arguments apply to all institutional environments, it is still necessary to review the specific characteristics of the institutional environment of transition economies, in order to specify the institutional framework to guide this study. Initially, the researching destination is China, which is illustrated as the representative of transition economies (Child & Tse, 2001). The extant literatures indicate that these transition economies show distinct and unknown institutional environments and characteristics, compared with those well-reported western developed countries (Child & Tse, 2001; Peng, 2005). Therefore, one review of the literatures on transition economies helps to understand how and what kind of distinct institutions influence economic transactions. More importantly, the research on institutions, particularly in the field of international business, shows considerably diversification. One review helps to develop a specific institutional framework, which guides later data collection and analysis. In addition, this study choose North's formal and informal classification on institutions (North, 1990), as such classification

is widely accepted and used in extant institution-related studies in international business and strategic management (Peng & Heath, 1996).

## **3.2 The characteristics of institutions in transition economies**

### ***3.2.1 What are transition economies?***

In the past century, almost all socialist economies demonstrate a great deal of problems and are difficult to maintain, while other capitalist countries show more productive economies (Ingram & Silverman, 2002). With the increasing seriousness of problems in these economies, the transition from the former to latter is inevitable. The *transition economies* are defined within some countries and region, especially some emerging markets, where formal and informal institutions are comprehensively and fundamentally changing, particularly from central planning to market-based economic reform (Peng, 2003, p275). The transitional process at least affects the lives of 1.65 billion people (Roland, 2004, p17).

From 1922, when the Soviet Union, the first socialist country, was established, there emerged more than 12 more socialist countries, such as China, Yugoslavia, etc. (See the below Table 3-3 ), representing one third of the population of the whole world. In these countries the so-called state socialism of “social-political-economic system” is run by the ruling Communist Party, while the communist ideology prevails. Two typical characteristics of these countries are central planning and bureaucratic control. Central planning, like the popular five-year plan in Soviet Union, replaces the market in terms of resource allocation, while the bureaucrats and bureaucratic system, like the national planning office, become the most dominant planner in these countries. Correspondingly, the social-economic system is highly planned, rather than market-based, while the firms are characterised by administrative agents, rather than economic agents.

After a brief economic booming period at the beginning, these countries were confronted with considerable problems, like lack of incentive mechanisms and coordination. Plus there were some political events, such that these counties had to reform previous institutions to survive during huge social and economic crises.

During these institutional transitions, “shock therapy” and “gradualist approach” are respectively adapted by one group of countries represented by the Soviet Union and CEE, and another group of countries represented by China and Vietnam. The former means a series of fierce and fast reforms, like the openness of price, liberalized market, private ownership shift, etc, most of which happen overnight. The latter means the reforms firstly happen in one area experimentally and then gradually extend to the rest. Although there are debates and difference of speed and outcome of different reforms, the processes are similar: namely, institutional transition from central planning to a marketing system (Peng, 2000, p13-39).

**Table 3-3 Socialist Countries and Their Reforms and Transitions.**

<i>Country</i>	<i>Year of Communist Takeover</i>	<i>Key Dates in Reforms and Transitions</i>	<i>Political Events Connected With the Key Dates</i>
1. Soviet Union	1917	1953-1964 1985 1991	Excesses of Stalinism denounced Gorbachev came to power The Soviet Union was dissolved
2. Mongolia	1921	1990	Communist government stepped down
3. Albania	1944	1990	Multiparty system established
4. Yugoslavia	1945	1949  1990	Broke away from the orthodox Soviet bloc  First multiparty elections in certain republics
5. Bulgaria	1947	1991 1989	The former Yugoslavia broken up Communist government stepped down
6. Czechoslovakia	1948	1968  1989 1993	“Prague Spring” crushed by Soviet military  “Velvet Revolution” The former Czechoslovakia split in two
7. Hungary	1948	1956  1968  1989	Reform program crushed by Soviet military  New Economic Mechanisms launched  Multiparty system declared
8. Poland	1948	1981  1989	Solidarity trade union crushed by martial law  Noncommunist government formed
9. Romania	1948	1989	Communist government removed by military
10. China	1949	1978 1989	Economic reforms launched Pro-democracy movement crushed by military
11. East Germany	1949	1989 1990	Berlin Wall fell Reunited with West Germany
12. Vietnam	1954	1987	Economic reforms launched

Source :(Peng, 2000, p15)

### ***3.2.2 The characteristics of institutions in transition economies***

Thus institutional transition becomes the main social, economic and political phenomenon in these countries and regions. In brief, as stated above, the *transitional*

*process* includes the collapse of previous (formal and informal) institutions under the central planning system and the emergence of new (formal and informal) institutions corresponding to the marketing system (Meyer, 2001b; Peng, 2003). But the process of replacement is gradual (Gelbuda, Meyer, & Delios, 2008), and incremental (North, 1990, p6; Peng, 2003), due to path dependency and bounded rationality. As Peng (2003) argued, institutional transition, especially with regard to the informal, is generally incremental, though with some discontinuous transformations sometimes. And also the collapse of previous institutions is not necessary in order to accompany the emergence of new institutions in the meanwhile. The result turns out to be a special period of mixed institutions with some of the previous central planning system and of the incomplete emerging marketing system (Nee, 1992).

Correspondingly, a number of problems related to institutional transition also take place in these transition economies (one overview of formal and informal institutional factors in transition economies is shown in Table 3-4). For instance institutional constraints (Child & Yuan, 1996), institutional voids (Miller et al., 2009), uncertainty with institutional change (Child & Tse, 2001), misalignment between institutional supply and firm demand (Witt & Lewin, 2007), and so on. These jointly construct a distinctive institutional environment in these transition economies, which is different from previous planning systems, or far from that in developed economies with stable and matured institutions, and incur additional transaction costs for local and international firms' business activities. It therefore requires one workable institutional framework, which is suitable for the process of institutional transition in these countries, and also integrates and structures of these extant institutional problems, to guide later data collection and the of process analysis.

### ***3.2.3 How institutions affect transaction costs in transition economies?***

As discussed previously in section 3.1.3, the institutions considerably influence on transaction costs by impacting *bounded rationality, opportunism, frequency, uncertainty and asset specificity*. This part further discusses how specific institutions, especially those problematic ones, influence these characteristics of transaction costs in transition economies. The existing literatures have proved that some dysfunctional

institutions obstruct business activities, and increase costs for transactions in transition economies (Estrin, Meyer, & Bychkova, 2008; Khanna & Palepu, 1997, 1999; Khanna, Palepu, & Sinha, 2005; Meyer, 2001a; Meyer & Peng, 2005; Peng, 2003; Peng & Heath, 1996). Following them, this study mainly discusses four specific institutions from formal and informal categories, which are commonly reported in studies on transition economies and become the **most possible** institutions involved in this study.

### **3.1.3.1 Formal institutions**

Formal institutions, representing regulative or coercive pillar, refer to political, judicial and economic rules, and contracts (North, 1990). They are normally provided by state, some “regulations are enforced by judges, courts, police bureaucracy and the like” (Keefer & Shirley, 2000b). However, it is reported that formal institutions, like government policy and legal system, in transition economies turn out to be problematic and increase transaction costs for business (Hitt, Ahlstrom, Dacin, Levitas, & Svobodina, 2004).

#### ***Unstable government policies***

First, formal institutions continuously change in transition economies, which create an extremely *uncertain environment* (North, 1990; Peng & Heath, 1996) and *opportunistic behaviours* (Peng, Lee, & Wang, 2005). Transition economies are characterised as institutional transition from central planning towards market-based (Peng, 2003), implying local institutions, especially the formal institutions (Bevan, Estrin, & Meyer, 2004) like government policies (Estrin et al., 2008), are unstable and changing during both incremental and discontinuous institutional transition (Hitt et al., 2004; Peng, 2003). As Peng and Heath (1996) described, “every rule is rapidly changing and the only constant is uncertainty.”

Such unstable government policies obstruct business in transition economies. Estrin et al (2008) find that unstable government policies, such as the uncertain administrative procedures, create series of problems for local entrepreneurs. Similarly, Hitt et al (2004) also discover that the changing government policies make

local firms tend to short-term relationship, rather than more healthy long-term relationship, with business partners in Russia.

Transaction costs analysis believes that such unstable institutions in these transition economies will lead to *uncertainty and opportunistic behaviours* for business activities and transactions, and therefore increase transaction costs. After study of Entrepreneurship in Russia, Puffer & McCarthy (2001) indicate that the situation that Russian government unpredictably passed policies and produced chaotic formal institutions significantly increase *uncertainty* and resulting transaction costs for related business. Meyer et al (2005) also express similar statement. They find that the changing regulation and rules, as one significant problem for foreign investors in transition economies, increase *uncertainty* and transaction costs. In addition, the uncertain environment in transition economies increases the level of information asymmetry, and further results in growing possibility of *opportunistic behaviours* in the transactions between unknown parties (Peng, Lee, & Wang, 2005). As a result, the unstable government policies in transition economies raise transaction costs by increasing uncertainty and opportunistic behaviours for business there.

### ***Bureaucratic administrative procedures for business***

Second, formal institutions, like administrative procedure for business, in transition economies have the reputation of being bureaucratic, which increase *uncertainty* for business activities. The bureaucratic institutions are characterised as being inefficient and less transparent (Estrin et al., 2008). Meyer (2001a) identifies that the bureaucratic procedures in Eastern Europe, such as the approval for real estate acquisition, could generate significant costs in term of time, as these procedures are complex and slow. Estrin et al (2008) also reveals a similar finding in the study of the institutional environment in transitional economies. They find that some administrative barriers obstruct businesses in these economies, such as the lengthy timescales and massive procedures for starting up businesses. They further take Hungarian for example, it can take up to 52 days to start up a business. Such complex and ambiguous administrative procedures result in uncertain policy



outcome, then increase *uncertainty* and transaction costs for business (Estrin et al., 2008; Khanna & Palepu, 1997).

### ***Weak legal system***

Legal system, as one main formal institution, is one of the most concerning issues for institutional economists (Coase, 1998; North, 1990), because it directly influence the transaction enforcement and related costs (Furubotn & Richter, 2005). Obviously, the well-developed legal system effectively limits *opportunistic behaviours* and reduces the enforcement costs of transaction (Peng & Heath, 1996). Nevertheless, the ineffective legal system, including formal law and legal enforcement (Meyer, 2001b), is the most commonly reported obstacle for doing business in transitional economies (Khanna & Palepu, 1997; Khanna et al., 2005; Meyer, 2001a).

The transaction costs analyses explain that weaker legal systems magnify *opportunism* and therefore increase transaction costs, particular the enforcement/monitoring costs, in transition economies (Coase, 2008; Peng & Heath, 1996; Walker, Tilly, & Nelson, 1998). For instance, by investigating IJVs' contracts in China, Luo (2002) reveals that the commercial contracts, as part of the inefficient legal system in China, fails to efficiently enforce contracts in China. As a result, opportunistic behaviours prevail during transaction enforcement in these countries (Choi et al., 1999; Luo, 2007).

From the existing studies on transition economies, the most criticized legal framework in transitional economies may refer to protection of property rights (Estrin et al., 2008; Peng & Heath, 1996), commercial law and contract enforcement (Choi, Lee, & Kim, 1999; Estrin et al., 2008; Khanna et al., 2005; Luo, 2002; Meyer, 2001b), official requirements for listed companies (Peng, 2004) and so on. Among them, it is noteworthy to mention the intellectual property, including patents, trademarks, copyrights and trade secrets (Hisrich, 2012), as it is considered as one main element to determine exporting activities (Maskus & Penubarti, 1995). Moreover, this study also finds that the consideration of protection of intellectual property becomes determinant for some exporting decision (in case B and D). Plenty studies have jointly proved that the legal system fails to define and effectively protect

property rights in transition economies (Boisot & Child, 1988; Meyer, 2001b; Peng & Heath, 1996; Puffer, McCarthy, & Boisot, 2010). As intangible assets, intellectual property becomes more vulnerable to *opportunistic behaviours* influenced by weaker legal systems (Beata, 2004; Meyer, 2001a; Oxley, 1999).

### ***3.1.3.2 Informal institutions***

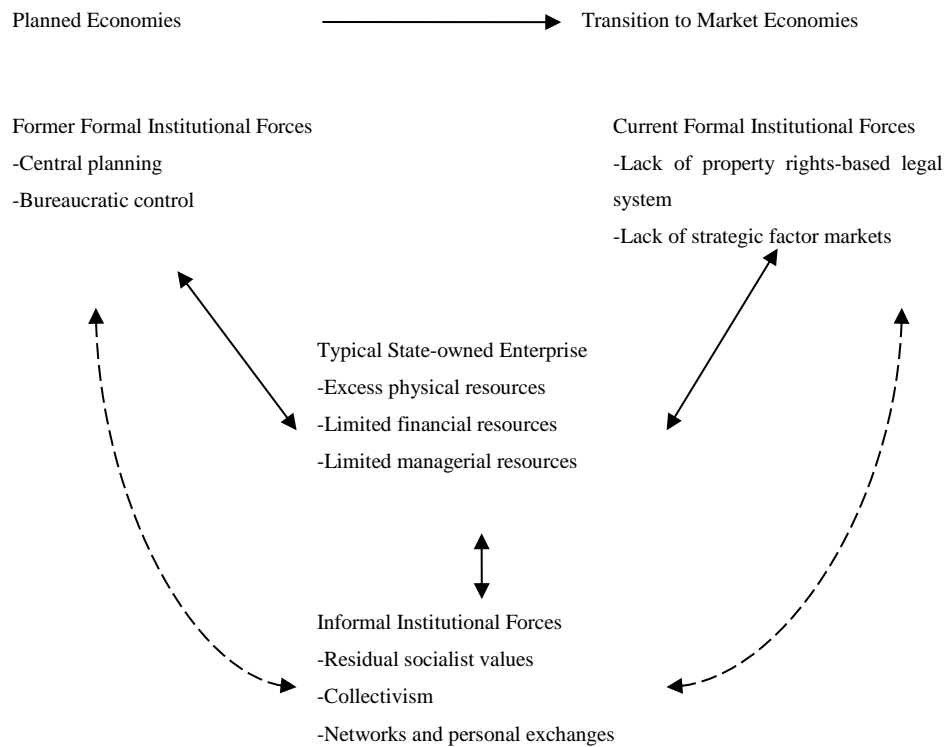
Informal institutions usually refer to cultures, customs, traditions, and codes of conducts, which “come from socially transmitted information”(North, 1990, p37). They are usually enforced by business and social groups, family or private entity and can substitute and supplement formal ones (Keefer & Shirley, 2000b, p96). Because of bounded rationality, neither formal institutions nor individual contracts are perfect, the informal institutions, which usually generate ahead of formal ones, will assist here (Furubotn & Richter, 2005, p19) Therefore, informal institutions could be more important for business and transaction costs in transition economies, where formal ones are dysfunctional.

However, some informal institutions also bring relatively higher *uncertainty* and additional transaction costs for the firms and transactions, which are unfamiliar with or unable to use these informal institutions. For instance, it is widely reported that many informal institutions in transition economies, like China’s Guanxi and Russia blat, are quite unique and *hard-to-master* for foreign and even domestic firms, as their complexity root in local social and cultural factors and have been gradually developed for long history (Hitt et al., 2004). Inevitably these informal institutions also deeply influence and change business activities related. It is found that some informal institutions actually considerably support, mainly by reducing uncertainty, business activities in transition economies (Peng, 2003; Peng & Heath, 1996; Xin & Pearce, 1996). For instance, Peng and Heath (1996) suggest that the use of network contacts and personal relation are able to help reduce environment uncertainty and favour firms’ growth in transition economies. Meyer also comes to a similar finding in their study on transition economies (Meyer, 2001b). Meanwhile, other firms, usually outside the networks, which are unfamiliar with and/or unable to use these network-based strategies, have to confront with relatively higher *uncertainty* during

their transactions in these transition economies. As a result, these informal institutions incur *uncertainty* and additional transaction costs for the firms outside networks.

### **3.3 The part of institutional perspective in integrative analytical framework**

To develop the institutional part of analytical framework, this study uses one “institutional frameworks in planned economies in transition” from the study of Peng and Heath (1996) (Shown in Figure 3-1). First, it is highly synthesized to comprehend formal, informal institutional constraints and resulting resource constraints for the firms involved. By doing this, it could conclude all emergent constraining items for this explorative research. Moreover, it has been proved by Peng and Heath (1996) to support the institutional environment in China, particularly the characteristics of institutional transition.



**Figure 3-1 Institutional frameworks in planned economies in transition.**

Source: (Peng & Heath, 1996).

This framework comprises three main institutional constraints which jointly reflect the characteristics of institutions during the institutional transition in transition economies.

### ***3.3.1 Former formal institutional constraints***

The first groups of institutional forces refer to the *former formal institutional constraints*, such as central planning and bureaucratic control (Peng & Heath, 1996), which were inherited from the previous planned economy system (Estrin et al., 2008), but still exist in many ways in the transition economies. They reflect the first process of institutional transition in transition economies: the collapse of previous institutions

under the central planning system. They existed before transition, and are characterized by central planning system.

In North's institutional change theory, institutions are commonly characterized as path dependent, which means the institutional changes are incremental rather than discontinuous (North, 1990). Thus when the institutional transition is considered as one special institutional change from central planning to market-based institutions, the path dependence characteristic of institutional change results in the previous institutional conditions (central planning system) in transition economies not being completely withdrawn and largely influences the entire institutional transition (Hitt et al., 2004). For instance, though most marketing-style businesses are nominally permitted, the bureaucracy is still popular after transition, like the slow and complicated approval and administrative procedures for some projects and licences (Estrin et al., 2008; Meyer, 2001a).

In addition, the "gradualism" of reform also leads to such formal institutional constraints. The most typical gradualist reform takes place in China. "Cross a river by feeling for the stones" is the vivid description of China's reform by Deng Xiaoping, the Chinese reformer and politician. It means the reform firstly takes place in some specific aspects, like regions, industries, firms etc., and then is gradually extended to others, in order to avoid massive uncertainty and costs of rapid and significant transition (like "shock therapy" reform in Russia) (Buck, Filatotchev, Nolan, & Wright, 2001; Peng, 2000). As a result, some institutions will gradually fade out or be changed into more invisible ones. Buck et al (2001) take China's government regulations to JVs as an example, and illustrate that though the regulation of foreign involvement has been gradually dismantled since 1970s, and the majority foreign ownership of JVs permitted since 1988 in China, state approval procedures were then introduced by central government to "hold back" the foreign levels of commitment. They further argue that these unreformed institutions, like the limitations on foreign commitment, will potentially affect MNEs' strategy and long-term performance, like weak corporate governance, and result in higher risk. Another study on MNEs' FDI strategy towards Vietnam also confirmed that the institutional

barriers, like implementation of regulations, local government's attitude to FDI, etc., had been slowly reformed in the long term, and particularly with different steps for each region in a single country due to local interests (Meyer & Nguyen, 2005).

### ***3.3.2 Current formal institutional constraints during transition***

The second sort of institutional forces are *current formal institutional constraints*, which show the lack of market-supporting institutions in transition economies, such as the lack of a property rights-based legal system (Peng & Heath, 1996). They reflect the second process of institutional transition in transition economies: the emergence of new institutions supporting the market-based system.

Roland (2004, p19) states "successful institutions of capitalism are already present in advanced economies, and we tend to take them for granted when reasoning about economies in transition or about developing economies where such institutions are absent." These "situations, where institutional arrangements that support markets are absent, weak, or fail to accomplish the role expected of them" are called "institutional voids" (Mair & Marti, 2009), which have become the main problems for business and obstruct economic transactions in transition economies (Khanna & Palepu, 1997, 1999; Khanna et al., 2005), compared with the developed countries, where the mature institutions are able to facilitate business activities. For instance, Khanna & Palepu (1997) stated three typical institutional voids, namely lack of adequate and reliable information, market(ing)-efficiency regulations, and inefficient judicial systems, that lead to considerable market failures, among capital markets, labour markets, product markets, government regulation, and contract enforcement in emerging markets.

On one hand, the new institutions are usually faced with resistance from previous institutions (Oliver, 1992). It is argued, for instance, that as the main agent for constructing new institutions, the (bureaucratic) governments (Scott, 2008, p95) in transitional countries fail to make great efforts to construct market-supporting institutions, like efficient judicial systems and enforcement frameworks (Puffer et al., 2010).

On the other hand, it is hard and slow to establish a series of new market-supporting institutions in these former central-planning-dominated countries. The market-supporting institutions contain a series of complex, inter-related, inter-acting, formal and informal institutions, which are not able to be constructed in the short term due to bounded rationality of institutional designers (Scott, 2008). And the characteristic of path-dependence makes new institutions, especially informal institutions, more difficult to emerge without the marketing tradition (Meyer, 2001b; North, 1990). For instance, some basic market-based institutions, like privation, price liberalization, commercial law, enterprise restructuring, etc., have been gradually established in some former planning economies. Due to the inconsistency and uncertainty of these new institutions, however, the transaction costs of business are not reduced to a level similar to developed countries (Meyer, 2001a). Thus there will be a relatively long time without complete market-supporting formal institutions in these transition economies.

### ***3.3.3 Informal constraints before and during the transition***

Informal institutions, like cultures, customs, traditions, and codes of conduct, “come from socially transmitted information”, and are important as well as formal institutions, though they “defy, for the most part, neat specification and it is extremely difficult to develop unambiguous tests of their significance.” (North, 1990, p36-37). “They are they are (1) extensions, elaborations, and modifications of formal rules; (2) socially sanctioned norms of behaviour; and (3) internally enforced standards of conduct.” (North, 1990, p40). Because of informal institutions, whole institutions normally change incrementally (North, 1990, p6).

Due to the path dependence, the informal institutions are apparently more difficult to change compared with formal institutions. As North (1990, p6) said, “although formal rules may change overnight as the result of political or judicial decisions, informal constraints embodied in customs, traditions, and codes of conduct are much more impervious to deliberate policies.” In addition, the informal institutions can both substitute for and supplement formal institutions. In some cases, the informal institutions are more entrenched than the formal ones (Keefer & Shirley, 2000a, p46-

47; North, 1990). In the study of Peng & Heath (1996), they indicate that the popularity of some informal institutions in transition economics is indeed the result (substitution and supplement of formal institutions) when former formal institutions are dismissed and emerging formal institutions are still inefficient. They later illustrate three informal constraints as instances of this: residual socialist values, collectivism and networks and personal exchanges. In the extant literatures, many studies have also noted such informal institutions, most of which generates incontinence for marketing transactions. For instance, Meyer (2001a) states that workers and managers' working routines, habits and attitudes, which had been developed in previous central-planning regime, such as shirking, will persist during transition.



**Table 3-4 The formal and informal institutional factors in transition economies.**

Formal Institutions	Informal Institutions	Countries and regions	Literatures & Authors
Continuous effects by previous planning regime and bureaucratic control	Residual socialist values	General transition economies	The Growth of the Firm in Planned Economies in Transition: Institutions, Organizations, and Strategic Choice (Peng & Heath, 1996)
Lack of property rights and relative legal system	Collectivism		
Lack of strategic factor markets	Networks and personal exchanges		
Lack of stable political structures			
The institutional transition in unpredictable ways	The popularity of relational networks	China & Russia	The institutional effects on strategic alliance partner selection in transition economies: China vs. Russia (Hitt et al., 2004)
Underdeveloped capital market	Manager seeks short-term investment rather long-term. Strategic alliance		
The gradually developing financial institutions	Social capital embedded in networks prevails	General emerging markets	What determines the scope of the firm over time-a focus on institutional relatedness (Peng et al., 2005)
The formal market-supporting institutions e.g. government-imposed entry barriers, are gradually workable, but uneven in different sectors in short-term	Political capital, like political connections, increase public reputation, social legitimacy & political effectiveness		
	Reputation capital reduces information asymmetry		
Restrictive legislation, regulative entry barrier for foreign entrants	Relatively large psychic distance from transition economies	Eastern European Countries	Institutions, transaction costs, and entry mode choice in Eastern Europe (Meyer, 2001a)
Inefficient bureaucratic procedures, administrative approval			
Inefficient business “negotiation with government authority, management and work councils”			

insufficient protection of intellectual property rights			
Lack of strong legal requirements (regulative) to appoint more outside directors in boards of listed companies	Lack of strong cognitive pressures on the top managers of newly listed joint-stock companies to have more outside directors	China	Outside directors and firm performance during institutional transitions (Peng, 2004)
Lack of regulatory systems	Lack of contract-enforcing mechanisms	General emerging markets	Strategies that fit emerging markets (Khanna et al., 2005)
	Lack of specialized intermediaries, like marketing, logistic & job agents		
Distinct institutions, such as legal systems, labour market structure, culture, etc		General transition economies	Learning about the institutional environment (Henisz & Delios, 2002)
Lack of institutional mechanisms for adequate and reliable information		General emerging markets	Why focused strategies may be wrong for emerging markets (Khanna & Palepu, 1997)  Is group affiliation profitable in emerging markets? An analysis of diversified Indian business groups (Khanna & Palepu, 2000) ( <i>General emerging markets</i> )
Lack of marking-efficiency regulations			
Lack of efficient judicial systems			
Lack of effective institutional mechanisms (judicial systems & resulting confidence) to enforce contracts			
The powerful effects on business from central and local government	Incumbent firms are lacking in financing capability	China & Russia	The institutional effects on strategic alliance partner selection in transition economies: China vs. Russia (Hitt et al., 2004)
Institutional instability	Incumbent firms own strong capability in relational networking, guanxi in China and blat in Russia		
Unsophisticated, insular banking systems and undeveloped capital market	Incumbent firms lack the knowledge and capabilities to develop or employ		

	sophisticated manufacturing or product technologies		
	Incumbent firms are lacking in managerial capabilities		
	Incumbent firms are lacking in intangible assets, like reputation, brands		
	Incumbent firms lack international collaborative experience		
Flexible rather restrictive environmental regulation for official authorities		China	The Dynamic Between Firms' Environmental Strategies and Institutional Constraints in Emerging Economies: Evidence from China and Taiwan(Child & Tsai, 2005)
Financial barriers, such as less individual and family saving, and financial assets due to lack of private property rights in previous planned economy, and large gaps between the rich and poor		General transition economies	Entrepreneurship in transition economies (Estrin et al., 2008)
Unstable policies			
Administrative barriers, such as slow registering property procedures, complicated business start-up procedures and uncertain outcomes			
High costs, especially for SMEs, generated by inefficient and unfair taxation systems, such as “frequent changes to tax policy” and “ambiguity of taxes”			
Financial voids, such as underdeveloped financial markets and inexperienced banks, which are not capable of financing emerging private SMEs			
Lack of an updated and appropriate legal system			

and enforcement for a market economy			
Weak formal and informal contract enforcement, such as the uncertain capability of the courts to enforce contracts, and suppliers unable to deliver			
Lack of security of private property rights	Trust within networks	China & Russia	Entrepreneurship in Russia and China: The impact of formal institutional voids (Puffer et al., 2010)
	Personal relationship, like Guanxi & blat		
Lack of effective legal framework and enforcement for commercial contracts	The obligation of contracts relying on personal relationships	China	Partnering with Foreign Firms: How Do Chinese Managers View the Governance and Importance of Contracts (Luo, 2002)
	Lack of contract spirit and obligation		
The common use of consultation and renegotiation, while less use of law suits and arbitration			
A bureaucratic regime hostile to market competition	The popularity of relationship-based, personalized exchange	General transition economies	Institutional transitions and strategic choices (Peng, 2003)
A bureaucratic regime friendly to certain projects and industries, such as the military and space programs			
The lack of rule-based, impersonal exchange			
The lack of effective third-party enforcement			
Islamic pre-emption laws (shuf'a) (to stop the concept of property rights)	The lack of concept of property rights	Bangladesh	Entrepreneurship in and around institutional voids: A case study from Bangladesh (Mair & Marti, 2009)
The lack of the access to credit (	kinship norms of behaviour (to stop the concept of property rights)		
	Norms of purdah and the patriarchal system (to stop the development of marketing enforcement mechanisms)		
	The Patron/client norms		
	Moral obligation to help the needy		

	Microfinance groups' rules and norms		
Lack of unambiguously specified ownership of state assets		China	Business group affiliation and firm performance in a transition economy: A focus on ownership voids (Ma, Yao, & Xi, 2006)
Governmental interventions such as business licenses, real estate policy, access to public utilities	Unfavourable Government attitude to FDI (I)	Vietnam	Foreign Investment Strategies and Sub-national Institutions in Emerging Markets: Evidence from Vietnam (Meyer & Nguyen, 2005)
Local government's interpretation of laws and regulations in their interests	Government's protection of incumbent firms' interests		
Lack of tax incentives	Corruption		
	The popularity of networks		
Lack of effective legal system (legal enforcement of contracts, enforcement of property rights)	Lack of business routines, knowledge, and procedures	General transition economies	International Business Research on Transition Economies (Meyer, 2001b)
Lack of capital market	The popularity of opportunistic behaviour, rent shifting, bribery, and corruption		
Lack of systems providing information, accounting and auditing	Existing vested interests		
The inexperienced bureaucracy	The tradition of few incentives for quality and customer service		
	Weak linkages between firms within the supply chain		
	The common use of informal networks as intermediate mechanisms of exchange		

### **3.4 An integrative analytical framework based on transaction costs economics analysis and institutional perspective**

#### ***3.4.1 The part of transaction costs economics analysis on trading companies in integrative analytical framework***

##### **3.4.1.1 New transaction costs economics analysis on trading companies**

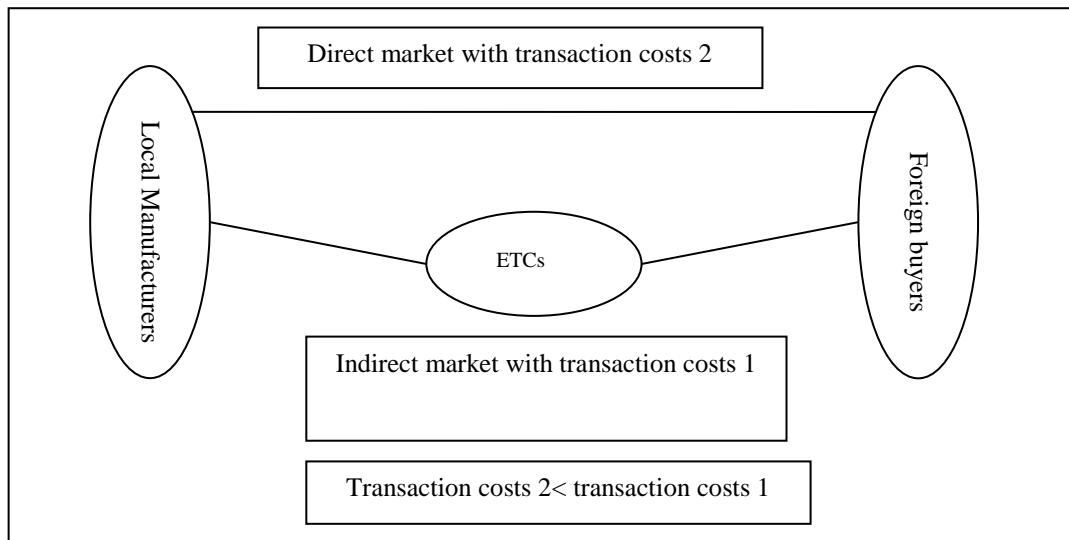
Williamson (1979, 1985, 1988, 1996) indicates that markets, firms and hybrid modes, as different government structures for organizing transactions, incur different degrees of costs, “the superior efficient one can form”. Williamson’s studies prefer the firm or hierarchy, to the markets with relatively higher transaction costs. It maybe helps to explain the existence of firm, integration decision’s logic and some inappropriate parts in former American antitrust laws. Nevertheless, the TCE doesn’t raise the conclusion that the “firm” must institute the market. As Coase said “the firm is not the only possible answer to the problem” and the “administrative costs of organising a transaction through a firm are inevitably less than the costs of the market transactions which are superseded”. Also the administrative costs may be high, “particularly so when many diverse activities are brought within the control of a single organisation” (Coase, 1960). Thus the market, as an alternative choice for economizing on transaction costs apart from “hierarchy”, should also acquire more attention. Moreover, the different markets with varying government structures also incur different costs.

With the development of the TCE, the theory of the firm has been refreshed. The firm is not a black box any more. The firm is a substitute for the market mechanism (Coase, 1937). The firm is an more efficient arrangement for internal contracts, replacing external market contracts(Cheung, 1983). The firm is the “team production” of members with effective monitoring(Alchian & Demsetz, 1972). Spulber et al (Anderson & Gatignon, 2008; Casson, 1982; Spulber, 1996, 1999, 2003) argues that the firm is also considered as the market-maker.

In Spulber’s “intermediation theory”, firms are believed to be the intermediary between the sellers and buyers, suppliers and buyers, and employees and buyers or

between consumers and providers of inputs, like finance, delivery etc (Anderson & Gatignon, 2008)). “They are formed when the gains from intermediated exchange exceed the gains from direct exchange” (Spulber, 1999, p19), Spulber further indicates “through pricing and market-making activities, the most efficient market microstructure produces the greatest gains from trade net of transaction costs” (Spulber, 1999, p256). In other words, firms can profit in two ways in increasing gains from trade and reducing transaction costs (Spulber, 1999, p259). And here the former one can also ensure that the firm achieves the same gains as others but with the lowest costs by these “pricing and market-making activities”. More specifically, he argues that these market-makers are able to reduce the transaction costs, by taking advantage of the “economies of scale and scope”, “coordination economies” and the identity of third party. These arguments are echoed by other scholars. Ménard et al (2000) stated that a firm’s activities, ..., create new markets, ..., principally by reducing transaction costs (incurred when using the price mechanism). In addition, Foss and Foss (2005) also mention “While transaction costs are a major source of value dissipation, reducing such dissipation may create value.” In the end, the firm, as the intermediary, can achieve gains from reducing transaction costs.

The market is “a group of buyers and sellers of a particular good or service.” (Mankiw, 2008, p66). In the markets of international trade, in particular, there are normally three players: sellers (manufacturers), buyers and trading companies (brokers and resellers) (Casson, 1998; Peng, 1998), which consist of two basic markets (shown as Figure 3-2). One contains manufacturers and buyers, called the “direct market”. Another one, the “indirect market”, includes the intermediary companies, namely trading companies, apart from manufacturers and buyers. From the perspective of manufacturers, or buyers, either the direct or indirect market incurs transaction costs; they will choose whichever has the lowest transaction costs. From a trading company’s point view, they have to reduce the transaction costs of the indirect market operated by them, in order to survive and acquire the value postulated by Spulber et al.



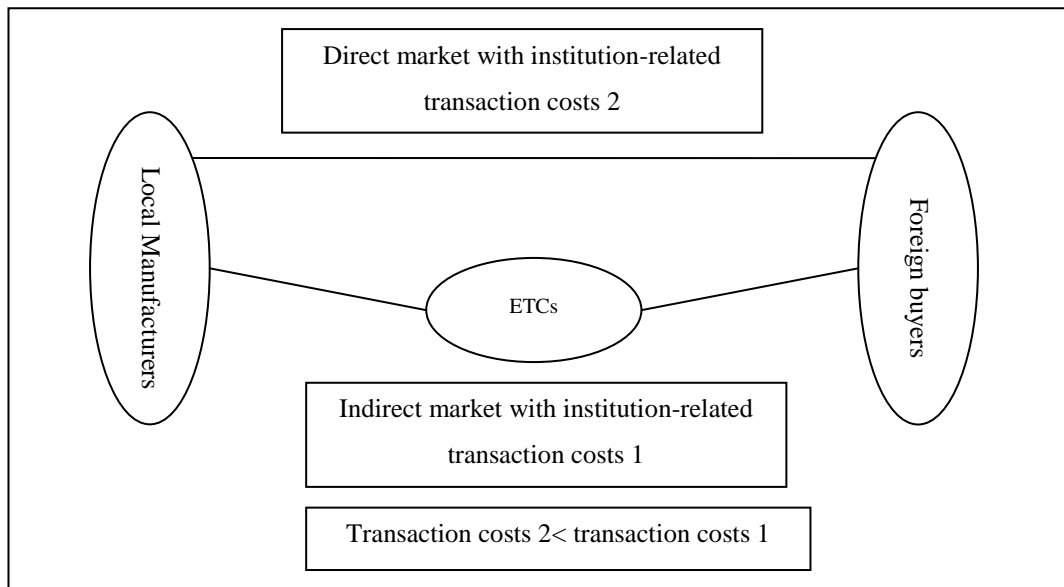
**Figure 3-2 The direct and indirect markets with different transaction costs in export**

Source: adapted from Spulber (2003)

***3.4.2 The analytical framework by integrating institutional perspective (section 3.3) into transaction costs economics analysis on trading companies (section 3.4.1)***

According to the previous arguments of the institutional effects on transaction costs, stated in 3.2 and 3.3, it is reasonable to believe that local institutions in transition economies will exert effects on direct export transactions between domestic manufacturers and foreign buyers, and those operated by ETCs on indirect markets. As a result, the ETCs can reduce the institution-related costs on China's export markets, while domestic manufacturers and foreign buyers fail to do so. Correspondingly, the previous TCE analysis on ETCs and direct and indirect export markets will be revised by such two arguments from the institutional perspective (shown as Figure 3-3).





**Figure 3-3 The direct and indirect markets with different institution-related transaction costs in export**

Adapted from Spulber (2003)

The sort of “double-edged sword” (increase and reduce) influence of institutions on transaction costs becomes more obvious in transition economies, where the absence of market-supporting institutions or some inherent market-preventing institutions largely raise transaction costs, and people have to pursue other institutions, like informal institutions and personal transactions, to pursue lower transaction costs (Meyer & Peng, 2005; North, 1990, p67). There are three main institutional constraints within the previous institutional framework applied to these just-transiting economies that jointly increase the transaction costs for both inexperienced local economic agents’ and foreign players (Meyer, 2001a).

First of all, these *former formal institutional constraints* increase both foreign and incumbent firms’ costs for doing business in transition economies. Buck et al (2001) found that though the trend is getting better, some existing regulations on JVs in these economies still limit foreign firms’ entry and mode into the market, and choice of local business partner, which obviously increase the MNEs’ costs for negotiation and ex post governance (Meyer, 2001a). In the meantime, these institutional constraints also raise incumbent firms’ transaction costs.

Moreover, an efficient marketing economy needs supporting institutions (Roland, 2004), but the institutional transition has not finish, and leads to *current formal institutional constraints*, which also incur additional costs for business transactions in transition economies with efficient markets (Khanna & Palepu, 1999; Mair & Marti, 2009; Meyer, 2001b). For instance, Khanna et al (2000) compare developed countries and emerging markets, and indicate that the absence of specialized intermediary institutions, such as specialized financial markets, is one major institutional voids in emerging markets, which certainly increase transaction costs for both foreign and local firms (Ricart, Enright, Ghemawat, Hart, & Khanna, 2004), like the response of which local large firms have to diversify into other functions with additional costs and resources (Khanna et al., 2005).

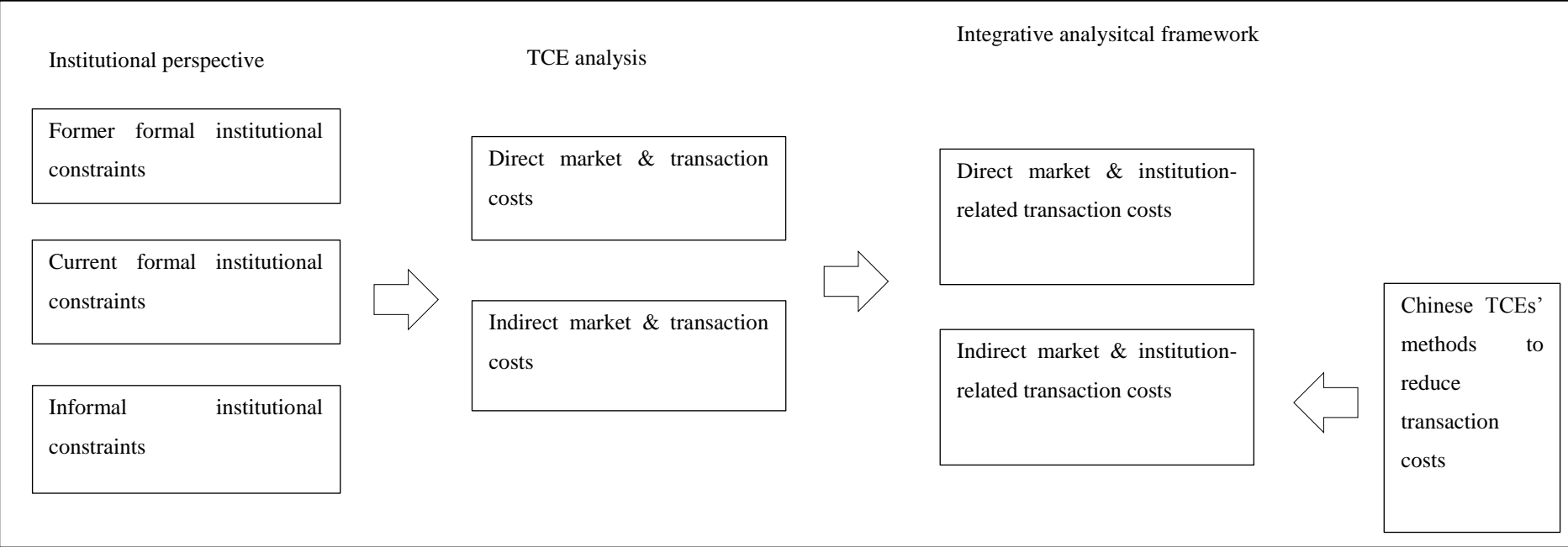
Likewise, Witt et al (2007) define the misalignment as home countries' institutional environment fails to support incumbent firms' needs; this will incur additional costs, like opportunity costs, and further result in competitive disadvantages compared with other counterparts from countries without this institutional misalignment. Furthermore, the lack of transparency will increase foreign firms' searching costs for a qualified local partner, while the lack of intellectual property protection and contract spirit increase enforcement costs of contracts (Gelbuda et al., 2008).

Thirdly, *informal institutional constraints* also bring additional transaction costs for foreign and incumbent firms. For instance, the popular use of informal networks is one of the well-known informal institutional constraints in transition economies, like China's *guanxi* and Russia *blat* (Hitt et al., 2004). But the use of these informal networks is also costly for both sides, especially for those new entrant firms and people, "because transaction parties need to build strong social networks through a time- and resource-consuming process" (Peng, 2003). In addition, in one study of Chinese-Western supply chain partnerships, Jia & Lamming (2013) indicate the foreign managers admit they manage to adapt to Chinese partners' *guanxi*-style culture during the collaborative work. And this adaptation certainly costs much for both parties. Peng (2003) also states that these established networks and personal

relationships also lift barriers for new entrants, as the firms in the networks will be locked into the networks and fail to search and transact with newcomers. Thus they also increase these new entrants' costs of entering networks.

Therefore, this study argues that these three institutional constraints in transition economies also raise the transaction costs on China's export market. Actually some recent surveys about foreign purchasers have already indicated some key problems highly related to these three institutional constraints for importing from transition economies. For instance, According to the China Purchasing Development Report of 2010 (LFRC, 2010), the "unreliable supplier" and "on-time delivery" are listed as 1st and 3rd (the 2nd is increasing operational costs) challenges by foreign purchasers for their sourcing in China. Moreover, another research study about international purchasing offices (IPOs) in China indicates the one main function of these IPOs is for controlling quality (Nassimbeni & Sartor, 2006). These "quality" problems certainly increase costs of enforcement of contracting, and monitoring costs for importers. Certainly some institutional barriers and voids, like weak formal legal systems, and lack of informal contract enforcement, the increase possibility of these problems (Luo, 2002).

As a result, the previous transactional framework is integrated into this institutional framework (shown in the Figure 3-4). In this new integrative framework, the previous TCE analysis on ETCs and direct and indirect export markets are affected by three institutional constraints from the institutional framework, and then generate different institution-related costs. On the other side, the Chinese ETCs effectively reduce such costs on their methods.



**Figure 3-4 Effects from institutional perspective on TCE analysis**

### ***3.4.3 The framework for this study***

Based on previous discussion on institutional theory (section 3.3 and 3.4) and transaction costs economics (section 2.3.1 and 3.4.1), empirical findings from pilot study (chapter 6) as well as historical review on trading companies (chapter 2 and 4), an integrative and feasible theoretical framework (shown as figure 3-5) is generated in this section in order to practicably guide future data collection and analysis. In turn, the chapter 8 cross- case analysis finally echo this theoretical framework by illustrating and analysis the findings cross multiple cases.

As illustrated in figure 3-5, the integrative framework contains three parts: three groups of institutional constraints from pilot study and six cases, five elements of transaction costs, and ETCs' methods on economizing transaction costs from six cases. In general, institutional constraints influence five elements and increase transaction costs for export transaction in China, which can be then reduced by various methods employed by ETCs in turn.

First of all, the previous literatures help to identify three groups of ordinary institutional constraints in institutional transition, which may inhibit export transaction in China (discussed in section 3.3 and pilot study chapter 6), including former formal institutional constraints, current formal institutional constraints and informal institutional constraints. The findings from pilot study (chapter 6) have proved these three groups and further clarify them as inefficient bureaucratic procedures and administrative approvals, weak legal system and informal contract obligation in each group, which require further confirmation from cases.

Then the integrative approach of institutional theories and transaction costs economics (discussed in section 3.4.1 and 3.4.2) takes place: three groups of institutional constraints will increase the level of costs of export transaction, by influencing any elements of transaction costs: bounded rationality, opportunism, frequency, uncertainty and asset specificity (discussed in section 2.3.1).

The last stage of this framework refers to ETCs' responses to such institutional constraints in institutional transition, say institutional constraints create opportunities for ETCs and ETCs will strategically develop business to make up these institutional constraints (discussed in the conclusions of section 2.2 and chapter 4). The logic is that ETCs have their methods and advantages on economizing these institution-related transaction costs by influencing any elements of transaction costs: bounded rationality, opportunism, frequency, uncertainty and asset specificity (discussed in section 2.3.1).

Regarding the methodology, this framework identifies the direction of data collection. On the one hand, data collection will follow the direction of three groups of institutional constraints to explore institutional constraints in each case, including confirmation of known ones found in pilot study and previous cases, which can influence any elements of transaction costs. By doing this, it answers the first research question in this study: *what are the institutions, which generate transaction costs for domestic manufacturers and foreign buyers, in China's export market?* On the other hand, this framework guides to collect data from the perspective of ETCs' methods and advantages on economizing these institution-related transaction costs. In other words, ETCs' responses to institutional constraint will be investigated one by one in each case. Thus the answer for second research question is collected in this way.

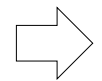
Last, this framework is analytical framework for data analyses as well. It firstly confirms the sequence of data analysis: it will follow the sequence of institutional constraints. Moreover, it also confirms the logic of analysis: the analyses and explanation will surround five elements of transaction costs. The detailed analysis is finally finished in chapter 8 cross cases study.

Institutional constraints during institutional transition in China (including examples found from pilot study)

Former formal institutional constraints  
*e.g. inefficient bureaucratic procedures and administrative*

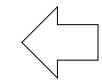
Current formal institutional constraints  
*e.g. weak legal system from pilot*

Informal institutional constraints  
*e.g. Inefficient Informal Contract*



Main elements of transaction costs, which can be increased by institutional constraints and reduced by case ETCs

- Transaction costs on China's export markets (Direct/Indirect markets)
- Bounded rationality
  - Opportunism
  - Frequency
  - Uncertainty
  - Asset specificity



Findings from cases to show by which way ETCs reduce transaction costs

- Case A
- Case B
- Case C
- Case D
- Case E
- Case F

**Figure 3-5 Integrative analytical framework for data collection and analysis**



### **3.5 Chapter summary**

In order to construct one analytical framework for this study, this chapter initially discusses relevant arguments in the literatures on institutions in general academic. Then after more specific discussion of the literatures related to institutional perspective in transaction costs, one general institutional framework specifically for transition economies, developed and used by previous literature, is adopted. In the meanwhile, one new TCE analysis on ETCs is developed to fix one gap in extant TCE analysis of missing the perspective of foreign buyers. In the end, one integrative analytical framework for this study is developed based on the initial institutional perspective and subsequent TCE analysis on ETCs.

## **Chapter 4 The history of Chinese trading companies since 1949**

Compared with the relative handful studies on exporting intermediaries from the US and EU, and general trading companies from Japan and Korea, trading companies or exporting trading companies from China are still shrouded in mystery. There are two reasons: the first one concerns under-developed research about China. Although the recent emphasis in academic circles is being shifted to emerging markets, transition economies and China, especially as they continue their brilliant economic performance when other developed economies are in a persistent downturn, studies on China are still unstructured and lack of sound theories (Peng, 2005). The second reason is the lack of data on the sector of trading companies in question, due to their characteristic as service firms that render them difficult to separate from manufacturers in the whole exporter dataset (Peng & Ilinitich, 1998). For instance, there is no separate statistic on trading companies or ETCs in any of China's official annual statistical reports (made by custom, the national bureau of statistics or other department).

In this section, in line with the different periods of transition in China's trading system, the history of Chinese trading companies is divided into three periods: 1949-1978; 1979-1993; 1994-now. In addition, two main institutions in China's exporting market and ETCs, namely the import/export authority and reselling system, are also discussed.

### **4.1 First period (1949-1977): the period of 12 state-owned trading companies**

This is the initial period of international trade in the new China. From the institutional perspective, China's trading system was completely based on central planning in this period. Under such a system, around 12 state-owned trading companies monopolized the import/export trade in China (Young, Hood, & Lu, 1998). As the only bridges linking China and outside world, they organized domestic supply for export according to international orders, and international purchase for domestic demand. In turn, domestic manufacturers were only able to receive

international orders through these trading companies, produced products according to their requirements, and had no chance to direct exports; essentially they functioned as factory “agents” for these trading companies.

Meantime during the establishment of the new China in 1949, there had been 4600 private trading companies, which then employed a total of 350,000 staff and made up 50% of domestic exports (Fu, 2008, p4). Under the socialist transformation from 1949 that entailed “utilizing, restricting and transforming the capitalist sector of the economy” (e.g. gradually reducing and stopping the approval of foreign exchange to private trading companies, and shifting im/export activity to newly established state-owned trading companies (Fu, 2008, p13)), these private trading companies were gradually nationalized and disappeared in 1950-1956. At the same time, the new central government of China established 12 state-owned trading companies<sup>1</sup> according to different product categories (shown in the table 4-1), which were under the control of the newly established Ministry of Trade<sup>2</sup>(MOFCOM now) in 1949 (MOFCOM, 2012). Each of these trading companies took charge of one specific category of products with an exclusively authorised license for this category of products. Therefore, each of their official names contained a corresponding products category. Such allocation of tradable products even had an influence on present state-owned trading companies, according to the “company name at present” in table 4-1.

**Table 4-1 12 state-owned trading companies established in 1950s.**

Company name when established	Company name at present	Year of established	authorised category of products when established
China Minerals Company.	China Minerals Company and China Metals Import	1950	minerals
China Metals Import Company	Company merged into China Metals & Minerals Import &	1952	Metals, electrical products and

<sup>1</sup> 14 specialized large state-owned trading companies in (Fu,2008) and (Liu,2007) , 12 in (Young, Hood, & Lu, 1998)

<sup>2</sup> Ministry of Trade (1949.11-1952.8), Ministry of Foreign Trade (1952.8-1982.3, splitting to Ministry of Commerce), Ministry of Foreign Economic Relations and Trade (1982.3-1993.3, combining Ministry of Foreign Economic liaison, State Import and Export Regulation Commission, State Foreign Investment Regulation Commission), Ministry of Foreign Trade and Economic Co-operation (1993.3-2003.3), Ministry of Commerce (2003.3-now) (MOFCOM. 2012. The restructuring of MOFCOM, Vol. 2012.)

	Export Corporation in 1961.1, and renamed China Minmetals Group in 2004		telecommunication products
China Import Company	SINOCHEM Corporation	1950.3.10	Rubber, fertilizers, etc
China Cereals Export Company, China Oils Export Company and China Foods Export Company	China National Cereals, Oils and Foodstuffs Corporation (COFCO)	1949.2-1952.9	Agricultural products such as cereals, oils and food.
China Silk Export Company	Chinatex Corporation	1951.10	Silk
China Sundries Export Company	None	1952.9	Wool, cotton, hemp, textiles etc
China Light Industrial Products Export Company	China National Light Industrial Products Import and Export Corporation (ChinaLight) , a fully-owned subsidiary of China Genertec Technology (Group) Holding	1952.9	Light industrial products
China Technical Import and Export Company	China National Technical IMP. & EXP. CORP (CATIC)	1952.9	156 types of specific technical and related complete equipments in 1950s (supported by Soviet Union)
China Instruments Import and Export Company	China National Instruments Import & Export (Group) Corporation (INSTRIMPEX), a fully-owned subsidiary of China Genertec Technology (Group) Holding	1955	Mechanical and electrical instruments and equipment
China Machinery Import and Export Company	China National Machinery Import & Export Corporation (CMC)	1950	Mechanical and Electrical Products
China Tea Export Company	China National Native Products & Animal By-Products Import & Export Corporation at 1970.1 (CHINA TUHSU), a fully-owned subsidiary of COFCO from 2004.9	1949.11	Tea
China Native Products Export Company		1950.3	Native Products
China Animal By-Products Export Company		1951.3	Animal By-Products

Till 1978, these state-owned trading companies had in total 12 headquarters and 130 subsidiaries spread over the major cities in China (Fu, 2008, p18). Only the headquarters and several special subsidiaries, which were typically in certain trading ports, had the monopoly of import/export authorities, which were only and strictly approved through Ministry of Trade, whereas the majority of the other subsidiaries could only take responsibility for purchasing domestic products for export (Fu, 2008).

In other words, fewer than 20 trading companies directly participated in international trade during that period in China.

At this time, these 12 state-owned trading companies mainly followed the instructions from central government. They were “executives of the national plan” and acted as a government department for administrative purposes rather than as a profit-seeking economic organization (Liu, 2007, p32). Under this highly planned economy, the operation and business of these trading companies relied on the central plan for purchasing, allocating, exporting, importing, the balance of foreign exchange, etc. Firstly, the import and export plan is mainly constructed by the State Planning Commission (SPC)<sup>3</sup>, and then issued to trading companies as the annual plan.

In addition, trading companies’ finance was planned and managed by the Ministry of Finance. The individual trading company only calculated and balanced profit and loss, and reported to the Ministry of Foreign Trade, which further calculated and balanced profit and loss in the sum total of foreign trade, and reported to Ministry of Finance. Ministry of Finance obtained any profit or undertook any loss. The trading companies, manufacturers and companies using imported products did not take profit or loss. And also the liquid capital required by trading companies was also allocated by Ministry of Finance.

Third, the import/export authority was only issued to state-owned trading companies and several of their subsidiaries in some important ports, like Tianjin & Guangzhou. These trading companies operated all import and export transactions, such as negotiation and enforcement with/to foreign importers and exporters. Other majority of subsidiaries of these trading companies across the country took responsibility for purchasing domestic products in the way of buy-out with domestic prices, and then it was left to previous trading companies to export. In terms of imports, according to

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<sup>3</sup> 1952.11.15-State Planning Commission (SPC); 1998.3-renamed as State Development Planning Commission (SDPC); 2003.3- change to National Development and Reform Commission (NDRC), by merging with the State Council Office for Restructuring the Economic System (SCORES) and part of the State Economic and Trade Commission (SETC)

instructions from the SPC or Ministry of foreign trade, these trading companies finished transactional task, like ordering, payment, freight, inspection etc. The real user or importer could only participate in technical negotiation, and left all others to the trading companies. In other words, the real domestic manufacturers and importers failed to participate in exporting or importing, and to have contact with the international market.

Fourth, because of foreign exchange control and central planning, the foreign exchange obtained by trading companies through exporting would be collected and used by central government through specific authorized banks, according to the then Bank of China . In practice, they only focused on the amount of foreign exchange obtained from export, failing to consider the export's profitability (Fu, 2008, p13-14).

Fifth, due to the distance between domestic manufacturers and the international markets and the planned economy, these trading companies also expanded into other trade-related functions, such as warehousing, freight, packaging and even manufacturing (Fu, 2008, p19).

In particular, during this period, the responsibility of all trading companies was to complete the export task under the central plan and to pursue the foreign exchange needed by government to purchase necessary materials and industrial inputs. The achievement of exporting task assured future support from government, and whether or not the trading authority would be granted(Liu, 2007, p104).

## **4.2 Second period (1978-1993): the monopoly of massive state-owned trading companies**

During the second period, China's trading system began to transit from a central-planning to market-based system. In 1978, the Third Plenary Session of the Eleventh Central Committee marked the beginning of China's reform and opening-up policy. In terms of foreign systems, reform mainly focused on the decentralization of import/export authorities, as the over-concentrated trading authority decreased the

incentive for exports for local government and domestic manufacturers (Fu, 2008, p35). It can be concluded that such decentralization could take place in three ways.

First of all, the import/export authorities were gradually delegated from several state-owned trading companies' headquarters to their subsidiaries from 1978 to 1988. More specifically, each subsidiary was granted the exclusively import/export authorities for specific products, which differed from each other and from the parent companies' products categories. (Liu, 2007, 102-103).

Second, the import/export authorities were gradually delegated from central government to local governments. Some provinces and cities, including Liaoning Province, Fujian Province, Beijing City, Tianjin City, Shanghai City, etc, were granted permission to establish province-level trading companies, mainly to import and export specific products which are normally manufactured and used in these regions. Two Experiment regions, Guangdong Province and Fujian Province, were granted larger import/export authorities; for instance, the newly established province-level trading companies could process almost all products in this province, and province government could arrange import and export by themselves out of the central plan. (Fu, 2008, p89-90).

Third, the import/export authorities were gradually delegated from the trading companies sector to other industries. Initially, many large state-owned manufacturers were gradually granted exporting authorities for owned products, and some importing authorities for inputs<sup>4</sup>(Fu, 2008, p89-90). It is worth noticing that these sorts of import/export authorities could only export their manufacturing products, and/or imports needed as input for manufacturing. They were different from trading

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<sup>4</sup> In particular, there are two kinds of export authority in China. One is called trading authority, and specifically issued to organizations, like trading companies, to trade products or services offered by others, like manufacturers. Another one is called a manufacturer's export authority, and allows manufacturers to export their own products (Ma & Li, 2003)

companies' import/export authorities, which could export most of products from domestic manufacturers.

In addition, 19 Ministries and commissions of the central government were also allowed to establish their owned trading companies to import/export certain products, which were formerly exclusively imported/exported through the trading companies under the Ministry of Foreign Trade (Fu, 2008, p89-90) such as the China National Machinery & Equipment Import & Export Corporation (now the China Machinery Engineering Corporation (CMEC)) that was established in 1978. Six of these were under the Ministry of Machinery Industry (now Ministry of Industry and Information Technology)(CMEC, 2011), rather than the Ministry of Foreign Trade.

In particular, some industrial departments or groups of manufacturers were also allowed to establish their trading companies, in order to improve the manufacturers' significant distance from international markets. This new group of trading companies were named the "Industrial trading companies" (ITCs), and were usually based on existing trading companies or manufacturers, in order to obtain closer relations between trading and manufacturing departments. These ITCs commonly took charge of the export of all or partial manufacturers' output in each industrial department and group. They were organized and managed by national and local governments or certain government departments. For instance, the China Silk Corporation was one example of a national ITC. In the 1970s, the production and sale of silk-related products belonged to different departments according to value chains, like the Ministry of Textile Industry, the Ministry of Foreign Trade, the Ministry of Commerce, and the All-China Federation of Supply and Marketing Co-operatives (another Ministry-level department in China). The poor collaboration between different chains resulted in the problematic export of silk-related products. Thus through removing these silk-related functions from previous departments, and combining them together again, a new China Silk Corporation was established in 1982, in order to unify process inputs, production, and the domestic and foreign sale of silk nation-wide (Fu, 2008, p92; Liu, 2007, p21).



Moreover, the Qingdao Textile United Import & Export Company is another local ITC in Qingdao City. It was established by 9 state-owned textile-related manufacturers, including textile mills, textile printing & dyeing mills, weaving mills, knitwear mills and flannel mills (it was extended to the whole textile industry in Qingdao City and emerged with the Qingdao Textile Industry Company in 1985.10), in 1982. It owned 80 employees and exports amounted to 20,210,000\$ in 1982(Liu, 2007, p21; QDSQ, 2011). The 3<sup>rd</sup> group of ITCs were commonly established by some manufacturers under same government industry department. For instance, the Ministry of Machinery and Industry Ministry established the China Abrasives Industry Joint Export Company (China Abrasives Import & Export Corporation (CAEC) now (CAEC, 2011)), the China Bearing Industry Joint Export Company (China National Bearing Joint Import & Export Corporation (CBEC) now (CBEC, 2011)) etc respectively in the 1980s(Liu, 2007, p21).

As a result of such decentralization of import/export authorities, there gradually appeared a great deal of new state-owned trading companies, with various names, sizes and tradable products, in China from 1978 to 1988. According to the statistics, the number of exporters from 1979 to 1987 increased by around 2,200. Most of them were trading companies (Fu, 2008, p88).

However, these emerging state-owned trading companies, as affiliated institutions of government, failed to act as independent economic agents on the export market, and therefore failed to efficiently facilitate domestic exports (Fu, 2008, p104). More specifically, these state-owned trading companies had no economic incentive to actively participate in the export business, due to some of the practices of previous institutions under the planning system. For instance, the trading companies had to hand in the profits from exports, in term of foreign exchange, and re-apply for the foreign exchange from the relevant departments for import, due to the strict control of foreign exchange. On the other hand, these state-owned trading companies often operated export business at a loss, in order to achieve the required export amount (as tasked to do). As a result, central finances had to shore up these losses, and became gradually unable to bear such a financial burden.

Therefore, a series of policies and reforms took place inside these state-owned trading companies from 1988 to 1993, in order to change them gradually from affiliated institutions of government to independent economic agent in the marketplace (Fu, 2008, p104).

From 1988, a 3-year “foreign trade contract responsibility system” was initially applied to trading companies to replace the previous planning system. Under such a policy, each national trading company (and local government), as contractors, set a certain number of export targets, earned foreign exchange targets, and economic performance targets within in 3 years. It was further modified in 1991, by changing direct government subsidies to banks loan (Fu, 2008, p96-p104; Huang, 2000, p30; Liu, 2007, p154). The trading companies were also allowed to keep a portion of export profits to encourage their business. In the meanwhile, most of the subsidiaries of the 12 large state-owned trading companies were separated from their parent companies, and became independent companies or were re-integrated into trading companies groups, under the control of local government (normally the local commission of foreign trade) (Liu, 2007, p147). These parent companies of the 12 trading companies got rid of these financial burdens and inefficient subsidiaries, and became one new independent company (Huang, 2000). For instance, all the subsidiaries of the China Minmetals were handed over to local government in 1988, and then China Minmetals established 13 new trading companies based on the previous internal departments of the parent company, including China Minmetals Trading Corporation, China Minmetals Non-ferrous Metal International Trading Corporation, etc.(Minmetals, 2011).

In addition, these reforms went further in some special state-owned trading companies. For instance, according to the government’s regulations, trading companies related to light industrial products, handicraft and garments had to “assume sole responsibility for its own profits and losses”, but were allowed to keep the majority of foreign exchange profits through exports (Fu, 2008, p96), which basically resembled normal economic agents in marketing economies.

Driven by these incentive policies to encourage exports and growth in exports in China, the number of exporters with import/export authority was further extended. Up to 1993, the number increased to around 6,000. Amongst these, the state-owned trading companies numbered around 4,000 (Fu, 2008, p104).

In summary, the transition towards market-based trading systems, and reforms of trading companies were not completed and fully successful during the second period. The import/export authorities were delegated from the 12 national state-owned trading companies to more companies. But they were still dominated and monopolized by the industry of trade, particularly the state-owned trading companies. Their numbers were greater than before and their size variable. They were controlled by central and local government, or certain government departments. Meanwhile, other domestic exporters, including the majority of manufacturers, especially the private manufacturers who were the real engine for the emerging “world factory”, failed to obtain the import/export authority.

### **4.3 Third period (1994-now): the emergence of private trading companies**

The third period is characterised by the further transition of China’s trading system, embracing the full openness of import/export authority. The situation of Chinese trading companies shows the deeper internal reform of state-owned trading companies towards that of economic agents, and the gradual rise of powerful private trading companies.

First of all, a group of subsequent regulations and policies relating to import/export authority confirms that import and export businesses are no longer the monopoly of state-owned trading companies. A great number of private exporters, including manufacturers and trading companies, were allowed to participate in import/export activity.

In 1994.07.01, China's government issued the first Foreign Trade Law of PRC, which historically clarified certain important regulations and legitimacy issues on import and export, including the introduction of one compulsory approval system for grant import/export authority to qualified exporters through the MOFCOM (Ministry of Commerce) and one alternative agency trading method for other companies and organizations without exporting authority(NPC, 1994).

In 1999.01.01, the Ministry of Foreign Trade and Economic Co-operation (now MOFCOM) issued one new regulation to allow private manufacturers to apply for manufacturers' exporting authority (MFTEC, 1998); this means that private manufacturers began to acquire the right to export directly (Fu, 2008, p118). In the meantime, one new and easier registration system of application for import/export authority has been experimentally attempted replacing the previous examination and approval system in five special economic zones from 1997, and then extended to 1000 larger state-owned manufacturers in 1998(Fu, 2008, p118).

After China's accession into the WTO in 2001, the government began to lower the barriers for market access, including import/export authority on the export market. In 2004, a new edition of the Foreign Trade Law of PRC was renewed (NPC, 2004): the approval system for import/export authority was officially replaced by the registration system, and the requirements to qualify for eligibility for import/export authority were also lowered. As a result, small and medium-sized private firms and individuals, including manufacturers and trading companies, began to participate in the import/export business(Fu, 2008).

Under the impact of such changes, the reform of state-owned trading companies has been deepened. The share-holding reform is the most important characteristic of state-owned trading companies. For instance, the China National Cereals, Oils and Foodstuffs Corporation (COFCO) and several large trading companies, were processed on an experimental basis through share-holding reforms, and became wholly state-owned enterprises or limited liability companies, including corporate governance, personnel systems, income distribution systems, organizational structure

and financial management systems. Then, similar reforms were gradually extended to other state-owned trading companies from 1994. They were changed to a limited liability company or joint-stock company, which usually contains state-owned majority shares and employee minority shares. After such reforms, the traditional state-owned trading companies further changed themselves from the administrative institutions that operated under the central planning system to independent economic agents in a marketing economy. In turn, a great number of unsuccessful state-owned trading companies gradually disappeared from the stage, due to a series of restructuring, mergers, and acquisitions, losses in market competition and loss of support from the government.

Due to the full openness for accessing import/export authority, the forms of Chinese trading companies, in term of size and ownership, has shown diversification. Briefly they can be divided into three groups: central state-owned trading companies, local state-owned trading companies, and private trading companies.

Central state-owned trading companies refer to the large state-owned trading companies among the 115 central SOEs in China, which are under the control of the State-owned Assets Supervision and Administration Commission of the State Council (SASAC). They include the Sinochem Corporation (Sinochem), China National Cereals, Oils and Foodstuffs Corporation (COFCO), China Minmetals Corporation (Minmetals), China General Technology Group (Genertec), Chinatex Corporation, China National Arts & Crafts (Group) Corp (CNACGC), and the China Silk Corporation. Most of them stemmed from previous parent companies of state-owned trading companies. They are large conglomerates with diversified businesses across the world. For instance, the COFCO clearly demonstrated its transitional strategy from traditional trading companies to diversified companies from 1992. It currently has 13 various businesses inside and outside China, including manufacturing, food production, electronic commerce, real estate, finance and so forth (COFCO, 2013). Such a situation also took place in other central state-owned trading companies during the third period. Some of them still participate in international trade, but mainly in commodities, such as grain and steel, and hold

monopoly power on these commodities in China's export market. For instance, the COFCO monopolizes the import/export of many grains (COFCO, 2013). Due to extensive diversification in various businesses, the nature of these conglomerates becomes fuzzy and far from transitional trading companies.

The second group are massive local state-owned trading companies. As stated before, the state-owned trading companies had experience of several rounds of reform from 1978, and increasing and severe competition from other emerging domestic exporters. Therefore these local state-owned trading companies are the survivors of these reforms, and the relatively successful ones compared with the defunct ones. They are still a presence in international trade but they differ in history and conditions from each other. Some of them used to be the subsidiaries of central state-owned trading companies, whilst others are the result of multiple restructuring and re-organization of state-owned trading companies, manufacturers and certain government departments.

To take one example of local state-owned trading companies in Tianjin, one of the four largest municipalities in China. There were more than 40 state-owned trading companies during the 1980s. They contained the local subsidiaries or branches of central state-owned trading companies and government departments, and some of the then newly established state-owned trading companies belonged to local government. From the end of the 1980s, these trading companies were gradually separated from previous parent companies and government departments, and re-affiliated to the Tianjin Foreign Economic Relations and Trade Commission (the local agent of the Ministry of Foreign Economic Relations and Trade of P.R.China), to ease financial pressure on central finance. Afterwards, due to weaker competitive capacity than the exporters that emerged when government opened up the import/export authorities, most of them were discontinued and integrated into other companies. The remaining 20 were re-structured, merged, and processed in the share-holding reform, and finally were constructed into two new state-owned trading companies groups in 2003 that were affiliated to the Tianjin Commission of Commerce (the Tianjin Foreign Economic Relations and Trade Commission was reformed into the Tianjin Commission of Commerce, which was changed to be affiliated to the Tianjin

Municipal Government), and State-owned Assets Supervision and Administration Commission of the Tianjin Municipal Government. The headquarters of the group only takes charge of administrative issues, but does not participate in corporate management.

These local state-owned trading companies are inter-independent. They usually have 30 to 150 employees, relatively fixed products and domestic manufacturers that developed historically. Due to the loss of monopoly of import/export authorisation, they had to compete with other exporters, including domestic manufacturers and trading companies on the same import/export market.

The last group is a large number of private trading companies, which emerged from 1994 onwards, and gradually became the most important facilitator for current international trade in China. They are the most unknown group of trading companies. Due to lack of official data, the description here mainly relies on the interviews in this study. These private trading companies' number is numerous. It is easy to find a couple of them in each business building in China. Some of them are formal companies, whilst others are special individual exporting traders (IETs), now called self-employed individual traders or SOHOs. Similar to the import/export intermediaries in western countries, they are usually small sized (1 to 20 employees). Their services are as diversified as each unit in the whole trading process. The tradable products through them can range cross almost all products, which are manufactured in China. The owners and staff of these private trading companies usually used to work in traditional state-owned trading companies. Some of them had the experience "Guakao<sup>5</sup>" in state-owned trading companies. They were well trained

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<sup>5</sup> The method is called guakao, means literally 'nominal, rather than actual, affiliates'(Li, Yao, Sueâ Chan, & Xi, 2011). It happens in many circumstances in China, such as Chinese household register system, construction industry, NGOs etc. "The guakao mechanism has been widely used by private entrepreneurs to handle issues such as legitimacy, market entry barriers, and other discrimination as well as political, legal, regulatory, and administrative uncertainties. Under the guakao mechanism, private investors "attach" or "affiliate" themselves or their subsidiaries either to collectively owned or state-owned units. Such an enterprise was sometimes said to be wearing a "red hat," which enabled it to circumvent

in the knowledge of international trade, especially on China's import/export markets during the period of state-owned trading companies, and open private companies after the government opened up the import/export authorities to pursue higher economics returns. They mainly serve domestic SME manufacturers, which normally lack resources for and knowledge of international trade. Due to a more efficient service, they are also attractive to foreign buyers, especially those who are unfamiliar with purchasing from China.

In general, these three groups of trading companies comprise the whole picture of Chinese trading companies at present. The first group gradually changed themselves to large MNEs, due to their considerable diversification. The second group has stuck with their traditional customers and products in international trade. The third group is the most dynamic of the trading companies on current import/export markets, due to their flexibility and efficiency.

#### **4.4 Two distinct features of Chinese trading companies in the whole process of evolution**

In addition to the previous description, there are two significant features of Chinese trading companies during their evolution, which are worthwhile highlighting here as distinct from the trading companies in extant literatures.

##### ***4.4.1 Import/export authorities***

During the three periods in which Chinese trading companies evolved, the import/export authorities constituted one important factor. The change of import/export authorities reflects faithfully the nature of institutional transition in China, namely gradualist reforms and the characteristics of path dependency of institutional change failing to quickly change previous institutions developed over time under a central-planning system (see chapter 3).

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discriminations towards private enterprises and reduce the uncertainties of business environments.”(Huang, 2001)



The policies on import/export authorities in China kept changing from initially wholly monopolistic through several state-owned trading companies to other more state-owned trading companies and manufacturers, and finally to other private trading companies and manufacturers. Actually such change is still on-going today, and changed into certain indistinguishable “authorities”, that continue to generate invisible institutional constraints for domestic exporters. The procedure is also complicated for them. To apply for export authority, one firm may have to register with many government authorities, including the local Administration of Industries and Commerce, Taxation Bureau (which is important for the product with export tax rebates), the Administration of Foreign Exchange (the foreign exchange is controlled in China), Customs (including e-port, on-line customs, etc), the Bureau of Quality and Technical Supervision, banks and so on.

The details of export authorities and how they generate institutional constraints for domestic exporters are found and discussed in the pilot study in next chapter together with the findings of this study. In turn, the import/export authority had been the exclusive authorities for trading companies (state-owned and other ownership) and some large manufacturers for a long time. As a result, these trading companies accumulated a great deal of knowledge, experience and information on international trade, related industries and institutions, which generate huge advantages compared with domestic manufacturers when import/export authorities are gradually decentralized to all domestic exporters.

#### ***4.4.2 Reselling system in China’s exporting market***

Under this import/export authority, a special “reselling system” had been developed in the export market in China. The reselling system means that ETCs firstly purchase outright the ownership of products from domestic manufacturers by means of a buying contract, and then sell it to foreign buyers through a selling contract. From 1949 to 1978, this system was compulsory for all domestic manufacturers and ETCs under government regulation. From 1979 when the foreign trade system in China was reformed, the central government experimentally promoted the “agency system”,

which allows ETCs to represent manufacturers without export authority ( that is, by an agency contract) and to contract with buyers (by means of a selling contract).

However, the related laws, such as Civil Law General Principles of PRC and Contract Law of PRC, fail to clearly identify obligation, rights and principal-agent relationships for ETCs and manufacturers in the agency contract. The main problems are that the ETCs, as the agent, take more and even full risk during the transaction, since the agency contract is not fairly protected under these domestic laws, and the selling contract only appears in the agent's name. In addition, the commission fee for brokerage is only 1-3% in practice, which is far less than the profit from a normal exporting transaction. Therefore, both business tradition and rationality enable most ETCs to undertake the reselling system in practice in China. Moreover, as the foreign exchange and tax rebates systems run by government authorities are complicated and time-consuming, the manufacturers are willing to accept this reselling system to reduce the turnaround time of capital. Thus until 1986, the export activity under the agency system only made up 6.3% of the total amount; 1990 it rose to 7.29%; 1991 it was running at 5.1%, 1992 at 1.2%, 1993 at 3.7%, 1994 at 1.41, and in 2000 at 4.4% (Xu, 2000; Yao & Chen, 2001).

Similar to the previous import/export authorities, the long-term reselling system enabled and even pushed these trading companies to obtain more knowledge about export and other related industries and institutions. In addition, it enabled Chinese trading companies to take full responsibility, rather than partial responsibility, as they were neither the agent for domestic manufacturers nor foreign buyers, as assumed in some recent studies on trading companies in western countries (Peng, 1998; Peng & Ilinitich, 1998; Peng & York, 2001). As a result, Chinese trading companies undertake more jobs in the export process, such as coordinating with each part in one transaction, and monitoring the quality, time and other related issues on contract, that are usually problematic in export markets in China. The details of the advantages of reselling system will be discussed in chapter 8.

## **4.5 Implications from historical developments of Chinese trading companies**

Last, it is interesting to note that the history of Chinese trading companies also supports previous statement made in Chapter 2, which is the improvement of institutional environment diminishes the significance of trading companies in trade business. Since the second period (1978-1993), the institutions in China's export market had been largely improved, such as the delegation of import/export authorities. In the meanwhile, there were increasing numbers of domestic manufacturers to bypass trading companies and participate in exporting business on their own. As a result, it makes existing trading companies quit trading industry and others have to switch to other business. Despite of multiple reasons, the institutional change is an important cause of such situation.

## **4.6 Chapter summary**

This chapter presents the history of Chinese trading companies since 1949 following three main periods. Among of them, the significant events, relevant institutions and government policies, and Chinese trading companies' characteristics and change are respectively displayed. Finally, import/export authorities and reselling system, as two main features of Chinese trading companies, are discussed.

## **Chapter 5 Research strategy and methodology**

### **5.1 Introduction**

The previous two chapters respectively identify the research gaps and research questions, and generate the analytical framework. This chapter aims to illustrate the research strategy and methodology, which “ensure that the evidence obtained enables us to answer the initial question as unambiguously as possible”(De Vaus, 2001, p9). Section 3.2 sets out the author’s philosophical stance. Sections 3.3 and 3.4 respectively offer the justification for the use of a qualitative approach and abductive logic in this study. Section 3.5 provides the reasons behind the choice of the case study as the preferred method. Then the detailed case study design is discussed in the section 3.5. Finally, section 3.6 summarizes this chapter.

### **5.2 Research Philosophy**

The philosophical stance or paradigm, is one vital part of the research methodology, that sets the scene for the whole research enterprise (Creswell, 2008; Maxwell, 2012). It refers to “certain assumptions about how they will learn and what they will learn during their inquiry” (Creswell, 2008, p6). It draws conclusions about “the nature of the world (ontology), and how we can understand it (epistemology), ” (Maxwell, 2012). The main paradigms are drawn from positivism, constructivism, interpretivism, realism, pragmatism and so on. Although these paradigms might seem controversial and contradictory, a confluent trend had gradually emerged within recent academic thinking (Lincoln, Lynham, & Guba, 2011).

The philosophical stance of this study is interpretivism. Interpretivism can be traced back to the sociologists of the 19<sup>th</sup> century, such as Weber and Wilhem. From viewpoint of interpretivism, “what distinguishes human (social) action from the movement of physical objects is that the former is inherently meaningful. Thus, to understand a particular social action (e.g., friendship, voting, marrying, teaching), the inquirer must grasp the meanings that constitute that action.....To find meaning in an action, or to say one understands what a particular action means, requires that one

interprets in a particular way what the actors are doing.....In other words, interpretivists argue that it is possible to understand the subjective meaning of action (grasping the actor beliefs, desires, and so on) yet do so in an objective manner” (Schwandt, 2000). Therefore the researcher must understand the actors’ actions from their field, think about the delivered information, find out the relations between them, and finally indicate their significance. In order to do so, the researcher has to “participate in the life world of others”. Understanding is “an intellectual process whereby a knower (the inquirer as subject) gains knowledge about an object (the meaning of human action).” (Schwandt, 2000).

In line with interpretivism, the research process in this study should take the following form: the researcher(s) interviews specific informants involved in the export business in China, observes their company, transaction process and related activities. From these experiences, the researcher elucidates an understanding of the main problems and solutions for these practitioners in undertaking exports from China. Researcher then further transposes these problems and solutions into their common export transaction process and related activities, against the backdrop of China’s institutional background. When the researcher realizes most of the institutional constraints and the ETCs’ corresponding solutions in China’s export market, he/she will describe these findings with the acceptable methods by audience.

### **5.3 Qualitative approach**

The qualitative and quantitative approaches are two main streams in academic study. These two approaches show large distinctions, though there exists some common ground (Neuman, 2007). Denzin & Lincoln (2000) define qualitative research as “a situated activity that locates the observer in the world. It consists of a set of interpretive, material practices that make the world visible. These practices transform the world. They turn the world into a series of representations, including field notes, interviews, conversations, photographs, recordings, and memos to the self”. It stresses the qualities of entities and processes and meanings, the situational constraints that shape inquiry, and how social experience is created and given meaning. Alternatively, Creswell (2008) states that “a quantitative approach is one

in which the investigator primarily uses postpositive claims for developing knowledge (i.e., cause and effect thinking, reduction to specific variables and hypotheses and questions, use of measurement and observation, and the test of the theories), employs strategies of inquiry such as experiments and surveys, and collects data on predetermined instruments that yield statistical data”. Therefore, these two research approaches do appear to have large differences, in terms of philosophical stand, research design, method of data collection and analytical approach. Although most studies on trading companies use qualitative approach, the quantitative approach is also adopted in several studies.

This study chooses qualitative approach for many reasons. First, it consists of one explorative study. Creswell (2008) states the decision to select a qualitative or quantitative approach mainly relies on the topic being researched. When researching a phenomenon where the problems are underdeveloped, significant variables are unknown, existing theories do not apply, or research is exploratory, the qualitative approach is appropriate. The topic of this study closely reflects such features. The knowledge on trading companies from transition economies, like China, is unknown. The existing theories on trading companies are confronted with a large challenge in explaining trading companies from traditional economies.

#### **5.4 Why case study research?**

Case is “an empirical inquiry that investigates a contemporary phenomenon in depth and within its real-life context, especially when the boundaries between phenomenon and context are not clearly evident.” (Yin, 2003b, p13) . Yin (2003b, p5) indicates that one research can choose different research strategies, such as experiments, surveys, archival analysis, and case study, according to three basic conditions: “(a) the type of research question posed, (b) the extent of control an investigator has over actual behavioural events, and (c) the degree of focus on contemporary as opposed to historical events” (shown in Table 5-1). Correspondingly, the case study is suitable, when “a how or why question is being asked about a contemporary set of events over which the investigator has little or no control”

**Table 5-1 Relevant Situations for Different Research Strategies.**

Strategy	Form of research question	Requires Control of Behavioural Events	Focuses on Contemporary Events
Experiment	How, why?	Yes	Yes
Survey	Who, what, where, how many, how much?	No	Yes
Archival analysis	Who, what, where, how many, how much?	No	Yes/No
History	How, why?	No	No
Case study	How, why?	No	Yes

Source: (Yin, 2003b, p5)

The character of this study is aligned to the case study approach in terms of these three conditions. The main aim of this research is to explore the unknown Chinese ETCs and institutional environment, which is one “empirical investigation of a contemporary phenomenon”. The research questions (what are the institutions, which generate transaction costs for domestic manufacturers and foreign buyers, in China’s export market? And how do Chinese exporting trading companies respond to such institution-related costs as an intermediary between domestic manufacturers and foreign buyers) are typical “how” questions. Meanwhile, the institutions, as a “real-life context” will be explored, as their effects on Chinese ETCs are one main objective in this research. These institutions and Chinese ETCs will be illustrated as a combination, which is in line with the statement that “boundaries between phenomenon and context are not clearly evident”. In addition, this study intends to develop theory on trading companies, which is another important function for case study research (Eisenhardt, 1989).

It is necessary to note the sort of case study in this study. The case study could be exploratory, descriptive and explanatory (Yin, 2003b). The cases studies in this study contain such three characteristics. The exploration of export-related institutions and ETCs in China results in a characteristic, exploratory case study. The description of complicated export-related institutions and Chinese ETCs’ export process make the case for a descriptive one. In the end, the effort to explain why Chinese ETCs are able to reduce these institution-related transaction costs contributes to one explanatory case study. Moreover, the case study can be qualitative, quantitative or mixed at the same time (Denzin & Lincoln, 2000; Yin, 2003b). But most researchers tend to support the case study’s qualitative nature (Merriam, 1998; Miles &

Huberman, 1999). Due to the decision of qualitative approach, the case study is qualitative in this study. In the end, this case study is qualitative one with exploratory, descriptive and explanatory characteristics.

## 5.5 Case study design

One clear procedure is able to enhance the rigor with which the case study is undertaken. Eisenhardt (1989) establishes one basic structure to process case study (shown in Table 5-2); this comprises eight steps from the research questions through to data collection and analysis, and then to final theoretical development.

**Table 5-2 Process of Building Theory from Case Study Research.**

Step	Activity	Reason
Getting Started	Definition of research question Possibly a priori constructs	Focuses efforts Provides better grounding of construct measures
Selecting Cases	Neither theory nor hypotheses Specified population  Theoretical, not random, sampling	Retains theoretical flexibility Constrains extraneous variation and sharpens external validity Focuses efforts on theoretically useful cases—i.e., those that replicate or extend theory by filling conceptual categories
Crafting Instruments and Protocols	Multiple data collection methods  Qualitative and quantitative data combined Multiple investigators	Strengthens grounding of theory by triangulation of evidence Synergistic view of evidence Fosters divergent perspectives and strengthens grounding
Entering the Field	Overlap data collection and analysis, including field notes  Flexible and opportunistic data collection methods	Speeds analyses and reveals helpful adjustments to data collection Allows investigators to take advantage of emergent themes and unique case features
Analyzing Data	Within-case analysis  Cross-case pattern search using divergent techniques	Gains familiarity with data and preliminary theory generation Forces investigators to look beyond initial impressions and see evidence thru multiple lenses
Shaping Hypotheses	Iterative tabulation of evidence for each construct Replication, not sampling, logic across cases Search evidence for "why" behind relationships	Sharpens construct definition, validity, and measurability Confirms, extends, and sharpens theory  Builds internal validity
Enfolding Literature	Comparison with conflicting literature  Comparison with similar literature	Builds internal validity, raises theoretical level, and sharpens construct definitions Sharpens generalizability, improves construct definition, and raises theoretical level
Reaching Closure	Theoretical saturation when possible	Ends process when marginal improvement becomes small

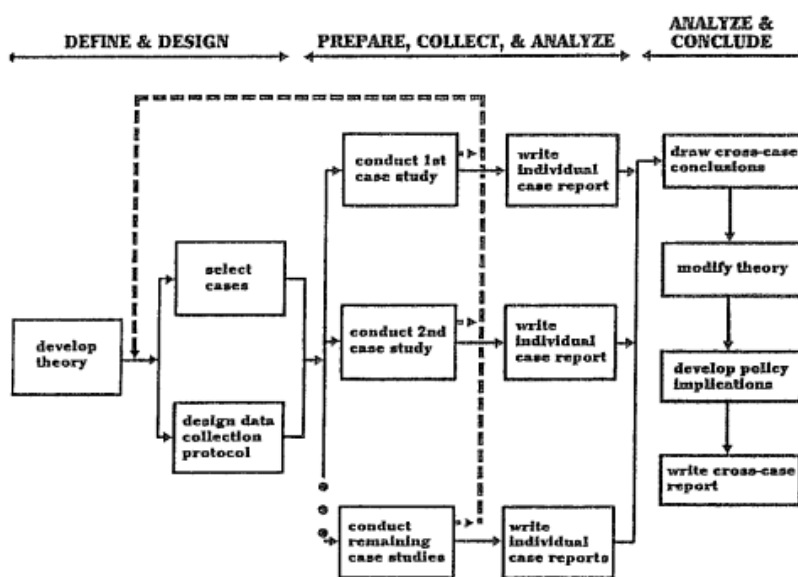
Source: (Eisenhardt, 1989)



Pettigrew (1997) also illustrates one research approach for “processual analysis” of the case study by combining deductive and inductive approaches:

“the core question of the study -- related themes and questions -- preliminary data collection -- early pattern recognition -- early writing -- disconfirmation and verification -- elaborated themes and questions -- further data collection -- additional pattern recognition -- across more case examples -- comparative analysis -- a more refined study vocabulary and research questions. (Pettigrew, 1997)

Yin (2003b) concludes one common strategy for the case study approach in his famous book. The obvious additions to the previous procedures include the highlighting of the pilot study and pre-study, and the “feedback” loop, which enables re-visiting of previous cases with new findings in a current case.



**Figure 5-1 Case Study Method.**

Source: (Yin, 2003b, p50)

These three procedures have a high resemblance to each other and are mutually complementary. By synthesizing them, one comprehensive case study procedure is developed for this study (shown in Table 5-3).

**Table 5-3 The comparison of three procedures and procedure used in this study.**

Eisenhardt	Pettigrew	Yin	This study
Related themes and questions	Research questions and related themes	Research questions and existing theories	Research questions and existing theories
		Developed theory	Developed theory/analytical framework
	Preliminary data collection		Pilot study (The preliminary identification of institutional constraints in China's export market)
	Early pattern recognition		Early pattern recognition
	Early writing		Early writing
	Disconfirmation and verification		Disconfirmation and verification
	Elaborated themes and questions		Elaborated themes and questions
Selecting cases		Selecting cases	Selecting cases
		Design data collection protocol	Design data collection protocol
		Pilot case study	Pilot case study-Case A
Crafting Instruments and Protocols	Elaborated themes and questions	Revised data collection protocol	Revised data collection protocol
Entering the Field	Further data collection	Data collecting	Further data collecting from more case
Analysing Data	Additional pattern recognition across more case examples	Data analysis	Additional data analysis across more case
		Feedback loop	Feedback loop on emergent findings
	Comparative analysis	Cross-case analysis	Cross-case analysis
Shaping Hypotheses	A more refined study vocabulary and research questions	Modify theory	Modify theory
Enfolding Literature			

### ***5.5.1 Role of Theory***

The analytical framework “is derived from the orientation or stance that you bring to your study. It is the structure, scaffolding, the frame of your study” (Merriam, 1998, p45). Yin (2003a, b) suggests that the theory (analytical framework) development should be concluded and play an important role in the process of the research design. He concludes that there are several main roles for theory in case study research.

Theory development should be undertaken before the stage of data collection, irrespective of the research aims to develop or to test theory. It offers research the “blueprint”, which helps to choose data types, analysis strategies and generate a fine research design (Yin, 2003b). It also helps to collect data and generalizing theory from cases (Yin, 2003b, p31). Merriam (1998) also indicates that the analytical framework helps to clarify the importance of the research topic, those aspects that are already available in the extant literatures and those that remain unknown and gaps in the extant literatures relevant to this topic, and the necessity of unveiling these unknown features. He further states that the analytical framework comes from the extant literatures related to the topic, especially the commonly accepted concepts, models, theories and other important aspects.

Therefore, in this study, the analytical frameworks mainly come from the existing literatures on trading companies, transaction costs economics and institutions related ones, particularly the ones related to transition economies and emerging markets (both of them are overlapping in academic). These theoretical literatures, together with the findings from the pilot study, jointly contribute to one analytical framework, indicating the perspective from which the data is collected in the stage of data collection, the description during data display and explanation in the later data analysis.

### ***5.5.2 Research questions***

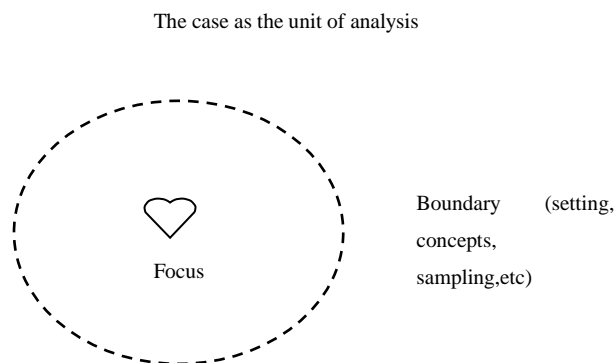
The generation of research questions is the first challenging aspect in the case study research design (Yin, 2003b). By finding the gaps, such as the ignorance of certain important fields, from extant literatures, namely the “gap-spotting” method, is the most common approach for generating the research questions in academic studies (Wynkoop & Russo, 1993). In this study, there are three main gaps after reviewing the extant literatures. They are 1) while most studies are about the trading companies from developed countries, less attention is paid to the transition economies, like China, which has become one of the most important players in international trade. 2) The extant literatures using TCE analysis, which is considered the most significant theory on trading companies, fail to pay enough attention to other players involved in international trade, especially foreign buyers or importers. 3) These literatures using TCE analysis ignore concerns from an institutional perspective, which have been proved the most important determinant for the study of business in transition economies.

Correspondingly, the research questions in this study are: 1) what are the institutions, which generate transaction costs for domestic manufacturers and foreign buyers, in China’s export market? And 2) how do Chinese exporting trading companies respond to such institution-related costs as an intermediate between domestic manufacturers and foreign buyers. These two research questions initially lead to one new study on the trading companies from transition economies, say China, which fill in the first gap in the studies on trading companies. Then, putting the spot light on “institution” in the research questions shows that this study tends to explore the institutional perspective in particular, which fills in the third gap. In addition, part of the transaction costs in the research questions concern the extension of transaction costs economics analysis on trading companies to foreign buyers’ perspective.

### ***5.5.3 Unit of analysis***

The unit of analysis, namely the question of what constitutes the case, is another necessary component in the research design. The case can be individual, an event, a decision, a programme, a process, organizational change and so forth. But one research design cannot contain all information related to the research topic.

Therefore, the unit of analysis helps to focus on the specific and feasible scope of data collection and analysis. (Yin, 2003b, p24-25) Miles & Huberman (1999, p25) indicate that a case is “a phenomenon of some sort of occurring in a bounded context” , and it contains “a focus, or “heart,” of the study, and in a somewhat indeterminate manner defines the edge of the case: in other words, what the study will not comprise.” (Shown in Figure 5-2) In addition, the choice of the unit of analysis relies on the research objectives (Merriam, 1998, p27), and provides signpost to relative literatures (Yin, 2003b, p26).



**Figure 5-2 The case as the unit of analysis.**

Source: (Miles & Huberman, 1999, p25)

Therefore, the research focus in this study is the Chinese ETCs, while the boundary of the case study, is their business activities related to transaction cost-economizing. More specifically, the unit of analysis is the Chinese ETCs business activities and institution-related transaction costs during the export transaction process.. As a result, the choice of such a unit of analysis enables this study to focus on the Chinese ETCs’ export transaction *process*. The export transaction process is the main unit of analysis in previous literatures on trading companies (Casson, 1998; Peng, 1998; Peng & York, 2001; Roehl, 1983), and transaction costs economics (Williamson, 1975, 1985). In addition, it also makes this study pay more attention to the institutions on China’s export market and institution-related costs during these export transactions process, as the institutional perspective on the analysis of trading companies is the main concern of this study.

The embedded unit involved in the case study means the subunit in one case to enable a more in-depth and specific analysis (Yin, 2003b). In this study, the exporting transaction processed by ETCs is appropriate as a subunit for two reasons. First, the nature of transaction costs economics focuses on the transaction analysis (Williamson 1975; Williamson 1985). Second, the existing literatures on trading companies (Roehl 1983; Casson 1998; Peng 1998; Peng and York 2001), especially those based on transaction costs economics, had already proved that the focus on analysis of trading companies is transaction itself. Third, one major research question is how ETCs process the exporting transaction, which inevitably throws the spotlight on the transaction process.

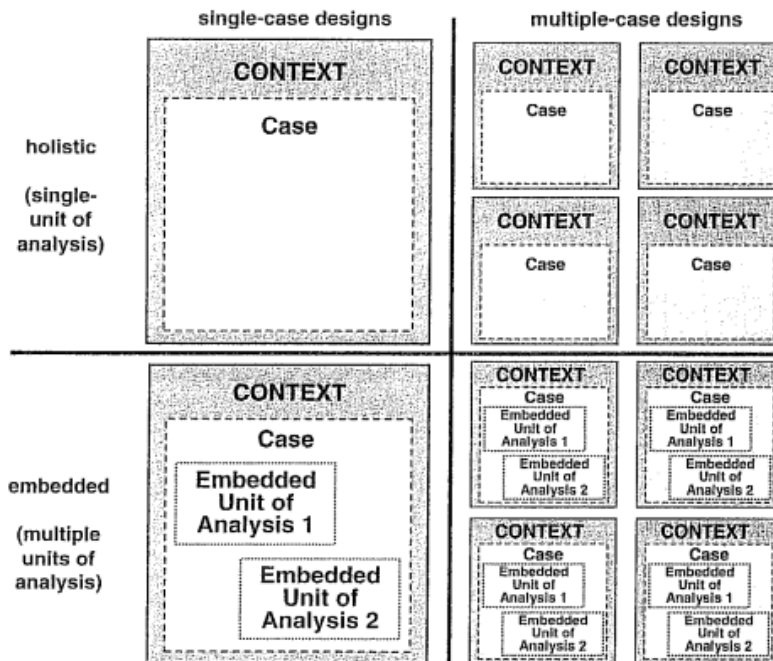
#### ***5.5.4 Case Selection***

There are two basic decisions to be made in selecting appropriate cases in one's research: the number of cases, and how to sample the cases (Voss, Tsikriktsis, & Frohlich, 2002). In addition, the criteria for selecting cases, as the 3<sup>rd</sup> decision in this section, are also helpful for guiding rigorous case selection.

##### **5.5.4.1 Number of Cases**

Yin (2003b) settles on four situations for the case study approach: single case, single case with an embedded unit, multiple-cases, and multiple-cases with embedded unit (this study does not refer to the fifth which is the longitudinal case). Due to its stronger external validity and generalizability (Yin, 2003b), most scholars recommend the multiple case design (Merriam, 1998; Miles & Huberman, 1999; Yin, 2003b). After reviewing many studies on the case study method, Perry (1998) calculates that the number of cases recommended in these studies ranges from two to fifteen. More importantly, the number of cases rely on the point at which "theoretical saturation" is reached according to Eisenhardt (1989). It means that "theoretical saturation is simply the point at which incremental learning is minimal because the researchers are observing phenomena seen before". Such a similar argument is also mentioned by many other scholars (Denzin & Lincoln, 2000; Glaser

& Strauss, 2009; Merriam, 1998). In addition, many scholars also warn that PhD students should consider their limited time and funding, and other strict practical troubles during the real data collection period, in choosing appropriate an number of cases (Merriam, 1998; Perry, 1998).



**Figure 5-3 Basic Types of Designs for Case Studies.**

Source: (Yin, 2003b, p40)

In this study and before entering the field, four cases were decided as the minimum number. During the process of data collection and analysis, the number became six, when the study reached the theoretical saturation. More specifically, from the fifth and sixth cases, no new findings emerged on institution-related transaction costs and new methods, by which these ETCs were able to reduce institution-related transaction costs. In addition, the time and funding did not allow another case in China.

### **5.5.4.2 Sampling**

For the case study design, the sampling method is not random, but purposive (Merriam, 1998; Miles & Huberman, 1999; Seawright & Gerring, 2008; Yin, 2003b).

Merriam (1998) believes that “purposive sampling is based on the assumption that the investigator wants to discover, understand, and gain insight and therefore must select a sample from which the most can be learned” As Yin states, “every case should serve a specific purpose within the overall scope of inquiry” Therefore, the sampling and selection of cases should follow specific objectives.

Seawright & Gerring (2008) highlight two basic objectives of case selection: “(1) a representative sample and (2) useful variation on the dimensions of theoretical interest.” To achieve such aims, they further conclude that seven common sampling strategies are required in case studies: typical, diverse, extreme, deviant, influential, most similar, and most different. Similarly Merriam (1998) concludes seven common sampling strategies in cases studies: typical, unique, maximum variation, convenience, snowball, chain and network

The case selection in this study mainly follows the *maximum variation* strategy of purposeful sampling by concluding the common pattern from various cases (Merriam, 1998). Trading companies are usually divided into agent and trader or pure and hybrid trading companies (Balabanis & Baker, 1993a; Casson, 1998). Also ownership (private and state-owned) may affect the firms’ characteristics in China. Thus six cases were chosen, representing agent, trader, pure trading companies, and hybrid trading companies (that included manufacturing), private trading companies and state-owned trading companies.

In addition, the sampling in this study also follows the *replication logic*, more specifically *literal replication*(Yin, 2003b). Yin(2003b, p46-47) indicates that the replication logic is the same as doing multiple experiments, where experiments are repeated with the same conditions, or with several expected-changed irrelevant conditions, to test the consistency of findings. The former is named literal replication, while the latter one is called theoretical replication. Among of this procedure, the previously established analytical framework helps to construct these experimental conditions.



### **5.5.4.3 Case Company Selection Criteria**

Merriam (1998, p65) recommends that it is best to build up a series of criteria, which can guide the case selection. All cases in the study should follow those criteria. The chosen criteria should be consistent with the sampling strategy. Peng (1998) concludes three main parameters: location, ownership, and function, as the criteria for case selection in the research on American export intermediaries. In line with his parameters, this one also uses these three parameters, plus with another two, shown as follow.

1. Location: The main entities of the cases, such as office and human capital, are located within Mainland China. As a result, the Chinese firms' sales operations, subsidiaries overseas, and independent foreign import trading companies are excluded. These companies also help Chinese manufacturers to export or foreign buyers to import from China. However, they don't have any entities in China, and usually act in the same manner as other foreign buyers. In addition, Peng (1998) indicates the specific state context might impact on his study of American EIs', and therefore, cases from different states were selected. Bearing in mind this caution, this study also tries to search for cases from different provinces or areas in China, to avoid any regional bias.

2. Ownership: The cases must be China-owned companies so that the difference between the influence on foreign and local firms by Chinese government policies is removed. For instance, Chinese government usually adopts incentive policies on foreign firms. This could reduce the policy-related effects on the export transaction that is the objective of this study.

3. Function: The main business of these companies must be exports. The trading companies have the reputation of being diversified in function (Casson, 1998; Jones, 1998b, 2002b; Sarathy, 1985), as discussed in the literature review chapter. Therefore the trading companies, which mainly participate in export business from China, become the most valuable cases. In practice, one method is adopted to select the right cases. The turnover from the export business of the chosen ETCs must be

over 50%. Therefore, those trading companies with export as their main business were selected.

4. Size: trading companies can be large and small in general. The large trading companies, like JGTCs, can have thousands of employees, while the small ones, like the American EIs, only have around 10 employees. In order to fulfil the maximum variation strategy, it is necessary to obtain both small and large trading companies in this study.

5. As stated in chapter four, the trading companies in China are classified into three groups: large centrally state-owned trading companies with diversified businesses, state-owned trading companies with pure trading businesses and private trading companies. The cases involved in this study mainly come from the last two groups. By doing this, this study can focus on the trading companies whose core business is export. The details of this issue will be discussed in section 9.6 (Limitation and future direction) in this study.

In the end, the target cases in this study are named as Chinese Export Trading Companies (Chinese ETCs), to show that they are located in the mainland of China, owned by Chinese, and mainly participate in the export business.

Table 5-4 summarizes the main characteristics of the six ETCs in this study. In general, the selection of these ETCs fulfils the criteria in term of location, ownership, and function, which are stated in this section. Cases are selected from five different cities in the mainland of China to avoid regional bias. Then all of them are China-owned companies to remove the effects from the difference between Chinese government policies on foreign and local firms. Third, all cases concentrate on export business, while two of them have or jointly have own manufacturers. Forth, five cases are small ETCs with 9 to 17 staffs, while the other one is large ETC with 120 staffs. Last, all cases are selected from two groups: state-owned trading companies with pure trading businesses and private trading companies, according to classification of Chinese trading companies described in chapter four.

**Table 5-4 A summary of the six cases**

		<b>Case A</b>	<b>Case B</b>	<b>Case C</b>
<b>Name</b>		Guangzhou H-Sentury Imp&Exp Co., Ltd	Tianjin Minmetal	Hua Kang International Trade Ltd
<b>Location</b>		Guangzhou	Tianjin	Shanghai
<b>Ownership</b>		Private	State-owned	Private
<b>Size(Personals)</b>		10	120 (trading companies)+235 (manufacturers)	9
<b>Establishment</b>		2005	1955	2004
<b>Product</b>		Apparels	Welding consumables, hardware, steel products, etc	ferroalloy, iron hardware, and machinery
<b>Foreign markets</b>		Spain, France and The United Arab Emirates	worldwide	Thailand, Malaysia, South Korea and Tainwan
<b>Performance</b>	<b>Amount</b>	\$5,000,000	\$60,000,000	\$30,000,000
	<b>Per capital</b>	\$625,000	\$500,000	\$3,000,000
	<b>Margin</b>	15%	2.5%	1%
		<b>Case D</b>	<b>Case E</b>	<b>Case F</b>
<b>Name</b>		Fulu exporting trading companies	Lueyuan Imp&Exp Co., Ltd	Aomeite Exp Co., Ltd
<b>Location</b>		Beijing	Qingdao	Qingdao
<b>Ownership</b>		Private	Private	Private
<b>Size(Personals)</b>		15 (trading companies)+50 (manufacturers)	17	17
<b>Establishment</b>		1997	2000	2007
<b>Product</b>		Bedding products	Tableware	Wooden furniture
<b>Foreign markets</b>		worldwide	Worldwide	US (60%), Spain (30%) and Australia (10%)
<b>Performance</b>	\$7,000,000	\$7,000,000	\$7,000,000 (2010)	NA
	\$333,000	\$333,000	\$411,746 (2010)	NA
	10%	10%	12% (2010)	NA

**5.5.5 Case Study Protocol**

Case study protocol is one main method for enhancing the reliability of a case study. It is able to guide data collection during each case, and is extremely helpful for multiple-case study. In addition, it helps to focus on the subjects of the research, structure the case report and later writing, and lock the research to audience. One case study protocol should contain an overview of the research, fieldwork procedures, research questions, and so forth (Yin, 2003b, p67-69). One case study protocol is generated for this study in accordance with the recommendations (shown in appendix 1)

### ***5.5.6 Data Collecting***

Yin (2003b, p85-86) arrives at six common methods for data collection in a case study design. They are: documentation, archival records, interviews, direct observations, participant observation, and physical artefacts. They have different strengths and weakness (shown in the Table 5-4). This study adopts *interviews, documentation, and observation, together with one pilot study*, for gathering the data. In the timeline, there are two stages: pilot study and case studies. The former mainly offers the specification of institutional constraints on China's export market, while the latter one leads to the main multiple-case study. In the specific process of data collecting, they are similar. One informal email, telephone or visit was undertaken at very beginning, in order to enquire if they were interested in being involved in this study. After they agreed, the background documentation relating to the company, product, and industry, would be collected at the outset. Material was collected from academic journals, the company website, government websites, newspapers, magazines, etc. Then specific interview notes, which differed according to the previous background data, would be generated. During the formal interviews, the main questions were first asked to the key informants, while some additional questions and triangulation questions to other informants. It is worth mentioning that these methods are usually alternately used, as the "data collection in case is a recursive and interactive process" (Merriam, 1998, p134)

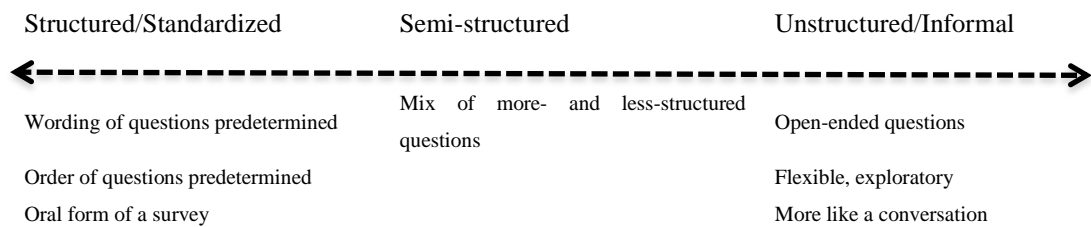
**Table 5-5 Six Sources of Evidence: Strenths and Weaknesses.**

Source of Evidence	Strengths	Weaknesses
Documentation	<ul style="list-style-type: none"> <li>stable—can be reviewed repeatedly</li> <li>unobtrusive—not created as a result of the case study</li> <li>exact—contains exact names, references, and details of an event</li> <li>broad coverage—long span of time, many events, and many settings</li> </ul>	<ul style="list-style-type: none"> <li>retrievability—can be low</li> <li>biased selectivity, if collection is incomplete</li> <li>reporting bias—reflects (unknown) bias of author</li> <li>access—may be deliberately blocked</li> </ul>
Archival Records	<ul style="list-style-type: none"> <li>[Same as above for documentation]</li> <li>precise and quantitative</li> </ul>	<ul style="list-style-type: none"> <li>[Same as above for documentation]</li> <li>accessibility due to privacy reasons</li> </ul>
Interviews	<ul style="list-style-type: none"> <li>targeted—focuses directly on case study topic</li> <li>insightful—provides perceived causal inferences</li> </ul>	<ul style="list-style-type: none"> <li>bias due to poorly constructed questions</li> <li>response bias</li> <li>inaccuracies due to poor recall</li> <li>reflexivity—interviewee gives what interviewer wants to hear</li> </ul>
Direct Observations	<ul style="list-style-type: none"> <li>reality—covers events in real time</li> <li>contextual—covers context of event</li> </ul>	<ul style="list-style-type: none"> <li>time-consuming</li> <li>selectivity—unless broad coverage</li> <li>reflexivity—event may proceed differently because it is being observed</li> <li>cost—hours needed by human observers</li> </ul>
Participant-Observation	<ul style="list-style-type: none"> <li>[Same as above for direct observations]</li> <li>insightful into interpersonal behavior and motives</li> </ul>	<ul style="list-style-type: none"> <li>[Same as above for direct observations]</li> <li>bias due to investigator's manipulation of events</li> </ul>
Physical Artifacts	<ul style="list-style-type: none"> <li>insightful into cultural features</li> <li>insightful into technical operations</li> </ul>	<ul style="list-style-type: none"> <li>selectivity</li> <li>availability</li> </ul>

Source: (Yin, 2003b)

### 5.6.6.1 Interviews

Interviewing is the most important source, sometimes the only source (Merriam, 1998, p71), of data for a case study (Yin, 2003b). It commonly contains three main types: structured, semi-structured and unstructured, according to different level of control on questions and structure (Ghauri, Gronhaug, & Kristianslund, 1995; Merriam, 1998; Yin, 2003b). The Figure 5-4 below shows the different characteristics of three types of interviews.



**Figure 5-4 Interview structure continuum.**

Source: (Merriam, 1998, p73)

The structured interviews, or standardized interviews, is a standard format of the interview, which is used with an emphasis on fixed response categories and systematic sampling, and loading procedures combined with quantitative measures and statistical methods. The unstructured interview (or in-depth interviewing) is the freer data-collection method, during which the respondent is offered almost full liberty to discuss reactions, opinions and behaviour on a particular issue (Ghauri et al., 1995, p64). The semi-structured interview is the other different kind of interview that tries to integrate the former two methods. Burns and Robert (2000) state “this has been used either as part of a structured interview or an unstructured interview, as investigators from both persuasions feel that this may help their study”. On the one hand, it acquires a degree of structure, such as the main issues, sample size, specific interviewees and leading questions. At the same time, its relatively “open” format aims to avoid the bias that can arise from the sequencing of subject matter by the interviewer, from any inadvertent omission of questions, from unrepresentative sampling and from an uncontrolled, over- or under- representation of subgroups among the respondents (Ghauri et al., 1995, p64).

In this study, the in-depth and semi-structured interviews are adopted in order to increase the freedom of interviewers to obtain more information; after all this study is a kind of exploratory research. However, this format is vulnerable to the interviewers’ emotions and subjectivity; the researcher can often lose control of the interview. To overcome these problems, the interviews are guided by a series of question lists and brief structure guide, and open-ended questions at the same time (see the details in the interview guide). The setting of such a framework attempts to

enquire after specific questions from all respondents, and in the meanwhile it also allows some flexibility to pursue emergent information in each case (Merriam, 1998).

### **Questions and probe**

Good questions are vital for obtaining good data during interviewing. Merriam (1998, p75-80) concludes with four types of good questions and three types of bad questions (Shown as Table 5-5). This offers constructive suggestions for the generation of questions in the interviews in this study (Shown as Table 5-6). For instance, the “Devil’s Advocate” leads to the questions on checking one statement from previous respondents, including within cases and cross-cases. The “ideal position question” can explore the difficulty generated by institutional constraints.

**Table 5-6 Four Types of questions with examples from a JTPA Training Program Case study.**

<b>Type of Question</b>	<b>Example</b>
Hypothetical Question: asks what the respondent might do or what it might be like in a particular situation; usually begins with “what if” or “suppose”	“Suppose it is my first day in this training program. What would it be like?”
Devil’s Advocate Question: challenges the respondent to consider an opposing view	“Some people would say that employees who lose their job did something to bring it about. What would you say to them?”
Ideal Position Question: asks the respondent to describe an ideal situation	“What do you think the ideal training program would be like?”
Interpretive Question: advances tentative interpretation of what the respondent has been saying and asks for a reaction	“Would you say that returning to school as an adult is different from what you expected?”

(Merriam, 1998, p75-80)

**Table 5-7 Questions to avoid.**

<b>Type of Question</b>	<b>Example</b>
Multiple Questions	How do you feel about the instructors and the classes?
Leading Questions	What emotional problems have you had since losing your job?
Yes-or-No Questions	Do you like the program? Has returning to school been difficult?

(Merriam, 1998, p75-80)

The probing question refers to the interviewers’ questions in response interviewees’ previous answers. It is constructed to ask more details, clarification and examples (Merriam, 1998). It helps to extend the different and emergent information from previous interviews, and specific reasons on the special transaction process in this study.

The interview guide is the list of prepared questions for the interviews (Merriam, 1998). It is generated and amended from pilot study to the final case, as the multiple case study should repeatedly check the emergent issues from previous cases (Yin, 2003b). In general, the questions in this study start with the questions on historical and background information on the cases and interviewees, and are followed by the questions on transaction process, the whole process for the case and the specific transactional procedure for interviewees, and conclude with the open-end questions on the interviewees' opinions (the details are shown in appendix 2 interview guide).

In practice, the questions of interviews (shown in appendix 2: interview guide) in this study are generated according to the theoretical framework in this study, referring to previous literatures on institutional theory, transaction costs and trading companies in particular. These questions can be separated into two main groups. The first group is about the context of the case. The second group are surrounding theoretical concepts of theoretical framework.

*The context-related* questions aim to introduce the case companies, like history and staff roles, which will help researcher and readers to realize the background of cases, Therefore the questions in practice are usually like “Can you briefly introduce the firm, like date of establishment”.

The second group of questions, related to the *theoretical concepts*, become the most important part in interviews, as data from the answers test and develop theoretical framework. First of all, export transaction is proved to be focus in previous literatures on trading companies (Casson, 1998; Peng, 1998; Peng & York, 2001; Roehl, 1983), and transaction costs economics (Williamson, 1975, 1985), and therefore become the unit of analysis in this study, as stated in section 5.5.3. As a result, many questions are about the whole process of export transaction, from manufacturer to foreign buyers. These questions are shown as “can you briefly introduce how to transact with foreign buyers, step by step?” In particular, one brief export transaction flow chart (shown as Figure 7-2) developed from case A is shown as a sample to interviewees to explore distinction of their export transactions.



Second, three groups of institutional constraints, which can obstruct export transaction, are one main concern of theoretical framework in this study. Thus questions related institutional constraints (term of *problems* are used in questions to make understandable for interviewees) are another important series of questions. The interviewees will be asked the problems in their import/export process, especially those related to institutions, like government policy, industrial traditions and norms and culture. Those previous literatures on institutional constraints helps to highlight contain problems about doing business in transition economies, like government intervention, contract enforcement, and intellectual property protection. In particular, pilot study in chapter 6 has clarified three specific institutional constraints. Thus, the author directly enquires interviewees' opinions on such institutional constraints from their business practice in subsequent cases study. In some cases, the author describes these institutional constraints at first to explain the concept of institutional constraints and then enquires their opinion.

Third, the explanation of ETCs' advantage on economizing transaction costs, another important part of theoretical framework, leads to one different sort of questions in interviews. In response to previous questions on institutional constraints, the interviewees are enquired about their solutions to these problems. These questions usually are followed up by interviewees' description of institutional constraints involved in their export business, and take the form of "So, how does your company solve such problems?" These questions are also based on transaction costs economics. For instance, transaction amount/frequency, one common explanation in transaction costs economics (Williamson, 1985), generates the questions on numbers of ETCs' manufacturers and foreign buyers. Some of these questions are based on previous explanations on trading companies. For example, previous literatures argue that experience and knowledge on export business (Peng, 1998) and products' characteristics (Roehl, 1982) help ETCs to reduce related transaction costs. Thus the questions on experience and knowledge (staffs' work history) and export products are also asked in interviews.

At last, the information on ETCs' manufacturers and foreign buyers are also interviewed. As stated in chapter 2, the *comparative approach* of economizing transaction costs to different transactions and governance structures is the main research method in transaction costs analysis (Williamson, 1975, 1985). Moreover, comparison and contrast are also common analytical methods in case study (Miles & Huberman, 1999). Therefore this study will explore the situation of alternative trading partners in order to explain the ETCs' advantages on economizing transaction costs by comparing with their domestic manufacturers and foreign buyers. As a result, this group of questions are surrounding the information of these domestic manufacturers and foreign buyers. For instance, the size, production capability, characteristics of ETCs' domestic manufacturers are interviewed in case study.

### **Informants**

Purposeful sampling is also appropriate for the selection of informants (Seidman, 2012). Huber & Power (1985) indicates the importance of the key informant, as a consequence of their massive knowledge of events in the company. They further recommend that "If more than one informant per unit of analysis is to be interviewed, choose informants whose unique biases or lack of knowledge are likely to offset those of other informants"

Therefore, this study respectively interviews two groups of informants within each case: the key informants and ordinary informants. The key informants are mainly the owners and CEOs in the case, who are clearly the persons more likely to have acquired knowledge on trading companies and export transactions (Peng, 1998). They offer main and general data on the company, export transaction processes and significant parts in each case. The ordinary informants include department managers, ordinary staff, who offer information on specific transaction unit procedures, and on their related parts in the case. In addition, amongst the ordinary informants are some informants external but related to the ETCs, such as staff from manufacturing. The information from ordinary informants offers the triangulating check on previous interviews, thereby increasing internal consistency (Peng, 1998), and supplementary information for the case.

In the end, a total of 42 formal interviews from six cases and 10 independent interviewees in pilot study were completed. And many follow-up interviews, telephone calls and on-line conversations were adopted for clarification of some questions. The formal interviews lasted 60 to 120minutes on average. To enhance reliability, all interviews were recorded and transcribed (Merriam, 1998). Then all content related to the research was translated by the author, and checked by another PhD student.

### **5.6.6.2 Documentation**

Yin (2003b) indicates that the documentation covers various items, such as letters, agendas, administrative documents, formal studies and newspaper articles. In particular, the documentation on the background to the cases should be collected before formal and main data collection. This enables the researcher to identify the key points, events and persons in the case, and to establish the corresponding fieldwork guide for formal and main data collection. For instance, Pettigrew (1997) suggests that “the interviews should ideally be preceded by the collection and analysis of historical documents, which are used to establish the core of the chronology of the process and identify key individuals and transition points in the process.” In addition, Yin (2003b) states that the documentation is also useful for corroborating and augmenting evidence. In other words, this triangulation through the documentation offers the opportunity to both check the findings, and supplement any information lost in the main data collection process, such as the interviews in this study.

Therefore, the documentation relevant to this study is collected in two separate stages. First, the background documentation related to the company, product, and industry of the interviewees and case company is collected before the formal interviews. The documents are mainly referred to in the generation of specific interview notes. After the interviews, certain documentation is also specifically sought to further triangulate and check certain statements from the interviews. The main sources of the

documentation include academic journals, industrial reports, company websites, government websites, newspapers, magazines, etc.

### **5.6.6.3 Observation**

Observation is another important method for data collection in the case study which is commonly recommended by methodology studies (Merriam, 1998; Yin, 2003b). Merriam Merriam (1998), p94 believes that observation can construct one “natural field setting” and obtain first-hand data on the phenomenon.

Observation took place in the first case in this study, in order to develop a picture of the Chinese ETC in practical business. The author spent two months in this ETC. During this time, the author observed the ETC’s working site, each staff’s daily work, the transactional process, communications and business transactions with external organizations. In addition, formal interviews and informal chats were processed during the observation period.

### **5.6.6.4 Pilot study**

Many studies suggest that preliminary study should be used in a case study (Pettigrew, 1997; Yin, 2003b). Yin states that the pilot study is the preliminary study before proceeding with the formal case study. It helps to “to refine your data collection plans with respect to both the content of the data and the procedures to be followed.” The investigation and data in the pilot study could be “broader and less focused” than that in real case study. The timing should be as earlier as possible. The sources should contain as much as possible from previous research to empirical findings of your own. In addition, the data collection process should reflect “convenience, access and geographic proximity” (Yin, 2003b, p79-p81).

The pilot study is separated into two parts in this study. Initially, one pilot study was undertaken before all the case studies so that the main institutional constraints encountered in exporting in China, could be explored and specified. Since the scope of the institutions is too broad, and the specific institutional constraints in export

practice in China are unknown, one explorative investigation on specification of such institutional constraints helps to check the previous analytical framework, and to make more efficient data collection in the forthcoming case study. In addition, the practical information on China's export business and process, and Chinese ETCs also contribute to such aims. The main method of data collection is the interview, while the informants are from manufacturers, foreign buyers and Chinese ETCs. In the second stage, the pilot study was the same as the case study, as is widely adopted in the case study method (Yin, 2003b). As a formal single case, its procedure is same as in subsequent cases in this study. Similarly, it aims to check the analytical framework, and increase the efficiency for subsequent cases. For instance, one comprehensive export transaction flow chart, which is developed in Case A as observation offers more information, is also used in the interviews of subsequent cases. Such method largely increase efficiency of interview and is welcomed by the informants. The main methods of data collection in case A include the interviews and observation. The informants also represent key and ordinary informants, as stated in 3.6.6.1.

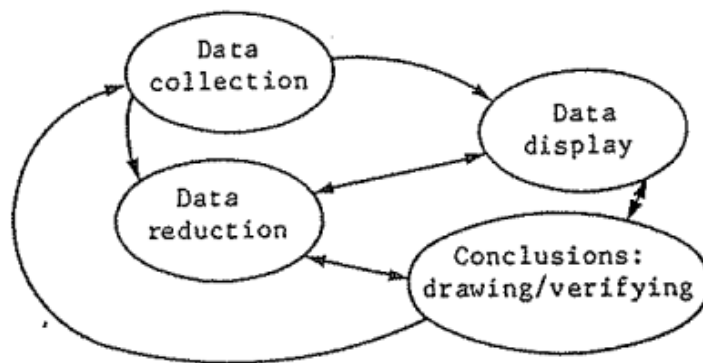
### ***5.5.7 Data Analysis***

Many studies recommended the data analysis should take place in the early stage of research and continued throughout the whole research (Merriam, 1998; Miles & Huberman, 1999; Yin, 2003b). In other words, the data collection, data analysis, and theoretical development are synchronous (Miles & Huberman, 1999). As stated in Yin's "feedback" loop, this enables re-visiting of previous cases with new findings in a current case, earlier data analysis also enables researchers to revise previous analytical frameworks, and to prepare further analysis (Miles & Huberman, 1999). Therefore, the data analysis in this study took place at the same time of pilot study and alongside the data collection and analysis. In addition, the main part of the data analysis is separated into within case analysis and cross-case analysis, a strategy also suggested by the extant literatures (Miles & Huberman, 1999; Yin, 2003b).

#### **5.6.7.1 within Case Analysis**

Miles & Huberman (1999) advise one interactive model for data analysis, which includes data collection, data reduction, data display and drawing/verifying (shown

as Figure 5-5 and 5-6). Amongst these, data reduction, data display and drawing/verifying jointly construct the process of data analysis. In the process of data reduction, the data on the field notes or transcriptions are selected, simplified, abstracted and transformed. This process takes place even before data collection. It is part of the analysis. It helps to sharpen, sort, focus, discard and organize data, so that the final conclusions can be drawn and verified (Miles & Huberman, 1999, p10-11) (shown as Figure 5-5). In this study, the data reduction ensures that the original interviews transcriptions are selectively simplified according the integrative analytical frameworks. In particular, the complex transactional process of each ETC is concentrated and simplified into simpler several transactional procedures. And the complicated institutions in China are simplified and organized according to the institutional framework.



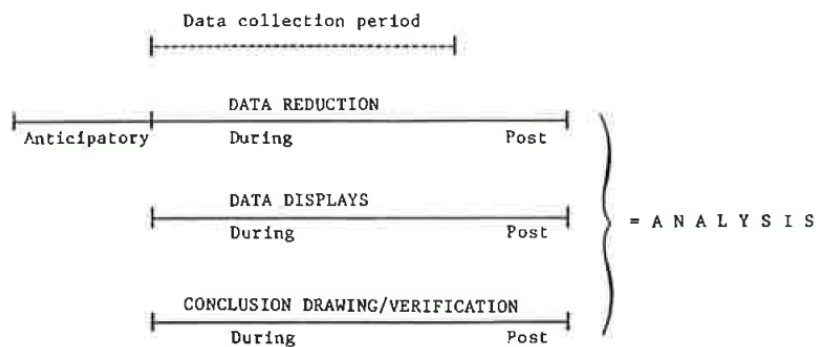
**Figure 5-5 Components of Data Analysis: Interactive Model.**

Source: (Miles & Huberman, 1999, p10-p12)

Data display is “an organized, compressed assembly of information that permits conclusion drawing and action”, and enables the researcher to find the patterns efficiently (Miles & Huberman, 1999, p11, p91). This part is similar to the “case description” (Yin, 2003b), which is argued by Yin as one main strategy for data analysis in a case study. Miles & Huberman’s work (1999) contribute many effective and workable means for data display, including various matrices, charts and networks. Among of them, this study adopts the synergetic data display between time-ordered display (Miles & Huberman, 1999, p110) and conceptually-ordered

display (Miles & Huberman, 1999, p127). First, following the time-order, time-series analysis in Yin's study (Yin, 2003b), the data are displayed according to sequential orders during the whole export transactional process. Then these data are reduced, simplified, organized and re-allocated into different export transactional procedures and different institutional constraints, which are distinctive concepts during whole export transactional process.

Conclusion drawing and verification is another component of the data analysis process. It requires the researcher to observe, search for, and analyse the “regularities, patterns, explanations, possible configurations, causal flows and propositions” among the data. In the meanwhile, the conclusion drawing and verification are simultaneous and interactive processes (Miles & Huberman, 1999, p11). Similarly in this study, the findings and conclusions from each case are verified and tested in other cases, in order to improve the validity.



**Figure 5-6 Components of Data Analysis: Flow Model.**

Source: (Miles & Huberman, 1999, p10-p12)

### **5.6.7.2 Cross Case Analysis**

Cross-case analysis/ synthesis is one more powerful analytical means in the case study, with its greater robustness compared with a single case (Yin, 2003b, p133). It enhances generalizability, and deepens understanding and explanation, by illustrating repeated-appearances of the same/similar event, process, and more important patterns (Eisenhardt, 1989) crossing different cases (Miles & Huberman, 1999). In addition,

cross-case analysis should not ignore the uniqueness of each case, when it pursues these general items across different cases (Sliverstein, 1988).

This study adopts the mixed strategy, sometimes referred to as stacking comparable cases, in cross-case analysis, by combining case-oriented strategies and variable-oriented strategies. Miles & Huberman (1999, p176) describe the specifications of such a strategy as “you write up each of a series of cases, using a more or less standard set of variables (with leeway for uniqueness as it emerges). Then you use matrices and other displays to analyse each case in depth. After each case is well understood (the cross-cutting variables may evolve and change during this process), you “stack” the case-level displays in a “meta-matrix,” which is then further condensed, permitting systematic comparison.”

### ***5.5.8 Criteria for Judging the Quality of Research Design***

**Table 5-8 Case Study Tactics for Four Design Tests.**

Test	Explanation	Case Study Tactic	Phase of research in which tactic occurs
Construct validity	Establish correct operational measures for the concepts being studied	Use multiple sources of evidence  Establish chain of evidence  Have key informants review draft case study report	Data collection  Data collection composition
Internal validity	Establish a causal relationship, whereby certain conditions are shown to lead to other conditions, as distinguished from spurious relationships	Do pattern-matching Do explanation-building Address rival explanations Use logic models	Data analysis Data analysis Data analysis Data analysis
External validity	Establish the domain to which a study's findings can be generalized	Use theory in single-case studies Use replication logic in multiple-case studies	Research design Research design
Reliability	Demonstrate that the operations of a study-such as the data collection procedures-can be repeated, with the same results	Use case study protocol Develop case study database	Data collection Data collection

Source: (Yin, 2003b, p34)



As shown in Table 5-7, criteria for judging the quality of research design in this study concludes four main aspects: construct validity, internal validity, external validity, and reliability. Construct validity refers to “establish(ing) correct operational measures for the concepts being studied” (Yin, 2003b, p34 :Kidder & Judd, 1986, p26-29). Following Yin’s recommendations (Yin, 2003b), the main solutions in this study contain multiple data collection methods (semi-structured interviews, observation and documentation), multiple interviewees in same case, establishing a chain of evidence, and requiring key informants (only accepted in certain cases) to review the draft case study report.

Internal validity refers to “establish(ing) a causal relationship, whereby certain conditions are shown to lead to other conditions, as distinguished from spurious relationships” (Yin, 2003b, p34 :Kidder & Judd, 1986, p26-29). This study adopts “pattern matching”, which is able to improve the internal validity by matching “empirically based patterns with a predicted one” (Yin, 2003b, p116). Therefore, the data collection and data analysis in this study do check the relationship between institutional constraints (institution-related transaction costs) with Chinese ETC’s export conditions. For instance, with the improvement of such institutional constraints, the interviews from ETCs express the loss of their comparative advantages on exports, while the foreign buyers and domestic manufacturers are more likely to appreciate these improvements.

In addition, long-term observation and peer examination are also able to improve internal validity (Merriam, 1998). During the two-month observation in one ETC, the relationship between the ETC’s business characteristics and institutional constraints show more clearly. Moreover, the explanation of such relationships to many practitioners and discussion between the author and other researchers, including the supervisors, also helps to clarify such relationship. As a result, they jointly increase internal validity.

External validity refers to “establish(ing) the domain to which a study’s findings can be generalized” (Yin, 2003b, p34 :Kidder & Judd, 1986, p26-29). Correspondingly,

replication logic is used from one case to another. More specifically, these cases share one general outcome in the analytical frameworks.

Reliability refers to “demonstrat(ing) that the operations of a study-such as the data collection procedures-can be repeated, with the same results”. There are two solutions in this study. First, one case study protocol is used. Second, the case database is also generated, including the interview guide, field notes, transcripts, recording, documentation and so on.

## **5.7 Chapter Summary**

This Chapter illustrates the research strategy and methodology, which offers the logical link between the evidence and research questions in this study. It includes the philosophical stance in this study, the justification for the use of qualitative case studies, and detailed case study design.

## **Chapter 6 The preliminary identification of institutional constraints in China's export market: pilot study A**

### **6.1 Introduction**

The pilot study or preliminary study is recommended before the formal case studies are undertaken (Pettigrew, 1997; Yin, 2003b), as it helps to “to refine your data collection plans with respect to both the content of the data and the procedures to be followed.” (Yin, 2003b) Therefore, this study adopts the pilot study approach, which covers the first step in this chapter and second step in the first within-case (case A) analysis. The pilot study A in this chapter aims to pre-test and modify the previous integrative framework and to specify the institutional constraints on China's export market. The interviews with ten experienced practitioners constitute the main source of data. Ten interviewees respectively come from three different groups of stakeholders involved in direct and indirect exporting from China: domestic manufacturers, foreign buyers and China's ETCs. All of them have long-standing experience of China's export market.

The section 6.1 is the introduction to this chapter. Then section 6.2 contains the general description of pilot study A, the introduction of the interviewees, and the main findings of pilot study A. In section 6.3, the previous analytical framework is modified and specified in line with the findings in 6.2. Finally section 6.4 summarizes this chapter

### **6.2 Pilot study**

The pilot study forms the preliminary study before the formal case studies. It helps to “to refine your data collection plans with respect to both the content of the data and the procedures to be followed.” The investigation and data in the pilot study should be “broader and less focused” than that in actual case studies. The timing should be as early as possible. The sources should include as much as possible from previous research to the empirical findings of your own. In addition, the data collection process should reflect “convenience, access and geographic proximity” (Yin, 2003b, p79-p81). Therefore, these recommendations help to guide the pilot study strategy in this study. For instance, the timing is chosen as early as possible, while sample of the

interviewees is achieved through introductions by friends, and the research sites are mainly located in regions most convenient and accessible to the author.

### ***6.2.1 Description of pilot study in this chapter***

The pilot study A in this chapter aims to explore and specify the main institutional constraints that impinge on exporting in China. According to the previous analytical framework developed in Chapter 3, the major participants involved in export transactions comprise domestic manufacturers, ETCs and foreign buyers. Thus this pilot study is conducted mainly from the perspective of domestic manufacturers and foreign buyers, together with the triangulation check from the ETCs' perspective, in order to explore the challenging problems that are generated by institutional constraints within China's export market in the course of export and import practice in China. After that, the analytical framework will be refined to incorporate several specific institutional constraints that will be checked and used as a general guide for data collection in subsequent cases for exploring potential methods, by which Chinese ETCs can reduce these institution-related transaction costs. The main data in the pilot study are collected through interviews with practitioners drawn from these three groups of participants. As a triangulation check supplementing these main data, secondary data are also collected from public channels, such as industrial reports, government reports, academic literature, newspapers, and other reliable sources.

### ***6.2.2 Introduction of the interviewees***

During the pilot study A, 10 practitioners, who had been worked in the export business in China, were interviewed. The interviews took place in the autumn of 2009 in the UK and China, which preceded the main data collection in the winter of 2009 and the spring of 2010 in China. These interviewees included three practitioners (coded as BUY-P-A, B, C) from foreign importing companies, five practitioners (coded as MAN-P-A, B, C, D) from domestic manufacturers, and two practitioners (coded as ETC-P-A, B, C) from Chinese ETCs.

BUY-P-A is one co-owner of an importing company from Taiwan. He had been working in China for more than ten years before he opened an importing company

with another partner in Taiwan in 2000. His companies mainly import building materials, such as fireproof materials from China, and then resell to construction companies in Taiwan. Due to his close contact with the culture and long-term working and living experience in China, he well understands China's business system, including the necessary trading authority for each exporter, and is familiar with Chinese business habits, such as unreliable contracts. His companies initially transacted directly with several Chinese manufacturers. But after a number of serious "quality problems", he turned to Chinese ETCs for indirect imports.

BUY-P-B is one co-owner of oan importing company from Saudi Arabia. His father had participated in the importing business between China and Saudi Arabia since the 1990s. With such a family background, he opened one importing company with another partner in Saudi Arabia in 2002. His company mainly designs and sells toys in Arab countries that are produced by Chinese manufacturers. Since 2003 he had been accustomed to travelling around China once a year, in order to search for and negotiate with suitable manufacturers and ETCs. At first, he used one HK trading company that had branches in China and Saudi Arabia, to facilitate the whole importing and purchasing process. Then he now changes to one Chinese ETC, which he knew during one business travel in China.

BUY-P-C is the owner of one importing company from the UK. His company was established in 1998. His company mainly imports bedding products, such as pillows from China. Based on his 15-year business experience in China, his company has two main collaborative Chinese ETCs with many other backup ones, with which he occasionally transacts. He used to have some direct transactions with Chinese manufacturers but due to some problems, such as quality and delivery times, he turned to collaborating with ETCs, which could better facilitate with whole export process.

MAN-P-A is the owner of one Chinese manufacturer, which is located in Tianjin. He had many different kinds of business experience, mainly in domestic trade, such as apparel, lumber, furniture etc. His company, which then produced furniture for the

domestic market, began to participate in exporting in 2005, when one ETC enquired after some cabinets from them. His main exporting market is the United States. His exporting channel is exclusively through two ETCs.

MAN-P-B is the owner of one Chinese manufacturing company, which located is in Tianjin. He used to work as a senior manager in one ETC, which was operated by his brother and exported pre-fabricated houses. As a consequence of increasing orders and understanding of manufacturing, he turned to opening his own factory in 1998, which mainly supplied products for the previous ETC. The exporting destinations include Australia and New Zealand. Their exporting channel is dominated by one ETC.

MAN-P-C is one of the main salesmen in one Chinese manufacturing company, which located in Qingdao. She has worked in this company for four-years as a salesman. Her main job is to search for new foreign buyers and maintain current foreign buyers. This factory produces various kinds of wooden packaging cases. 50% of the output from the manufacturer is exported through an ETC, whilst the other half is through their own export channel.

MAN-P-D is a manager in the exporting department of a Chinese manufacturing company located in Shanghai. After graduating in business studies from the UK in 2006, he worked as salesmen in one ETC. Then he moved to his current factory in 2008. His department takes charge of the whole export process, from searching for buyers to the final enforcement of contracts. This factory produces stationery, such as note-boards. Before 2007, this factory only offered products to one ETC. Then, it gradually developed its own export channel. At present, his department takes charge of exporting 30% of the output, whilst the remaining 70% is still undertaken by the ETC.

ETC-P-A is the co-owner of a Chinese private ETC located in Tianjin. He had been working in the export business since the 1980s, when he graduated from college and was recruited by one state-owned trading company. He has worked in many different

ETCs over the last 20s years. This ETC was established in the 1990s. At present, it mainly exports apparel to several foreign buyers in Japan. Its collaborative manufacturers are SMEs, located in the rural areas around Tianjin. These collaborative manufacturers are relatively fixed and have more than four years' collaborative history with him.

ETC-P-B is one manager of a private Chinese ETC, which is located in Shanghai. She has had more than ten years' working experience in the export industry in China. She used to work in three different ETCs before the current one, which mainly exports plastic bags, such as shopping bags, to the EU and US. Although she continues to search for new buyers, her department mainly takes charge of two important existing foreign buyers from Germany and the UK, which jointly make up more than 50% of the export volume of this ETC. Her department takes responsibility for the whole export process.

ETC-P-C is one manger of a state-owned ETC located in Tianjin. He graduated with a major in international trade in 1998, then worked as salesmen in the current ETC, and finally became a senior manager in this ETC. This is a large ETC that has been established since 1965. It has 6 exporting departments, which are divided according to different exporting products, and three supporting and administrative departments, which had a total of 70 employees and an export turnover of \$40,000,000 in 2010. The main tradable products exported by this ETC include drawn work, artificial flowers, etc. His department mainly exports plastic flowers to more than 10 countries.

**Table 6-1 Summary of interviewees in pilot study A.**

Coded name	Firm	Products	position	Experience
BUY-P-A	Importing company in Taiwan	building materials	Co-owner	Long-term working experience in China, and 10-years purchasing experience from China
BUY-P-B	Importing company in Saudi Arabia	Toys	Co-owner	7-years purchasing experience from China
BUY-P-C	importing company in UK	Bedding products	Owner	15-years purchasing experience from

					China
MAN-P-A	Manufacturer in Tianjin, China	furniture	Owner		4-years exporting experience through ETC
MAN-P-B	Manufacturer in Tianjin, China	Pre-fabricated houses	Owner		11-years exporting experience through ETC
MAN-P-C	Manufacturer in Qingdao, China	wooden packaging cases	Salesman in exporting department		4-years exporting experience
MAN-P-D	Manufacturer in Shanghai, China	stationery	Manager of exporting department		3-years exporting experience
ETC-P-A	Private ETC in Tianjin, China	Apparel	Co-owner		20-years exporting experience
ETC-P-B	Private ETC in Shanghai, China	plastic bags	Manager		More than 10-years exporting experience
ETC-P-C	State-owned ETC, in Tianjin, China	drawn work, artificial flowers, etc	Manager		11-years exporting experience

In order to identify any institutional constraints during exporting in China, the main content of the interviews with these practitioners focused on the problems confronting them in their daily work in importing/exporting. In particular, the institution-related problems were highlighted during these interviews. For interviews with BUY-P-A, B, C, the questions were about what kinds of problems they met or perceived during their own import process in China; if and why they used indirect Chinese ETCs' export channels; and how these ETCs facilitated their import process. For interviews with MAN-P-A, B, C, D, the questions focused on what kinds of problems they met or perceived during their own export process; if and why they use indirect Chinese ETCs' export channels; and how these ETCs facilitated their export process. In terms of the interviews with ETC-P-A, B, C, the enquiries concentrated on what kinds of problems they met during their export process. In particular, some previous answers from BUY-P-A, B, C and MAN-P-A, B, C, D were also mentioned and checked out in the interviews with ETC-P-A, B, C. By doing such triangulation, the construct validity of these data was enhanced. Table 6-2 summarizes these problems related to local institutional constraints reflected in the interviews.



**Table 6-2 Summary of the problems related to local institutional constraints reflected in the interviews.**

Problems	Related institutional constraints	Interviewees	Interviewees									
			MAN-P				BUY-P			ETC-P		
			A	B	C	D	A	B	C	A	B	C
Complex and time-consuming administrative procedures for applications for export authority, business licences and registrations	Bureaucratic procedures and administrative approvals	MAN-P-A, B, C, D ETC-P-A, B, C	Y	Y	Y	Y				Y	Y	Y
Complex and time-consuming administrative procedures for approvals for each export transaction			Y	Y	Y	Y				Y	Y	Y
Complex and time-consuming administrative procedures for tax rebates			Y	Y	Y	Y				Y	Y	Y
Export contracts are not protected	Inefficient legal system	BUY-P-A, B, C						Y	Y	Y		
Uncertainty of product quality	Ineffective legal system and contract obligation	BUY-P-A, B, C ETC-P-A, B, C						Y	Y	Y	Y	Y
Delay in delivery time	Ineffective legal system and contract obligation	BUY-P-A, B, C ETC-P-A, B, C						Y	Y	Y	Y	Y

### ***6.2.3 Findings from pilot study***

#### **6.2.3.1 Bureaucratic procedures and administrative approvals**

The *inefficient bureaucratic procedures and administrative approvals* in transitional economies have been criticized by many related studies (Estrin et al., 2008; Meyer, 2001a; Zou, Zhang, & Wang, 2007). Meyer (2001a) indicates the local “bureaucratic procedures” in Eastern Europe, such as the approval for real estate acquisition, could generate significant costs in term of time, as these procedures are complex and slow. Estrin (2008) also reveals a similar finding in the study on the institutional environment in transitional economies. They found that some “administrative barriers” obstruct businesses in these transitional economies. For instance, there are the lengthy timescales and massive procedures for starting up businesses. These bureaucratic procedures and administrative approvals typically inherited from the previous planned economy system that persist to the present time, and therefore are located as the “*former formal institutional constraints*”.

First, all participants from domestic manufacturers (MAN-P-A, B, C, D) and ETCs (ETC-P-A, B, C) expressed the view that exporters have to obtain a series of export authorities, business licences, and registrations for the start-up of export businesses. But the applications procedures for such official documents are complex, time-consuming and subject to change in China. This procedure is not related to the export transactions between exporters and buyers, but is an unavoidable feature of the export business in China.

The secondary data (shown in the table 6-3) also support such findings. It emerges that the Chinese exporters have to apply for and annually renew various permissions, licences registration and authorities before their export business can proceed. The main ones are listed on the following table. The whole period of all application and registration needs at least two months (SINA, 2008). Also, most of these licences and registrations need to be renewed every year. Thus these applications and registrations generate additional costs, in terms of time and money, for domestic exporters. As

these procedures take place before any formal transaction between domestic exporters and foreign buyers, they add one additional *pre-export procedure* in formal export transaction process.

**Table 6-3 Summary of official licences/registrations for operating export business in China.**

Licences and registration	Government departments	Annual (Y/N)
Export authority/registration	Local Commission of Commerce	Y
Business licence	Administration for Industry and Commerce	Y
Registration for receiving and exchanging foreign exchange	Foreign exchange branches	Y
Registration for customs declaration	Customs	Y
Registration for the on-line customs service	Customs	Y
Registration for obtaining product inspection certification	Entry-exit inspection and quarantine bureau	Y
Registration for tax rebates	Taxation bureau	Y

Apart from such export start-up approvals, the findings from the interviews (MAN-P-A, B, C, D, ETC-P-A, B, C) show that China's exporters have also to submit and/or receive a series of related documents/receipts to/from these relative government departments for each export transaction. These procedures actually take place after formal transactions between domestic exporters and foreign buyers (referred to as the *post-export procedure in export transactions*). To take foreign exchange approvals as an example, the use and receipt of foreign exchange does not only require initial registration with local foreign exchange branches and customs, but also needs exporters to process a series of documents, paper documents, receipts and on-line records, through these departments for each export transaction, as a result of the government's strict control on foreign exchange. Without one of the necessary documents, the exporters will fail to export.

Another example is the tax rebate procedures, which are time-consuming in China. The rebate of taxes is significant for exporters, as it often make up around 10% of the product price in China. The tax rebate procedures in China have been strict and complex in order to avoid fraud cases, and they constantly change as the export system in China changes. Likewise such procedures require documents and records

from local Taxation bureau and customs. Then the exporters have to wait for three-months processing time until they receive the tax rebate. On occasion, the waiting time can even rise to more than half a year. Moreover, there is an expiry limit of three-months, which it means the exporters risk failing to receive the tax rebate if they make some mistakes and miss the deadline during the procedure. Finally, the levels of tax rebate can differ by product and over different periods. The Chinese Customs usually issue one large booklet containing all tradable products, every year. Sometimes, these rates are also changed during different periods in the year in accordance with changes of export policy. Exporters have to fill in the tax code accurately in term of their products. This increases the possibilities for making mistakes.

In practice, therefore, the exporting company usually has to set specific and experienced staff to deal with these complicated documents and procedures on foreign exchange approvals and tax rebating.

What is worse, these procedures are often changed by these government departments. As some changes are initially issued by central governments, or some are initially trialled in some regions and then extended to other regions, the real editions are different for different local governments. Thus even the officers and staff in these government departments are unfamiliar with and still learning about some of the new changes. In addition, some of changes are in conflict with previous and other procedures. As a result, domestic exporters constantly had to keep learning, adapting and even accepting losses from these changes.

MAN-P-B describes one confusing situation as below:

*“The foreign exchange branches recently changed the procedure for applying for the approval to receive and use foreign exchange. But it confused us for a while. We asked the officers in the branch. The officers couldn’t explain it because it is a new policy, and told me to prepare two sets of documents respectively in line with both the previous and new procedures. And up until now they are taking two documents.”*

Due to these complicated and changing post-export procedures, it has been reported that a lot of Chinese exports, which have already obtained the necessary relevant official licenses and registrations to undertake export business (which are needed in the pre-export procedure), do not necessarily export on their own account (SINA, 2008). In other words, these exporters give up direct export channels due to these costly post-export procedures, even after they have obtained the compulsory licences that form part of the pre-export procedures.

As a result, both of these additional transactional procedures, generated by institutional constraints, lead to considerable costs for domestic exporters and use up resources for example, on the employment of additional staff to work on these procedures and on time spent waiting for some official document or other. Moreover, government policies on these procedures are continuously changing. These domestic exporters had to learn and understand these changing and new procedures. Otherwise, it will delay and even stop the progress of some export transactions. In the end, government policies from such procedures generate additional uncertainty, and related costs for export transactions.

Therefore, the findings from this pilot study A initially show that bureaucratic procedures and administrative approvals do exist in China's exporting markets, and generate additional transaction costs for domestic exporters (including manufacturers and ETCs, the same as in the rest of this study), as they add additional transactional procedures and/or generate uncertainty in export transactions.

### **6.2.3.2 Inefficient/Weak legal system**

The cost of enforcement contracts is one important sub-cost in transaction costs theory (Furubotn & Richter, 2005, p25), and is closely related to international trade in practice (Peng, 1998). The extant literatures on international purchasing and importing indicate that the quality and timely delivery of products become the most concerning problems for purchaser's decisions as to selection of suppliers (Kannan & Tan, 2002; Katsikeas & Dalgic, 1995; Leonidou, 1999). In China this condition is even more significant. According to the China Purchasing Development Report of

2010(LFRC, 2010), the “unreliable supplier” and “on-time delivery” are listed as the 1<sup>st</sup> and 3<sup>rd</sup> challenges (the 2<sup>nd</sup> is increasing operational costs) by foreign purchasers for sourcing suppliers in China. Moreover, other research about international purchasing offices (IPOs) in China also reports one main function of these IPOs is to control for quality (Nassimbeni & Sartor, 2006). This example indirectly shows that enforcement of the export contract, such as “quality” of product, is one of the the main problems for importing from China. The inefficient *formal legal system and informal contract obligation* are the main determinants of such problems.

The inefficient legal system, including formal law and legal enforcement (Meyer, 2001b), is the most commonly reported obstacle for doing business in transitional economies (Khanna & Palepu, 1997; Khanna et al., 2005; Meyer, 2001a). These inefficient legal systems in transitional economies include private property rights (Estrin et al., 2008; Peng & Heath, 1996), commercial law and contract enforcement (Choi et al., 1999; Estrin et al., 2008; Khanna et al., 2005; Luo, 2002; Meyer, 2001b), intellectual protection(Meyer, 2001a), official requirements for listed companies (Peng, 2004) and so on. Since the legal systems have been developing from the beginning of the transition in these countries in order to fulfil the increasing need for emerging market transactions, they are classified into current formal institutional constraints in the analytical framework. These inefficient legal systems considerably increase transaction costs, especially the enforcement/monitoring costs (Coase, 2008). Peng (1998) also indicates that contract enforcement and resulting monitoring costs on contracts are the most likely procedure during export transactions to be affected by the local legal system. More specifically, Luo (2002) reveals that commercial contracts, as part of the inefficient legal system in China, are not efficiently enforced in China. Ultimately, such problems and costs in import/export practice are reflected in the massive problems of product quality, delivery time and other contact-breaking behaviours from Chinese exporters, which are reported in last paragraph.

During the interviews with the ETCs and foreign buyers, it emerged that export transactions are extremely affected by China’s inefficient legal system. BUY-P-C described one of their bad experiences many years ago.

*“We used to have one (collaborative) factory in China..... Then we sent one order to them last year. The sample (sent by this factory) was fine. One month after we paid them the deposit, they told us they could not finish on time. I asked them when they could finish. They replied it would be two months late. This means four months for production. It’s too late for us, as our customers would refuse to receive on that time. So I asked to cancel order and for the return the deposit. They refused to do so. In the end, I gave up the order and deposit, as I would lose more if I received all products.”*

*When I ask why not he appeal for the court or arbitrage*

*“It is impossible to win in the court and recoup the loss in China.”*

Similar situations are echoed in the comments of other buyers (BUY-P-A, B,) and ETCs (ETC-P-A, B, C). They jointly agree with the statement that the costs of using legal system to protect their purchasing contracts are too high in China, in term of time and outcome. For instance, both BUY-P-A and BUY-P-B agreed that they would rather accept losses on the Chinese manufacturers’ failure on contracts, than pursue local legal arbitrage, in order to avoid potentially even greater costs on such legal issues without any confidence in the outcome. For instance, BUY-P-A believed that the local judicial departments would not treat them fairly, would lean towards local manufacturers as he is Taiwanese, and the costs of using these methods could be more than the loss of one export transaction. It is interesting to note that the Chinese ETCs in the interviews also had same complaints. ETC-P-A expressed that legal enforcement is costly in time and the outcome of any enforcement attempt would be problematic. He believed that it would take too long time to appeal to the courts or proceed with arbitrage, and the outcome would not be successfully enforced as the manufacturers can easily escape punishment in China. The ETC-P-C also argued that the legal procedures are costly and the enforcement is problematic, as the manufacturers could refuse to pay your loss with any, or even illegal means.



It is interesting to note that neither the local ETC or foreign buyers had actual experience of using China's legal system when their contracts ran into problems. Their opinions on the inefficient and relatively costly legal system in China come from the recommendations and failures of friends, from the multimedia, and some personal experience in other businesses. Therefore, it means the costs related to China's inefficient legal system are projected ones rather than reality based, at least, for the interviewees in pilot study A. The transaction costs economics indicates that many sorts of transactions costs actually do not take place, as they are very high, or/and transactions cannot proceed (Benham & Benham, 2000). As a result, these imagined costs generated by the inefficient legal system are large enough to stop direct importing from foreign buyers. From the interviews with three foreign buyers (BUY-P-A, B, C), it emerged that all of them chose to use Chinese ETCs more or less. One of the main determinants is their previous unsatisfactory import experience and high costs of enforcement on manufacturers in China. Therefore the inefficient legal system in China increases costs of enforcing compliance by domestic manufacturers in the export transactions.

### **6.2.3.3 Inefficient Informal Contract obligation**

In addition to the legal system, the *inefficient informal contractual obligation/spirit* is another reason for contract enforcement in China. These informal contract obligations were initiated at the outset of the transition, but failed to become sufficiently well established to support efficient market transactions. Thus they belong to the *informal institutional constraints* in the analytical framework.

As stated before, the formal legal system fails to efficiently support market transactions in transition economies. For instance, by investigating IJVs' contracts in China, Luo (2002) reveals that the commercial contracts, as part of the inefficient legal system in China, fails to efficiently enforce contracts in China. As a result, opportunistic behaviours are magnified in these countries (Choi et al., 1999; Luo, 2007). Therefore, the contract enforcement procedure is more vulnerable to trading partners' opportunistic behaviours and environmental uncertainty, which have been

compounded by the inefficient legal system in China. Foreign partners have to enhance adaptability to unfamiliar contract obligations, and master some unique contract enforcement methods. Therefore, these unique contract obligations in China generate additional costs for foreign partners, who are not familiar with these business practices in China.

The interviews with foreign buyers and the ETCs positively support these ideas. All three foreign buyers (BUY-P-A, B, C) had complained of the inadequate contract obligations and untruthful manufacturers in China. Their challenging problems include freely broken contractual obligations in terms of delivery times, quality, style and pricing, cheating on productive capabilities and problems during the transaction etc.

One buyer (BUY-P-A) described one poor purchasing experience in China

*“We used to have one [Chinese] factory, which changed the materials’ parameter without our permission. Then these products did not match the equipment specification of our factory in Taiwan, which was supposed to reprocess these products in the plan. I telephoned the manager of that factory asking why they didn’t follow the original parameters on the contract. He replied that they meant to do that in our best interests, as they increased the percentage of that material to ensure better quality. I didn’t know whether I should thank him or not!”*

BUY-P-B complained about their Chinese manufacturers’ dishonest activities

*“They always have various excuses for their delay in delivering.....They never told me the truth. Sometimes we could have saved the loss, if they have told me the truth. For instance, if they had told me they had problems with the delivery time, I would have changed that part of the order to other factories. But they always told me they could not finish at last minute”*

On the other hand, the interviews with manufacturers also find some clues as to why such failures take place in contracts with domestic manufacturers: they ignore the

importance of contracts, which is similar to the findings in Luo's argument on Chinese managers in international joint ventures (Luo, 2002).

MAN-P-A admitted that his factory sometimes takes on too many orders, even though they knew they could not finish.

When I asked him if his factory encounters the situation where their output could not fulfil the full range of orders, he replied that

*“Yes, it sometimes took place. Sometimes we had few orders, but sometimes orders are too numerous.... In order to manage our labour costs, we only employ the normal numbers of workers. But we sometimes have a large order. So we might temporarily employ some more workers, or we might divert some orders to other factories [even the farmers' family]..... In some cases, our factory could not produce the products (lack of the skills for such products) ordered by the customers, and so we would re-send this order to other factories, which can produce. And we only earn the price difference”*

When I asked if there are ever any problems, such as delivery time and quality and how do they do tackle them, he replied that

*“Normally there is no problem. Sometimes it might delay the delivery time, as you could not find enough temporary workers or other factories have delayed the production schedule. ....your customers [foreign buyers] would not be angry if it's not too late”*

MAN-P-C expressed that her factory had problems in delivery time sometimes as her boss accepted too many orders.

*“They [the failures to meet the delivery time] made too much trouble for me. It is the boss's decision. ....The export business was not good last year. To recoup some losses, the boss took on too many orders during the two months before Christmas. Then our productive capability could not meet the schedule. In the end, there was one order we could not finish”*

When I ask what happened then, he told me

*“The boss asked me to talk with that customer [foreign buyer] to ask for some extra time. He even told me to find some excuses to persuade the customer. I did as he told me. The customer agreed to give us another week. But we still could not finish on time. Then the customer was really angry. In the end, we made the deal that we first sent some products by air [much quicker but more expensive than by sea] at that time, and the remaining products were delayed for another two weeks. The customer was quite angry, and never come back after that time”*

From these interviews, it is clear that the domestic manufacturers do have some problems with contractual obligations. First, these two manufacturers accepted production orders when they already knew they could not finish them on time. Second, they refuse to tell the foreign buyers the real situation in production. It is therefore found that the inefficient contract obligations in China increase the costs of monitoring domestic manufacturers in export transactions.

### **6.3 Specification of analytical framework**

By interviewing ten practitioners, who had considerable operative experience in export transactions in China, four institutional constraints on China’s export market were identified, which can be allocated into three institutional constraints in the previous analytical framework. The *bureaucratic procedures and administrative approvals (former formal institutional constraints)*, which generate two additional transactional procedures, and thereby increase domestic exporters’ transaction costs. The *inefficient legal system (current formal institutional constraints)* and *informal contract obligations (informal institutional constraints)* increase foreign buyers’ costs of enforcing domestic manufacturers’ compliance.

### **6.4 Chapter Summary**

This Chapter, as the first part of pilot study (pilot study A), pre-test and modify the previous integrative framework, and to specify the institutional constrains on China's export market, by interviewing ten experienced practitioners from the domestic manufacturers, foreign buyers and ETCs. In the end, three formal and informal institutional constraints, which influenced export transactions in China, are identified. They are respectively bureaucratic procedures and administrative approvals (former formal institutional constraints), inefficient legal system (current formal institutional constraints) and informal contract obligations (informal institutional constraints).

## **Chapter 7 Within case analysis**

### **7.1 Introduction**

This chapter illustrates the analysis of four selective cases out of the total of six. In particular, case A is one pilot case study, namely the second part of pilot study (pilot study B), which were undertaken before the remaining ones. This aims to test the previous analytical framework and institutional constraints identified from the pilot study A in one real ETC company, and to refine data collection plans for the subsequent cases (Yin, 2003b, p79-p81). In addition, case A used both the author's observation and semi-structured interview as data collection methods, whilst the remaining cases adopted a semi-structured interview.

In this chapter section 7.1 briefly introduces this chapter. Then the four main cases within the case analysis are displayed from section 7.2 to 7.5 respectively. More specifically, each within case analysis is structured as follows: 1) the background information about case ETC, its products, and collaborating manufacturers and buyers; 2) the export transaction processes undertaken by this ETC in practice, are included; 3) the exploration and discussion of specified institutional constraints according to the previous analytical framework in order to test the known institutional constraints from chapter 6 and to explore new ones for each case; 4) the exploration and discussion of specified methods, by which each case ETC is able to reduce these institution-related transaction costs. In the end, section 7.6 summarizes this chapter.

### **7.2 Case A analysis**

#### ***7.2.1 The background information on ETC A***

“H-Sentury Imp&Exp Co”, founded in 2005, is one private ETC in Guangzhou, one of the most important export hubs in China. Its exporting turnover reached \$5,000,000 in 2009. Its three main foreign buyers respectively come from Spain

(25%), France (15%) and The United Arab Emirates (UAE) (20%), which has different products in style, quality and amount.

This ETC has 6 major domestic manufacturers, which have 200-300 workers and are located in several rural regions (like Panyu) surrounding Guangzhou. They usually do not export directly, and have several ETCs as their agents. But these factories are different from each other in terms of preferred products style, delivery time, management style, productivity etc. Thus the ETC gives them orders according to their different characteristics and different requirements from the buyers.

In addition, this ETC also has several suppliers for main materials and trimmings. Due to the variety of style and quality each time orders are placed, the main materials and trimmings likewise change. This ETC has a flexible strategy for choosing suppliers for materials according to price and availability on the market. As a result, suppliers are only engaged as required whereas others are more likely to be held on retainers due to a long-standing collaborative history.

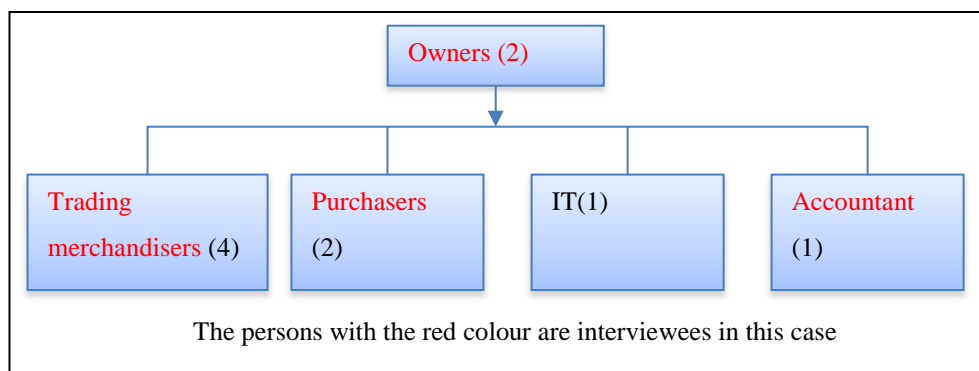
**Table 7-1 Summary of background of ETC A.**

<b>Name</b>	Guangzhou H-Sentury Imp&Exp Co., Ltd	
<b>Location</b>	Guangzhou	
<b>Ownership</b>	Private	
<b>Size(Personals)</b>	10	
<b>Establishment</b>	2005	
<b>Product</b>	Apparels	
<b>Foreign markets</b>	Spain, France and The United Arab Emirates	
<b>Per forma nce</b>	<b>Amount</b>	\$5,000,000 (2010)
	<b>Per capital</b>	\$625,000 (2010)
	<b>Margin</b>	15% (2010)

The owners are a young couple in their 30s. The husband lived and studied business administration in New Zealand for 4 years. After graduation, he came back to China and worked in the Canton Fair, the most important and largest Imp&Exp trading show in China. During 2-years' work there, he mastered the export skills and established an embryonic relationship with some manufacturers and buyers. After that, he opened "H-Sentury", which mainly exported arts and crafts during that time. The initial export business of arts and crafts was unsuccessful. In the owners' opinion, the reasons were due to their inadequate knowledge and understanding of

products, manufacturers and production and a low volume of export orders. After the 1<sup>st</sup> year, they gradually changed the products to clothing, the present product, with an increase of orders and familiarity with clothing and production. Then the business gradually stabilised with regular foreign buyers and collaborative manufacturers.

This ETCs has a total of 10 employees. Their main duties and organizational structure are shown in figure 7-1 and table 7-2.



**Figure 7-1 Organizational structure of ETC A.**

**Table 7-2 Summary of staffs in ETC A.**

Title (number of person)	Main description
Owner (2)	One of the owners holds the most important position in this ETC. He generally managed the whole export process, including searching for new buyers, new manufacturers, negotiating with current buyers and manufacturers, monitoring the production, quality controlling, enforcing delivery of manufacturers' products, and the design of new products. Among of them, searching for foreign buyers is one major job. The other owner is mainly in charge of administrative management and assistant work for the first owner. She is also responsible for part of the task of foreign exchange approval and tax rebate procedures (which are then mainly completed by the accountant)
Trading merchandisers (TMs) (4)	TMs generally take responsibility of all exporting documentation, such as drawing up exporting contracts and other documents for export. In particular, they also take part of the work submitting/receiving official approvals from government departments, including the local Administration of Industries and Commerce and Bureau of Quality and Technical Supervision. Another main job of these TMs is to enforce manufacturers' production, including the production schedule, quality investigation, delivery time etc. All TMs have relevant experience and educational background in exporting. The manager of the TMs teams has five years working experience in exports.
Purchasers (2)	Purchasers mainly take the job of searching and purchasing raw materials from suppliers or on the market. Due to their understanding of production, they also take on the job of enforcing sample making from specific sample companies or collaborating manufacturers, and of



	helping enforcing production. Two of the purchasers have long-term working experience in clothing production. Interestingly, they do not speak English, which is commonly considered as the universal language in the field of international trade.
Accountant(1)	She has 10 years' experience in corporate finance, especially in exporting companies. Amongst her main tasks are the completion of the tax rebate procedures, approvals of foreign exchange and receipt of payment from foreign buyers.
Internet staff (1)	One IT staff member is specialized in website design, photo design

In this case, a 2-month observation was undertaken in this ETC. In addition, 11 interviews with the seven interviewees were completed. These interviewees included two owners, one TM manager, two purchasers and one accountant, who are the main participants in the export transactions in this ETC and are highlighted in red in the organizational structure. Further, one owner of a manufacturing company was interviewed for the purposes of triangulation and clarifying some points. The core interviewees are the two owners, who offer the general information about background of the companies and transaction process, while the unit interviewees are the manager of TMs, two purchasers, one account and the owner of manufacturer who introduce their working experience in specific unit in whole process.

### ***7.2.2 Export transaction process***

In this section, one general export transaction process, operated by ETC A, is illustrated step by step (Shown in Table 7-3 and 7-4) in order to highlight the parts where the institutional constraints and related transaction costs occur. At first the two owners offer the general flow of export transactions in this ETC. Then the details of each step are obtained and/or checked from related interviewees. Certainly the author's observation also modifies and polishes these processes. In the meantime, the additional procedures related to local institutional constraints are also watched out.

**Table 7-3 Summary of transactional procedures of ETC A.**

1	Sample making and searching for buyers
2	Negotiations
3	Transacting with materials suppliers
4	Enforcing the production of manufacturers
5	Processing relevant documents
6	Receiving payment from foreign buyers
7	Tax rebating

**Table 7-4 Details of transactional procedures of ETC A.**

1 Sample making and searching for buyers
This procedure could be twofold. First, and most of the time, the ETC made clothing styles according to the foreign buyers' requirements, which was presented in documentation with a series of parameters and standards, like colour, size, materials requirements, etc. These samples, plus some other samples, such as colour samples, material samples etc., would be sent back to the buyers immediately for feedback. On receiving the buyers' feedback, corresponding modifications would be made in the next samples. This process would happen once or be repeated several times according to the different cases. Second, the ETC sometimes makes promotional styles for the trade shows, B2B website or other marketing activities. The sample making process usually takes place in the collaborative manufacturers, or sometimes in specialized sample making companies.
2 Negotiations
The ETC negotiates with buyers, potential manufacturers and suppliers, in terms of price, quantity, lead-in time, payment terms etc. This process is cyclical and dynamic, mainly including buyers' inquiries to the ETC and the ETC's inquiry to potential manufacturers and suppliers. In this procedure, the ETC has to choose one or several of the most suitable manufacturers and suppliers for certain order depending on this order's quantity, quality, style, delivery time, etc. Price is not the most important consideration for the ETC, as some manufacturers and suppliers could also give a competitive price, but without any guarantee. Thus the manufacturers and suppliers, with whom the ETC has had collaborative experience, are the most trustworthy. Actually the owners of this ETC had understood which manufacturers and suppliers would be able to finish this task when they knew the order's requirements based on their previous experience with products and manufacturers. Then the remaining considerations are the manufacturers' production schedule, availability of material, and so on.
3 Transacting with materials suppliers
Two purchasers took charge of the supply of materials, including the main materials and trimmings. Actually the searching for materials began as early as the sample making process. Although there are several large-scale public markets in Guangzhou, which can offer many kinds of materials for clothing, the main materials are usually not immediately available goods, but customized from material manufacturers. Their long-term experience in the clothing industry and private connections with some large material manufacturers facilitates purchasers search for suitable materials. As material suppliers are more likely to have no additional schedule for your orders, an advanced plan from the ETC is necessary. Thus this ETC usually booked one production schedule with material suppliers during the sample making or negotiation procedure. In addition, the large-scale public markets in Guangzhou also offer alternative choices for some rare materials. Finally the purchasers have to closely monitor the production of the material and in line with quality and time requirements.
4 Enforcing the production of manufacturers
One owner and one staff member from the TM and purchasers tightly enforced manufacturers' production. They formally inspected the production on three occasions, namely at the beginning, 10-days before lead-in time, and loading date. But sometimes they have to visit the manufacturers many times informally to check the production schedule and quality. The experience and knowledge of production and products is necessary to better monitor timing and quality. In some extreme cases, they have had to live in the manufacturers' factory to ensure the production schedule. In some cases, they divide one order between several manufacturers due to different products, or large quantities. The situation becomes more complicated, as they have to ensure the production, packaging and shipping synchronously and collaboratively, the delivery time and quality.
5 Processing relative documents

In the meantime, the TMs process all exporting documents, deliver and receive to and from various organizations. These documents usually include a “letter of credit” from the bank, a foreign exchange receipt certificate (or called verification sheet) from the local foreign exchange branches, packing lists from the manufacturers, a customs declaration from the customs broker, a bill of loading (B/L) from the shipping agent, certification from the local entry-exit inspection and quarantine bureau etc. These documents need to be accurate, consistent and mutually linked (the approval of some documents needs the others). Some of them have to be loaded onto corresponding datasets on websites of government departments, like the customs websites and foreign exchange branch system. Most importantly, many of the organizations involved are government departments. Thus TMs have to be familiar with their procedures, policies, regulations, traditions, officials’ habits, etc, which are highly changeable, different from each other and time-consuming, in order to finish all documents accurately and timely.

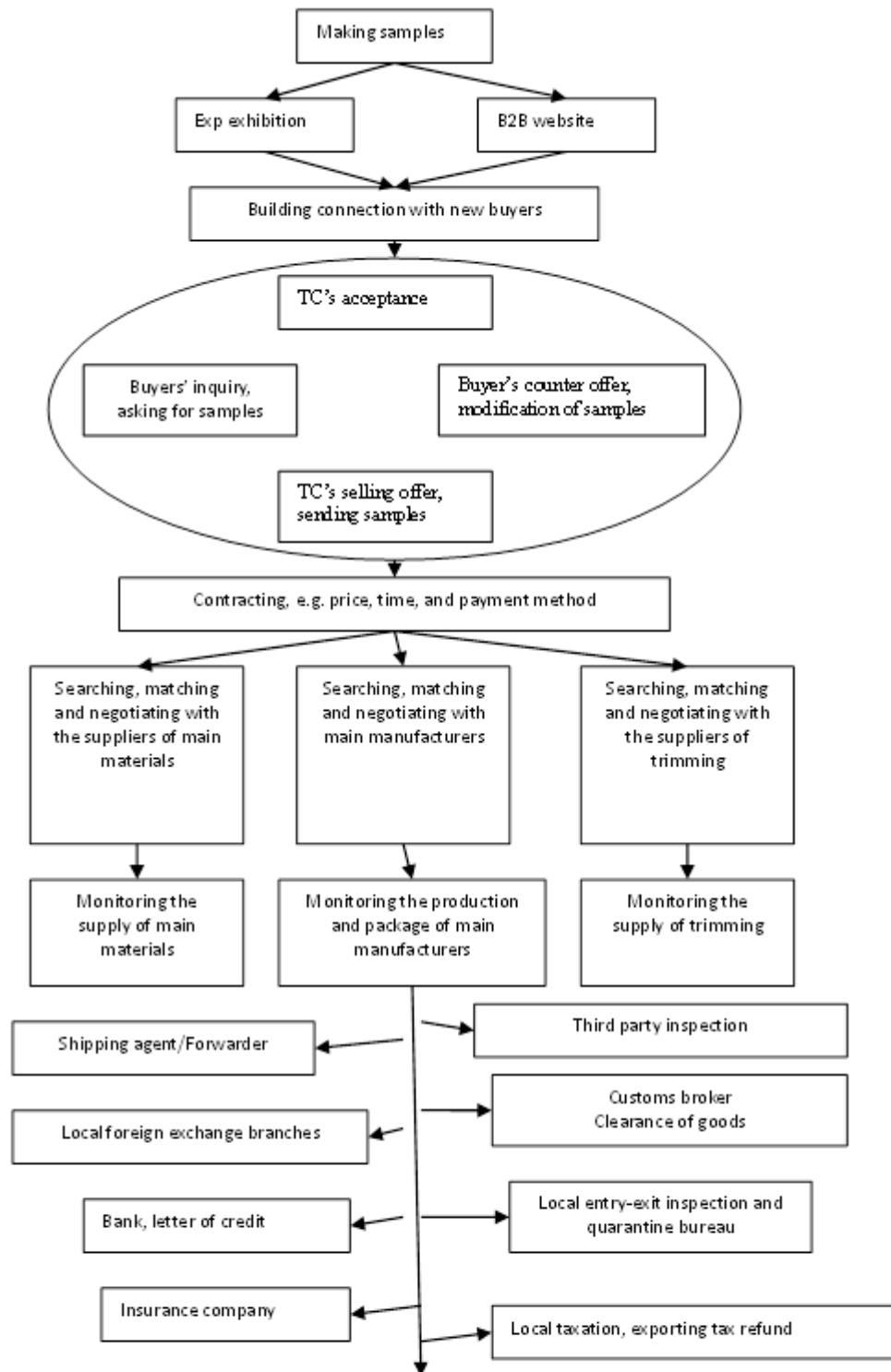
6 Receiving payment from foreign buyers

The accountant will take charge of receiving payment from foreign buyers after shipping the products and sending the documents. It needs to go through the bank, local foreign exchange branches, and customs, and takes one-month (mainly waiting for the receipt from customs) in order to finally receive these payments, as the payment and receipt of foreign exchanges are strictly monitored by government.

7 Tax rebating

On completion of the whole transaction and possession of the whole official document, the accountant will apply for the tax rebate from the local taxation office. The tax rebating rate is 7% for products in this ETC. This application normally takes 3 months. This procedure is important for the ETC’s capital flow and profits.

Figure 7-2 The flow chart of export transaction process in ETC A.



### ***7.2.3 The institutional constraints and related transaction costs***

This section aims to explore the institutional constraints, which can generate transaction costs in China's export market. The four known institutional constraints, developed in chapter 6 (pilot study A), will be checked in the first instance. Meanwhile, the emergent institutional constraints and costs in China's export market will be explored according to the findings. The analytical order follows the TCE analysis in the analytical framework, more specifically following transactional procedures from the domestic manufacturers to the foreign buyers. Table 7-5 summarizes the institutional constraints and related transaction costs in ETC A.

#### **7.2.3.1 The side of domestic manufacturers**

##### **7.2.3.1.1 The pre-export and post-export procedures**

The findings discussed in chapter 6 (pilot study A) suggest that *bureaucratic procedures and administrative approvals* are main the *former formal institutional constraints* that generate additional transactional procedures and costs for standard export transactions in China. The main evidences for such institution-related costs from the pilot study A are that Chinese exporters have to obtain a series of applications, registrations and approvals with many government departments for the start-up of an export business, and have also to submit/receive a series of related official documents to/from these government departments for each current export transaction. In this case, the pre-export and post-export procedures provide similar evidence to that of the pilot study.

First, the main owner of this ETC admits that these administrative approvals do cost them a lot of time during the interviews. He indicates that his company used to employ one agent company to assist with finishing the initial applications for these administrative approvals, and subsequent annual renewals. But in recent years he has begun to do it himself. He also agreed with the argument that these procedures changed regularly, and that he and the staff had to keep learning and enquiring from the officers and other people.

Second, I found from observation that one major aspect of each TM's work is to submit/receive official documents to/from these government departments, which process the administrative approvals that cost additional time and human resources for this ETC in the post-export procedure.

Third, the tax rebating procedure (procedure 7 tax rebating) referred to 7.2.2 transaction process also shows that the administrative procedure is also time-consuming. The interview with the accountant responsible for tax rebating in this ETC, shows that the slow tax rebating system in China actually reduces the capital turnover, the possibility of more transactions and resulting profits, and increases transaction costs for exporters in the end.

She told me that

*“The tax rebating rate for clothes is 7%, which means that 7% of the export value is occupied for 2-3 months. If this sum of money is paid back into our company immediately, we will use it for the next orders [such as materials' payment, deposits to factory]. So our profits will increase”*

In other words, to some extent, the ETC relies on how often it can recycle these financial capitals, given fixed profits from each transaction. Therefore, these administrative procedures before and during export transactions generate additional costs, in term of time, human resources, and financial capital, for domestic exporters.

#### **7.2.3.1.2 The procedure of transacting with materials suppliers**

This procedure is new, compared with the normal transactional procedures, where ETC only resell final products, and the findings from pilot study A, as most of trading companies in the literature and in pilot A do not refer to their additional transactions with materials' suppliers. Therefore one new institutional constraint is found as the reason for such additional transactional procedures.

Original Equipment Manufacturing (OEM) is one transactional arrangement between brand name company (OEM buyer) and the contract supplier, where the OEM buyer

offers detailed technical blueprints and most of the components to allow the contract supplier to produce according to specifications (Ernst, 2000; Kang, Mahoney, & Tan, 2009). Such arrangements become the most important trading method in China. The famous example is the Foxconn, which is the major OEM manufacturer for iPhone, iPad, Kindle PlayStation, etc. In addition, there is another OEM-like arrangement, named “processing trade”, which mainly relies on export contract in China. Different from traditional export process, where manufacturers design, produce, market and export products, and processing trade enables manufacturers to receive export orders, then to produce and export according to the requirements of orders. These orders come from various foreign and domestic companies, including ETCs as well.

As manufacturers only take responsibility for manufacturing products, these OEM trade methods lower the requirements of manufacturers in terms of costs, capabilities and risk (Hobday, 2000), and become popular in China. It was estimated that export through these sorts of trade methods made up half of the export volume in China up to recent years (Fu, 2008; Yu, 2012). The manufacturers in the pilot study also witnessed the popularity of OEM trade methods in China. The MAN-P-A’s manufacturer currently still uses the processing trade method with one buyer, and the owner of MAN-P-A used to work in one OEM manufacturer before he opened his factory. The MAN-P-A’s manufacturer is also an OEM. In addition, most of the current and former collaborative manufacturers of ETC A also work under OEM trade methods. According to the owners’ description, their manufacturers mainly produce the orders from ETCs or perhaps some foreign buyers, while the latter ones offer designed modes and materials. These manufacturers only focus on the processing without the other business functions.

However, OEM trade methods also generate many problems for those manufacturers’ own direct export. Hobday (2000) indicates that the OEM trade method has some disadvantages, making manufacturers subordinate to partners, become dependent on buyers and other core components. In this case, some similar problems are found related to OEM trade method in China. Under the long-term OEM trade method, the Chinese manufacturers might lose some important functions, necessary for direct

exporting, and thereby generating additional costs for domestic manufacturers' direct export. Therefore, the long-term OEM trading method, as current formal institutional constraint in China's export market, generates additional transactional procedures and relative costs for domestic manufacturers.

In this case, it emerges that there is one procedure of transacting with suppliers (procedure 3 enforcing the supply of materials) during the export transaction. In this procedure, ETC needs to organize, including searching for, negotiating and enforcing, the main supply of materials and trimmings for the manufacturers, rather than simply to buy end products from domestic manufacturers.

The main owner explains that *“the point is price. If we ask factories to find materials, they usually give us a more expensive price for same products. In addition, they often cannot find the suppliers for some materials.”*

When I tried to confirm this with the owner of one of their manufacturer, he confirmed that *“all customers do it this way. Most of our customers [ETCs] bring materials of their own. We can help them to find [materials] from nearby areas of our factory. But we cannot go too far to find [materials]. We have no time or additional staff to do that job, especially as some materials are hard to find; we are busy on the production for many ETCs. If we help all of them, there will be a lot of different materials. So if we do that work, we have to employ additional staff. And also we have to enforce the material supply, and buy out these materials from suppliers on our own; I will definitely charge more for that. So, all our customers purchase materials on their own. We only take care of manufacturing. We felt less exposed to risk, when we only charge manufacturing fee”*

In short, it is found that the domestic manufacturers have little information on material supply, in term of price and style, as they get used to outsource such functions to buyers, including ETCs and foreign buyers, and are lack of relevant information. As a result, they fail to find the suitable materials in term of price when buyers have such requirements. In other words, the long-term OEM trading method



decreases trading possibility of manufacturers' direct export. In conclusion there is one additional transaction procedure for transacting with materials suppliers, which is the result of domestic manufacturers' lack of market information, specifically lack of information on material supply, in the context of the long-term OEM trading method. Therefore, the long-term OEM trading method interfere domestic manufacturers' direct export, and become one formal institutional constraint in China's export market.

### **7.2.3.2 The side of foreign buyers**

#### **7.2.3.2.1 The procedure of enforcing manufacturers**

As proposed before, enforcement costs will increase due to the *inefficient legal system (current formal institutional constraints) and unique contract obligation (informal institutional constraints)*. The interviews in this case strongly support this proposition. Both owners in this case continuously mention the “quality problems” and “delivery time problem” during their interviews.

*“Our collaborative manufacturers are all SMEs without systematic quality control, so we have to go to the factories to monitor production regularly. Indeed, the quality problems happen many times during production. In some case, it is quite serious. Taking a recent example, I found the factories used a wrong mark label (the one with the size and logo on back of collar) one day before shipping. So we had to ask all the workers to take them out manually, and redo them. It took us the whole night to finish. Fortunately I found that problem on time to avoid the loss.....Because these factories also offer products for other exporters, we have to monitor their production schedule, especially at some peak time, we are afraid that they might delay our order.....In some extreme cases, we have to live in the factories for several days to ensure our production order on time”*

The observations also support this point. The period before the shipping out of products is the busiest and most important time. One owner and purchasers had to take turns visiting the factories to investigate the production schedule and product quality to avoid any problems.

**Table 7-5 The summary of institutional constraints and related transaction costs in ETC A.**

Procedure in export transaction	Related institutions	Parts in institutional framework	Evidence in case	Specific transaction costs	How costs are increased
<b>The pre-export and post-export procedures</b>	Bureaucratic procedures and administrative approvals	Former formal institutional constraints	Licences and registration from various government departments to start export business	Administrative costs	By generating additional transactional procedures
			Registration and approvals from various government departments for each export transaction		By generate additional transactional procedures
			Changing administrative procedures and policy		By generating uncertainty
			Slow administrative procedures, such as tax rebating system		By generate additional transactional procedures
<b>The procedure for transacting with suppliers</b>	OEM trading method	Current formal institutional constraints	The manufacturers could not find suitable suppliers	Cost of organizing production	By generating additional procedures
<b>The procedure for enforcing manufacturers</b>	Inefficient legal system	Current formal institutional constraints	The quality problems, delivery problems, freely breaking contracts, untruthful manufacturers etc., during manufacturing	Cost of enforcing manufacturers	By generating opportunistic behaviour
	Inefficient contract obligations	Informal institutional constraints			

## ***7.2.4 The ETC's methods for reducing institution-related transaction costs***

This section aims to explore the methods, by which this ETC can effectively and efficiently reduce these institution-related transaction costs in indirect export market. The analytical order also follows the TCE analysis in the analytical framework, from the domestic manufacturers to the foreign buyers. Table 7-7 summarizes ETC A's methods and advantage in export transaction.

### **7.2.4.1 The side of domestic manufacturers**

#### **7.2.4.1.1 The pre-export and post-export procedures**

Many studies have proved that having staffs knowledgeable and experienced in the export process can reduce the costs of export transactions (Peng, 1998; Peng & York, 2001). Similarly, this case demonstrated that the costs related to administrative approvals during pre-export and post-export procedures, which are found in 7.2.3.1.1, could be reduced by ETC's *knowledge (experience) on these administrative approvals procedures during the export transactions in China*. The specific knowledge required is about how and where to apply for and register these official approvals and licences; about how, when and where to prepare, submit and receive these necessary official documents to/from various government departments. The description below of the characteristics of staff in this ETC show that the relevant staff in this ETC are professional, and possess plenty of experience in such administrative approvals.

The relevant staff in the TM team, two owners and an accountant in this ETC, jointly finish the administrative approvals during pre-export and post-export procedures of each transaction. The description from the main owner of administrative approvals for the start-up of an export business in China in 7.2.3.1.1 indicates the owner gradually learnt and mastered the relevant knowledge on how to obtain these official administrative approvals during his practice. This evidence explains how this ETC reduces the transaction costs during pre-export procedures.

Moreover, it is evident that other relevant staff had knowledge on these administrative approvals that also helps to reduce the costs during post-export procedures. The TMs team finish some parts of the administrative procedures of each transaction, such as applying for certificates from the local Bureau of Quality and Technical Supervision, and Registration with Customs. The staffs not only graduated with an export-related major from college, but also have several-years' experience in exporting. TMs average number of years of working in exports is 2.25 year, while the manager in TMs has 5 years' experience. The accountant in this ETC undertakes the main job of tax rebating and approval of foreign exchanges. She has 10-years' experience in export-related accounting, and has worked in many other ETCs. Relevant staff's working experience is shown in Table 7-6. During the interview, the owner expressed the view that they prefer to employ the people with the export-related education backgrounds or/and experience. In China, colleges and universities teach students the administrative procedures as one unit during whole export process. Also these graduates would be supervised by the manager of TMs team for at least one month at the beginning. More importantly from the author's observation, both pre-export and post-export procedures are dealt with as a matter of regular routine in this ETC. The ETC has one formal timeline plus instructions in one handbook for different administrative procedures in export transactions. Moreover, the second owner often reminds to relevant staff of the timing of key administrative procedures during their daily work.

**Table 7-6 Relevant staff's working experience in participating in administrative approvals during pre-export and post-export procedures.**

Title	Manager of TMs	TM (1)	TM (2)	TM (3)	accountant	owner	owner	Average
yrs.	5	2	1.5	1.5	10	5	5	4.3

The logic behind why the ETC can reduce its costs by obtaining these sorts of knowledge is based on *the advantages of economics of scale*, which is commonly considered as the ETC's advantage in cost-economizing in international trade (Carlos, 1992; Carlos & Nicholas, 1996; Peng, 1998; Roehl, 1983; Spulber, 1999). It enables this ETC to process these administrative procedures with lower costs for each transaction than manufacturers. This ETC has a greater volume of transactions, as

reflected in more collaborative manufacturers and buyers, and tradable products, than an individual manufacturing exporter. Thus the costs, in terms of time, resources to employ specific staff, and other fixed costs are shared and reduced. The interviews with domestic manufacturers also show one of reasons why they prefer to use ETC's for indirect exporting than owned direct exporting is that the increased labour costs on these specific personnel are not economic for their lower export volume. In addition, experience and work routine is established through the repeated work. It saves the costs, in terms of time, and reduces the possibilities of making mistakes. Also, the greater the volume, the greater the opportunities for understanding any new procedures and policy on the export market.

#### **7.2.4.1.2 The procedure of transacting with suppliers**

OEM trading methods undermine manufacturers' ability to function with regard to supply of materials in this case, and further increase transaction costs of domestic manufacturers' direct exports. ETC A relies on *its knowledge of materials' supply*, which is based on their professional purchasers, to release these costs.

As stated in the literature review, one of the Japanese GTCs roles in international trade is the organizer/coordinator of the production system, as they organize and coordinate with many different stages of whole production system, such as the purchase of raw materials, sale of products, logistics, finance, marketing and so on (Kojima & Ozawa, 1984; Yoshino & Lifson, 1986). Kojima & Ozawa (1984) indicate that the contextual explanation for such JGTC characteristics could be attributed to then inefficient business system in Japan, which could not support domestic inexperienced manufacturers in achieving the national targets at that time, namely quick economic development during the Meiji period and post-WWII period. Yoshino & Lifson's study (Yoshino & Lifson, 1986, p45) add that the reason for such conditions is the long-term isolation of Japan from the world resulting in domestic manufacturers failing to understand advanced industrial production systems. Under the previous logic of institutional constraints in this study, the institutional constraints in Japan make domestic manufacturers inefficient and lacking in knowledge of the whole production functions, and therefore failing to produce

products for export on their own. This situation is as same as the one in the findings noted in 7.2.3.2.1, in that the long-term OEM trading method in China's export market disables some domestic manufacturers through their lack of knowledge of material supply.

In turn, Japanese GTCs acquired specific knowledge on each distinct but related units of the whole production system, as long as they participated long-term in various trades, some of which were related to these units, and provided opportunities for incremental learning alongside the development of trading businesses. In the end, by organizing the whole production system, JGTCs achieved "economies of scope", and reduced the total costs and sub costs for each of the units (Yoshino & Lifson, 1986)

Although without such comprehensive organization and coordination of production systems, the ETC A in this study also shows similar capabilities in helping domestic manufacturers' incompetence with regard to the supply of materials, through access to specialized staff and knowledge.

Two purchasers in this ETC specifically take charge of this material supply procedure. Interestingly, they do not speak English, which is commonly considered as the universal languages in the field of international trade. The explanation from the owner is that "*they don't need to know English. Their main job is to take care of the supply and manufacturing. That is the reason we employ them.*" But both of them have long-term experience in the supply of material in the clothing industry. One purchaser has 10 years' experience in the clothing industry, while the other one has 3 years. Both of them used to work in manufacturing. Therefore, they master a great deal of knowledge on materials, in term of price, place of origin, quality, style and so forth. In addition, their knowledge on the supply of materials has also been kept updated during their current daily work. From the author's observation, both suppliers often visit different suppliers and public markets to search for materials and update their price information. They also keep the regular contact with various

remote suppliers, especially the suppliers of certain main materials, who are based in some clusters across the country.

Therefore, these sorts of knowledge on the supply of materials held by these two purchasers largely help this ETC to search for the required supply (according to the buyers' order) with low costs. According to the logic of the *advantages of economies of scale*, the larger transaction amounts and the greater number of products and materials, enable ETC A to obtain knowledge and information by employing professional purchasers, with greater economy than manufacturers with fewer orders and product lines.

#### **7.2.4.2 The side of foreign buyers**

##### **7.2.4.2.1 The procedure for enforcing manufacturers**

Asymmetric information is one major reason for difficulty in identifying the quality of products and other resulting problems that stop transactions, such as adverse selection and moral hazard (Akerlof, 1970; Stiglitz & Weiss, 1981). Obtaining more information on products, production and producers helps to reduce such information asymmetry.

In general, this *ETC's knowledge of production* helps to reduce information asymmetry and the related costs of enforcing manufacturers. Knowledge of production mainly includes the knowledge of *current production conditions, of the production process and products, and of manufacturers' characteristics*. It is clear that this ETC pays a lot attention to the enforcement of their manufacturers according to transactional procedure 4 (Enforcing the production of manufacturers) during the export transaction process. The author's observation also supports this idea. This sort of work is jointly undertaken by the main owner, manager of the TMs team, together with support from two purchasers and other TMs. These persons regularly visit their manufacturers during the whole production period for various aims, such as sample making, modification, and material supply. Although the aims of these visits could be irrelevant to the monitoring activity, a great deal of *information on current production conditions*, such as workers' number, production schedule and technical

problems, had taken place in each visit. In addition, the period before the shipping out of products is the busiest and most important time during the transaction process of this ETC. The main owners and others often take turns to investigate the production schedule and product quality of the manufacturer to avoid any problems. According to the description of the main owner, he even had to live in the factory for many weeks in some extreme cases in order to monitor closely the manufacturing process.

Moreover, this ETC's familiarity with the materials' supply also enables them to master more knowledge about production, which helps to reduce any opportunism by manufacturers in changing the product's price and quality. As mentioned in pilot study A and in 7.2.3.2, the manufacturers could increase the price with the excuse of rising prices of inputs, including material supply. As ETC A takes responsibility for the supply of materials to their manufacturers, it possesses more knowledge on costs of production for estimating the final products' price. The acquisition of the information on material supply reduces the asymmetry between manufacturers and buyers, and avoids manufacturer's opportunism.

Knowledge of the production process and characteristics of the products also helps them to deal with the quality problems. The main owner, TM's manager and purchasers have a great deal of knowledge about the production process and products, as a result of long-standing quality investigation experience, and/or working experience with manufacturers. The main owner stated one recent case where he had to save one large order with quality problems the day before shipment, as he found the wrong neck label in the garment; he had to ask the factory to modify them overnight. The owner also confirmed that one criterion for employing the TMs manager is the direct work experience in enforcing production.

Last but not least, knowledge of the characteristics of their manufacturers is important as well. This knowledge helps the ETC to choose the "right" and reliable manufacturers before committing to formal production, and to quickly change manufacturers when some emergency happens.



The owner described how detailed their understanding of their manufacturers is as described below:

*“Our current manufacturers had been filtered from previous many collaborative transactions..... Indeed we had withdrawn from some bad manufacturers.....We knew their productive capability, such as their favourite products, quality level, and output amount.....When I receive an order from buyers, I will think about which manufacturer is suitable for this order. For instance, one manufacturer is suitable for the European orders, as the products require higher quality. Another one is suitable for the UAE’s order, as their price is cheaper.....I will try to understand the characteristics of the owner of factories, such as if he is a reliable person, if his factory has a poor track record so that I can choose if and how I can collaborate with him.....We would check their production schedule before we choose the manufacturer for this order.....We usually have some backup manufacturers, which can be used for some special orders”*

Therefore, it emerged that knowledge of the characteristics of manufacturers actually operates prior to the real enforcement, so that the problems can be avoided during formal production.

**Table 7-7 The summary of ETC A's methods and advantage in export transaction.**

Procedure in export transaction	Institutional constraints	ETC's methods	Evidence in the case	How to reduce costs
The pre-export and post-export procedures	Bureaucratic procedures and administrative approvals	Knowledge on administrative approval procedures	Staff educational background and work training on administrative procedures	Advantages of economics of scale
			Staff experience in such administrative procedures	
			Regular routines for such administrative procedures during daily work in the ETC	
The procedure for transacting with suppliers	OEM trading method	Knowledge on materials supply	Professional purchasers with long-term experience on purchases	Advantages of economics of scale
			On-site visits to the suppliers and public markets	
			regular contact with remote suppliers	
The procedure for enforcing manufacturers	Inefficient legal system & unique contract obligation	Knowledge on current production conditions	Obtaining updated information on production at any point during the whole production period	Reducing information asymmetry
			Close monitoring in the factory	
		Knowledge on the production process and products	Main staff knowledge and experience in production	
		Knowledge of manufactures' characteristics.	Matching suitable collaborative manufacturers with the order, according to their productive capability before the delivery of order	
		Knowledge of manufactures' characteristics.	Eliminating the unreliable manufacturers	

## 7.3 Case B analysis

### 7.3.1 The background information on ETC B

Tianjin-Minmetals (TJM) (Century Minmetals also well) is a state-owned trading company in Tianjin. It had 120 employees in trading companies, and jointly owned one welding electrodes firm of 230 employees. Its exports reached \$60,000,000, while it turned in a profit of \$1,500,000 in 2010. Its buyers are numerous, worldwide, and different from each other, from middlemen to ship factories. TJM used to be one subsidiary of China Minmetals, one of largest and earliest central state-owned trading companies, which engage in mineral and metal products in China. After the reform of the trading system and state-owned companies in China during the 1980s, the TJM and related properties (offices, warehouse, etc.) were separated from China Minmetals, and became one independent trading company indirectly controlled by local government through one group company, the Northernint.

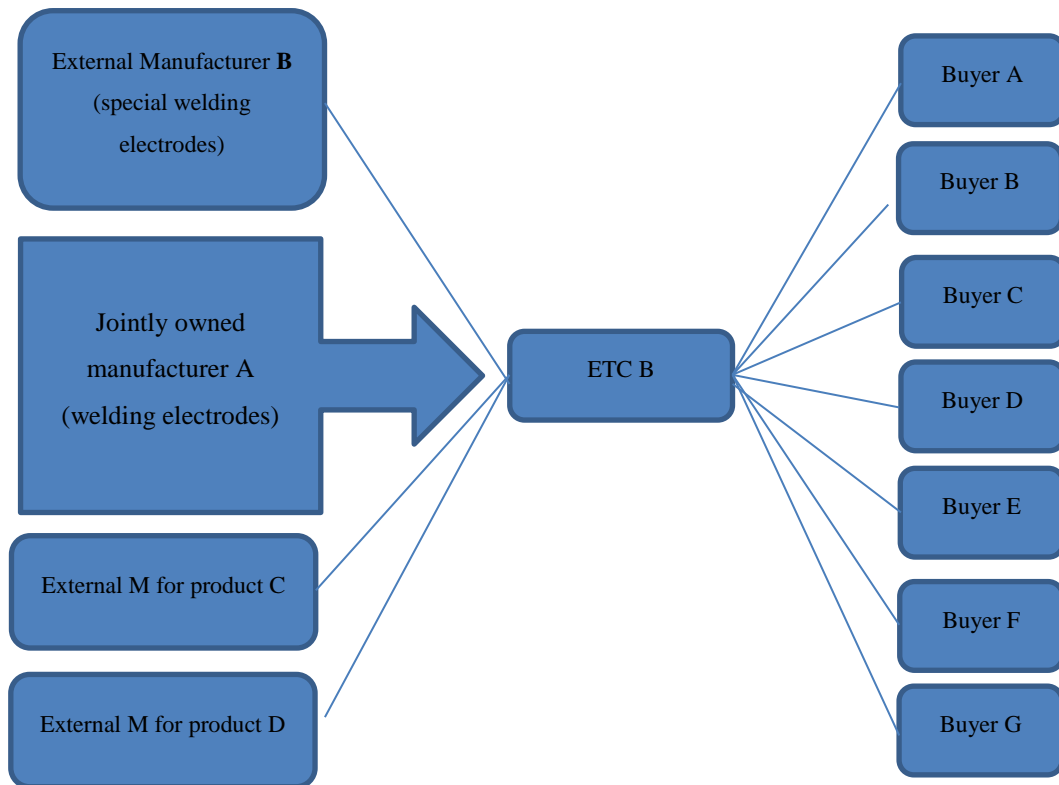
**Table 7-8 Summary of background of ETC B.**

Name	Tianjin Minmetal	
Location	Tianjin	
Ownership	State-owned	
Size(Personals)	120 (trading companies)+235 (manufacturers)	
Established	1955	
Products	Welding consumables, hardware, steel products, etc	
Foreign markets	worldwide	
Performance	Amount	\$60,000,000
	Per capital	\$500,000
	Margin	2.5%

The main products of this ETC are concentrated in the field of metal products, such as welding consumables (welding electrodes), welding tools, sealing and insulation products, pipes and fittings, etc, which are respectively processed by five export process departments in this ETC. The series of welding electrodes become the most important products accounting for 60-70% of the total export volume. For this the transaction of welding electrodes becomes the main focus for this case analysis.

The ETC B have developed, marketed and managed two well-known brands and trademarks for their welding electrodes, say “Permanent” and “MT-12”, since as early as 1970s.

**Figure 7-3 The trading partners of ETC B.**



In general, the brief situation of domestic manufacturers and foreign buyers is illustrated in the Figure 7-3. From the 1970s to 1990s, all collaborative manufacturers of TJM went through the OEM trading method: TJM received orders from foreign buyers, then many factories produced the products according to the orders from TJM, and pasted TJM’s brands on them, finally TJM bought out these products, and resold to foreign buyers and processed the whole export transaction. This method was based on TJM’s exclusive export authority. But with the economic reforms and the introduction of the free market in China, some manufacturers began to export on their own and into the domestic market as well. In turn, TJM gradually changed into other emerging small factories. In the end, TJM jointly invested in one collaborative factory, Tianjin Dagang Welding Electrodes Company (TDWE), with

former shareholders of this factory in Tianjin in 1991, and helped it develop into a qualified large supplier.

The former factory of TDWE was established in the 1970s, when it was a single village factory with only 50 employees. From the 1980s onwards it began collaboration with TJM with a few orders, as it could only produce very simple products due to lower technical capabilities and simple equipment. In 1991, the TJM invested a 20% stake in this factory to enhance their production capabilities, including equipment, technique, etc. Most importantly, TJM helped them increase quality products, by purchasing high-tech equipment and skills, introducing technicians from other large factories and universities, applying for the certificates from classification societies (international standard agents). Till now, TDWE had 235 employees, could produce 50,000 ton various welding electrodes annually, and became the main supplier, making up 80% of the welding electrodes in TJM.

The classification society, such as Lloyd's Register, ABS, etc, is “an organization, whose main function is to carry out surveys of vessels, its purpose being to set and maintain standards of construction and upkeep for vessels, their engines and safety equipment” (Mike, 2006, p41). Approval from these classification bodies, has become necessary in ship building, including the main engines, pumps and other machineries on the ship, and other offshore structures, like the oil platforms, etc, in order to ensure the shipping safety. Due to the strict standards and public credibility, the approvals and certificates from these classification societies have also come to symbolise official certificates for many other products in international trade. Welding electrodes are used widely and mostly in ship building, the certificates from the classification society for these products have become universal quality guarantees and/or necessary certificates in recent international trade. Thus this ETC had obtained these certificates for their Permanent welding electrodes in the 1990s, when they started the factory.

The application for such certificates is not easy for many inexperienced companies. Initially this ETC asked for help from the Tianjin Commission of Commerce and the

parent companies. Through their introduction, this ETC found another factory, which just applied for the same certificates one year ago. After several months' communications, they learned and mastered the procedures for applying for these certificates. In the meantime, they also found that the products and production process of their new factory could not fulfil the requirements of classification society. In the end, they had to employ several technicians from the local university and factory to train staff in the new skills, had to buy new equipment, and enforce some management and production process reforms in the factory. One year later, they eventually passed the quality control, and obtained the first certificates' from classification society. Till now, all their welding electrodes, including Permanent and TM-12 series, have received certificates from seven main international classification societies (as the certificates are not inter-accepted by different classification societies and importing countries, the foreign buyers usually require different certificates) , which generally cover all overseas customers' requirements. Moreover, ETC B also continues to help this factory welding electrodes to be successful in the annual review.

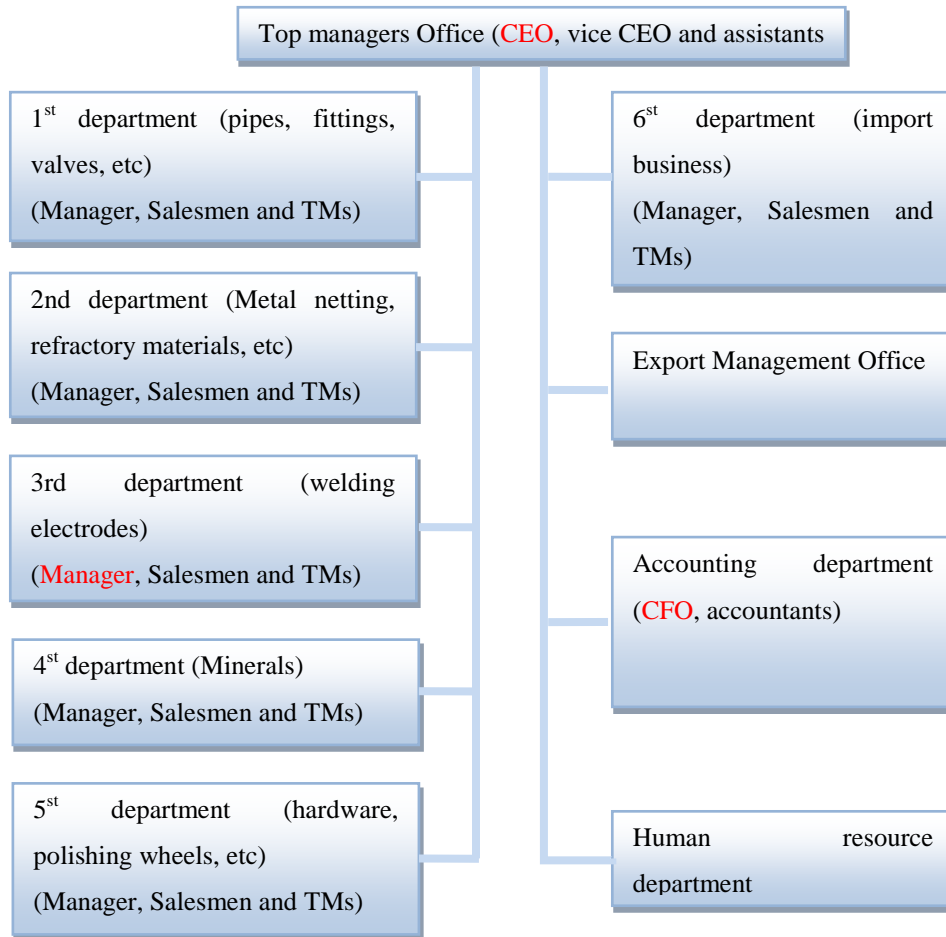
As shown in Table 7-9 and Figure 7-4, this ETC has ten internal departments. Apart from the administrative departments, there are five main export process departments, which are classified according to the groups of products. One export transaction is processed by several trading merchandisers (TMs) from these process departments, and accountants from accounting department. In addition, the top manager office takes charge of the administrative process of all licenses and official documentation involved in exporting, such as the annual renewal of export rights, business licenses, etc.

**Table 7-9 Brief introduction of departments of ETC B.**

1	Top managers office	CEO and vice CEO office, general management
2	Export Management Office	To offering supportive service to all departments
3	1 <sup>st</sup> department	Specified export process of pipes, fittings, valves, etc
4	2 <sup>nd</sup> department	Specified export process of metal netting, refractory materials, etc. This department is the second department, which makes up about 15% export
5	3 <sup>rd</sup> department	Specified export process of welding electrodes. This department is the largest department, which makes up about 60-70% export, 12 employees
6	4 <sup>th</sup> department	Specified export process of minerals. This department is the one that is shrinking most with the gradual loss

		of exclusive import and export authorities for minerals
7	5 <sup>th</sup> department	Specified export process of hardware, polishing wheels, etc
8	6 <sup>th</sup> department	Import business
9	Accounting department	Cooperate finance, tax rebate, etc.
10	Human resource department	Recruitment, etc

**Figure 7-4 Organizational structure of ETC B.**



The persons in red colour are interviewees

During this case, seven interviews from five interviewees were undertaken. These include two interviews with the CEO of ETC; one interview with a retired manager in ETC who used to participate in investment into the factory; two interviews with the manager in 3<sup>rd</sup> department; one with the CFO in accountant department; one interview with a retired manager from the joint-venture welding electrodes manufacturing company. At first the CEO offer genral information on this ETC, while the manager of 3<sup>rd</sup> department offer the general flow of export transactions in

this ETC. Then the details of each step are obtained and/or checked from other related interviewees. In addition, one retired manager in ETC, who used to participate in investment into the factory, and another retired manager from the joint-venture welding electrodes manufacturing company also offer additional information on the process of vertical integration and the joint-venture manufacturers.

### ***7.3.2 Export transaction process***

In this section, one general export transaction process, operated by ETC B, is illustrated step by step (Shown in Table 7-10 and 7-11) in order to highlight the parts where the institutional constraints and related transaction costs occur.

**Table 7-10 Summary of transactional procedures in 3rd department of ETC B.**

1	Sample making and searching for buyers
2	Negotiations
3	Enforcing the production of manufacturers
4	Processing the relevant documents
5	Receiving the payment from foreign buyers
6	Tax rebating
7	Classifications in classification society
8	Managing the brand

**Table 7-11 Details of transactional procedures in 3rd department of ETC B.**

1 Sample making
Different from ETC A, the procedure for sample making is easier and does not need to enforce in this case. During most cases, on receipt of the requirements for sending samples (the existing modes) from the potential and existing buyers, the TMs would ask for them from the welding electrodes manufacturer, and resend them to the buyers, as these products are usually standardized and stocked in the manufacturers' warehouse. In addition, these samples can also be used during many other marketing activities in this ETC, like the trade show and B2B website. Sometimes, the buyers would ask for certain unique modes, which are different from their existing modes, or have unique requirements on standardized modes. In these cases, the TM will ask the manufacturers to experimentally produce some samples according to these requirements (if the production capabilities can fulfil these requirements), and then monitor and test them. When the performance of welding is able to fulfil these requirements, they send them to buyer for further test modification as well.
2 Negotiations
The buyers would inquire the price from the ETC for the required products. Then the ETC will make the same request of their factory. When they receive the price from the factory, we would add their fixed profits and send to the buyers. The buyers would make decision to accept the price or give another bid.
3 Enforcing the production of manufacturers
Technically, this ETC only enforces the lead-in time of production, as the modes and series of welding electrodes have been consistent for a long time, and the quality of products has been stable throughout this longstanding collaboration.
4 Processing the relative documents



The TMs from the 3rd export process department produce, submit and receive most of the exporting documents to/from relevant external organizations, which is as same as the previous ETC A.
5 Receiving the payment from foreign buyers
The accounting department takes charge of receiving the payment from foreign buyers, which is as same as that in ETC A.
6 Tax rebating
The accounting department takes charge of tax rebate applications from local taxation, which is the same as that in ETC A. The tax rebate rate is 9%, 11%, or 13% for the welding electrodes in this ETC.
7 Classifications in classification society
Due to many foreign buyers requiring the classification societies' approvals for welding electrodes, this ETC has to help the manufacturer apply for different classifications from seven classification societies. The 3 <sup>rd</sup> export process department and top manager office jointly work on these application procedures, including training the manufacturers, document preparation, communication, and payment for the classification. In addition, these classifications have to be renewed every year or every two years.
8 Managing the brands
The top managers' office has been renewing the brands with the local Trademark Office of Administration for Industry and Commerce, and registering with China Customs every six years. In order to protect these brands, the top managers' office has to investigate fake products, which are mainly produced by other Chinese factories, on the export markets with the help of China Customs. In some extreme cases, they have had to instigate lawsuits in relation to a large number of fake products as well.

### ***7.3.3 The institutional constraints and related transaction costs***

Similarly to 7.2.3, this section aims to explore the institutional constraints and relevant transaction costs in China's export market. The four identified institutional constraints, three from developed in the pilot study and one from case A, are initially explored. In the meantime, the emerging institutional constraints and costs in China's export market are explored and analysed according to current findings. The analytical path continues to follow from domestic manufacturers' perspective to foreign buyers' perspective.

#### **7.3.3.1 The side of domestic manufacturers**

##### **7.3.3.1.1 The pre-export and post-export procedures**

In case B, the administrative approvals during the pre-export and post-export procedures also resemble those in pilot study A and case A. This supports the proposed argument in chapter 6 that “the *bureaucratic procedures and administrative approvals* are the main former formal institutional constraints, which

generate additional transactional procedures and costs for standard export transactions in China.”

More specifically, the CEO of ETC B admits that his company also meets the same problems and costs as in case A. ETC B needs to renew or maintain some of the registrations with these government departments every year, though certain official applications, mainly compulsory for exporters’ start-up export businesses, had been discontinued officially a long time ago.

In addition, the transactional procedures of 4 and 6 in 7.3.2 show that the *administrative approvals* during “*post-export*” when this ETC was set up, mainly involved the TMs from the 1<sup>st</sup> to 5<sup>th</sup> export process departments, and staffs from accounting department. It was their responsibility to submit/receive these relevant official documents and approvals to/from these government departments for each current export transaction, including the local foreign exchange branches, local entry-exit inspection and quarantine bureaux, and the local China Customs Office. The transactional procedure 6 (Tax rebating) also shows that this ETC completed tax rebating under their own steam.

#### **7.3.3.1.2 The procedure for managing brands and applying for special certificates**

Case A found that the long-term OEM trading method results in a series of problems and costs for domestic manufacturers in China. A similar situation is also found in case B. The long-term OEM trading method in China’s export market makes the domestic manufacturers incapable of managing brands and applying for special certificates. As a result, the findings in case B also support the argument in case A: that “the long-term OEM trading method in China’s export market, as the informal institutional constraints, generates additional transactional procedures and relative costs for domestic manufacturers.”

As stated in case A, the OEM trading method helps Chinese manufacturers to quickly acquire opportunities to participate in global business, with cheap labour costs. However, it also results in a lack of massive marketing functions, such as

brand, market, and sales channels. In case B, it can be said that the main influence falls on two parts: the brands management and special certificates for products.

### *Brands*

Brand is one effective method for offering quality information for buyers. It reduces their measurement costs on products, and further increases transactional possibilities for both sellers and buyers (Akerlof, 1970; Barzel, 1982, 2001). This became more important for the manufacturers from transition economies, where the inefficient institutions generate considerable quality problems and increase measurement costs for foreign buyers. However, to establish, manage and maintain brand is costly and not easy, especially in China, where some institutions constrain such business activities, such as the popularity of pirate activity. The long-term OEM trading method is one of these institutions. It obstructs domestic manufacturers in using owned brands. An interview with one retired senior manager of a factory also reveals that the manufacturers' lack of brand and capabilities for establishing brand quickly undermines the development of direct transactions with foreign buyers.

*“Before the establishment of the factory, we only received orders from ETCs. Our factory’s ability [then] was limited. So we did not think about exporting on our own....We used different brands of customers [ETCs] during that time, we didn’t have a brand till recent....When the TJM recommended establishing one joint venture, our consideration was that their “Permanent” brand [TJM’s brand] could help us develop and open up foreign markets...To quote the factory director, it was called “to borrow the ship to go to sea” ... we tried to export under our own brand in recent years, but the outcome was not good... currently 95% of our output is offered through the TJM”*

Obviously, the brand became a large obstacle for this manufacturer's direct export to foreign buyers, before and after the establishment of a joint venture. 30 years have passed since the establishment of the joint venture. This manufacturer's products still paste the TJM's brand, though their production capability has advanced and branding knowledge is no longer secretive. This proves that the long-term OEM trading method leads to this manufacturer failing to establish an own brand, and miss the

opportune time to do so. The reality is that this manufacturer still meets the problem of brand to this day. Therefore, the OEM style export mode in China disables manufacturer's other functions apart from the manufacturing, including brand management. As a result, these manufacturers come to lack these capabilities when they really want to start their owning export.

### *Special certificates*

Similar to the issue of brand, products' guarantee is another effective method for avoiding quality problems in the products for buyers (Akerlof, 1970; Barzel, 1982, 2001). Many extant studies (Clougherty & Grajek, 2008; Urbonavicius, 2005) also indicate that quality certificates, such as the ISO system, which is widely accepted on international markets, is extremely valuable for manufacturers with limited international reputations, and in developing countries, where local institutions fail to effectively reduce information asymmetry resulting products' quality problems. As stated in 7.3.1, the requirement for certificates from international classification societies becomes one universal standard and source of reliable evidence for good-quality products on the export markets, such as the welding electrodes in this ETC. Therefore, these certificates become the products' guarantee, which could reduce foreign buyers' monitoring costs on products' quality.

However, the successful application of these certificates is not one easy job in China. The transactional procedure 7 (Classifications in classification society) have briefly indicated that the application procedures for such certificates requires a series of documentation for the work, quality system requirements, on-site investigations, experiments with products, and so on. It requires manufacturers, products and production processes to fulfil strict surveys. During 1980s, fewer factories, especially the emergent small private factories like the factory in this case, were able to successfully pass these surveys, due to poor production systems, low-quality products, and lack of knowledge and experience in these surveys. In addition, due to the trading method of the OEM, such jobs as applying for these certificates had been undertaken by TJM with the result that the manufacturer still does not know how to process such certificates.

In addition, the interview with the manager in the 3<sup>rd</sup> department illustrates the difficulty in such work and the manufacturer's problems with this. As stated by the manager

*“The TJM arranged the surveys of certificates from classification societies every year, including early preparation and applications, inside investigations on factories, on-site investigations, and so on.....[more specifically]we usually prepare for applications from November every year, preparing relevant documents. After deciding the date, we will send experienced staff to the factory to investigate the production conditions, and advise them on any important modifications to the production.....sometimes, we also need to communicate with external labs for some special experiments.”*

When I asked him if the staff in the factory know how to apply for such certificates, he replied that they only knew some parts, not whole process. He further add that they had to help the manufacturers a lot during the survey, including on-site checking, as they knew the “points” of these surveys, which had been accumulated through long-term experience.

Therefore, these certificates of classification societies in this procedure become another problem for factories' direct export, and create additional costs in their direct export market.

In general, the acquisition of brands and certain special certificates helps exporters export with the assurance of the products' quality, which is attractive for many foreign buyers as such activities reduce their enforcing costs (which will be further discussed in next section). In other words, it increases the possibilities, and reduces the costs of searching for foreign buyers. But the long-term OEM method increases the difficulty of doing so for domestic manufacturers, as it obstructs them in obtaining, learning and improving their capabilities in these fields.

### **7.3.3.2 The side of foreign buyers**

### **7.3.3.2.1 The procedure of enforcing manufacturers**

As proposed before, the enforcement costs will be increased due to the *inefficient legal system (current formal institutional constraints) and contract obligations (informal institutional constraints)* in China. The evidence in this case also confirms this proposition by showing the reasons for this ETC's vertical integration.

#### *Vertical integration of production*

Although the reasons for vertical integration are variable and debatable, the studies from transaction costs economics believe the relatively large transaction costs is the major one (Klein, Crawford, & Alchian, 1978; Williamson, 1971, 1979, 1985). Given the level of asset specificity, the opportunistic behaviour, especially the “post-contractual opportunistic behaviour”, such as moral hazards and hold-ups, lead to the vertical integration (Demsetz, 1990; Klein et al., 1978). Obviously the formal legal system and informal contract enforcement influence opportunistic behaviours, and the resulting decision for vertical integration. Fan et al (Fan, Huang, Morck, & Yeung, 2009) indicates that China's institutional factors, such as the inefficient legal system and less well developed market mechanism, generate a great deal of transactional difficulties. As a result, many local firms choose vertical integration as a countermeasure.

Since this ETC invested in one factory since 1980s, the author interviewed *one retired senior manager* who used to work in this ETC at that time. He describes the reasons why they made such an investment at that time. First, it solves the supply problem. Since the 1950s, this ETC monopolistically operated the export of welding electrodes in the area of Tianjin. Two large factories in this area had to collaborate amicably with this ETC, and arrange production completely in line with the ETC's export orders. Since the export authorities gradually began to issue some manufacturers with certificates since the 1980s, and with the development of the domestic markets, these factories began to change their focus towards other export orders and domestic markets. Therefore the supply from these two factories suffered with shortages. After that, this ETC had to send some export orders to some smaller

factories. But some problems emerged, such as untimely delivery, un-negotiated increases in price and so on. Details are shown below:

*“Our orders from them usually had problems at that time.....All factories began to work for other export and domestic orders. But they had limited productivities. Thus our orders were not exclusive and not guaranteed in terms of quality and time. Some orders were delayed as factories sent products to other buyers.....Usually we would not think about changing factories, as others were no different to the previous ones. In some worst cases, we could change factories for some products, such as standardized hardware. But we could not change factories for the welding electrodes, as there were only several manufacturers nearby Tianjian (the city of the ETC’s location). We didn’t think the others were any better. They might be even worse.....[Most importantly,] these factories could change contract terms arbitrarily, especially the price. They always had some reasons raising the price, such as the increasing price of raw materials and labour costs. But we already offered the original price to our customers (buyers). So we sometimes had to explain a lot to our customers, or even lose money in business.”*

In terms of the current partner, the joint-venture welding electrodes manufacturer, this ETC does not have complete confidence in them, the manager of the 3<sup>rd</sup> department described as follows:

*“We have three staff in this factory. One is vice manager in the accounting department of this factory, in the event that they arbitrarily raise product price. He would take care of this issue. Moreover our products [welding electrodes] have some patents, such as the prescription. We are afraid that they sell same products to other exporters, and may do harm to our brand and patents. By sending these people, we can avoid they could do so [to some extent].”*

According to these descriptions, this ETC, as the buyers, integrate products’ suppliers, in an attempt to ease their opportunistic behaviours generated by the inefficient legal system and unique contract obligations, such as raising prices,

delaying supply, and so on, which worsen the enforcement problems. The aims of this ETC's integration of manufacturers and placing their own staffs in this factory reflect that the inefficient legal system and informal contract obligation actually fails to lighten manufacturers' opportunistic behaviours. As a result, the buyers, says the ETC in this case, had to use internalization and close monitoring of the factories' behaviours to avoid potential risk. In the same logic, the foreign buyers could be faced with similar and even more severe difficulties in China.



**Table 7-12 The summary of institutional constraints and related transaction costs in ETC B.**

Procedure in export transaction	Related institutions	Parts of the institutional framework	Evidence in case	Specific transaction costs	How costs are increased
<b>The pre-export and post-export procedures</b>	Bureaucratic procedures and administrative approvals	Former formal institutional constraints	Licences and registration from various government departments to start export business	Administrative costs	By generating additional transactional procedures
			Registration and approvals from various government departments for each export transaction		By generate additional transactional procedures
			Changing administrative procedures and policy		By generating uncertainty
			Slow tax rebating system		By generating additional transactional procedures
<b>The procedure of managing brands and applying for special certificates</b>	OEM trading method	Current formal institutional constraints	The manufacturer is lack of owned brands	Costs of searching foreign buyers	By reducing the possibility of transaction
			The manufacturer is lack of information and experience to obtain certain industrial certificates		
<b>The procedure for enforcing manufacturers</b>	Inefficient legal system	Current formal institutional constraints	Quality problems such as untimely delivery, random increases in price, illegal sell of products to other exporters	Cost of enforcing manufacturers	By generating opportunistic behaviour
	inefficient contract obligation	Informal institutional constraints			

### ***7.3.4 The ETC's methods for reducing institution-related transaction costs***

#### **7.3.4.1 The side of domestic manufacturers**

##### **7.3.4.1.1 The pre-export and post-export procedures**

Similar to the findings and analysis in case A, the costs of related administrative approvals during pre-export and post-export procedures in this case can be reduced by this ETC's knowledge (experience) of these administrative approvals procedures during the export transactions in China. First, according to the introduction from the CEO, this ETC arranges several specific staff from the Export Management Office and Accounting Department to respectively finish the administrative approvals, and license applications, which are compulsory for start-up export businesses, and subsequent renewals of such approvals, including the export authority, business license, and various registrations with customs, foreign exchange bureaux and so on. Most of these staffs had been working on these tasks for many years. In addition, according to the manager from the 3<sup>rd</sup> department, the export process, especially the post-export procedures, is routine work as well, which is as same as the findings in case A. For instance, the specific TMs in each department work on export documents processing; some other staff in accounting department works on the tax rebating process and foreign exchange approvals with foreign exchange branches, customs, and taxation bureaux. Therefore, these experienced staffs, and an established routine reminder system helps this ETC to reduce time and failure during the process of these administrative approvals, and further reduce the costs related to such formal institutional constraints.

In addition, according to the CEO's interview, this ETC is able to quickly obtain information about new export regulations. There are two sources for the information. First, the Northernint, as the leader company, would share these kinds of information inside the group. Second, the relevant government departments often organize training sessions and conferences for related changes in procedures. Due to their high export volume, this ETC is often invited.

## **7.3.4.2 The side of foreign buyers**

### **7.3.4.2.1 The procedure for enforcing manufacturers**

As proposed before, the inefficient legal system (current formal institutional constraints) and unique contract obligations (informal institutional constraints) increase the costs of enforcing domestic manufacturers. It has been argued that the ETC is able to reduce these costs by easing information asymmetry in Case A. The same logic also works in this case. More specifically, this ETC reduces the information asymmetry by *establishing brand, applying for well-known industrial certificates and vertical integration into production.*

#### *Brand*

The establishment and management of brands in China are faced with many difficulties, such as the inefficient legal system, popularity of pirate activity, and domestic manufacturer's inadequacies under the long-term OEM trading method.

Akerlof (1970) indicates that the brand name helps buyers to reduce the uncertainty of products' quality and adverse selection by signing customers the quality information and reducing information asymmetry. Barzel (1982) also states that the measurement cost of products' quality is considerable for buyers, the brand names reduce such measurement costs when products are transferred between owners in a market. Therefore, the brand can largely reduce foreign buyers' costs for enforcing domestic manufacturers in export transactions.

In this case, the ETC owns, manages and maintains the brand for a long time, which reduces the foreign buyers' costs for direct monitoring/measuring of product quality, and eases the possibilities of adverse selection. This ETC has many advantages in such areas. First, this ETC has a longer track record and more experience in brand management. As stated in 7.3.1, as the real owner, this ETC has owned and managed the brand of "Permanent" on the export market for more than 40 years. This is because the ETC, as the earliest group of exporters from China, had to establish and manage brands for tradable products in international competition. Conversely, most

of the domestic manufacturers have not had own brands until recently, due to the long-term OEM trading method, having no tradition of brand management, and high requirements/costs in order to manage the brand. It is hard for most domestic manufacturers.

Second, this ETC has more specified staff. According to the introduction from the CEO, they have specified staff in the Export Management Office in this ETC to specifically work on the registration of these brands and trademarks with the Administration for Industry and Commerce and Customs. Moreover, their more specified coordination with some external facilitators, like China Customs, local courts and lawyers, also considerably supports the management of brand.

*“We valued these brands very highly, and pay attention to protecting these brands.....we often received the claims from Customs for the investigation of some faked examples of our products. We would send our staff to assist these investigations.....we also meet these claims from Customs from other cities.....there have been three occasions till now that we took legal action on the matter, as the export amount (of faked products)was really large.....We employed a lawyer and then went to Shanghai, Shenzhen and Guangzhou for the court issues”*

As mentioned in procedure 8 (Managing the brand) and in the statement above from the CEO, it is clear that this ETC actively participates in the activities of managing and protecting their brands. Therefore, this ETC had actively *established and managed brands for tradable products for long time, which enhance the quality guaranty, to reduce foreign buyers’ enforcement costs on export transaction.*

### *Special certificates*

As stated before, the certificates from the classification societies, as the guarantee of product quality, is able to *resolve the information asymmetry* (Akerlof, 1970; Barzel, 1982, 2001) in the export market, and reduce foreign buyers’ monitoring costs, particularly when they purchase from developing countries, such as China. However,

the long-term OEM trading method in China's export market ensures that domestic manufacturers fail to obtain these certificates on their own.

The ETC in this case is able to help its manufacturers to complete such certificates from the classification societies. First of all, this ETC has helped the factory to finish the initial certificates from the 1980s, when such certificates were still unfamiliar to most Chinese manufacturers of welding electrodes. The ETC's efforts to learn the application procedures and assessment process and to improve production technology enabled this factory to successfully pass the investigation from classification societies. Second, the ETC's continuously helped this factory to acquire another seven certificates from different classification societies, which further increased trading opportunities from more foreign buyers with different requirements. It is worth mentioning that these classification societies do not accept certificates from each other. And also the different foreign buyers acquire different certificates from certain classification societies, due to distinctions in national, industrial and business traditions. In the end, the application procedures and requirements for certificates from these classification societies are definitely different from each other. Apparently, this ETC must have learned such differences in knowledge to ensure the factory could fulfil these different requirements. Thirdly, the ETC also helps the factory to renew such certificates every year.

*“We did the renewal for these classification societies every year or two years. We [3<sup>rd</sup> department] took these jobs for welding electrodes. That period could be the busiest one during the year. We apply for the renewal to these classification societies, and inform the factory to arrange/change the production of certain welding electrodes on the days when they come for investigation. We have 6 different certificates; these classification societies have different working styles and requirements. So, this is a lot of work.” (Manager in 3<sup>rd</sup> department)*

In a short, this ETC had actively applied for different well-accepted industrial certificates for tradable products for long time, which enhance the quality guaranty, to reduce foreign buyers' enforcement costs on export transaction.

### *Vertical integration of production*

Some trading companies, such as the JGTCs, are reported to participate in manufacturing. Such phenomenon is also found in this case. The reason is to be found in economizing transaction costs as well.

Williamson (1975, 1985) directly indicates that the firms' vertical integration aims to economize transaction costs. As stated in 7.3.3.2.1, the opportunistic behaviour, such as moral hazards and hold-ups, is a major reason for such transaction costs, in particular for the enforcement costs, which is evident in this case.

Arrow (1975) argues that "uncertainty in the supply of the up-stream good(s) and the consequent need for information by down-stream firm(s)" is one of the major motives for vertical integration. By studying the US food industry, Hennessy (1996) further empirically illustrates that one important benefit from integration between producers and processors is the reduction of the quality-related information asymmetry. It is therefore understood that the information, especially that related to "product quality" can reduce the uncertainty and opportunistic behaviour from domestic manufacturers, and therefore reduce foreign buyers' enforcement costs.

In this case, the ETC adopts vertical quasi-integration (Harrigan, 1984) by establishing a joint venture with a manufacturer, which lowers transaction costs, and is more likely to alleviate transactional problems, such as moral hazards, compared with simple market transactions (Williamson, 1971) with a manufacturer. In practice, more specifically, the ETC placed *three monitoring staff* in the joint venture; the vice CEO, the accountant and the senior manager. By doing this, the ETC obtains complete information about the production and the manufacturer, such as the real price and change in materials and products, clear production schedule, and quality-related information. The complete information effectively avoids the manufacturer's opportunistic behaviours, such as the unreasonable price changes, changes in the production schedule and delays in delivery time.

In addition, the interviews also indicate that such placing of staff in the factory also avoids this manufacturer's other potential opportunistic behaviours, such as selling the products to other domestic exporters, which could influence the price of products in export markets. Therefore, the logic here is similar to that in Case A and previous "Brand" and "special certificates"; the vertical quasi-integration of the manufacturer aims to obtain more information on production and the domestic manufacturer. So that the ETC is able to effectively enforce the manufacturer, reduce their opportunistic behaviours and the transaction costs within them. *Therefore, it is found that this ETC is able to reduce foreign buyers' enforcement costs on export transaction, by vertically integrating into production and mastering information on production, which effectively reduce manufacturers' opportunistic behaviours in export and export-related transactions.*

**Table 7-13 The summary of ETC B's methods and advantage in export transaction.**

Procedure in export transaction	Institutional constraints	ETC's methods	Evidence in the case	How to reduce costs
<p><b>The pre-export and post-export procedures</b></p>	<p>Bureaucratic procedures and administrative approvals</p>	<p>Knowledge of administrative approval procedures</p>	<p>Staff educational background and work-based training on administrative procedures</p>	<p>Advantages of economics of scale</p>
			<p>Staff experience of such administrative procedures</p>	
			<p>Regular routines for such administrative procedures during daily work in ETC</p>	
			<p>Updated information on the current export process and policy, and changes</p>	
<p><b>The procedure for enforcing manufacturers</b></p>	<p>Inefficient legal system &amp; unique contract obligations &amp; OEM trading method</p>	<p>To establish and manage brand for tradable products</p>	<p>Long-term participation in the brand management and protection in China</p>	<p>To reduce the information asymmetry</p>
		<p>To apply for well-known industrial certificates for tradable products</p>	<p>Long-term participation in the applications to classification societies</p>	
		<p>Integration of production</p>	<p>Integration of production</p>	<p>To reduce opportunistic behaviours</p>
		<p>Acquirement of information on production and export-relation transaction</p>	<p>To place monitoring staff Factory</p>	<p>To reduce the information asymmetry</p>



## **7.4 Case C analysis**

### ***7.4.1 The background information on ETC C***

Huakang Imp&Exp is a private ETC, established in 2004 with an export turnover was \$30,000,000 in 2010 in Shanghai. It mainly exports ferroalloy, such as silicon-manganese, ferrosilicon, and ferromanganese, one sort of additive in fabricating products, such as steel, to achieve special characteristics, which makes up about 70% export amount annually. With the development of business and buyers' orders in recent years, Huakang began to export other steel materials, like steel pipes. These products make up the remaining 30% of exports. Its main foreign buyers come from Thailand, Malaysia, South Korea, and Taiwan. All of them are also middlemen, who also transact with other ETCs and manufacturers in China, and resell in their countries. Huakang has long term export business contracts with these buyers. The earliest one (Thailand) can be traced back to 1999, when the owner of this ETC worked as a TM in another state-owned trading company.

In general, the ETC does not have stable suppliers, due to the characteristics of its products and related markets in China, which will be discussed in later parts of this case. Broadly speaking, the main suppliers of ETC C include four domestic wholesalers (traders) and two steel mining companies (manufacturers) in China, while numerous external suppliers occasionally offer products. These suppliers' main business takes place in China, though the wholesalers also undertake export on their own account. Among them, two wholesalers are large ones with four times the trading volume of ETC C at least. They also offer products to other ETCs, lower level wholesalers and some end customers such as steel plants. And two steel mining companies only do domestic trade. Their customers also include other ETCs and wholesalers. In addition, the products from these different suppliers, mainly refer to ferroalloy and steel material, are similar to each other in terms of quality and kind, and only differ in price and available quantity. Thus the reasons for keeping many suppliers relate to considerations of price and availability of products at certain times.

The owner of this ETC used to work in a state-owned ETC. Such working experience helps him to master general skills on export, to establish strong trust with one current foreign buyer (Thailand), enhance his understanding of the industry of steel trade, and require connections with several large traders in the field of ferroalloy and steel. All of them become the most important steps during the first of several export transactions. After 2000, he became an independent broker affiliated to a private ETC. During that time, he operated export transactions on his own account, but used the company's title, export authority and money to resell products, and finally shared some part of profits under the title of brokerage fee. Eventually in 2004 he opened the current ETC, the ETC C.

**Table 7-14 Summary of background of ETC C.**

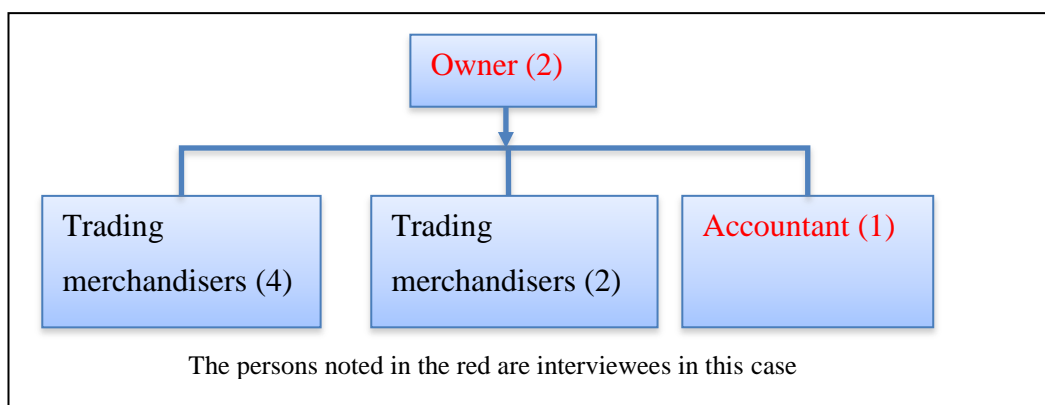
Name	Hua Kang International Trade Ltd	
Location	Shanghai	
Ownership	Private	
Size(Personals)	9	
Established	2004	
Products	ferroalloy, iron hardware, and machinery	
Foreign markets	Thailand, Malaysia, South Korea and Tainwan	
Performance	Amount	\$30,000,000
	Per capital	\$3,000,000
	Margin	1%

This ETCs has a total of 9 employees. They are shown in table 7-15 and figure 7-5

**Table 7-15 Summary of staffs in ETC C.**

Title (number of person)	Main description
Owners (2)	One owner is the founder on this ETC. As mentioned before, he is in the core place in this company. He took charge of the general management of this ETC, and important units during transaction processes, especially the transactions with new partners, such as the investigation of the characteristics of new suppliers, he randomly monitored of products, and visited the buyers. Another owner takes charge of the administrative management and part of the accounting work.
Trading merchandisers (TMs)(6)	They are divided into two groups, though there are no clear departments and strict divisions in this ETC. Four of them generally take charge of the export of products through HK-registered company (without export rebates and export documents processes), whilst two of them work on the export of products through the China-registered company (with export rebates and documentary preparation). As with the previous cases, these TMs have a relevant educational background and experience in exporting.
Accountant (1)	corporate finance, tax rebating, foreign exchange payment, etc

**Figure 7-5 Organizational structure of ETC C.**



In this case, I took three face-to-face interviews with two owners and an accountant, another two on-line interviews with one owner (which is the major interviewee) and one interview with the accountant. The main owner is chosen as the core interviewee as he can offer most of the information on the ETC and export transaction process. On the one hand, he completely understands the whole information on the ETC and transaction process. On the other hand, other employees in this ETC are limited in their work, in a rather secretive approach for avoiding loss of key know-how held by the ETC, such as the source of buyers. In addition, the other owner and the accountant mainly offer the information in their work in this ETC.

#### ***7.4.2 Transaction process***

In this section, one general export transaction process, operated by ETC C, is illustrated step by step (Shown in Table 7-16 and 7-17) in order to highlight the parts where the institutional constraints and related transaction costs occur.

**Table 7-16 Summary of transactional procedures of ETC C.**

1	Inquiry and negotiation
2	Choosing from two different companies
3	Payments and contracting
4	Enforcement of supply of products/re-negotiation with the price
5	Processing export documents
6	Making full payment to supplier
7	Receiving the payment from foreign buyers
8	Tax rebating
9	Registering off-shore company and account
10	Legal issues

**Table 7-17 Details of transactional procedures of ETC C.**

1 Inquiry and negotiation
<p>At first, foreign buyers inquire about the current price for a certain amount of products to ETC C (as the price could be different according different amount). Then TMs of ETC C look for one reference price and availability of his quantity on the current market (The TMs's main work every day is to obtain price information on the market, as it changes each day). The information channels include the current suppliers, previous partner suppliers, other suppliers on the markets and public trading platforms. Then ETC C negotiates with reliable suppliers in terms of price according to the reference price on the current market. After that the price (modified by adding their profits, usually 1%-2%) is delivered to the foreign buyer. When there is less or no stock in their existing supplier, this ETC has to use external suppliers, which could be previous suppliers and some new ones. This ETC is cautious about choosing external suppliers, due to the higher risks entailed and the difficulty in contract enforcement in the future. In some large orders, this ETC needs to use more than one supplier. Therefore inquiry and negotiation procedures will take place with more than one supplier. In the end, the ETC will choose the most profitable and suitable combination of suppliers in this situation. On the other hand, the negotiations between them and foreign buyers are usually simple, as the ETC's offering prices are reasonable according the then market.</p>
2 Choice of two different companies
<p>This ETC has two different companies registered in China (on-shore) and HK (off-shore company), though all real processes took place in same office in Shanghai. They will choose one to undertake certain transactions according different tax rebate policies issued by the Chinese customs. When the products have a tax rebate, these transactions will be processed by using the title of the China company so that tax rebates may be successfully claimed. The rest of the process is similar to that in cases A and B. When the products do have tax rebates or even have an export tax, they are dealt with through the name of HK-registered company, because there is no tax to claim from the China customs. This process is one third-country trade and by doing this the ETC can avoid massive taxation in China, benefiting from a lower rate in the HK</p>
3 payments and contracting
<p>After negotiations, a purchasing contract will be signed between suppliers and the ETC, whilst a selling contract will be sealed between the ETC and buyers. In terms of the payment term, the telegraphic transfer (TT) with some percentage of the deposit is popular in this field. In such payment terms, the manufacturers will ask at least 30% deposit from ETC C. In turn, ETC C will ask 20-30% deposit from the buyers. These deposits could be sent and received from/to the ETC's on-shore or off-shore account according to the different modes.</p>
4 Enforcement of supply of products/re-negotiation with the price
<p>The main problems related to steel and ferroalloy in this ETC are that the domestic manufacturers (including traders) often break the contract in order to change the original price. Such a situation often takes place, especially at particular times when large fluctuations in price had occurred on the domestic and international markets. The lead-in time for steel and ferroalloy between contracting and real implementation is usually 10 to 30 days, and even 60 days in some extreme cases. Due to price fluctuations, the price can show some differences between the contracting and the real implementation. Because of ineffective legal protections and inadequate contractual obligations, the domestic suppliers, especially the SMEs, often ask to re-arrange a new contract with a different deal price or even refuse to finish the contract when the price gap is large. In these cases, this ETC has to immediately re-negotiate a new contract or find an alternative supplier, in order to successfully finish their transactions with the foreign buyers.</p>
5 Processing of relevant export documents

<p>When the products have an export rebate, the TMs in this ETC will complete all the export documents, while the accountant completes the rebating procedure. The procedure is similar to that in the previous ETCs. When the products have no export rebate or have an export tax, this ETC only processes fewer documents, such as shipping bills, and leaves the major work to the suppliers, who usually have export licences for these products. In this situation, this procedure is like one 3<sup>rd</sup>-country trade, where this ETC is acting as a foreign buyer from the HK that resells products to another 3<sup>rd</sup> country.</p>
<p>6 Making full payment to the supplier</p>
<p>At the time of shipping by the suppliers', the ETC will pay the remaining payment (the remaining 70%) to the suppliers.</p>
<p>7 Receipt of the payment from the buyers</p>
<p>When the ETC re-sends the shipping documents from the forwarder, the buyers will pay the rest of money to the ETC. For products processed under the title of a company in China, the payment will be sent to the on-shore bank account. For the others through an off-shore company, it will be sent to the off-shore account in a local bank. But in this way, the ETC had to find ways of transferring the money (usually US dollars) to the RMB account, as Chinese policies of currency control only allow non-business accounts to receive small amounts of foreign currency. As a result, this ETC had to find ways of changing foreign exchange into Chinese currency, including personal small amount payments abroad which are then transferred from illegal secret private banks.</p>
<p>8 Tax rebating</p>
<p>For the products with a tax rebate the accountant of this ETC will operate the procedure of tax rebating. This procedure is the same as that in Cases A and B. The period of tax rebating is also 2-3 months</p>
<p>9 Registering an off-shore company and account</p>
<p>Due to the use of an off-shore company and bank account, it is necessary for this ETC to apply for (from the HK government), to renew annually, and really operate in HK (occasionally receiving some forms and mail from relevant departments in HK), make and offer financial reports to HK government, and open one off-shore bank account (before in HK, now in Shanghai). This ETC employs one agent, who is a special agent to help the ETCs to process these series of procedures. In order to pay less tax in HK, the agent also helps to construct the technical financial report.</p>
<p>10 Legal issues</p>
<p>As stated in transactional procedure 4, some suppliers could require new contracts or refuse to finish the existing contracts. In this case, the ETC often absorbs the loss, as it cannot change the selling contracts with foreign buyers. But when the loss is large, this ETC had to appeal for the legal assistance to save some losses. In this case, such a situation happened twice in 2009 and 2011. But the procedures are really costly, while the outcome is not satisfactory. In this case, each time it took several months to finish the implementation of adjudication in the local court in China. And also this ETC only received back part of loss in the end.</p>

### ***7.4.3 The institutional constraints and related transaction costs***

The exploration of institutional constraints is the main focus in this section. The known institutional constraints on China's export market, found in pilot study A and the subsequent two cases will be checked first of all. Similar to the previous cases,

additional attention is also paid to the emergent institutional constraints on export markets, which appear during export transactions in this case.

#### **7.4.3.1 Some additional background information in the case**

Before entering the data analysis, some relevant background information, which is different from the previous cases due to the characteristics of the products and related markets, are separately introduced. They are the market for steel materials and ferroalloy, and some export policies for these products in China.

##### **7.4.3.1 .1 the market of steel materials and ferroalloy in China**

The market of ferroalloy and steel materials in China has the reputation for complex distribution channels, uncertain prices, and large financial pressures (Davies, 2013; Lian & Soh, 2012; WSJ, 2013). First, there are various manufacturers and traders on this market, ranging from large SOEs to individual brokers. The manufacturers only sign annual contracts for a large amount with first-tier traders and large end users, as they can arrange the production schedule in advance, and receive some deposits from them before production to avoid loss on prices and release financial pressures. Then the first-tier traders resell these products to 2<sup>nd</sup>-tier traders, which resell to 3<sup>rd</sup>-tier traders. Certainly they also contain various small traders and end customers. In the end, there are all kinds of traders and manufacturers with different stocks on the market.

Second, the real deal price of trade has been changing continuously due to rapid growth of demand of steel products in China and the popularity of opportunism and speculation in this field. The price of steel products and relative materials on the Chinese steel market can change in the same day. On the one hand, the domestic demand as continued to increase rise due to the economic boom in contemporary China. The growth of (international and domestic) prices of raw materials and energy prices (electricity and coal) also contributes to the increase in costs of these products. On the other hand, the popularity and tradition of opportunism and speculation in this industry aggravate the situation. In the past, numerous multiple-tier traders have had

the tradition of speculation since the beginning of the economic reform. Due to the lack of steel products during the economic transition and the continuous fluctuation of the price of steel in recent years, these traders could easily earn profits through holding/reducing their stock.

In addition, the involvement of bank loans also enhances this situation, as the loan to traders on their stock can be used on the next-round buyout and additional speculation. Under these circumstances together with inefficient legal protection, certain manufacturers and traders indulge in strong opportunistic behaviours. They would often break the contacts with buyers to pursue higher economic benefits when the price increased or to avoid losses in periods of declining prices. In some extreme cases some suppliers in this industry choose to flee from China (Lian & Soh, 2012).

As a result, the real deal price could vary with each transaction and change overnight. Due to these uncertainties and opportunistic behaviours, many transactions, especially those with small traders, take place using the spot method. And also the payment terms in these transactions mainly adopt full payment before shipping.

#### **7.4.3.1.2 The export policy of steel materials and ferroalloy**

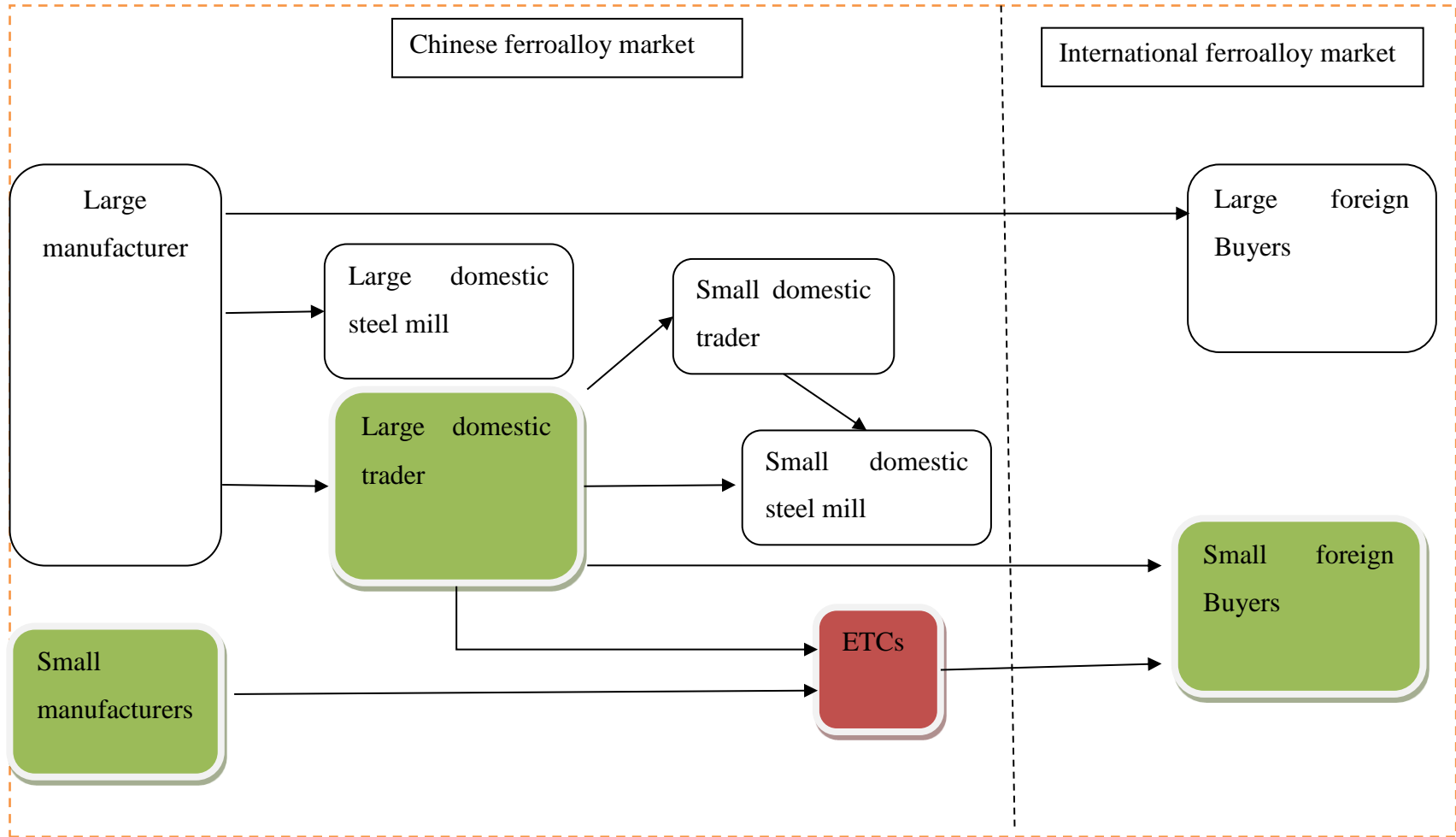
The export policy (trade policy) of steel materials and ferroalloy, mainly in terms of the tax rebate, export tax and export licences (quotas), have been constantly changing in recent years in China for some external reasons, such as environmental issues, energy issues, the government's industrial policy, and WTO regulations. As a result, during the same period, some products might apply for tax rebates, whilst others had to impose additional export taxes and even limited export licences (quotas). For instance, the export of steel pipe has 9% tax rebates, while the export of ferroalloy had to acquire export licences apart from the additional 20% export tax in 2010.

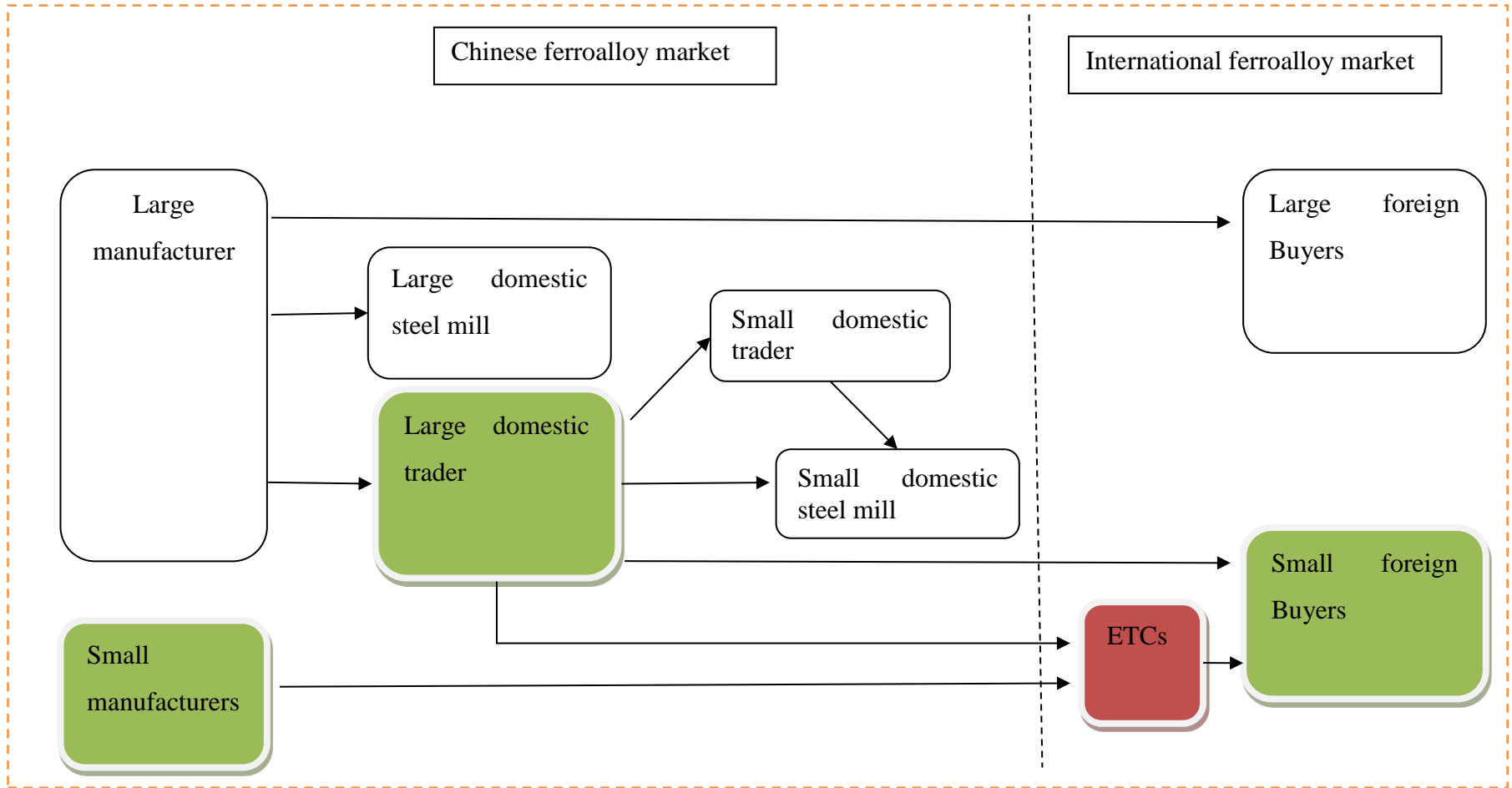
In addition, the government's export policies for the same products could change between different periods. By way of example, before 2005, the export of ferroalloy was subsidized by the Chinese government through the device of an export tax rebate (rate 11%-15%). Then for many reasons, such as the reduction in the high

consumption of a natural resource and the pollution from this industry together with the re-structuring of distribution and marketing by reducing the number of small manufacturers ,the government began to cancel the tax rebate, and to apply a 5% export tax on ferroalloy from 2005 (MOFCOM, 2005), and then increased the export tax to 10% in 2006 (MOFCOM, 2006), and finally set an additional limited export quotas/licence and export tax at 20-25% from 2008 (MOFCOM, 2008).

Under the new policy export quotas, there are only around 250 companies (traders and manufacturers in 2010), which were allowed to export ferroalloy in China. The numerous manufacturers and traders outside of this list had no right to export. Therefore, some of these companies began to export ferroalloy illegally. According to the author's investigation, there are two channels. One is through formal export channels with different items registered in customs, as the official investigations are random. And also the agent forwarding companies are usually faked in this case. Another one is through frontier trade with some neighbouring countries, such as Vietnam, as frontier trading in small amounts is free from export tax in some provinces. In this ETC, their current sources of tradable products come from formal companies with export licences and informal (illegal) channels, as the shipping sheets show Vietnam as the place of origin.







**Figure 7-6 Flow chart for two different trading modes in ETC C.**

### **7.4.3.2 The side of domestic manufacturers**

#### **7.4.3.2.1 The pre-export and post-export procedures**

In this case, the administrative approvals procedures during pre-export and post-export procedures are also found to be similar to those in the pilot study A, cases A and B. It supports proposed argument in pilot study A that the *bureaucratic procedures and administrative approvals* are the main *former formal institutional constraints* that generate additional transactional procedures and costs for normal export transactions in China.

According to the interviews, the owner of this ETC takes care of all applications and renewals of the administrative documents. In his opinion, these sorts of *pre-export* tasks that are compulsory for Chinese exporters, do cost them a lot of time and energy, as these administrative approvals are complicated, time-consuming and continuously changing. Second, the transactional procedure 5 (Processing relevant export documents) and procedure 9 (tax rebating) confirm that this ETC, as in previous cases, also had to obtain these sorts of post-export administrative approvals from relevant government departments, especially for the products processed through the on-shore company in China. More importantly, the owner expresses the view that these approvals in pre-export and post-export administration are extremely important and necessary for claiming tax rebates, which make up a large portion of their profits. Therefore, the administrative approvals do appear in the pre-export and post-export procedures in this case.

### **7.4.3.3 The side of foreign buyers**

#### **7.4.3.3.1 The procedure for searching for domestic manufacturers**

The bureaucratic procedures and administrative approvals do not only contain the complex and time-consuming procedures, but also refer to the continuously changing policy in China's export market. Policy instability is often reported as one obstacle for business in transition economies (Estrin et al., 2008; Hitt et al., 2004). Estrin et al (2008) critique that the "frequent changes to tax policy" limited the entrepreneurial

growth in transition economies. Meyer et al 's (2004) study also suggest that the instable rule and regulation become one main obstacle for FDI in Central and Eastern Europe.

In this case, the procedure 2 (Choosing from two different companies) in the export transaction process shows that the changing tax rebating policy generates additional costs for foreign buyers' in search of domestic manufacturers (or the purposes of consistence with the rest of the cases and analytical frameworks, the suppliers, including traders and steel mills, will be also called "manufacturers" in the remaining parts of this case). As stated in 7.4.3.1, the changes in export taxes on ferroalloy has become a normal phenomenon in China's export market. *Uncertainty* is one major source of the increase in transaction costs (Williamson, 1975, 1985). These sorts of changes result in two negative outcomes, which jointly worsen the difficulty and uncertainty for foreign buyers searching for reliable manufacturers. First, the number of suitable domestic manufacturers is reduced. Second, the price of is increased.

When the Chinese government reduced tax rebates and increased export tax in 2005, some existing trading partners faced increasing prices of products on a sufficient scale to stop profit and transactions. Therefore these trading partners, especially the buyers, had to change to others trading partners able to offer suitable products at more competitive prices compared with other export markets.

When the government issued export licences in 2008, the foreign buyers were obliged to change to those suppliers who had additional export licences. In both situations, buyers, including foreign and ETCs, face with additional uncertainty and costs related to searching for new trading partners and to establishing trust with and adapting to new trading partners. Actually the findings in this case did show such problems. For instance, from 2005 this ETC began to look for new suppliers as some existing ones were unable to continue to supply the ETC at an acceptable price under the new export tax. But it took them long time to identify the current ones, as they could not immediately take the risk of transacting on a large scale with these newcomers. At the same time, it would be risky and uncertain for the buyers to use

new manufacturers, who could offer cheap supplies but through illegal channels. The description below from the owner in ETC C supports such points:

*“We used to have several long-term collaborative suppliers in the past. Although there were some problems during previous transactions more or less, they are better than others. But when the government began to control the export of ferroalloy, our business became difficult.....When the policy changed [in 2005], we had to change to some other suppliers with the licences..... We attempted several transactions at first. But most of these suppliers with export licences are large traders. They had their fixed buyers. They don’t care about these small orders. So their price is not cheap enough and the supply is not on time usually. Finally some friends introduced me another two suppliers, who could offer some “Vietnam products”. We attempted many small orders at first. Their product and supply [reliability] are not too bad. Then we just start new transactions”*

When I ask for information on the “Vietnam products”, he replied

*“These ‘Vietnam products’ became popular in recent years. They might be smuggled products, or through the border trade. I am not sure how they can make it. But from the export documents, I can see some products depart from Vietnam”*

Therefore, it seems the new-added export tax and export licences do increase buyers’ searching costs for new available suppliers by reducing the number of available suppliers on China’s export market. The export of ferroalloy is administratively reduced and limited to several large players by the government. The buyers (whether ETC and foreign buyers) in this case have to change suppliers with illegal channels, which give rise to additional risks and uncertainty for foreign buyers. Otherwise they could not continue their business in China. Therefore, these changes of export policy largely increase foreign buyers’ searching costs for domestic manufacturers.

Moreover, the foreign buyers would face the additional costs and potential uncertainty of searching for and transacting with the suppliers with illegal channels. The change of export policy destroys some business, while leaving the opportunities

for others. Though they are illegal, the “Vietnam products” have become popular on the export market due to their cheaper price. But the foreign buyers obviously lack information on how to find these suppliers. Even if they could find them, many resulting problems and the potential uncertainties surrounding these supplies would deter most of foreign buyers. For instance, are these suppliers reliable considering they are acting illegally? What if the supply is impounded by Chinese customs? And can they get the deposit back in that case? In the end, *bureaucratic procedures and administrative approvals*, more specifically the *continuous changes of policy* in China’s export market, and *the former formal institutional constraints*, generate additional costs for foreign buyer’s direct transactions in this case.

#### **7.4.3.3.2 The procedure for enforcing domestic manufacturers**

In the previous pilot study A and cases, it is clear that the *inefficient legal system (current formal institutional constraints) and contract obligations (informal institutional constraints)* jointly increase foreign buyers’ enforcement costs on domestic manufacturers. Such an assertion is also supported in this case.

According to procedures 4 “Enforcement of supply of products/re-negotiation of the price” and 11 “Legal issues”, it is found that the enforcement of export transaction does meet with some problems due to domestic suppliers’ opportunistic behaviours, such as the breach of contract. The *inefficient legal system and contract obligations* on the domestic markets worsen the situation. Distinct from the pilot study, where the quality of products and lead-in time of production are the main problems in transactions, it is the uncertainty of the price that becomes the main problem in this case.

According to the owner of this ETC

*“The participants [in this field] are not truthful and promising. No one will follow the contracts [in this field]. All transactions have to re-arrange the price. The only difference is extent. The better ones will inform of you the change of price in advance, increase price reasonably according market fluctuation, and agree with the re-negotiation. Some others just ignore you and deny the contracts.”*

When I enquired about the availability of appeal for legal protection, he said that the costs are too high to go for court for every problematic contract in China.

*“You cannot settle every transaction through the court; the costs are too high to go for courts [in China]..... You have to go to the local court, where the suppliers are located. They [local court] might favour them [suppliers]..... And even if you can win [in the court]; the enforcement of the sentence always has problems.....Usually we will undertake the loss, if it is not too high..... we only went through legal procedures once, when we really lost too much”*

The owner described that extreme case, which made them lose money and all back on the legal process.

*“There is one supplier, with which we have had a couple of transactions before, who refused to finish one transaction. They told us they lacked the products and could not finish the contract. We knew they were selling the products to other buyers at a higher price. But we could do nothing at that time. The foreign buyers couldn't delay the contract either. In order to avoid a breach of contract, and keep this long-term buyer, we had to buy the product from another source according to the then market price (higher than our contract price), and send to our buyers. We lost too much and brought a law suit against this supplier within international arbitration. We knew the local court could be one problem. We would not be treated fair by local court. So we went through international arbitration. We are a HK company. We import from China. It is a case for international trade (rather than domestic trade). It fulfils the requirements of international arbitration. It (arbitration) took place in HK. We thought it would be fairer than domestic court. By the way, the fees of international arbitration would be borne by the losing party.....As a result, We got the complete win, they [the supplier] lost the case, and were punished by carrying all the liabilities and costs. But the implementation [of the result of arbitration] was still a problem. We then visited the executive division of the local court with this result. One officer told me it would take very long time to execute. I knew his meaning. It might be one year, two year or forever. Who knows? I did not want to wait. So I found one local friend to help us, who introduced us to another officer in the*



*executive division. Finally with the help of this friend, that local supplier only agreed to compensate half of our loss..... We thought it would be the best way at that time, and accepted the solution”*

From the introduction in 7.4.3.1 and the interviews above, it seems that the behaviours of freely breaking the contract, as the inefficient contract obligation, are really popular among the manufacturers in the industry of this case. In the meantime, the experience of this ETC also indicates that the inefficient legal system, especially the execution of the law and sentence, fails to protect export transactions against these opportunistic behaviours of suppliers. In the end, the inefficient legal system and contractual obligations increase buyers’ enforcement costs on domestic manufacturers.

**Table 7-18 The summary of institutional constraints and related transaction costs in ETC C.**

Procedures in export transactions	Related institutions	Parts institutional framework in	Evidence in case	Specific transaction costs	How costs are increased
<b>The pre-export and post-export procedures</b>	Bureaucratic procedures and administrative approvals	Former formal institutional constraints	Licences and registration from various government departments to start export business	Administrative costs	By generating additional procedures
			Registration and approvals from various government departments for each export transaction		By generating additional procedures
			Changing administrative procedures and policy		By generating uncertainty
			Slow tax rebating system		By reducing the number of transactions
<b>The procedure for searching domestic manufacturers</b>	Bureaucratic procedures and administrative approvals (continuous changes of policy)	Former formal institutional constraints	The additional export tax and export licences reduce the number of domestic manufacturers, and increase export price	Costs of searching for domestic manufacturers	By increasing uncertainty
			The alternative supply with acceptable price is illegal	Costs of searching for domestic manufacturers	By increasing uncertainty
<b>The procedure for enforcing manufacturers</b>	Inefficient legal system	Current formal institutional constraints	The execution of the law and sentence fails to protect the buyer in export transaction	Cost of enforcing manufacturers	By generating opportunism
	Inefficient contract obligation	Informal institutional constraints	manufacturers freely raise price and break the contract,		

#### ***7.4.4 The ETC's methods for reducing institution-related transaction costs***

##### **7.4.4.1 The side of domestic manufacturers**

###### **7.4.4.1.1 The pre-export and post-export procedures**

Similar to previous cases, the costs related to administrative approvals during pre-export and post-export procedures in this case, can be reduced by this *ETC's knowledge (experience) of these administrative approvals procedures*. More specifically, this ETC is able to reduce these administrative costs during the pre-export and post-export procedures, by using the staff's knowledge of these administrative procedures during export transactions. First, the owner's knowledge of the administrative procedures is a key contribution during the pre-export procedures. One owner takes most of the work of administrative approvals during the pre-export procedure, including the renewal of business licences and export authority and registrations with customs. This owner has long-term working experience in the exporting business, from the time of his employment with state-owned trading companies at first. He also confirmed that much of his knowledge came through long-term working experience.

Second, the 2nd owner, two TMs and accountant mainly take charge of usual works of submit/receive the official documents to/from these administrative departments during post-export procedures in this case. All these three members of staff also have long-term experience in this work. The accountant is one of the experienced staff and used to work in another ETC. The 2nd owner has undertaken this work since the establishment of this company. The two main TMs graduated with an international trade major in the college. Both of them have more than 3 years' history in the current work.

Therefore, the ETC's knowledge of these administrative procedures helps to reduce the administrative costs during the pre-export and post-export procedures.

## **7.4.4.2 The side of foreign buyers**

### **7.4.4.2.1 The procedure of searching for domestic manufacturers**

This ETC's *knowledge of alternative suppliers* helps to reduce the costs of searching for domestic manufacturers, which are influenced by *the changes in export policy* in this case. As stated in 7.4.3.3.1, *the changes in export policy* particularly in the issue of export licences and export tax, largely reduce the available suppliers in export market in China, and generate additional searching costs for domestic suppliers. This ETC is also faced with the problems of searching for new suppliers with export licences and acceptable prices. From the interviews in 7.4.3.3.1, it is noticed that this ETC initially did find two suppliers with export licences, then changed to other two suppliers with cheaper "Vietnam products". Double searching procedures showed that this ETC has enough information on potential alternative suppliers on markets. By mastering these sorts of information, this ETC considerably reduces the uncertainty generated by changing export policy on export transactions.

When I enquired how they were able to find these suppliers, the owner reply that *"They [these suppliers] are usually from friends' introduction.....I have worked [in this industry] for long time. So I had many friends in this industry.....They include traders, manufacturers, logistics, and so on. With most of them, I haev had collaborative experience.....We often exchange information about prices, new export policies and so on,.....in addition, they (these channels) are more reliable.*

When I asked him if other public platforms, such as the internet and public market, are helpful in this situation, he replied that

*"they are not reliable, there are too many frauds there"*

Therefore, the interviews show that the owner's experience does help to obtain massive *information on the source of domestic suppliers*. And these suppliers are more reliable than those from other channels.

Second, this ETC's *knowledge of how to use the off-shore company* also helps foreign buyers' transaction costs for searching for relatively cheap and low-risk domestic supply in China. As stated in 7.4.1 and 7.4.3.3.1, and in transactional procedure 2 (Choosing two different companies) and transactional procedure 9 (Registering off-shore company and account) in 7.4.2, it is noted that this ETC used one UK-registered off-shore company to operate the export of products with export licences and export tax from China. This method is a kind of 3<sup>rd</sup>-party trading method (illustrated in the literature review). By using this method, this ETC partly reduced export prices by avoiding some corporate taxes. On the other hand, it also partly avoid their involvement in the illegal problems of "Vietnam" products, as this ETC played the role of one "foreign buyer" in HK on all export documents.

Obviously rather than normal export processes on export handbooks, these extraordinary sorts of operation require some special knowledge, such as knowledge of China and HK's law, export policy, tax policy, and export technical process, which cannot easily be obtained from textbooks, as it is technically illegal, and requires long-term export practice to carry off. The owner of this ETC is the key player in this procedure. He told me how he learnt this process

*"Initially I knew this method from some internet forum, which is specific to Chinese exporters. Then I began to ask if someone really did that from my friends, as I thought it might be useful for those products without tax rebating (the products with tax rebating needs China-registered company to claim tax). Then one of my friends told me his company worked with this method, and introduced one HK agent to me. This agent helps to initial register an off-shore bank account in HK, and subsequent daily and annual maintenance tasks (the HK-registered company still needs physical office and staffs to receive and deliver some documents to HK governments), including the preparation of financial reports under HK law. After a year, when I had mastered the whole process, I changed to another agent, which offered a better service. And also I changed the off-shore bank account in HK to Shanghai (this ETC's location), where some banks have opened off-shore businesses as well, as I felt it's safer to manage the money on my own"*

Apart from these, the transactional procedure 7 (Receiving the payment from foreign buyers) shows that the owner had to find ways, such as payments of personal small amounts from abroad and transfers from illegal secret private banks, to exchange the foreign currency for Chinese currency for the export of transactions through the HK company, as this ETC has no business receipts to show the legitimacy of such an amount of foreign exchange under China's currency control policy. Therefore, this process also needs special knowledge on such extraordinary sorts of operation, which can only be learnt through non-public channels and long-term export practice.

#### **7.4.4.2.2 The procedure of enforcing manufacturers**

As stated in the previously in this case, the enforcement of manufacturers is more likely to be influenced by the inefficient legal system and contractual obligations. As a result, there appear to be increased opportunistic behaviours, such as great deal of *breach of contract*, in the markets. In turn, it is found in this section that this ETC's knowledge of *updated prices, characteristics of manufacturers, and how to effectively use appropriate legal assistance in China* largely helps to solve these problems.

As stated in previous cases, the asymmetric information is one major reason for difficulty in identifying product quality and other resulting problems to stop transactions, such as adverse selection and moral hazard (Akerlof, 1970; Stiglitz & Weiss, 1981). In this case, the products' price and continuously-appearing *re-negotiations* with suppliers in this industry, is similar to the problems of product quality in transaction, as it is resulted from suppliers' opportunistic behaviours. Reducing asymmetric information, mainly on product price in the current market, is a key method for reducing transaction costs. Such a situation shows in 4 (Enforcement of supply of products/re-negotiation with the price) of the export process. Therefore, this *ETC's knowledge of updated pricing* becomes the tool and stake of these re-negotiations to for reducing suppliers' opportunistic behaviours, and the costs of re-negotiating with manufacturers.

According to the owner

*“TMs’ daily tasks are to check the price with a lot of suppliers, with the existing suppliers and with those with collaborative history, by telephone or internet.....of course, they also check them on the websites. There are many public websites, which offer timely transaction prices. We paid the registration fees every year. We also used foreign websites, which offer international pricing.”*

In addition, as stated before, the owner also exchanges the price information with his friends in this field as well. Therefore, it is found that this ETC has one “dataset” for the updated price information. Though it is not complicated, it offers most important price information for the negotiations with manufacturers.

Similar to the Case A, this ETC’s *knowledge of the characteristics of manufacturers* helps to reduce these enforcing costs of manufacturers. According to the interviews with the owners, this ETC also tries to filter out unreliable suppliers through trial orders (small amounts) as soon as they can in the past several years. In this way the ETC C can choose different manufacturers according to their transactions characteristics and change to the reliable manufacturers with relatively low costs if needed.

In addition, this ETC’s *knowledge of how to effectively use appropriate legal assistance in China*, especially on how to obtain most returns from China’s current legal and enforcement system, also helps to reduce enforcement costs. As stated in procedure 10 (Legal issues), and the description and interview in 7.4.3.3.2, this ETC had to appeal through a lawsuit to recoup their losses during one transaction. Interestingly, this ETC went for the international arbitration in the court in HK rather than the local court, which is normally the most convenient solution for a small ETC. The owner’s explanation has been shown in section 7.4.3.3.2.

Although this ETC finds honest external legal assistance in HK based on their “foreign” identity, the execution of the adjudication in the local court in China still encountered some problems. As further described by the owner below

*“But the execution (of the result of arbitration) was still a problem. We then visited the executive division of local court with this result. One officer told me it would take very long time to execute. I knew his meanings. It might be one year, two year or forever. Who knows? I did not want to wait. So I found one local friend to help us, who introduces another officer in executive division. Finally with the help of this friend, that local supplier only agreed to compensate half of our loss..... We thought it would be the best way at that time, and accept the solution”*

Obviously, the owner’s explanation in section 7.4.3.3.2 and description above relies on much specific knowledge on how to save losses in China, when one trading partner breaches the contract. The knowledge refers to the method by which you can get fair treatment and the most efficient execution, how to save your losses at most, and how to find the right person who can help you in this kind of issue in China.

Therefore, this ETC’s knowledge of updated prices, the characteristics of manufacturers, and how to effectively use appropriate legal assistance in China jointly help them to reduce the costs of enforcing domestic manufacturers.



**Table 7-19 The summary of ETC C's methods and advantage in export transaction.**

<b>Procedures in export transaction</b>	<b>Institutional constraints</b>	<b>ETC's methods</b>	<b>Evidence in the case</b>	<b>How to reduce costs</b>
<b>The pre-export and post-export procedures</b>	Bureaucratic procedures and administrative approvals	Knowledge of administrative approval procedures	Staff educational background and work-based training in administrative procedures	Advantages of economics of scale
			Staff experience of such administrative procedures	
			Regular routines for such administrative procedures during daily work in ETC	
			Updated information on the current export process and policy, and changes	
<b>The procedure for searching for domestic manufacturers</b>	Bureaucratic procedures and administrative approvals (continuous changes of policy)	Information on alternative suppliers	Owner's experience in this industry	Reducing uncertainty
		Knowledge of how to use the off-shore company	Owner's experience in this industry	
<b>The procedure for enforcing manufacturers</b>	Inefficient legal system & contractual obligations	Information on updating prices in market	TMs' regular checking on the price in market	Reducing the information asymmetry
			Contacts among the traders in this industry to communicate about price	
		Owner's experience in this industry		
		Knowledge of characteristics of manufacturers,	To filter out unreliable suppliers through previous transactions	

		Knowledge on how to effectively use legal assistance in China	Information on differences between local courts and international arbitration	
			Information on procedures international arbitration	
			Knowledge of the execution of penalties by local courts	

## **7.5 Case D analysis**

### ***7.5.1 The background information on ETC D***

The fourth ETC, “FULU Export Trading Company”, is a private ETC in Beijing. It was found in 1997. Its main products are bedding textiles, such as quilts and pillows. Its total export amount was \$7,000,000 in 2009. Its two major main foreign buyers, which have more than 10 year’s collaborative history with this ETC, are wholesalers in Netherlands and UK. They also purchase products from other Chinese ETCs and manufacturers. In addition, Fulu also had many foreign buyers from other countries and regions, which are normally found through trading shows. In general, the preferences of all buyers are different, in terms of quality, amount, sorts etc.

The manufacturers of this ETC include two types. First, this ETC owned one manufacturer, which exclusively offers products to this ETC and makes up 30-50% of the export volume of this ETC. It usually offers the high-quality and complex products, such as the spring pillows. This manufacturer has 50 employees at any one time, but could increase to 100 employees during some peak periods (depending on the volume of orders), by employing temporary workers. By doing this, the manufacturer can reduce the operative costs during off-peak times. It was established in 2004 and differs from other collaborative manufacturers in the ability to produce high-quality, more complicated products, by virtue of owning some advanced equipment and production lines. In practice, this core manufacturer works in three ways. First, it produces some high-quality products, which require more careful quality control. Second, it produces some complicated products, which require some special production and equipment. In some cases, this manufacturer only processes these special production units of one product, and then leaves other simple units of same product to other manufacturers. Three, it produces some orders with strict lead-in times. This ETC will decide the roles of this manufacturer in each order.

The reasons for establishing their own manufacturer are twofold. First, it aims to better control the price of products with increasing competition on the export market. Second, the growth of orders in this ETC leads to the need to employ more collaborative manufacturers, but also results in increasing difficulty of enforcing them, especially considering the increasing problems in lead-in time and quality

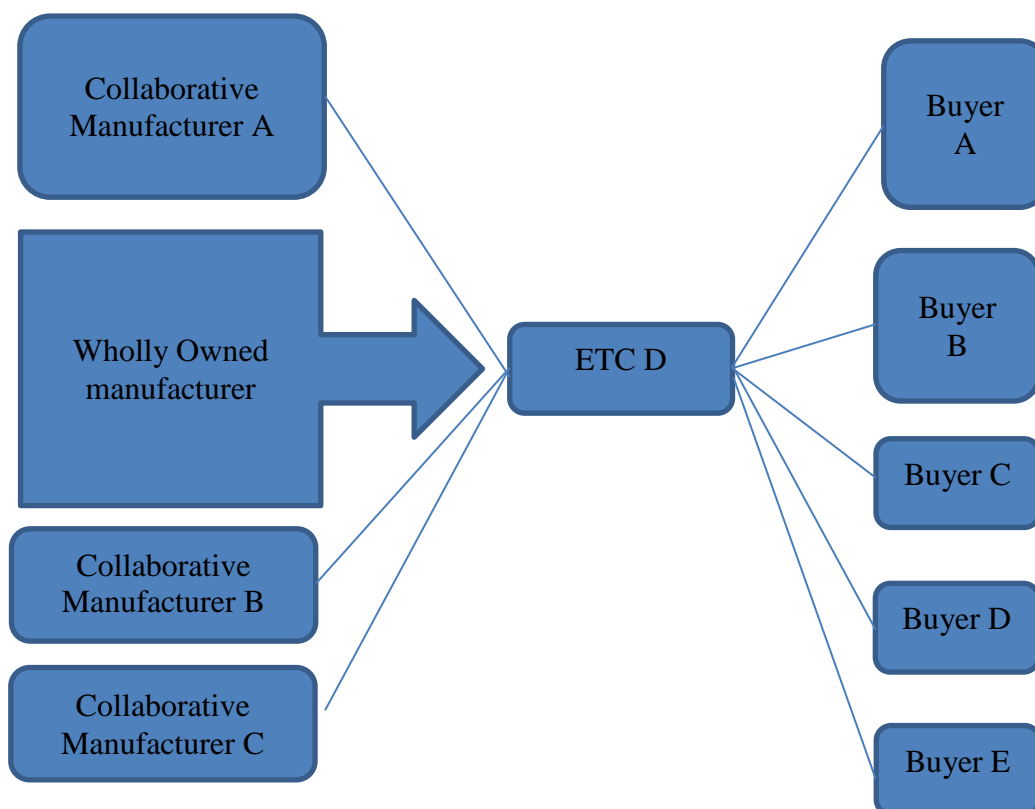
In addition, there are eight other external manufacturers (named collaborative manufacturers in this section) to offer the rest of the supply for this ETC. Similar to previous cases, these collaborative manufacturers also offer supply to other buyers. They vary from each other in terms of size (50 to 300 employees), output amount, quality, and preferred products. Some of them can only produce the low-quality products, whilst the quality of others' products is not consistent due to limited resources and changing requirements from different orders. In general, they are SMEs with unstable output and limited capability.

The owner of this ETC was one experienced trader. He had worked as a TM in a state-owned trading company since 1990. Then he worked in many different positions, including salesman and expatriate manager in this ETC. After 7-years working in that trading company, he opened this ETC in 1997. Up to 2010, his company had 15 employees with \$7,000,000 export amount. The Table 7-21 and Figure 7-8 show the situation of these staffs in the ETC C.

**Table 7-20 Summary of background of ETC D.**

<b>Name</b>		<b>Fulu exporting trading companies</b>
<b>Location</b>		Beijing
<b>Ownership</b>		Private
<b>Size(Personals)</b>		15 (trading companies)+50 (manufacturers)
<b>Establishment</b>		1997
<b>Product</b>		Bedding products
<b>Foreign markets</b>		worldwide
<b>Perfor mance</b>	Amount	\$7,000,000
	Per capital	\$333,000
	Margin	10%

**Figure 7-7 The trading partners of ETC D.**

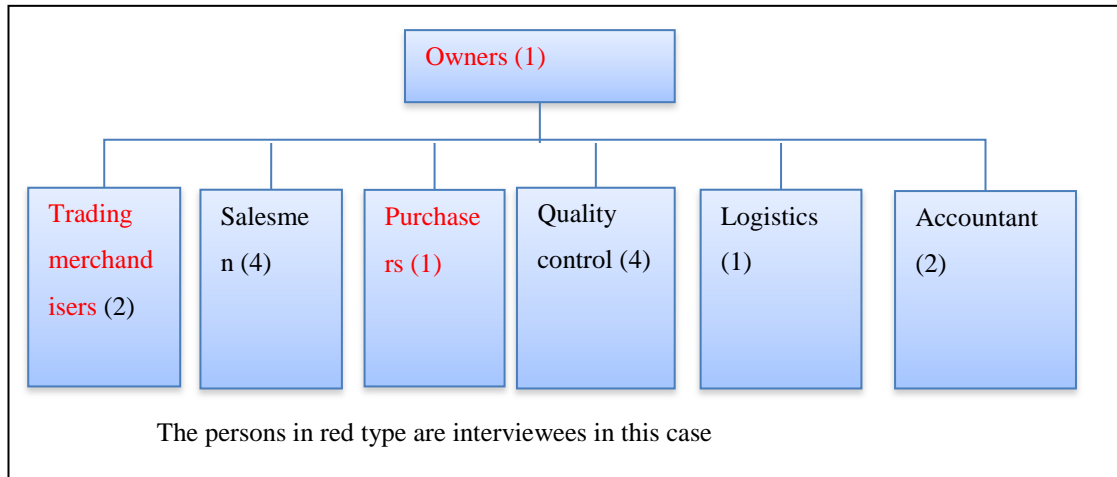


**Table 7-21 Summary of staffs in ETC C.**

Title (number of person)	Main description
Owner (1)	The owner took charge of the general management of this ETC, and monitoring of important units during the transactions process, especially negotiating with main buyers and manufacturers, enforcing the production of manufacturers, and making final decisions for some difficult transactions.
Salesmen (4)	Salesmen generally taking responsibility for searching for new orders from new and existing buyers. All salesmen have relevant experience and educational backgrounds in export.
Trading merchandisers (TMs) (2)	TMs generally taking responsibility for exporting documentation, such as making exporting contracts and other documents for export. In particular, they also take parts of the work for submitting/receiving official approvals from government departments, including the local Administration of Industries and Commerce and Bureau of Quality and Technical Supervision. All TMs have relevant experience and educational backgrounds in exporting.
Quality control (QCs) (4)	QCs specifically take charge of core and collaborative manufacturers' production, in terms of quality, lead-in time, amount, etc. Two QCs used to work in manufacturing, and then changed to ETCs. The other two have more than 2 years QCs'-related experience in ETCs. The manager used to work as a QC in manufacturing for 6 years
Purchaser (1)	Purchaser mainly takes the job of searching and purchasing materials from suppliers or on market. Moreover, he also works on making up samples according to the orders from salesmen, including translating the technical data according to the order, and searching for appropriate

	materials and manufacturers to make the sample. He has more than 10 years' experience in purchasing textile manufacturing, and fully understands the materials markets and suppliers' information in China.
Logistics (1)	He mainly works to process all shipments of products, with the assistance of many external forwarders.
Accountant (2)	They mainly process the ETC's corporate accounting, and also completes the tax rebating procedures, approvals of foreign exchange and receiving payment from foreign buyers in this ETC. Both of them have many years' experience in exporting companies' corporate accounting.

**Figure 7-8 Organizational structure of ETC D.**



In this case, I took four face-to-face interviews and two on-line conversations in total, including four with the owner, one with the purchaser and one with the manager of the TMs, between 2010 and 2011. The owner offered most of the information about the company, manufacturers, suppliers, buyers and general export process, while the manager introduced the details of the export process. The owner is key person in this company, and fully understands the whole information and export process.

### ***7.5.2 Export transaction process***

The general export transaction process, operated by ETC D, is illustrated step by step in order to identify those areas where the institutional constraints and related transaction cause further costs (shown in Table 7-22 and 7-23). In general, the transaction process in this ETC is quite similar to the Case A. The owner provided the general flow of export transaction in this ETC. Then the details of each step are obtained and/or checked from relevant interviewees.

**Table 7-22 Summary of transactional procedures of ETC A.**

1	Sample making and searching for buyers
2	Negotiations
3	Transacting with materials suppliers
4	Enforcing the production of manufacturers
5	Processing relative documents
6	Receiving the payment from foreign buyers
7	Tax rebating

**Table 7-23 Details of transactional procedures of ETC A.**

1	Sample making and searching for buyers
	The salesmen search for new orders from new and existing foreign buyers. According to these order, which normally contain a series of technical requirements, the purchaser searches for appropriate materials to make a sample. The sample can be made by their own core manufacturer or by collaborative manufacturers, depending on the products. Then they are sent by logistics to foreign buyers for suggestions and potential modifications. In addition, the sample is also made for promotional purposes (called promotion modes) in trade shows, the B2B website or other marketing activities.
2	Choice of production by own core manufacturer or other collaborative manufacturers
	After receiving orders from foreign buyers, ETC D will select one of the manufacturers (in-house or collaborative) according to the required quality, amount and sort, and the manufacturers' schedule. In general, higher quality and more complex products (or production procedures) will be finished by their own core manufacturer, whilst the simple and low quality products (or production procedures) will be produced by other collaborative manufacturers. In addition, the spring pillows are only produced by their own core manufacturer. Sometimes, they allocate one large order to many manufacturers
2	Negotiations
	At the same time, the ETC negotiates with buyers, potential manufacturers and suppliers, in terms of price, quantity, lead-in time, payment terms etc. This process is cyclical and dynamic, mainly including buyers' inquiries to ETC and ETC's inquiries to potential manufacturers and suppliers. In this procedure, the ETC has to choose one or several of the most suitable manufacturers and suppliers for certain orders according this order's quantity, quality, style, lead-in time, etc. But different from the Case A, ETC D will choose manufacturers from the core manufacturer and other collaborative manufacturers, according to required quality, amount and sort, and manufacturers' schedule. In general, higher quality and more complex products (or production procedures) will be finished by their own core manufacturer, while the simple and low quality products (or production procedures) will be produced by other collaborative manufacturers. In addition, the spring pillows are only produced by their own core manufacturer. Similarly to case A, price is not the most important consideration for this ETC, as some manufacturers and suppliers could also give the competitive price, but without any guarantee. Thus the manufacturers and suppliers, with whom this ETC has had collaborative experience, are the most trust worthy. By confirmation from the owner of ETC D, they did have an understanding of which manufacturers and suppliers would able to finish this task when they knew the order's requirements, according to their previous collaborative experience with these companies. The key factors are the manufacturers' production schedule, availability of material, and so on.
3	Transacting with materials' suppliers

<p>The purchaser takes charge of material supply, including main materials and trimmings. As in Case A, the searching for material begins as early as the sample marking process. ETC D usually chooses suppliers from the ones with whom it had been cooperating for many years. Sometimes it also chooses some external suppliers according to price, material availability etc. For some materials, it also uses some public markets for wholesalers. But all these activities largely rely on the experience and information of this purchaser and owner. In addition, they will enforce these suppliers' supply as well. They focus on lead-in time, amount and quality. The methods include sample checking, timely communication, and even on-site monitoring.</p>
<p>4 Enforcing the production of manufacturers</p>
<p>The QCs work on enforcing manufacturers' production, including their own core manufacturer. The QCs' experience and knowledge largely facilitate this procedure. Similar to Case A, ETC D also has a regular schedule for checking the production. During some peak time, all staff will participate in this process, as the involvement of more collaborative manufacturers.</p>
<p>5 Processing relevant documents</p>
<p>This procedure is jointly finished by two TMs, two accountants and a logistics member of staff. While the TMs process most exporting documents, the accountants complete the foreign exchange claim, and tax rebating task, the logistics staff process the shipment documents.</p>
<p>6 Receiving the payment from foreign buyers</p>
<p>The payment methods, such as a letter of credit, are different according to the terms. Accountants will take charge of receiving of payment from foreign buyers after shipping the products and sending the documents. It needs to go through the bank, local foreign exchange branches, and customs. This procedure usually takes one-month (mainly waiting for the receipt from customs) to finally receive these payments, as the payment and receipt of foreign exchanges are strictly monitored by the government.</p>
<p>7 Tax rebating</p>
<p>After completing the whole transaction and obtaining all official documents, the accountant will apply for the tax rebate from the local taxation office. The tax rebating rate is 7% for the products in this ETC. This application normally takes 3 months. This procedure is important for the ETC's capital flow and profits.</p>

### ***7.5.3 The institutional constraints and related transaction costs***

As in previous cases, this section aims to explore new and test known institutional constraints. The known institutional constraints on China's export market, found in previous cases will be checked at first, while additional attention is also paid to the emerging institutional constraints on export markets, which appear during the export transaction in this case.

#### **7.5.3.1 The side of domestic manufacturers**

##### **7.5.3.1.1 The pre-export and post-export procedures**

Initially, it appeared that the administrative approvals were required during pre-export and post-export procedures in this case. Therefore the proposed argument in



pilot study A, that “the *bureaucratic procedures and administrative approvals* are mainly *former formal institutional constraints*, which generates additional transactional procedures and costs for normal export transactions in China”, is supported.

More specifically, when I inquired to the owner of ETC D about the complex, time-consuming and changing administrative approvals during the pre-export and post-export, he confirmed that such problems do trouble them a lot, he had to employ one agent company to help finish this work many years ago. In this way, their products were actually exported under that agent’s name and export authority in the official records. When their orders began to increase in recent years, he began to do them on their own. At present, the administrative approvals for starting up export business are processed by the owner.

Second, the export transactional procedure 5 (Processing relevant documents), 6 (Receiving the payment from foreign buyers) and 7 (Tax rebating) show that the administrative approvals during post-export also exist in this ETC and are jointly finished by many different staffs. Therefore, the bureaucratic procedures and administrative approvals do generate additional costs for normal export transactions in ETC D.

#### **7.5.3.1.2 The procedure for transacting with materials suppliers**

The procedure for transacting with materials’ suppliers is initially found in case A. It shows that “the long-term OEM trademethodion China’s export market, as the current informal institutional constraints, generates additional transactional procedures and related costs for domestic manufacturers” in case A. In this case, such situation is found as well.

Similar to case A, it can be seen that long-term OEM trade method in China’s export market makes domestic manufacturers lose independent supply function. More specifically, the collaborative manufacturers for ETC D fail to offer suitable material

supply due to inadequate market information, specifically information on material supply. From transactional procedure 4 (Enforcing the material supply), it is clear that this ETC takes responsibility for the material purchase to their manufacturers. When I asked the owner if they take care of materials supply to manufacturers, he reply that

*“Yes, we always take the job of purchasing materials; since I started the business.....we are not their [manufacturers’] only customer. They could not specifically set one staff to do that [to find materials] for you..... [Moreover], they could not find the right materials. Sometimes, for convenience, I have asked them to help find some small trimming materials. They either could not find them, or find the wrong ones. For instance, I once asked a manufacturer to help purchase a few white colour ZIPs for the pillows. Then they gave me grey colours, and told me it is the closest colour they could find. I really suspected that they were trying to use cheaper ones rather than the right ones. We met similar situations several times before. So afterwards we never asked them purchase materials..... [More importantly] our materials are usually not in stock, and need specifically ordering from suppliers. So we need to negotiate with the suppliers about the price. The manufacturers would not try to find the cheaper ones for you. So their price is higher.”*

Therefore, the interviews do prove that the manufacturers of ETC D are incapable of finding out suitable materials, in terms of price and sort, for the ETC’s orders, as they get used to the simple manufacturing work under the OEM trade method. More specifically, these manufacturers only take care of production for different buyers, leaving the work of purchasing the materials to these buyers. As a result, they do not seek the information on markets for materials. In other words, these manufacturers will not be able to find the suitable materials (quality and price), when foreign buyers directly send orders to them. In the end, the long-term OEM trading method leads to domestic manufacturers’ lack of information on materials’ supply, and generates additional costs on direct transactions between the domestic manufacturers and foreign buyers.

### **7.5.3.2 The side of foreign buyers**

### **7.5.3.2.1 The procedure of enforcing manufacturers**

As proposed in pilot study A and previous case studies, the enforcement costs will increase due to the inefficient legal system (current formal institutional constraints) and contract obligations (informal institutional constraints). Such an argument is also supported in this case. The main problems are still the domestic manufacturers' opportunistic behaviours, such as quality problems and unpunctual delivery time, which are magnified by the inefficient legal system and weak contractual obligations.

More specifically, procedure 5 (Enforcing the production of manufacturers) obviously shows the enforcement costs that also appear in this ETC's transaction. Moreover, the owner also described one poor case they had met before, which indicates the manufacturers' opportunistic behaviours magnified by inefficient contract obligations.

*“We once used a particular manufacturer. As we found our products were delayed, I went to the manufacturer to check. When we were there without prior notice to them, I found that manufacturer was working on other products, rather than our products. We pushed them stop the production line, and change to our orders. Then we pretended to leave, but come back 30mins later. They had changed back to the previous products. We were very angry with that, and threatened to cancel our order. In the end we sent one staff member to stay in that manufacturer until they had finished our order. And we never worked with that manufacturer again.”*

When I asked him about appealing to legal methods, like arbitration, to protect themselves from losses when their collaborative manufacturers do not finish signed contracts, he replied that the costs and time is too high to do that, and the result might be unfair or unsatisfactory enforcement; therefore his company never did that before. He also stated that he usually appealed for compromising solutions, where the manufacturers only undertake parts of the loss, when such problems happen, and finally he would change to other manufacturers in the next order. Such answers are quite similar to the situation in previous cases, namely the costs of enforcing production are increased by the inefficient legal system.

### *Vertical integration of production*

More importantly, it is found that ETC D also adopts vertical integration of production by establishing one wholly-owned manufacturer in this case. As stated in Case B, the ETC's vertical integration, as one effective method of economizing transaction costs (Demsetz, 1990; Klein et al., 1978; Williamson, 1971, 1979, 1985), shows that the inefficient legal system and contract obligations generate considerable enforcement costs (Fan et al., 2009) conceived by ETC.

Therefore, the interviews with the owner of ETC D pays more attention to the reasons for their decision to newly establish one manufacturer, considering the lower costs and investment of straightforward buy-out products from independent manufacturers. As described by the owner in ETC D, the inefficient legal system and manufacturers' contract obligation is one important concern of ETC D's vertical integration.

*“At that time, our orders began increasing, [the number of collaborative manufacturers was also increased], factories became harder to get to collaborate..... We could not set one (quality control) staff to each factory,.....[moreover] some orders have high quality requirements or strict production schedules. We had met such situations before. The factories could not well collaborate..... So I began to think about opening our [own] factory.”*

In addition, another reason is the inefficient legal system and contract obligations that fail to effectively protect intellectual property in China. The intellectual property protection largely depends on the formal legal system (Oxley, 1999), and supplementing informal institutions, such as tradition (Wang, 2005). However, it has been commonly reported that the formal legal system and informal institutions in transitional economies, such as China, fail to effectively enforce the intellectual property (Meyer, 2001a; Oxley, 1999; Wang, 2005). Moreover, during one practical study, Midler (2010) vividly described many real cases where Chinese manufacturers freely copy intellectual property, such as design of products, without any punishment.

In this case, according to the interviews with the owner, there is one special pillow, called spring pillow, which is only produced in this core owned manufacturer. This

special product is one buyer's exclusive product with relevant patents registered in Europe. Although the intellectual property protection was not the direct reason for establishing this manufacturer, as this product was introduced by this buyer in 2007, the owner expressed that the view that there were oral agreements to avoid producing this product in other manufacturers, as both he and that buyer are worried about other exporters copying this product. Although there are no infringements of intellectual property activities in this case due to ETC D's strict enforcement of agreements with foreign buyers, the costs related to the inefficient legal system and contract obligation, which mainly show as conceived transaction costs, do take place.

Although there are many complex reasons for vertical integration in extant studies (Harrigan, 1984; Hill, 1998, p460-462; Williamson, 1971) and this case, the control of enforcement of production, such as product quality and delivery time, is one important factor behind this ETC's vertical integration decision. According to the description and discussion above, such problems are directly generated by the inefficient legal system and contract obligations in China's export market. In the end, the ETC D's vertical integration into production further supports the argument that the *inefficient legal system and contract obligation* generate considerable enforcement costs for foreign buyers' direct transactions with domestic manufacturers.

**Table 7-24 The summary of institutional constraints and related transaction costs in ETC D.**

Procedure in export transaction	Related institutions	Parts institutional framework in	Evidence in case	Specific transaction costs	How costs are increased
The pre-export and post-export procedures	Bureaucratic procedures and administrative approvals	Former formal institutional constraints	Licences and registration from various government departments to start export businesses	Administrative costs	By generating additional transactional procedures
			Registration and approvals from various government departments for each export transaction		By generating additional transactional procedures
			Changing administrative procedures and policy		By generating uncertainty
			Slow administrative procedures, such as the tax rebating system		By reducing the number of transaction
The procedure of transacting with suppliers	OEM trading method	Current formal institutional constraints	The manufacturers could not find suitable suppliers	Cost of organizing production	By generating additional procedures
The procedure of enforcing manufacturers	Inefficient legal system	Current formal institutional constraints	The aims for vertical integration is to ease quality problems, delivery problems, freely breach of contract, untruthful manufacturers etc., during manufacturing	Cost of enforcing manufacturers	By generating opportunistic behaviour
	Inefficient contract obligations	Informal institutional constraints			

## ***7.5.4 The ETC's methods for reducing institution-related transaction costs***

### **7.5.4.1 The side of domestic manufacturers**

#### **7.5.4.1.1 The pre-export and post-export procedures**

Confirming the statements in previous cases, the findings in this ETC also proved that the ETC's knowledge (experience) of administrative approvals procedures does reduce the costs related to administrative approvals during pre-export and post-export procedures during the export transactions. First, the administrative approvals required for the start-up of an export business are processed by the owner in this case. He admitted that these tasks do need massive knowledge, such as where, how and how often to obtain these approvals each year, which he even did not know when he worked previously in a state-owned trading company, and which he had gradually learnt in recent years after he decided to export on his own account. He also agreed that these procedures often change, especially in recent years. Second, the two TMs and two accountants mainly work on submitting/receiving these official documents to/from many administrative departments during the post-export procedures in this case. These members of staff have export-related educational backgrounds and many years' experience in processing these administrative approvals. The owner also indicates the significance of accountant's experience on tax rebating given the relatively high tax-rebating rate on their products.

In addition, it is interesting note that ETC D used to employ one agent trading company to help them pass the pre-export and post-export procedures, and then began to process these on their own in recent years when their orders increasingly began to grow. This means the economics of scale in the volume of export transactions is one determinant for such a decision.

#### **7.5.4.1.2 The procedure for transacting with suppliers**

As described in 7.5.3.1.2, the OEM trading method results in the manufacturers' inability to supply materials, relying on the ETC's supply in this case. Such a

situation can increase transaction costs for these manufacturers' direct export. In turn, ETC D's *knowledge of materials' supply* largely facilitates the completion of export transactions, and reduces the transaction costs. The purchaser in this ETC has more than 10 years' experience of purchasing in textile manufacturing, and fully understands the raw materials markets and suppliers' information in China. The owner also has the relevant knowledge as well as long term work experience in this industry. The interviews with one purchaser and owner witness such points.

*"I had worked [in this field] for more than 10 years.....I am very familiar with the situation of materials [in China].The Beijing and Tianjin areas [where this ETC located] are different from, and far from the areas of Zhejiang and Jiangsu. They [Beijing, Tianjin] are far from the original sources of the materials [Zhejiang and Jiangsu]. There is no large market for materials [in the areas of Beijing and Tianjin], especially the main materials. So the small manufacturers normally do not know where to find the right materials every time when I show them [our requirements]. Our materials are purchased from the large manufacturers from Zhejiang and Jiangsu. They are the main sources of materials (for clothes) in China. In those places, the materials' producers and processers [dyeing factories] are clustered....."*  
(Purchaser)

*"I often travel to the areas where numerous materials' suppliers are clustered, such as Zhejiang and Jiangsu with the aim of negotiating or enforcing the materials supply, but I would visit some other suppliers, which were introduced by friends, to check the situation [price and quality etc]. So I would contact the new suppliers by telephone the next time.....Don't look down on the wholesale markets. I sometimes go to the wholesale markets nearby to find some materials, they must surprise you.....Our materials are usually not stocked, but specifically ordered. So we need to negotiate with the suppliers about the price. The manufacturers would not do that for you. So the price is higher."* (Owner)

Thus it is concluded that the professional purchaser and owners have amassed a massive amount of knowledge on the supply of materials during their long-term working experience in purchasing, which largely helps ETC D to find the appropriate



materials with relatively lower costs, compared with their collaborative manufacturers.

## **7.5.4.2 The side of foreign buyers**

### **7.5.4.2.1 The procedure for enforcing manufacturers**

As stated in 7.5.3.2.1 in this case, the enforcement of collaborative manufacturers is also influenced by the inefficient legal system and contract obligations. As a result, they jointly increased manufacturers' opportunistic behaviours and buyers' enforcement costs. Correspondingly, the ETC D adopts two methods to solve these enforcement problems. First, ETC D actively obtains the *knowledge on production*, more specifically on *current production conditions, on production processes and products, and manufacturres' characteristics*. Second, ETC D adopts *vertical integration* into production to disperse some of the volume of production and selectively produce some special products. By doing this, ETC D reduces domestic manufacturers' potential opportunistic behaviours, and resulting transaction costs.

As discussed in Case A, the asymmetric information is one major reason for the buyers' difficulty in enforcing domestic manufacturers' production, while the ETC's knowledge of production can ease such problems (Akerlof, 1970; Stiglitz & Weiss, 1981). The same logic is supported by the evidence in ETC D as well. ETC D employs three professional QCs to specifically enforce collaborative manufacturers' production. Transactional procedure 4(Enforcing the production of manufacturers) and one interview from the owner in 7.5.3.2.1 also show that the ETC D closely masters and monitors the manufacturers' production conditions. These QCs have many years' experience in manufacturing, which also helps them, understand and modify the problems during production. In addition, the owner also admits that he tries to capitalize on these collaborative manufacturers' characteristics, including production and entrepreneurs, so that he can give the orders to the "right" manufacturers. Also he gradually filtered out the unreliable ones through trial orders as soon as possible during their regular order. In the end, ETC D is able to reduce the potential problems related to enforcement before the production process. Thus ETC D's acquisition of the *knowledge of current production conditions, on the production*

*process and products, and manufactures' characteristics* considerably reduces the information asymmetry between the domestic manufacturers and themselves, and reduces the enforcement costs.

#### *Vertical integration of production*

As discussed in 7.3.4.2.1 in Case B, the vertical integration of production is one effective method for the ETC to reduce enforcement costs by integrating more vulnerable transactions on the markets into orders inside the organizational hierarchy (Williamson, 1975, 1985). Different from Case B, this case adopts one wholly-owned (Harrigan, 1984) manufacturer as vertical integration. Under such an arrangement, ETC D is able to flexibly to arrange different products among all the manufacturers, including core owned ones and collaborative ones. 1) It can arrange all production of spring pillows in the core owned manufacturer, in order to effectively protect intellectual property rights. 2) It can arrange the production of the whole or parts of high-quality and/or complicated products in this core owned manufacturer, to achieve better quality control. 3) It can arrange production with relatively strict delivery times in this core owned manufacturer. Then the rest of the relatively simple products or parts of products can be arranged with other collaborative manufacturers, certainly also according to the characteristics of the products and their production capability.

These three kinds of situations are most likely to be influenced by two institutional constraints during this procedure: the inefficient legal system and contract obligations that therefore generate higher enforcing costs on manufacturers. The intellectual property protection is commonly seen to be vulnerable within a weak legal system (Oxley, 1999) and informal traditions (Wang, 2005). The products in the second situation require the buyers to invest more in the quality control system. The products and export transactions in the third situation incurred higher costs due to the potential risk and uncertainties and require more collaboration from the manufacturers. By integrating one owned manufacturer within its company, ETC D can easily change its production arrangements among core and collaborative manufacturers and speedily with a resulting reduction in enforcing costs related to these two institutional constraints during these three sorts of situation.

**Table 7-25 The summary of ETC D's methods and advantage in export transaction.**

Procedure in export transaction	Institutional constraints	ETC's methods	Evidence in the case	How to reduce costs
The pre-export and post-export procedures	Bureaucratic procedures and administrative approvals	Knowledge on administrative approval procedures	Staff educational background and work-based training in administrative procedures	Advantages of economics of scale
			Staff experience of such administrative procedures	
			Regular routines for such administrative procedures during daily work in the ETC	
The procedure of transacting with suppliers	OEM trading method	Knowledge of materials' supply	Professional purchasers and owner with long-term experience of purchasing	Advantages of economics of scale
			On-site visits to the suppliers and public markets	
			Regular contact with distantly located suppliers	
The procedure of enforcing manufacturers	Inefficient legal system & unique contract obligations	Knowledge of current production conditions	Obtaining updated information on production at any time in the whole production period	By reducing the information asymmetry
			Close monitoring in the manufacturer	
		Knowledge of production process and products	Main staff knowledge and experience in production	
			Knowledge on manufactures' characteristics.	
		Integration of production		Eliminating any unreliable manufacturers
			Producing products with high intellectual property requirements in their own manufacturer site	By reducing the opportunistic behaviours
			Producing products with high-quality or complicated production in their own manufacturer site	
Producing products with relatively strict delivery times in their own manufacturer site				

## 7.6 Case E analysis

### 7.6.1 The background information on ETC E

Lueyuan Imp&Exp Co., Ltd is the fifth case ETC. It is a private ETC in Qingdao, the capital city of Shandong Province. It was founded in 2000. Its main products are tableware, such as knives and forks. Its total export amount was \$ 7,000,000 in 2010. It has global buyers of various characters, from middlemen to superstores. Therefore, their preferences of all buyers are different, in terms of quality, amount, and types.

This ETC has three major long-term domestic manufacturers, which have 100-300 workers and are located in several rural regions in Shandong Province. These manufacturers also have other ETCs to help them to export. They are different from each other in terms of preferred products style, delivery time, management style, productivity etc. Thus this ETC gives them orders according to their different characteristics and different requirements from the buyers.

In addition, this ETC also has several suppliers for packaging materials, as manufacturers do not offer such service. The styles of packaging of products are different and generally from the foreign buyers' requirements. This ETC takes the job of searching, purchasing and enforcing production of packaging materials, and then sending to collaborative domestic manufacturers.

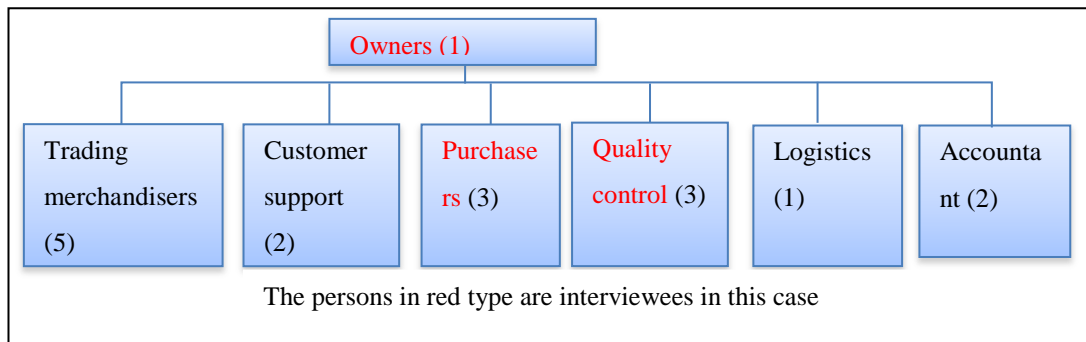
**Table 7-26 Summary of background of ETC E.**

<b>Name</b>	Lueyuan Imp&Exp Co., Ltd	
<b>Location</b>	Qingdao	
<b>Ownership</b>	Private	
<b>Size(Personnel)</b>	17	
<b>Establishment</b>	2000	
<b>Product</b>	Tableware	
<b>Foreign markets</b>	Worldwide	
<b>Per for ma nce</b>	<b>Amount</b>	\$7,000,000 (2010)
	<b>Per capital</b>	\$411,746 (2010)
	<b>Margin</b>	12% (2010)

**Table 7-27 Summary of staffs in ETC E.**

Title (number of person)	Main description
Owner (1)	This owner holds the most important position in this ETC. She generally manages and coordinates the whole export process in the ETC. As the manufacturers (three main) and foreign buyers (five main, and more than 50 in total) were stable in recent years, her responsibilities mainly focus on the maintenance of these manufacturers and foreign buyers, such as negotiating with them in terms of price, style and amount.
Trading merchandisers (TMs) (5)	TMs are divided into two groups. Two of them generally take responsibility for all exporting documentation, such as drawing up exporting contracts and other documents for export. In particular, they also take part of the work of submitting/receiving official approvals from government departments, including the local Administration of Industries and Commerce and Bureau of Quality and Technical Supervision. These two TMs have relevant experience and educational background in exporting. The second group, three TMs, takes the job of transacting with collaborative domestic manufacturers, including sending orders, producing purchasing contracts and so on.
Purchasers (3)	Purchasers mainly take the job of searching, purchasing and enforcing production of packaging materials, and then sending to collaborative domestic manufacturers. The styles of packaging are different and generally from the foreign buyers' requirements. But they also undertake simple designs for some orders. These purchasers have many years' experience one in the domestic manufacturers and markets for these packaging materials.
Quality control (QCs) (3)	QCs specifically take charge of the collaborative manufacturers' production, in terms of quality, lead-in time, amount, etc. One manager of QCs has more than 8 years' relevant experience in QC.
Customer support (2)	They take the job of communicating with foreign buyers, such as receiving orders, products enquiries and so on
Logistics (1)	He mainly works to process all shipments of products, with the assistance of many external forwarders.
Accountant(2)	She has 10 years' experience in corporate finance, especially in exporting companies. Amongst her main tasks are the completion of the tax rebate procedures, approvals of foreign exchange and receipt of payment from foreign buyers.

**Figure 7-9 Organizational structure of ETC E.**



In this case, I took three face-to-face interviews and one on-line conversation, including two with the owner, one with the purchaser and one with the manager of QCs, between 2010 and 2012. The owner offered most of the information about the company, manufacturers, suppliers, buyers and general export process, while the manager introduced the details of monitoring production. The owner is the key person in this company, and fully understands the whole information and export process.

### 7.6.2 Export transaction process

The general export transaction process, operated by ETC E, is illustrated step by step in order to identify those areas where the institutional constraints and related transaction cause further costs (shown in Table 7-28 and 7-29). In general, the transaction process in this ETC was quite similar to the Case A with the difference that ETC offered manufacturers the supply of packaging materials rather than production materials. The owner provided the general flow of export transaction in this ETC. Then the details of each step were obtained and/or checked by relevant interviewees.

**Table 7-28 Summary of transactional procedures of ETC E.**

1	Sample making
2	Negotiations
3	Enforcing the production of manufacturers
4	Transacting with packaging materials suppliers
5	Processing relevant documents
6	Receiving payment from foreign buyers
7	Tax rebating

**Table 7-29 Details of transactional procedures of ETC E.**

1	Sample making
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After receiving foreign buyers' orders, which normally contain a series of technical requirements, this ETC transfers them to one collaborative manufacturer to produce a sample. Then they are sent by logistics to foreign buyers for suggestions and potential modifications. In addition, the sample is also made for promotional purposes (called promotion modes) in trade shows, the B2B website or other marketing activities.
2 Negotiations
The ETC negotiates with foreign buyers, domestic manufacturers and suppliers, in terms of price, quantity, lead-in time, payment terms etc. This process is cyclical and dynamic, mainly including buyers' inquiries to the ETC and the ETC's inquiry to potential manufacturers and suppliers. In this procedure, the ETC has to choose one or several of the most suitable manufacturers for certain orders depending on this order's quantity, quality, style, lead-in time, etc. Due to the long-standing collaboration with current manufacturers, this ETC fully understands their situation, and easily allocates the orders to one or several of them.
3 Transacting with packaging materials suppliers
Three purchasers took charge of the supply of packaging materials. Due to many years' experience in this work, they have many reliable manufacturers, with which they have much collaborative experience. In addition, they also master the information on the markets. As the packages are different from each other, they often need to find other manufacturers on the markets. In particular, they also undertake simple designs for the package in some cases. Finally they have to enforce these manufacturers' production by monitoring products quality and delivery time.
4 Enforcing the production of manufacturers
The QCs work on enforcing manufacturers' production. The QCs' experience and knowledge largely facilitate this procedure. Similar to Case A, ETC E also has a regular schedule for checking the production. During some peak time, some other staff, such as the owner, will participate in this process, as the involvement of more collaborative manufacturers. In addition, the owner also emphasized that this part is the most important one in whole transaction.
5 Processing relevant documents
This procedure is jointly finished by TMs, accountants and logistics member of staff. While the TMs process most exporting documents, the accountants complete the foreign exchange claim, and tax rebating task, the logistics staff process the shipment documents.
6 Receiving payment from foreign buyers
The payment methods, such as a letter of credit, are different according to the terms. Accountants will take charge of receiving payment from foreign buyers after shipping the products and sending the documents. It needs to go through the bank, local foreign exchange branches, and customs. This procedure usually takes one-month (mainly waiting for the receipt from customs) to finally receive these payments, as the payment and receipt of foreign exchanges are strictly monitored by the government.
7 Tax rebating
After completing the whole transaction and obtaining all official documents, the accountant will apply for the tax rebate from the local taxation office. The tax rebating rate is 9% for the products in this ETC. This application normally takes 3 months. This procedure is important for the ETC's capital flow and profits.

### ***7.6.3 The institutional constraints and related transaction costs***

As in previous cases, this section aims to explore new and test known institutional constraints. The known institutional constraints on China's export market, found in

previous cases are checked first, while additional attention is also paid to the emerging institutional constraints on export markets, which appear during the export transaction in this case.

### **7.6.3.1 The side of domestic manufacturers**

#### **7.6.3.1.1 The pre-export and post-export procedures**

Initially, it appears that the administrative approvals were required during pre-export and post-export procedures in this case. Therefore the proposed argument in pilot study A, that the *bureaucratic procedures and administrative approvals* are mainly *former formal institutional constraints* and generate additional transactional procedures and costs for normal export transactions in China, is supported.

The owner of ETC E revealed that there were a series of applications, registrations and approvals with many government departments for the start-up of his export business. This ETC also had a similar experience as ETC C, where ETC had to use one state-owned trading company's title to operate export transaction to bypass these approvals in its start-up period. Such evidence witnessed the existence of these administrative approvals during pre-export in this case. He further admitted that his company found some administrative approvals to be complex, time-consuming and changing, such as export rebating. So he had to employ additional specific staffs to deal with these procedures and approvals. Moreover, the export transactional procedure 5 (Processing relevant documents), 6 (Receiving the payment from foreign buyers) and 7 (Tax rebating) showed that the administrative approvals during post-export also existed in this ETC and were jointly finished by many different staffs. Therefore, the bureaucratic procedures and administrative approvals did generate additional costs for normal export transactions in ETC E.

#### **7.6.3.1.2 The procedure for transacting with packaging materials suppliers**

The procedure for transacting with materials' suppliers was initially found in case A and then confirmed in Case D. It showed that the long-term OEM trading method in China's export market, as the current informal institutional constraints, generated



additional transactional procedures and related costs for domestic manufacturers in Case A and D. In this case, such situation was found in procedure 3 (Transacting with packaging materials suppliers).

Similar to case A and D, it was found that long-term OEM trade method in China's export market made domestic manufacturers lose independent supply function in case E. More specifically, the collaborative manufacturers for ETC D failed to offer suitable supply of packaging materials due to inadequate market information. From transactional procedure 3 (Transacting with packaging materials suppliers), it was clear that this ETC took the responsibility of packaging materials purchase to their manufacturers. The interview with the owner also supported that. When I asked the owner if and why they took care of this work, he replied that

*“they [manufacturers] didn't do that [packaging materials purchase]. They didn't know how to do that. They didn't have that sort of staffs, who could do this work...I am afraid of the quality of these packaging material. They would not give us the right things if we ask them to do that part.....So we purchased these things on our own, and then give our manufacturers”*

As a result, the data do demonstrate that the manufacturers of ETC E were incapable of seeking suitable packaging materials for the ETC's orders, as they got used to the simple manufacturing work under the OEM trade method. More specifically, these manufacturers only took care of production for different buyers, leaving the work of purchasing the packaging materials to these buyers. Thus, they did not master the information on packaging materials purchase. In other words, these manufacturers would not be able to find the suitable materials (quality), when foreign buyers directly sent orders to them. In the end, the long-term OEM trading method led to domestic manufacturers' lack of packaging materials purchase, and generated additional costs on direct transactions between the domestic manufacturers and foreign buyers.

### **7.6.3.2 The side of foreign buyers**

#### **7.6.3.2.1 The procedure of enforcing manufacturers**

In previous case studies, it was proposed that enforcement costs would increase due to the *inefficient legal system (current formal institutional constraints) and unique contract obligation (informal institutional constraints)* on China's export market. The data of this case considerably prove this proposition as well. First, procedure 5 (Enforcing the production of manufacturers) obviously showed the enforcement costs that also appear in this ETC's transaction. Then, the discussion with the owner and quality control manager also reflected their concerns on potential risks on manufacturers' opportunistic behaviours in production, such as uncertain product quality and delivery time. In addition, one solution of this ETC also witnessed such concern. The owner mentioned that they regularly took trainings on production for these manufacturers' staffs to enhance their capabilities and skills to stabilize product quality.

**Table 7-30 The summary of institutional constraints and related transaction costs in ETC E.**

Procedure in export transaction	Related institutions	Parts in institutional framework	Evidence in case	Specific transaction costs	How costs are increased
<b>The pre-export and post-export procedures</b>	Bureaucratic procedures and administrative approvals	Former formal institutional constraints	Licences and registration from various government departments to start export business	Administrative costs	By generating additional transactional procedures
			Registration and approvals from various government departments for each export transaction		By generating additional transactional procedures
			Changing administrative procedures and policy		By generating uncertainty
			Slow administrative procedures, such as tax rebating system		By reducing the number of transaction
<b>The procedure for transacting packaging materials suppliers</b>	OEM trading methods	Current formal institutional constraints	The manufacturers could not find suitable suppliers	Cost of organizing production	By generating additional procedures
<b>The procedure for enforcing manufacturers</b>	Inefficient legal system	Current formal institutional constraints	The quality problems, delivery problems, freely breaking contracts, untruthful manufacturers etc., during manufacturing	Cost of enforcing manufacturers	By generating opportunistic behaviour
	Inefficient contract obligations	Informal institutional constraints			

## ***7.6.4 The ETC's methods for reducing institution-related transaction costs***

### **7.6.4.1 The side of domestic manufacturers**

#### **7.6.4.1.1 The pre-export and post-export procedures**

The findings from ETC E also proved the statements confirmed by previous cases that the ETC's knowledge (experience) of administrative approvals procedures did reduce the costs related to administrative approvals during pre-export and post-export procedures during the export transactions.

First, the owner of this ETC believed that he had gradually learnt this kind of knowledge when he worked previously in a state-owned trading company. He also added that he and his staffs in current ETCs had to keep leaning this sort of knowledge during daily practice as these procedures often change. Then the data of export process of this ETC in 7.6.2 showed that TMs and accountant mainly worked on submitting/receiving these official documents to/from many administrative departments during the post-export procedures in this case. These members of staff had export-related educational backgrounds and many years' experience in processing these administrative approvals. The interviews from the owner showed that this type of experience became one important requirement for recruitment of these positions in this ETC.

#### **7.6.4.1.2 The procedure for transacting with suppliers**

The discussion in 7.6.3.1.2 indicated that OEM trading method brought about domestic manufactures' incompetence in supplying packaging materials, relying on the ETC's supply in this case. Thus the proposition, that long-term OEM trading methods raise transaction costs of manufacturers' direct export, was proven. Correspondingly, the ETC in this case proved that its knowledge of packaging materials supply helped to successfully process the export transactions and reduced this sort of institution-related transaction costs. From background information on ETC E, it was found that three purchasers, who took charge of this part of work in ETC E, had long-standing experience on packaging materials purchase. The owner

also expressed that this sort of experience became one important requirement for recruitment of these positions. Moreover, he further indicated that the quality, style and delivery time of packaging materials purchased by them became more reliable than manufacturers.

Thus it was concluded that the professional purchasers had amassed a massive amount of knowledge on the supply of packaging materials during their long-term working experience in purchasing, which helped ETC E to find the appropriate materials with accepted quality, style and delivery time, compared with their collaborative manufacturers.

#### **7.6.4.2 The side of foreign buyers**

##### **7.6.4.2.1 The procedure for enforcing manufacturers**

As stated in 7.6.3.2.1 in this case, the enforcement of collaborative manufacturers was also influenced by the inefficient legal system and contract obligations. Thus, these institutional constraints jointly increased manufacturers' opportunistic behaviours and enforcement costs of export transaction. In turn, the data from interview showed that this ETC actively obtained the *knowledge on production*, more specifically on *current production conditions, on production processes and products, and manufacturer's characteristics*. As a result, ETC E weakened domestic manufacturers' potential opportunistic behaviours, and resulting transaction costs.

As discussed in previous cases, the asymmetric information was one major reason for the buyers' difficulty in enforcing domestic manufacturers' production, while the ETC's knowledge of production could ease such problems (Akerlof, 1970; Stiglitz & Weiss, 1981). The same logic was supported by the evidence in this case. The background information showed that ETC E employed three professional quality controls (QCs) to specifically enforce collaborative manufacturers' production. Then, transactional procedure 3 (Enforcing the production of manufacturers) demonstrated that the ETC E closely mastered and monitored the manufacturers' production conditions. These QCs had many years' experience in manufacturing, which also helped them understand and modify the problems during production. In addition, the

interview with owner reflected that he tended to master manufacturers', especially new ones', characteristics, including production and entrepreneurs. So that he was able to reasonably arrange orders to the "right" manufacturers and gradually filtered out the unreliable ones through trial orders. As a result, the current collaborative manufacturers became the long-term ones. Correspondingly, ETC E could reduce the potential problems related to enforcement before the production process. Thus ETC E's acquisition of the knowledge of current production conditions, on the *production process and products, and manufactures' characteristics* remarkably helped to reduce the information asymmetry between the domestic manufacturers and themselves, and reduces the enforcement costs.

**Table 7-31 The summary of ETC E's methods and advantage in export transaction.**

Procedure in export transaction	Institutional constraints	ETC's method/resource/knowledge ?	Evidence in the case	How to reduce costs
<b>The pre-export and post-export procedures</b>	Bureaucratic procedures and administrative approvals	Knowledge of administrative approval procedures	Staff educational background and work training on administrative procedures	Advantages of economics of scale
			Staff experience in such administrative procedures	
			Regular routines for such administrative procedures during daily work in the ETC	
<b>The procedure for transacting with suppliers</b>	OEM trading method	Knowledge on packaging supply	Professional purchasers with long-term experience on purchases	Advantages of economics of scale
			On-site visits to the suppliers and public markets	
			regular contact with remote suppliers	
<b>The procedure for enforcing manufacturers</b>	Inefficient legal system & unique contract obligation	Knowledge of current production conditions	Obtaining updated information on production at any point during the whole production period	Reducing information asymmetry
		Knowledge of the production process and products	Close monitoring in the factory	
		Knowledge of manufactures' characteristics.	Main staff knowledge and experience in production	
			Matching suitable collaborative manufacturers with the order, according to their productive capability before the delivery of order	
			Eliminating the unreliable manufacturers	

## 7.7 Case F analysis

### 7.7.1 The background information on ETC E

The sixth ETC is Aomeite Export company, another private ETC with 17 staffs in Qingdao (details of ETC F is shown in table 7-32 and 7-33). It exports wooden furniture, such as tables and chairs, to three regions: US, Spain and Australia. The foreign buyers of this ETC show various preferences, such as quality and amount, on the purchases of products in China.

The owner of this ETC used to work in another private ETC, which had long-term exporting business with IKEA, the Swedish furniture retailer. Therefore, this working experience helped the owner to master basic skills on export and particularly to establish the connections with several domestic manufacturers and foreign buyers. With these, he founded Aomeite in 2007.

This ETC has three main domestic manufacturers with long-standing collaboration, which have 300-400 workers and are located in surrounding regions of Qingdao. They also work for many other trading companies. These manufacturers own different product styles, productivities, and management styles, with which this ETC can allocate them with different product orders. Moreover, this ETC also has many external manufacturers, which mostly work as backup for inadequate production of main manufacturers and special products.

**Table 7-32 Summary of background of ETC F.**

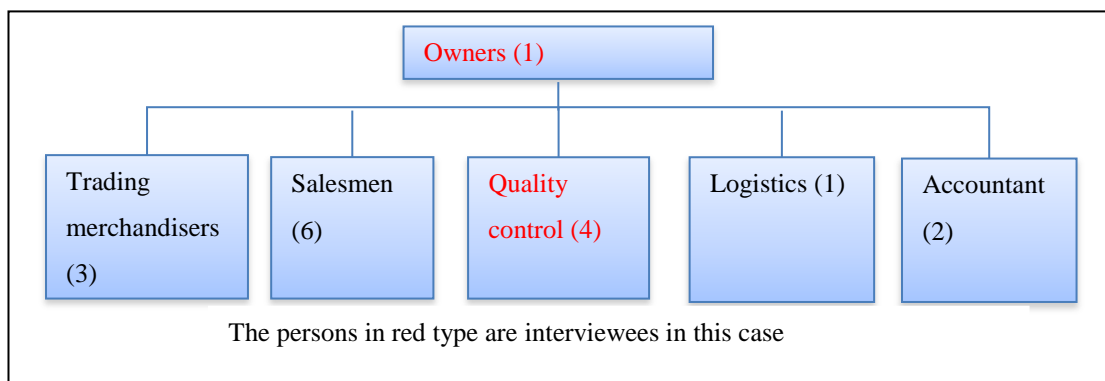
<b>Name</b>	Aomeite Exp Co., Ltd	
<b>Location</b>	Qingdao	
<b>Ownership</b>	Private	
<b>Size(Personnel)</b>	17	
<b>Establishment</b>	2007	
<b>Product</b>	Wooden furniture	
<b>Foreign markets</b>	US (60%), Spain (30%) and Australia (10%)	
<b>Per forma nce</b>	<b>Amount</b>	NA
	<b>Per capital</b>	NA
	<b>Margin</b>	NA

**Table 7-33 Summary of staffs in ETC F.**



Title (number of persons)	Main description
Owner (1)	This owner holds the most important position in this ETC. He generally managed and coordinated the whole export process in ETC. He used to work as a TM in domestic manufacturers, which is an OME manufacturer for IKEA. Then he opened this ETC in 2007.
Salesmen (6)	Salesmen generally taking responsibility for searching for new orders from new and existing buyers. All salesmen have relevant experience and educational backgrounds in export.
Trading merchandisers (TMs) (3)	TMs generally taking responsibility for exporting documentation, such as making exporting contracts and other documents for export. In particular, they also take parts of the work for submitting/receiving official approvals from government departments, including the local Administration of Industries and Commerce and Bureau of Quality and Technical Supervision. All TMs have relevant experience and educational backgrounds in exporting.
Quality control (QCs) (4)	QCs specifically take charge of core and collaborative manufacturers' production, in terms of quality, lead-in time, amount, etc. Three QCs used to work in manufacturing, QCs'-related work in ETCs.
Logistics (1)	He mainly works to process all shipments of products, with the assistance of many external forwarders.
Accountant (2)	They mainly process the ETC's corporate accounting, and also complete the tax rebating procedures, approvals of foreign exchange and receiving payment from foreign buyers in this ETC. Both of them have many years' experience in exporting companies' corporate accounting.

**Figure 7-10 Organizational structure of ETC F.**



In this case, three face-to-face interviews and one on-line conversation had been done, including three with the owner, one with the manager of QCs, between 2010 and 2012. The owner offered most of the information about the company, manufacturers, suppliers, buyers and general export process, while the manager introduced the details of monitoring production. The owner is key person in this company, and fully understands the whole information and export process.

### ***7.7.2 Export transaction process***

The general export transaction process of ETC F is illustrated step by step in order to identify those areas where the institutional constraints and related transaction cause further costs (shown in Table 7-34 and 7-35). In general, the transaction process in this ETC is quite similar to the Case A without the procedure of “Transacting with materials suppliers”. The owner provided the general flow of export transaction in this ETC. Then the details of each step were obtained and/or checked from relevant interviewees.

**Table 7-34 Summary of transactional procedures of ETC F.**

1	Sample making
2	Negotiations
3	Enforcing the production of manufacturers
4	Processing relevant documents
5	Receiving payment from foreign buyers
6	Tax rebating

**Table 7-35 Details of transactional procedures of ETC F.**

1	Sample making and searching for buyers
	The salesmen search for new orders from new and existing foreign buyers. According to these orders, which normally contain a series of technical requirements, a sample is made by collaborative manufacturers or other external ones. Then they are sent by logistics to foreign buyers for suggestions and potential modifications. In addition, the sample is also made for promotional purposes (called promotion modes) in trade shows, the B2B website or other marketing activities.
2	Negotiations
	At the same time, the ETC negotiates with buyers and manufacturers, in terms of price, quantity, lead-in time, payment terms etc. In this procedure, the ETC has to choose one or several of the most suitable manufacturers according to this order’s quantity, quality, style, lead-in time, etc. Similar to case A, price is not the most important consideration for this ETC, as some manufacturers and suppliers could also give the competitive price, but without any guarantee. Thus the manufacturers, with whom this ETC has had collaborative experience, are the most trustworthy. By confirmation from the owner of ETC F, they did have an understanding of which manufacturers would able to finish this task when they knew the order’s requirements, according to their previous collaborative experience with these companies. The key factors are the manufacturers’ production schedule, availability of material, and so on.
3	Enforcing the production of manufacturers
	The QCs work on enforcing manufacturers’ production, including their own core manufacturer. The QCs’ experience and knowledge largely facilitate this procedure. Similar to Case A, ETC F also has a regular schedule for checking the production. During some peak times, all staff will participate in this process, as the involvement of more collaborative manufacturers occurs.
5	Processing relevant documents
	This procedure is jointly finished by TMs, accountants and logistics member of staff. While the TMs process most exporting documents, the accountants complete the foreign exchange claim, and tax rebating task, the logistics staff process the shipment documents.

6 Receiving the payment from foreign buyers
The payment methods, such as a letter of credit, are different according to the terms. Accountants will take charge of receiving payment from foreign buyers after shipping the products and sending the documents. It needs to go through the bank, local foreign exchange branches, and customs. This procedure usually takes one-month (mainly waiting for the receipt from customs) to finally receive these payments, as the payment and receipt of foreign exchanges are strictly monitored by the government.
7 Tax rebating
After completing the whole transaction and obtaining all official documents, the accountant will apply for the tax rebate from the local taxation office. The tax rebating rate is 14% for the products in this ETC. This application normally takes 3 months. This procedure is important for the ETC's capital flow and profits.

### ***7.7.3 The institutional constraints and related transaction costs***

This section aims to explore new and test known institutional constraints. The known institutional constraints on China's export market, found in previous cases are checked at first, while additional attention is also paid to the emerging institutional constraints on export markets, which appear during the export transaction in this case.

#### **7.7.3.1 The side of domestic manufacturers**

##### **7.7.3.1.1 The pre-export and post-export procedures**

First of all, the proposed argument in pilot study A, that “the *bureaucratic procedures and administrative approvals* are mainly former formal institutional constraints, which generates additional transactional procedures and costs for normal export transactions in China”, was supported.

The owner of ETC E revealed that some administrative approvals, such as the tax rebating system, were complex, time-consuming and changing, and created problems in their daily business. He also admitted he had to obtain a series of applications, registrations and approvals with many government departments for the start-up of his export business, which supported the existence of these administrative approvals during pre-export in this case. According to the background information, ETC F did employ specific staffs, three TMs and two accountants, to deal with these procedures and approvals. Export transactional procedure 5 (Processing relevant documents), 6 (Receiving the payment from foreign buyers) and 7 (Tax rebating) became the

evidence of existence of these administrative approvals during post-export in this ETC. Therefore, the bureaucratic procedures and administrative approvals did generate additional costs for normal export transactions in case E.

### **7.7.3.2 The side of foreign buyers**

#### **7.7.3.2.1 The procedure of enforcing manufacturers**

This case also proved the proposition generated from previous cases, that *inefficient legal system (current formal institutional constraints) and unique contract obligation (informal institutional constraints)* increase enforcement costs of export transactions in China. Apparently, procedure 3 (Enforcing the production of manufacturers) in 7.7.2 was the evidence of existence of additional enforcement costs in this ETC's transaction. Then, the interviews with the owner and quality control manager also witnessed their worries on potential risks on manufacturers' opportunistic behaviours in production, such as uncertain product quality and delivery time. In addition, they also expressed that one main reason why they kept many external manufacturers as backup was due to such worries.

**Table 7-36 The summary of institutional constraints and related transaction costs in ETC F.**

Procedure in export transaction	Related institutions	Parts institutional framework	Evidence in case	Specific transaction costs	How costs are increased
<b>The pre-export and post-export procedures</b>	Bureaucratic procedures and administrative approvals	Former formal institutional constraints	Licences and registration from various government departments to start export business	Administrative costs	By generating additional transactional procedures
			Registration and approvals from various government departments for each export transaction		By generating additional transactional procedures
			Changing administrative procedures and policy		By generating uncertainty
			Slow administrative procedures, such as tax rebating system		By reducing the number of transactions
<b>The procedure for enforcing manufacturers</b>	Inefficient legal system	Current formal institutional constraints	Quality problems, delivery problems, freely breaking contracts, untruthful manufacturers etc., during manufacturing	Cost of enforcing manufacturers	By generating opportunistic behaviour
	Inefficient contract obligations	Informal institutional constraints			

## ***7.7.4 The ETC's methods for reducing institution-related transaction costs***

### **7.7.4.1 The side of domestic manufacturers**

#### **7.7.4.1.1 The pre-export and post-export procedures**

In previous case studies, it was proposed that the ETC's knowledge (experience) of administrative approval procedures did reduce the costs related to administrative approvals during pre-export and post-export procedures during the export transactions. The data of this case considerably proved this proposition as well.

The owner of this ETC revealed that these administrative approvals were difficult to process for the companies without related knowledge, which only professional and experienced staffs could deal with efficiently. He also admitted that they also kept learning certain new procedures due to governments' regular changes on policies. Moreover, export transactional procedure 5 (Processing relevant documents), 6 (Receiving the payment from foreign buyers) and 7 (Tax rebating) indicated that TMs and accountants jointly dealt with post-export procedures in this case. The interviews with the owner reflected that experience turn out be these staffs' most important character.

### **7.7.4.2 The side of foreign buyers**

#### **7.7.4.2.1 The procedure for enforcing manufacturers**

In section 7.7.3.2.1, it was found in this case that the inefficient legal system and contract obligations increased difficulty and costs of enforcing collaborative manufacturers, which became more opportunistic. In previous case studies, it was proposed that ETC's knowledge on production, more specifically on *current production conditions, on production processes and products, and manufacturers' characteristics*, was an effective solution to reduce enforcement cost by mediating manufacturers' opportunistic behaviours. This proposition was also supported by this case.

Previous case study had suggested that asymmetric information was a major reason for the buyers' difficulty in enforcing domestic manufacturers' production, while the ETC's knowledge of production could ease such problems (Akerlof, 1970; Stiglitz & Weiss, 1981). Such proposition was supported by the evidence in ETC F. First, four experienced quality control were employed to specifically enforce collaborative manufacturers' production in this case. Then these professional staffs and owner together participated in transactional procedure 3 (Enforcing the production of manufacturers). In addition, the interview with owner and manager of quality control teams showed that they actively collected the information on collaborative manufacturers' characteristics, including production and entrepreneurs, so that they could enforce transactions more efficiently. For instance, with the information on production, the owner introduced, they could reasonably arrange production orders to the "right" manufacturers. He also agreed that he often filtered out some "wrong" manufacturers when their production characteristics failed to match requirements of foreign orders. So that he could reduce the potential problems related to enforcement before the production. All these data supported the proposition generated in previous cases that ETC's acquisition of the knowledge of current production conditions, on the production process and products, and manufactures' characteristics considerably reduces the information asymmetry between the domestic manufacturers and themselves, and reduces the enforcement costs.

**Table 7-37 The summary of ETC F's methods and advantage in export transaction.**

Procedure in export transaction	Institutional constraints	ETC's method/resource/knowledge ?	Evidence in the case	How to reduce costs
The pre-export and post-export procedures	Bureaucratic procedures and administrative approvals	Knowledge of administrative approval procedures	Staff educational background and work training on administrative procedures	Advantages of economics of scale
			Staff experience in such administrative procedures	
			Regular routines for such administrative procedures during daily work in the ETC	
The procedure for enforcing manufacturers	Inefficient legal system & unique contract obligation	Knowledge of current production conditions	Obtaining updated information on production at any point during the whole production period	Reducing information asymmetry
		Knowledge of the production process and products	Close monitoring in the factory	
		Knowledge of manufactures' characteristics.	Main staff knowledge and experience in production	
			Matching suitable collaborative manufacturers with the order, according to their production capability before the delivery of order Eliminating the unreliable manufacturers	



## 7.6 Chapter Summary

Applying the proposed analytical framework for the main field work, this chapter displays and analyses four cases. It initially describes characteristics of each Chinese ETC and their business practice, by illustrating their company profiles, export transaction process, trading partners, and relevant industrial and institutional background. Following transactional sequence from domestic manufacturers to foreign buyers, institutions and related transaction costs on China's export markets are explored and analysed. Then, ETC's methods, by which they are able to effectively and efficiently reduce these institution-related costs, are presented and discussed. In the end, three proposed and one emergent institutional constraint in China's export markets, including the bureaucratic procedures and administrative approvals, inefficient legal system and informal contract obligation, and long-term OEM trading methods are tested and explored. In addition, it reveals that Chinese ETCs can reduce these institution-related transaction costs by a series of effective methods, such as acquirement of knowledge on administrative procedures, collection of information on production, vertical integration, and offering supplementary functions for dysfunctional domestic manufacturers.

## **Chapter 8 Cross- case analysis**

### **8.1 Introduction**

As stated in the methodology chapter, the cross-case analysis aims to enhance generalizability, and deepen understanding and explanation, through illustrating the same/similar patterns that repeatedly appear (Eisenhardt, 1989) across different cases (Miles & Huberman, 1999). Therefore, this chapter emphasizes that those patterns repeatedly appear across six cases following the integrative framework generated in chapter 3, namely the institutional constraints (including how they raise related transaction costs) in China's export markets, and the main methods by which Chinese ETCs reduce these institution-related transaction costs. By doing these, this chapter answers two research questions generated in chapter 2. Correspondingly, section 11.2 illustrates four different institutional constraints (including how they raise related transaction costs), and the Chinese ETCs' various corresponding solutions, which are found across six cases. Thirteen propositions are also generated as follow. Then section 11.3 further discusses the logic of how such methods help Chinese ETCs' to prevail in the competition to reduce transaction costs.

### **8.2 Institutional constraints and ETCs' methods in China's export market**

Following previous theoretical framework of this research in chapter 3 and findings in pilot study of chapter 6, this section concludes four significant institutional constraints across six cases, which generate different transaction costs by influencing transactional frequency, uncertainty and opportunism, and therefore increase difficulties for direct transactions between domestic manufacturers and foreign buyers. These institutional constraints include *bureaucratic procedures and administrative approvals (former formal institutional constraints); an inefficient legal system (current formal institutional constraints); inefficient informal contract obligation (informal institutional constraints); and long-term OEM trading methods (current formal institutional constraints)*. Correspondingly, this section also illustrates various methods adopted by Chinese ETCs to effectively solve these institution-related problems and transaction costs.

### ***8.2.1 Bureaucratic procedures and administrative approvals***

During pilot study A (1<sup>st</sup> part), the *bureaucratic procedures and administrative approvals* were initially highlighted as the formal institutional constraints in China's export market from practitioners' interviews and secondary data. Then they were confirmed and proved as the most commonly reported institutional constraint, supported by all cases (Case A to F). Table 8-1 and Figure 8-1 show one summary of such situation in all cases. The specific evidence across cases refers to pre-/post-export transactional procedures. The former one means a series of administrative procedures for applications for export authority and various business licences and registrations, which are compulsory for domestic exporters to start-up export businesses. In post-export transactional procedures, these domestic exporters have to submit/receive a series of official approvals and registrations to/from many different government departments for each of their export transactions. Therefore, this institutional constraint increases additional procedures, namely pre-/post-export transactional procedures within cases, beyond normal export transactions, where domestic exporters and foreign buyers only need to complete the buying-selling round.

The discussion on theoretical framework of this research in chapter 3 and pilot study jointly show that unstable government policies and bureaucratic administrative procedures are able to reduce transactional *frequency* and increase *uncertainty*, and therefore increase transaction costs in transition economies. Administrative barriers are mentioned as obstruction of businesses in transitional economies by many studies. For instance, there are lengthy timescales and massive procedures for starting up businesses. They generate time costs and reduce efficiency of transactions (Meyer, 2001a). More importantly, they also significantly increase *uncertainty*, as these bureaucratic procedures are unstable, non-transparent and unpredictable (Meyer et al., 2005; Puffer & McCarthy, 2001).

The findings across six cases echo such argument in this study. As stated in chapter 7 within case analysis, these bureaucratic procedures and administrative approvals are

complex, time-consuming and continuously changing for domestic exporters, and therefore increase transaction costs for export transactions in China. These procedures cost exporters' resources (mainly human resources), cost time for domestic exporters, and reduce the *frequency* of export transactions. For example, the tax rebating procedure in China bears witness to how long only one of these bureaucratic procedures can take. Moreover, the continuous changes, sometimes called reform by the government, of these bureaucratic procedures and administrative approvals further confuse these domestic exporters with new procedures, generating *uncertainty* and potentially failed possibilities for export transactions.

Existing studies on trading companies have suggested that the transaction costs on exports can come from the export processes (Peng, 1998; Peng & Ilinitich, 1998; Peng & York, 2001). However, such studies mainly focus on normative processes in export, such as export documentation, and fail to notice that the local institutions themselves might generate additional processes beyond normal export requirements. As argued in the chapter 2, these studies fail to pay attention at the institution-level to transaction costs. From the multiple cases in this study, bureaucratic procedures and administrative approvals, as one sort of institutional constraint, generate two additional transactional procedures for the normal export process, and therefore increase transaction costs in terms of time, resource commitment, and uncertainty during the export process in China's export markets.

These bureaucratic procedures and administrative approvals bear the typical characteristics of the central-planning system, and therefore belong to the category of *former formal institutional constraints*. From the descriptions in Chapter 4, the transition, or sometimes called the reform, of institutions related exporting in China, such as the export authority, has been underway since 1949 and up to the present day. During the transition, export-related institutions were changing from that of a wholly central monopoly, to one of relative decentralization among the state-owned economies, and then to recently relatively open and fair administrative procedures within private economies. However, the transition and reform of these former formal institutional constraints is not completed, just relatively weakened, and has shifted

from being obvious to invisible. Due to the nature of central-planning institutions, these bureaucratic procedures and administrative approvals still reduce the transaction efficiency on the current export market and generate additional costs for domestic exporters, especially for the emerging private and small-medium-sized exporters. Therefore, the first proposition is as follow.

***Proposition 1 The bureaucratic procedures and administrative approvals, as the main former formal institutional constraints in China’s export market, generate additional transaction costs for domestic manufacturers.***

<b><i>Related institutions</i></b>	Bureaucratic procedures and administrative approvals
<b><i>Procedures in export transaction</i></b>	The pre-export and post-export procedures
<b><i>Sorts of institutional constraints</i></b>	Former formal institutional constraints
<b><i>Evidence in case</i></b>	Licences and registration from various government departments to start export businesses
	Registration and approvals from various government departments for each export transaction
	Changing administrative procedures and policy
	Slow tax rebating system
<b><i>Specific transaction costs</i></b>	Administrative costs
<b><i>How costs are increased?</i></b>	By reducing frequency (generating additional procedures), and increasing uncertainty
<b><i>Supporting cases</i></b>	CS-A,B,C,D,E,F

**Table 8-1 Summary of institutional constraints and related transaction costs- bureaucratic procedures and administrative approvals.**

In turn, all ETCs in this study manage to efficiently process bureaucratic procedures and administrative approvals. Their major method is to amass and master specific and updated *knowledge (including information and experience)* on these bureaucratic procedures and administrative approvals, such as the knowledge on how and where to apply for and register these official approvals and licences; about how, when and where to prepare, submit and receive these necessary official documents to/from various government departments. This sort of knowledge helps ETCs to increase transactional efficiency and *frequency*, and reduce *uncertainty*.

This point is supported by all six cases, as summarised in Table 8-2 and Figure 8-1. More specifically, this knowledge includes those about how and where to apply for and register these official approvals and licences as well as about how, when and where to prepare, submit and receive these necessary official documents to/from many different government departments. This type of knowledge is based on the presence of well-trained and experienced staff, and relevant routines embedded within the daily work of the ETCs. By mastering this sort of knowledge, these ETCs efficiently process these bureaucratic procedures and administrative approvals with less time, resource-commitment and error rate. Thereby the transactional efficiency and frequency is increased. In addition, these ETCs frequently deal with these processes during their massive export transactions. Therefore they can also easily update their knowledge of the changes and new additions of the bureaucratic procedures and administrative approvals that ultimately reduce relative *uncertainty*.

Previous studies on trading companies have indicated that transaction-related knowledge is one main resource of trading companies for reducing transaction costs (Carlos & Nicholas, 1988; Peng, 1998; Peng & York, 2001; Roehl, 1983, 1998). Peng et al specifically indicate that the staff knowledge and experience of *export processes* is able to reduce the costs of export transactions (Peng, 1998; Peng & York, 2001), though such export processes refer to normative processes involved in export transactions. By the same logic, *the knowledge about the bureaucratic procedures and administrative approvals*, which are necessary transactional procedures during the export process in China's export market, are reasonably able to reduce relative transaction costs.

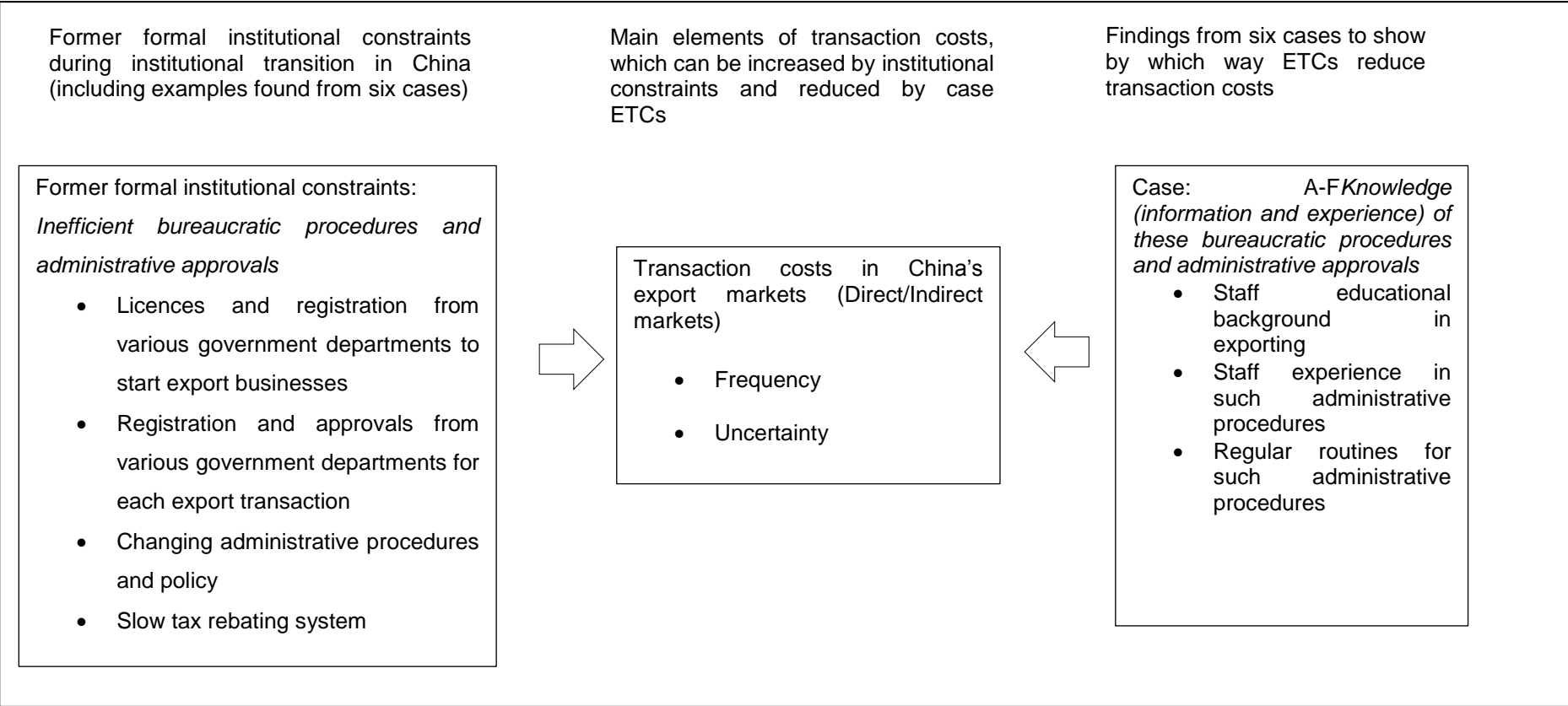
In addition, the studies on transition economies also indicate that the acquirement of knowledge on these bureaucratic procedures helps companies to successfully undertake business by reducing uncertainty and increase efficiency in these transition economies. Amsden & Hikino (1994) argued that the capabilities of companies to obtain permits and licences for start-up businesses from government, reduce the entry costs to new industries in late-industrializing countries. Guillen (2000) also indicates that the specialized knowledge of government policies, and procedures,

such as the specific country-related advantages, helps business groups to reduce the uncertainty, and transaction costs, and to increase efficiency in establishing new ventures in these economies. As a result, the second proposition is generated below.

***Proposition 2 being equipped with specific and updated knowledge of bureaucratic procedures and administrative approvals in China's export market, Chinese ETCs are able to reduce relative transaction costs for domestic manufacturers.***

**Table 8-2 Summary of Chinese ETCs' methods for reducing institution-related transaction costs- bureaucratic procedures and administrative approvals.**

<b><i>Institutional constraints</i></b>	Bureaucratic procedures and administrative approvals
<b><i>Procedures in export transactions</i></b>	The pre-export and post-export procedures
<b><i>Sorts of institutional constraints</i></b>	Former formal institutional constraints
<b><i>Chinese ETC's methods for reducing such institution-related transaction costs</i></b>	Knowledge (information and experience) of these bureaucratic procedures and administrative approvals
<b><i>Specific evidence in cases</i></b>	Staff educational background in exporting
	Staff experience in such administrative procedures
	Regular routines for such administrative procedures
<b><i>Specific transaction costs</i></b>	Administrative costs
<b><i>Supporting cases</i></b>	CS-A,B,C,D,E,F



**Figure 8-1 Integrative analytical framework with first institutional constraints**



### ***8.2.2 Inefficient legal system and contract obligation***

The *inefficient legal system and contract obligations* are another two institutional constraints from the findings of pilot study A. Analysis across the six cases further confirmed and proved this as the most commonly reported issue, as they appear in all cases (shown in Table 8-3 and Figure 8-2). The inefficient legal system is a matter of formal institutional constraints, while the latter one is informal. Since these two institutional constraints jointly appear in and have an influence on the enforcement of domestic manufacturers, they are discussed together in this section.

The previous discussions about theoretical framework of this study and pilot study argue that inefficient legal system, such as formal law and legal enforcement (Meyer, 2001b), may incur additional *opportunistic behaviours*, and increase costs of transactions, especially those related contract enforcement, in transitional economies (Khanna & Palepu, 1997; Khanna et al., 2005; Meyer, 2001a).

The findings across six cases do support such argument. All cases of this study show the huge difficulties of enforcing export transactions, which are generated by *opportunistic behaviours* of domestic manufacturers. More specifically, these opportunistic behaviours refer to product quality problems (in cases A-F), production and delivery delay (in cases A-F), and breach of contract (in case C), which appear in each case and become the most significant problems of purchase in China's export market. But the local legal system fails to prevent it and turns out to be the most important cause of such situation, according to the interviews from the cases.

In addition, legal system neither protects other related items with product from opportunistic behaviours. For instance, manufacturers could freely increase material price and illegally sell ETC's branded products to other buyers in Case B. Because of the worries about patent, ETC D only use self-owned manufacturer for such related products.

As a result, relatively weak legal system raises actual and perceived transaction costs by increasing additional opportunistic behaviours in export transaction in China. The use of the formal legal system to enforce transactions, such as by court and arbitration, are costly, even in developed countries (Williamson, 1985, 1991), where the formal legal system is normally considered relatively more efficient. In contrast to these developed countries, transition economies have the reputation of having an inefficient legal system. Influenced by such a situation, the enforcing costs of transactions are commonly reported high in these countries (Khanna & Palepu, 1997; Khanna et al., 2005; Meyer, 2001a, 2001b).

In this study, one ETC (case C) used the legal system in China in an attempt to recoup the losses associated with one unsuccessful transaction where domestic manufacturers broke the export contract provoking their large loss. With the “help” of local court, case C had to accept one compromise solution with half of the compensation paid. Therefore, the legal system does fail to efficiently protect buyers from losses in export transactions in China, thereby increasing their enforcing costs.

Moreover, the interviewees in pilot study A and rest of the cases show that the buyers in China’s export market, including ETCs and foreign buyers, are unwilling to use the legal system to safeguard their export transactions, as they are worried about the high costs (time and money) and unsatisfactory implementation. In other words, these buyers perceive the legal system as too inefficient to really use it to enforce their export transactions in China. As many studies have indicated, some types of transaction costs actually do not take place, as they are very high, or/and transactions cannot happen (Benham & Benham, 2000).

In term of both actual and perceived transaction costs, therefore, the findings witness that local legal system fails to efficiently enforce the export transactions, control opportunistic behaviours and generates additional enforcement costs for buyers in China’s export market.

Since the legal systems have been developed with institutional transition in these countries in order to fulfil the increasing need for emerging market transactions, they are classified into current formal institutional constraints in the analytical framework. Therefore this study proposed:

***Proposition 3 The inefficient legal system, as the current formal institutional constrains on China's export market, generates additional enforcement costs for foreign buyers' direct transaction with local manufacturers.***

**Table 8-3 Summary of institutional constraints and related transaction costs- Inefficient legal system.**

<b><i>Related institutions</i></b>	Inefficient legal system
<b><i>Procedure in export transaction</i></b>	The procedure of enforcing manufacturers
<b><i>Types of institutional constraints</i></b>	Current formal institutional constraints
<b><i>Evidence in case</i></b>	Quality problems
	Delivery problems
	Changed price
<b><i>Specific transaction costs</i></b>	Cost of monitoring manufacturers
<b><i>How to increase costs</i></b>	By generating opportunistic behaviour and uncertainty
<b><i>Supporting cases</i></b>	CS-A,B,C,D,E,F

As stated in theoretical framework in chapter 3 and chapter 6, some informal institutions may increase transaction costs for business in transition economies. Faced with an inefficient formal legal system in China, the informal contract enforcement, which is one complement of the formal institutions, should have been more efficient and prominent (Luo, 2002; North, 1990), so that the export transactions can be facilitated by informal contract enforcement in China's export markets.

From the findings across cases, however, it is clear that the informal contract obligations in China are also problematic, and leads to many *opportunistic behaviours* and additional *uncertainty*. In all cases and pilot study A, the domestic manufacturers fail to efficiently enforce the export transactions according to their promise in original export contracts. These domestic manufacturers often freely receive orders without considering their capabilities, ignore the quality control and

production schedule, and even intentionally raise prices, resulting in a series of problems during the enforcement of transactions.

The potential explanation of domestic manufacturers' inefficient contract obligations can be two fold. On one hand, the inefficient formal legal system actually magnifies the potential for *opportunistic behaviours* of trading partners. The manufacturers behave opportunistically, as they feel free from such an inefficient legal system in China. For example, the domestic manufacturers get used to changing the agreed price, and breaking the contract, as they seldom face punishment from the legal system, or as they often only need to make some compensation to the buyers when they break the contracts (Case C).

On the other hand, affected by the tradition and culture, the contract obligation in China become distinct, and require trading partners to completely understand, and adapt to them, and therefore generate additional *uncertainty* for them. For instance, Wang (2005) indicates that Confucianism and communist ideology can cause citizens in China to ignore certain necessary institutions in marketing economies, such as private property rights. In addition, Luo (2002) argued that the commercial contracts, as part of the inefficient legal system in China, fail to efficiently enforce contracts in China. Instead, the contract obligations largely rely on other social norms, such as personal relationships. However, the tradition of relying on personal relationships will result in inadequate contract obligations in normal cases, and newcomers' will poorly adapt to such unique enforcement methods. As a result, it increases *uncertainty* and foreign buyers' enforcing costs. In short, the inefficient contract obligations also fail to efficiently enforce export transactions in China's export market.

Like legal systems discussed before, contract obligation have also been developed from the beginning of the transition in these countries to fulfil the increasing need for emerging market transactions, thus they are classified into current formal institutional constraints in the theoretical framework. Therefore, the forth proposition is generated as follow.

***Proposition 4 Inefficient contract obligation, as the current informal institutional constraints in China's export market, generates additional enforcement costs for foreign buyers' direct transaction with local manufacturers.***

**Table 8-4 Summary of institutional constraints and related transaction costs- Inefficient contract obligation.**

<b><i>Related institutions</i></b>	Inefficient contract obligation
<b><i>Procedures in export transaction</i></b>	The procedures for enforcing manufacturers
<b><i>Types of institutional constraints</i></b>	Informal institutional constraints
<b><i>Evidence in case</i></b>	Quality problems
	Delivery problems
<b><i>Specific transaction costs</i></b>	Costs of monitoring manufacturers
<b><i>How to increase costs</i></b>	By generating opportunistic behaviour and uncertainty
<b><i>Supporting cases</i></b>	CS-A,B,C,D,E,F

Facing the inefficient legal system and contract obligations, Chinese ETCs find other ways to solve these problems (shown in Table 8-5 and Figure 8-2). One of their main methods is reducing *information asymmetry*. Studies from transaction costs economics have indicated that the uncertain and complex information, which generates bounded rationality, is the major reason for transaction costs (Williamson, 1975, 1985). Moreover, asymmetric information is the major reason for difficulty in identifying product quality and other resulting problems that stop transactions, such as adverse selection and moral hazards (Akerlof, 1970; Stiglitz & Weiss, 1981).

Many studies indicate that the acquisition of information become an effective method to counter *opportunistic behaviours, uncertainty*, and relative high monitoring costs generated by local deficient institutions, such as the inefficient legal system, in transitional economies. For instance, Hoskisson et al (2000) believe that the information is useful for reducing monitoring costs in transition economies, where inefficient institutions increase opportunistic behaviours. Ahlstrom & Bruton's (2006) study also indicates that accurate information on firms, which is vital for venture capitalists to monitor funded firms' performance, is valuable and hard to obtain in emerging markets, along with the difficulties presented by the inefficient legal system.

From the findings across the six cases, all ETCs acquire massive amounts of *information on production*, which definitely reduces the *information asymmetry* between manufacturers and buyers, decreases *opportunistic behaviours and uncertainty*, and reduces enforcement costs. The information on production generally contains three aspects: *current production conditions, production processes and products, and manufactures' characteristics*; this was initially found and concluded in Case A, and confirmed by subsequent cases. The information on *current production conditions*, such as the progress of production, enables Chinese ETCs to better control the production, including product quality and production schedule, minimizing the problems, and reducing the manufactures' *opportunistic behaviours* during the production process.

Moreover, the information on the *production process and products*, such as the quality control points on products and during the production process, increases the ETCs' capabilities for finding out and avoiding these *opportunistic behaviours and uncertainty* during whole production process. It is worth mentioning that the information on products does not only refer to the quality, types and styles, but contains all characteristics of the product. For instance, in Case C, pricing becomes rather important information, which is systematically collected, updated and used by the ETC to ease the *uncertainty* and manufactures' *opportunistic behaviours*, and for re-negotiation post transaction.

Finally, the information on *manufacturers' characteristics*, which refer to the manufacturers' product quality, capacity, credibility etc, makes ETCs choose the most reliable and suitable manufactures according to their different foreign orders. In general, the information on production helps Chinese ETCs to reduce the information asymmetry, to reduce the possibilities of *opportunistic behaviours and uncertainty* during production, and finally to reduce the enforcement costs.

Existing studies that discuss trading companies' acquisition of information on production mainly refer to large trading companies, such as former European CTCs, and Japanese GTCs. They acquire the information on production mainly for two

reasons. One can be for their diversification strategy, especially diversification into production. For instance, Roehl (1998) indicates that Japanese GTCs accumulate massive information on “unrelated” businesses, such as production, which is used in their further diversification, during their usual trading activities. Second, it aims to help domestic manufacturers, which lack some capabilities, such as technology, during the whole production process but fail to independently manufacture products for further export. Both Yoshino & Lifson’s (1986) study and Kojima & Ozawa’s (1984) study on Japanese GTCs mention the second situation. But the findings in this study suggest two differences. First, such activity does not only take place in large trading companies, but also in small trading companies, such as the CS-A,C,D,E,F in this study. Second, the acquisition of such information on production aims to better enforce manufacturers’ production, and avoid their opportunistic behaviours, at least in the countries where opportunistic behaviours are considerable. Chinese ETCs actually actively obtain information on production through employing staff with experience in production, in order to improve information asymmetry and reduce the enforcement costs on domestic manufacturers during export transactions.

Apart from the acquisition of information on production, the findings from these six cases show that Chinese ETCs also adopt other methods to solve the enforcement problems, *opportunistic behaviours and uncertainty*, and resulting costs. These methods include *vertical integration* into production, the establishment and management of *brand*, application of *special certificates* for products, and the use of appropriate legal assistance in China.

*Vertical integration*, such as into production, is one popular topic in the studies on trading companies, as they usually adopt a diversification strategy during their development. Scholars have stated many reasons for trading companies’ vertical integration. Jones (2002a) believes that multinational trading companies’ vertical integration aims to pursue new profitable opportunities and to make up the inadequate business supportive functions in underdeveloped/developing countries. Yoshino & Lifson (1986) state that Japanese GTCs’ vertical integration aims to support their core trading business. Hennart & Kryda (1998) added that Japanese

GTCs' vertical integration is used to "secure the custom of manufacturers". Casson (1998) includes several motives (advantages) and disadvantages for the vertical integration practised by the trading companies in production such as reselling (shown in table Table 8-5), and highlight the *quality assurance* is the most important one.

**Table 8-5 Integration of production and reselling.**

Advantages	Quality control
	Better forward planning with less inventory
	Elimination of monopolistic or monopsonistic price distortions in the wholesale product market
	Improved coordination of irreversible investments
	Better information feedback for product and process development
	Opportunities for tax avoidance through 'transfer pricing' where there are differences in the fiscal regimes of the exporting and importing countries
Disadvantages	Economies of scale in production limited by internal marketing capacity
	Economies of scope in marketing limited by internal production capabilities
	Bureaucracy weakens employee incentives
Potential compromise	Use both internal and external markets

(Casson, 1998)

The findings from the cases in this study show that efficiently enforcing manufacturers' production and reduce of *opportunistic behaviours and uncertainty* are main motives for Chinese ETCs' vertical integration. In the cross case analysis of the six firms, there are two ETCs (Case B & D), which adopt vertical integration. Both of them integrated into production. While Case B partly integrates one collaborative manufacturer with the original owners, Case D newly establishes one wholly owned manufacturer. In Case B, the vertical integration into production helps to obtain the information on production and reduce the information asymmetry, by placing three monitoring staff inside the manufacturers. In Case D, the vertical integration into production helps the ETC to flexibly arrange different orders and production between self-owned manufacturers and external collaborative manufacturers, so that parts of the process, which are more likely influenced by manufacturers' *opportunistic behaviours*, are produced by the in-house, own manufacturers, and the other parts by the external collaborative manufacturers. Both of these help to solve the problems associated with the manufacturers' *opportunistic behaviours* such as quantity, quality and punctuality problems, during the enforcement of manufacturers' production.



In addition, vertical integration into production also helps the ETCs enforce other related transactions and promises involved in export transactions, which are also vulnerable to the inefficient legal system and contract obligations in China. Intellectual property rights protection issues become the significant one in these two cases. Many studies have already mentioned that the inefficient legal system and certain informal institutions in transitional economies fails to effectively protect intellectual property (Luo, 2001; Wang, 2005), and therefore recommend the adoption of more hierarchical governance modes in these countries in order to safeguard their intellectual property (Luo, 2001; Oxley, 1999). Such an argument is confirmed by the findings from Case B and D. More specifically, one main motivation for their vertical integration is respectively to protect the formula, brand and trademarks of welding electrodes in Case B, and the skills to produce the spring pillow in Case D, from *opportunistic behaviours and uncertainty* in China. Apart from intellectual property protection, the ETC B's vertical integration also helps them to avoid their manufacturers illegally selling products to other exporters. Thus, vertical integration into production can achieve effective enforcement in many different relative transactions and promises during export transactions in China.

Finally, the findings across the cases also indicate that Chinese ETCs adopt many other methods to solve the *opportunistic behaviours and uncertainty* related to enforcement on domestic manufacturers. In case B, the ETC manages to *establish the brand and to apply for well-known industrial certificates for their products, which act as quality guarantees, and reduce foreign buyers' enforcement costs*. In cases C, the ETC *uses appropriate legal assistance, which are effective in China, to save their losses from the manufacturers' breach of contract*.

In short, Chinese ETCs try their best to help foreign buyers to reduce enforcement costs by mastering information on production, vertical integration into production, establishing brand and applying for well-known industrial certificates for their products, and effectively using appropriate legal assistance in China. Therefore, four resulting propositions are generated as follow.

***Proposition 5 By mastering the information on production, Chinese ETCs are able to reduce institution-related enforcement costs for foreign buyers.***

***Proposition 6 By vertical integration into production, Chinese ETCs are able to reduce institution-related enforcement costs for foreign buyers.***

***Proposition 7 By establishing brand and applying for well-known industrial certificates for tradable products, Chinese ETCs are able to reduce institution-related enforcement costs for foreign buyers.***

***Proposition 8 By effectively using appropriate legal assistance in China, Chinese ETCs are able to reduce institution-related enforcement costs for foreign buyers.***

It is worthy noticing that these two institutional constraints (the inefficient legal system and contract obligations) and Chinese ETCs' corresponding methods support the proposed modification of transaction costs economics (TCE) analysis of trading companies referred to in previous parts of this study. In Chapter 2, the critique is made that existing studies on TCE analysis of trading companies *fail to pay enough attention to other players, especially foreign buyers or importers, involved in international trade*. Then in chapter 3, the author re-develops a *both-sided TCE analysis of trading companies to integrate the perspective of foreign buyers*. The findings across cases strongly support such a proposed modification. The inefficient legal system and contract obligations in China's export market magnify the domestic manufacturers' opportunistic behaviours and related enforcement costs. Such problems became the most important consideration of foreign buyers' import or international purchase decisions (Kannan & Tan, 2002; Katsikeas & Dalgic, 1995; Leonidou, 1999), especially when they import from China (LFRC, 2010; Nassimbeni & Sartor, 2006). In order to solve such significant problems for foreign buyers, the Chinese ETCs had to develop corresponding methods and characteristics, which further emphasise the distinction with existing TCE analysis of trading companies. Therefore, the proposed both-sided TCE analysis of trading companies in order to integrate the perspective of foreign buyers in chapter 3 is significant and supported.

**Table 8-6 Summary of Chinese ETCs' methods for reducing institution-related transaction costs- Inefficient legal system and contract obligations.**

<b><i>Institutional constraints</i></b>	Inefficient legal system and contract obligations	<b><i>Supporting cases</i></b>
<b><i>Procedures in export transactions</i></b>	The procedure for enforcing manufacturers	
<b><i>Types of institutional constraints</i></b>	Former formal and informal institutional constraints	
<b><i>Chinese ETC's methods for reducing such institution-related transaction costs</i></b>	Information on production, including current production conditions, production processes, products, and manufacturers' characteristics	Case- A,B,C,D,E,F
	Information on updated prices of product	Case C
	Vertical integration	Case B, D
	Brand, special certificates	Case B
<b><i>Specific transaction costs</i></b>	Cost of monitoring manufacturers	
<b><i>How to reduce costs</i></b>	Reduce the information asymmetry	

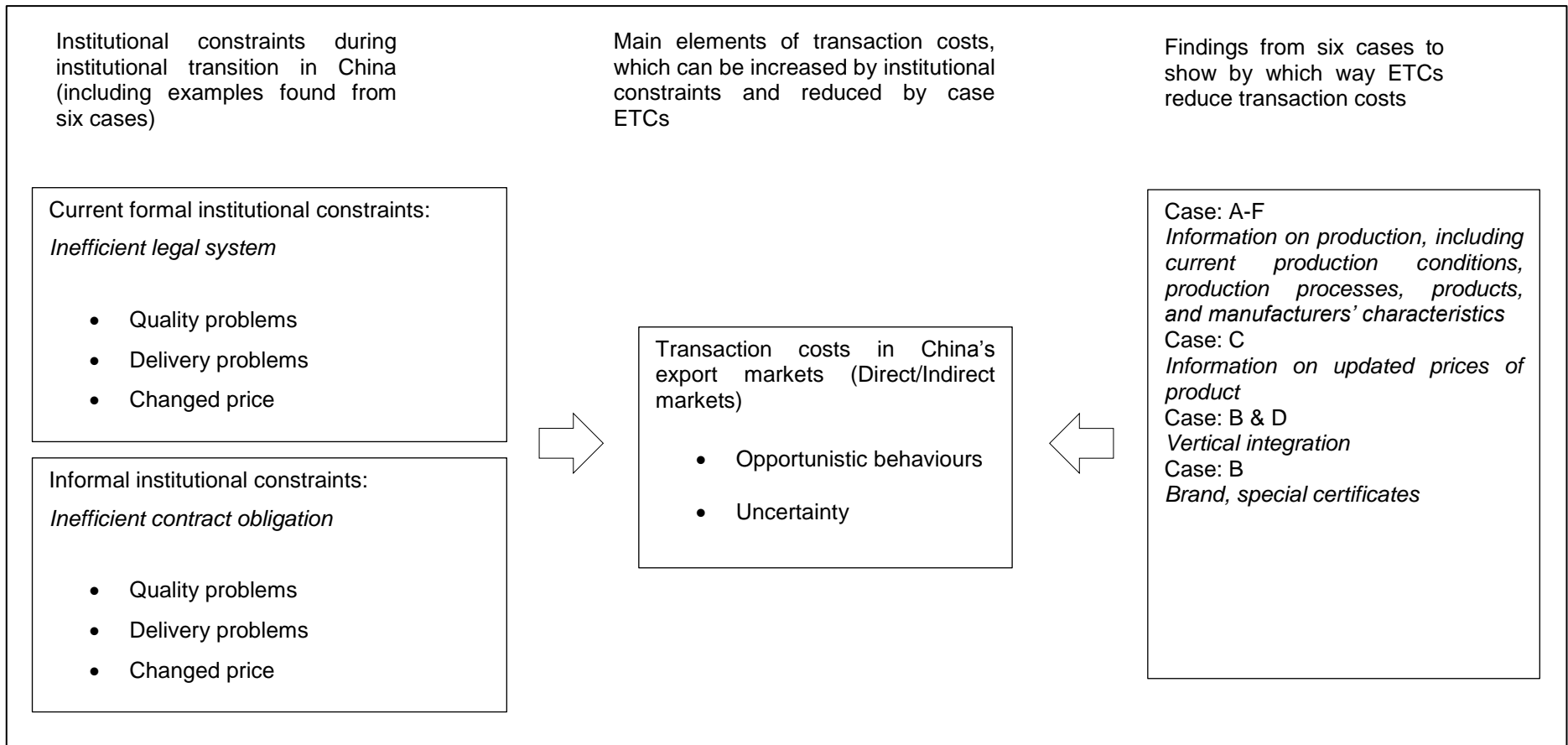


Figure 8-2 Integrative analytical framework with second and third institutional constraints

### **8.2.3 The OEM trading method**

The previous discussion of theoretical framework in chapter 5 states that some formal institutional constraints were inherited from the previous planned economy system (Estrin, Meyer, & Bychkova, 2008), but still exist in many ways in the transition economies. These *former formal institutional constraints*, such as *bureaucratic procedures and administrative approvals* discussed in previous section, may hamper business and raise transaction costs in these countries. In this study, The *OEM trading method* is found as another *former formal institutional constraint* in China's export market (shown in Table 8-7 and Figure 8-3).

Original Equipment Manufacturing (OEM) is a transactional arrangement between brand name company (OEM buyer) and the contract supplier, where the OEM buyer offers detailed technical blueprints and most of the components to allow the contract supplier to produce according to specifications (Ernst, 2000; Kang, Mahoney, & Tan, 2009). Process trade is another OEM-like arrangement. It enables manufacturers to receive export orders, then to produce and export according to the requirements of orders. These two trading methods are commonly used in China since the 1970s. They were estimated to make up half of the export amount in China until recent years (Fu, 2008; Yu, 2012).

In general, these two types of OEM trading methods incur additional *uncertainty* and raise transaction costs for export transactions in China. Domestic manufacturers, as part of the global value chains, only take responsibility for the processing of products in these two types of OEM trade. Under such trading methods, they, especially the SMEs, are able to quickly participate in international trade (by global supply chain) without developing the entire range of production and marketing functions. At the same time, these manufacturers also lose some functions, which are necessary for their direct exporting. As a result, export transactions are faced with significant *uncertainty* in China, and therefore transaction costs are raised. Such institutional constraint is initially found in Case A and then confirmed in Case B and Case D. More specially, in both cases A and D, the manufacturers fail to search for suitable materials' suppliers, in terms of price, amount, style, etc, and relies on the ETC's

supply. In other words, under long-term OEM trading methods, these manufacturers lose independent supply function. In Case B, long-term OEM methods interfere with manufacturers obtaining, learning and improving their capabilities to manage brands and to apply for certain special certificates, which can considerably facilitate product export. Without these capabilities, the domestic manufacturers fail to directly transact with foreign buyers, and have relatively higher costs.

Together with the previous statement that long-term OEM trading method is found as another former formal institutional constraint in China's export market, this study proposes that:

***Proposition 9 The long-term OEM trading method, as the main former formal institutional constraints in China's export market, generates additional transaction costs for domestic manufacturers.***

**Table 8-7 Summary of institutional constraints and related transaction costs-long-term OEM trading method.**

<b><i>Related institutions</i></b>	Long-term OEM trading method	<b><i>Supporting cases</i></b>
<b><i>Procedure in export transaction</i></b>	The procedure for transacting with materials' suppliers	Case A, D
	The procedure of managing brands and applying for special certificates	Case B
<b><i>Types of institutional constraints</i></b>	Former formal institutional constraints	
<b><i>Evidence in case</i></b>	The manufacturers could not find suitable suppliers, in terms of price, amount, style, etc	Case A, D
	The manufacturers could not manage brands and apply for certain special certificates	Case B
<b><i>Specific transaction costs</i></b>	Cost of organizing production	Case A, D
	Costs of branding and applying for special certificates	Case B
<b><i>How to increase costs</i></b>	By generating uncertainty	

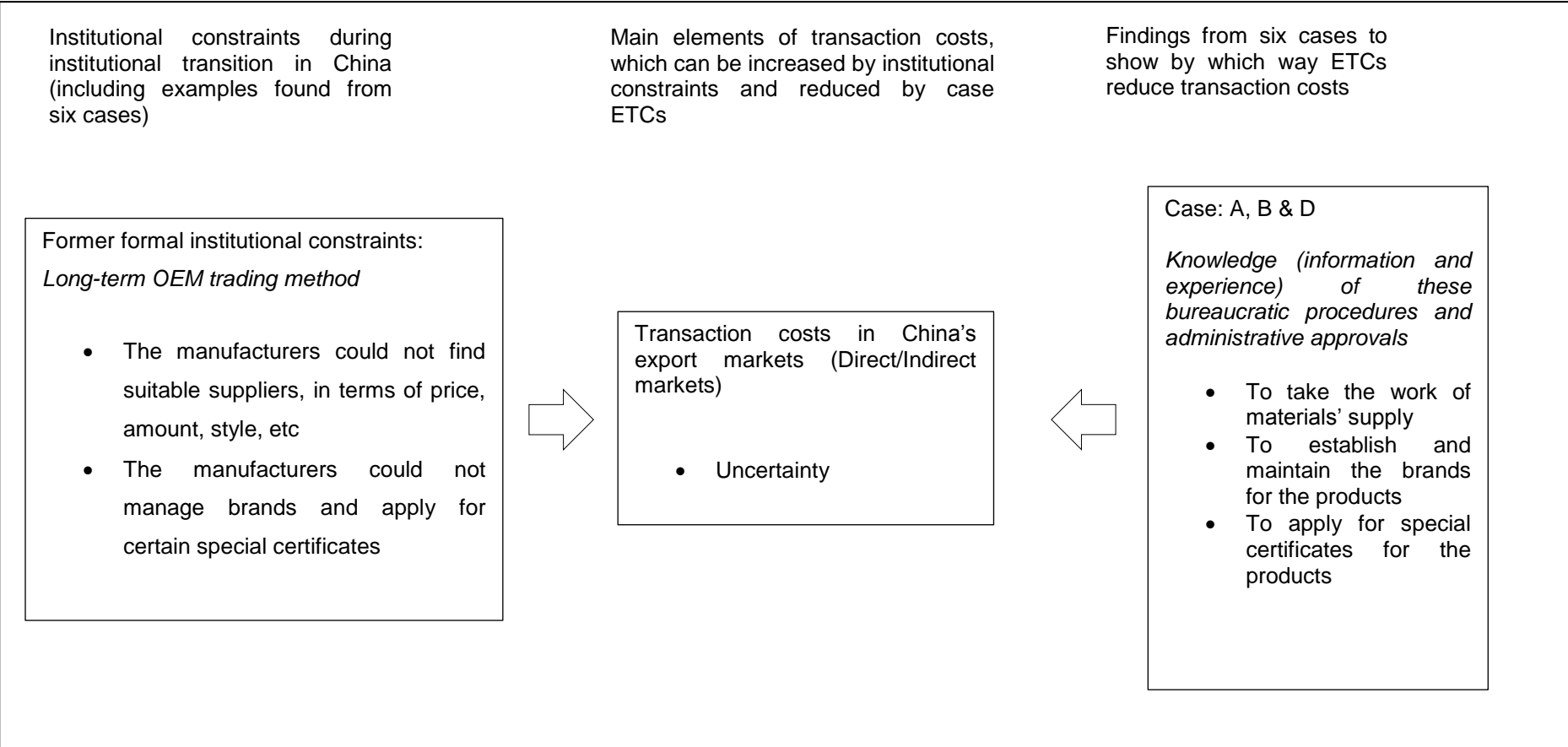
Regarding ETCs' solutions, the findings from Case A, B and D show that Chinese ETCs obtain these capabilities in order to reduce such uncertainty and relative transaction costs for these incompetent domestic manufacturers. These ETCs master adequate knowledge on material supply (Case A,D), on establishing and maintaining brands, and applying for those well-known industrial certificates, and finally successfully fill in these missing functions and complete export transactions.

As discussed in Case A, much of the existing literature on trading companies indicates that some trading companies did help manufactures to supply the materials. For instance, both Yoshino & Lifson’s (1986) study and Kojima & Ozawa’s (1984) study mention that the Japanese GTCs organize and coordinate the whole productive system in Japan, including the material supply. But the findings in this study have one difference from these existing explanations. The organization of material supply appears in two small ETCs, rather than in those large trading companies. In the case of Japanese GTCs, they normally have more resources, capabilities and experience of production than relatively weak manufacturers, due to their large scale. According to Roehl’s (1982, 1998) explanation, these large trading companies undertake such activities mainly because they are trying to make full use of the “unrelated” information, which is obtained through long-term trading business. Cases A & D are not, as least, larger than their manufacturers. Their activities can be considered as make-up or salvage activities, as they want to finish the export transactions. In other words, the institutional constraint, the long-term OEM trading method, pushes these ETCs to obtain unrelated capabilities, and fill in these missing functions, so that they can finish the export transactions. Thus the tenth proposition is generated as follow

***Proposition 10 By undertaking some non-trading activities, Chinese ETCs are able to organize/coordinate domestic production and reduce institution-related transaction costs for domestic manufacturers.***

**Table 8-8 Summary of Chinese ETCs’ method for reducing institution-related transaction costs- long-term OEM trading method.**

<b><i>Institutional constraints</i></b>	Long-term OEM trading methods	<b><i>Supporting cases</i></b>
<b><i>Procedure in export transaction</i></b>	The procedure for transacting material suppliers	Case A, D
	The procedure for managing brands and applying for special certificates	Case B
<b><i>Types of institutional constraints</i></b>	Former formal institutional constraints	
<b><i>Chinese ETC’s methods for reduinge such institution-related transaction costs</i></b>	To take the work of materials’ supply	Case A, D
	To establish and maintain the brands for the products	Case B
	To apply for special certificates for the products	Case B
<b><i>Specific transaction costs</i></b>	Cost of organizing production	Case A, D
	Costs of branding and applying for special certificates	Case B



**Figure 8-3 Integrative analytical framework with third institutional constraints**



### **8.3 Chinese ETCs' advantages on economizing these institution-related transaction costs**

During the within-case analysis, it emerged that the Chinese ETCs adopt efficient methods to solve the institution-related problems and costs, which are generated by institutional constraints in China. However, why these methods are efficient on these institution-related costs becomes another question. In other words, the question is why the indirect markets operated by Chinese ETCs is more efficient, and can process export transaction with lower costs, than direct markets between domestic manufacturers and foreign buyers?

The literature review of Chapter 2 has discussed current transaction costs analyses on trading companies' advantages on economizing traditional transaction costs in international trade. The historical analysis in Chapter 4 has highlighted some distinct features of Chinese trading companies. Taking advantage of the ideas from these two parts, this section further discusses the logic behind the ETCs' methods of economizing institution-related transaction costs, which are pointed out in section 8.2 by comparing and contrasting the findings from the cases. As a result, three explanations of Chinese ETCs' advantages in achieving economies in institution-related transaction costs are generated. They are *economies of scale*, *the long-term monopoly of export authority* and *the reselling system* in China.

#### ***8.3.1 Economies of scale***

*Economies of scale* refer to that the unit price of products can be reduced through large scale production (Hill, 1998). It "exist(s) when a firm's operating costs increase at a lower rate than its output" (Katrishen & Scordis, 1998). From the perspective of transaction cost economics, Spulber (1999; 2007, p101-113) stated that the economies of scale (and scope) is one reason why firms can reduce the transaction costs. By processing a higher volume of transactions than individual buyers and sellers, the intermediary (firm) is able to reduce the number of transactions or/and increase transaction efficiency. He further stated that actually "consolidating

transactions through intermediaries can yield returns to scale in producing and distributing this information” (Spulber, 1999, p23) .

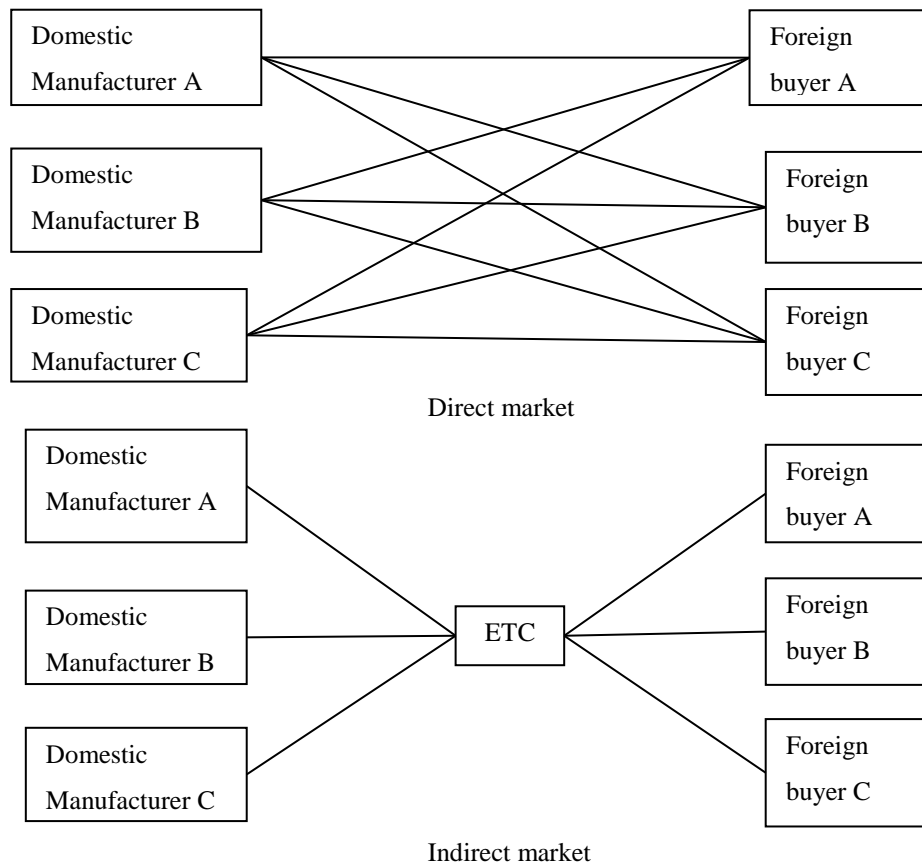
From discussion in chapter 2, the extant studies indicate that economies of scale are one key reason why trading companies are able to reduce transaction costs. Carlos & Nicholas (1988, 1996) argue that the European CTCs can achieve economies of scale through their large volume of transactions, and further reduce the costs per transaction. Similarly, Roehl et al (Roehl, 1983, 1998; Roehl et al., 1984) also indicate that the Japanese GTCs enjoy economies of scale to reduce the transaction costs when they recurrently process similar transactions.

The findings across the six cases prove that the economies of scale can also explain how Chinese ETCs reduce the institution-related transaction costs. Firstly, the costs related to *the bureaucratic procedures and administrative approvals* mainly result from a series of complex and time-consuming administrative procedures, which are compulsory for Chinese exporters’ start-ups of export business and each of their export transactions. Therefore, specific staffs are needed to take charge of the job of applying for these licenses, and of the daily processing of these official documents and approvals for each export transaction.

In practice, these staff can be employed by domestic manufacturers as well, but the costs are different between manufacturers and ETCs. Analysis across the six cases shows that each ETC has more than three domestic manufacturers and three foreign buyers (shown in Figure 8-1). As they have more in-house manufacturers and buyers who can process more exporting deals than individual manufacturers and buyers, these ETCs are able to achieve economies of scale, and then reduce costs per deal. From Figure 8-1, compared with the direct market between domestic manufacturers and foreign buyers, the fewer “lines” in indirect markets operated by the ETCs show the latter one is more efficient than former one.

In addition, the findings from the interviews with the practitioners about their actual decisions also support such an argument. During the pilot study A, the manufacturer

states that they gave up employing these staff as the costs of employing them are too high. In turn, across the cases, the ETCs express the view that they didn't feel that the costs were too high for them. Their different statements on the same costs come from their different volume of transactions. For the manufacturers, the costs of employing one ETC are lower than that of doing this on their own.



**Figure 8-1 The comparison of efficiency between direct market and indirect market.**

Adapted from (Spulber, 2007)

Second, it also helps Chinese ETCs to reduce the enforcement costs related to the inefficient legal system and contract obligations. These two institutional constraints mainly result in some problems, generated by manufacturers' opportunistic behaviours, during the enforcement of export transactions. To avoid these problems, the buyers (ETCs and foreign buyers) have to monitor more effectively

manufacturers' transaction enforcement. It requires extensive specific knowledge and resources (Barzel, 1982; Spulber, 1999, p198) to reduce the information asymmetry and related measurement costs (Barzel, 1982). As with the logic in figure 8-1, compared with individual foreign buyers, the ETCs have the advantage of the resource commitment required by these enforcement costs, based on their large volume of export transactions.

Spulber (1999) stated that the intermediary has more economic incentives than the individual buyer and seller for investing in monitoring quality and building a reputation, as the larger the volume of transactions and the longer time of trade leads to more return from trade. He recommends that buyers can depend on intermediaries' reputation to avoid any investigation of suppliers' information, and later enforcement and adaptation of production. He further argues that "The greater the gains from trading high-quality goods, the higher the value of the intermediary's intervention".

Moreover, the greater the proportion of low-quality goods, the more likely it is that the market-for-lemons condition is satisfied and thus the more likely an expert will enter the market. With a relatively low discount rate or relatively low set-up costs for experts, the intermediary will be profitable and the welfare gain from quality certification by the intermediary will be increased. (Spulber, 1999, p196). Such a situation does exist in the cases in this study. Across the six cases, it is found that Chinese ETCs actively learn and employ resources and capabilities in order to effectively enforce manufacturers' production and all export-related transactions, such as the acquisition of knowledge of production (Case-A to F) and of product price in the markets (Case C), management and maintenance of brands and industrial certificates (Case B), and vertical integration into production (Case A, D). Therefore, this study offers one proposition as follow.

***Proposition 11 By taking advantage of economies of scale, Chinese ETCs are able to more effectively reduce the institution-related transaction costs in China, compared with domestic manufacturers and foreign buyers***

### ***8.3.2 The monopoly of export authority and the reselling system in China***

The monopoly of export authority enables Chinese ETCs to accumulate extensive knowledge, which is then used to reduce institution-related transaction costs. As stated in chapter 4 about the “history of Chinese trading companies”, export authority has been monopolistically granted to Chinese trading companies since the 1950s. With the reform of the trading system in China in the 1980s, export authority has been gradually granted to other exporters, including the manufacturers. But the applications for such authority are still complicated and time-consuming for new exporters, especially the SMEs.

Roehl (1998) indicates that the “history” of Japanese GTCs is one important element in their success. The long history of JGTCs, mainly referring to their long-term participation in businesses, enables them to accumulate information and experience, which further supports their diversification in term of products, regions and businesses.

In a similar vein, the long-term monopoly of export authority has enabled Chinese ETCs to have longer experience of the export business, compared with other domestic exporters. This history is shown in the ETCs’ earlier establishment, and practitioners’ experience inside the ETCs in these cases. Across the six cases, the earliest established ETC is Case B, which was founded in 1955, whilst the second one, Case D, has 13-year history. Cases A and C respectively have 5 and 6 years history. More importantly, the key staff in these ETCs such as owners, main managers, accountants, etc, have long-term working experience in export and export-related sectors (details are shown in table 8-9), which normally predates the establishment of the ETC. These “histories” help Chinese ETCs to obtain “first mover advantages” on the acquisition of information, compared with the new exporters, as export authority has been gradually decentralized. Moreover, the existing information, accumulated through “history”, also helps Chinese ETCs to learn more information. For instance, knowledge of the changes in export administrative procedures during the pre-/post-export steps, have been accumulated

and updated during the ETCs' daily communication and participation in export transactions. In addition, knowledge on domestic manufacturers' characteristics, which helps the ETC to filter reliable manufacturers and to match orders with them, has also been accumulated through long-term and multiple co-operations with these manufacturers. Therefore, this study generates one proposition as follow.

**Table 8-9 Summary of key staffs' experience on export in cases.**

<b>Case</b>	<b>Title</b>	<b>Year</b>
<b>Case A</b>	Owner	8
	Accountant	10
	Manager of TMs	5
	Purchaser	10
<b>Case B</b>	CEO	26
	Manger of 3 <sup>rd</sup> export process departments	13
<b>Case C</b>	Owner 1	12
	Owner 2	6
	Accountant	8
<b>Case D</b>	Owner	20
	Manager of QCs	6
	Purchaser	10
<b>Case E</b>	Owner	15
	Manager of QCs	8
	Accountant	5
<b>Case F</b>	Owner	6
	Manager of Salesmen	5
	Accountant	4

***Proposition 12 The monopoly of export authority helps Chinese ETCs to more effectively reduce the institution-related transaction costs in China, compared with domestic manufacturers and foreign buyers***

### ***8.3.3 Reselling system in China***

In chapter 4 the “history of Chinese trading companies”, it is also highlighted that a *reselling system* is the majority trading method adopted by Chinese ETCs from the 1950s to the present time. The reselling system means that ETCs firstly purchase outright the ownership of products from domestic manufacturers by means of a buying contract, and then sell it on to foreign buyers through a selling contract. The reselling system facilitates Chinese ETCs in reducing institution-related transaction costs in two ways.

First, the reselling system in China enables ETCs to take the whole responsibility, rather than partial responsibility, for coordinating with every part in a transaction, and monitoring the quality, time and other related issues in the contract. Across the six cases, it can be seen that the Chinese ETCs act as the co-ordinators of export transactions, rather than the “agent” of manufacturers or foreign buyers, which is commonly considered as their role during export transactions (Bello & Lohtia, 1995; Peng, 1998; Peng et al., 1998; Peng & Ilinitich, 1998; Peng & York, 2001). They search for new buyers, products, and domestic manufacturers, effectively organize, coordinate and enforce production, and efficiently process various export procedures. These activities do not only conclude simple exports, but also refer to many export-supplements and export-facilitated ones, such as materials’ supply (Case A & D), brand management, technology support (Case B), vertical integration (Case B & D), searching for alternative suppliers and export methods (Case C) and so on.

Moreover, such a reselling system in China enables ETCs to become the neutral third-party. In traditional international trade, traders usually act as agents of manufacturers or foreign buyers, and therefore represent interests of one party. However, reselling system make Chinese ETCs work as resellers with neutral interests to both sides in export transactions. Thus they are in the position of neutral third-party. Compared with trading companies’ brokerage trading methods, Casson(1998) argues that their reselling trading method is more likely to make more commitments to the buyers, given the whole transfer of risk and ownership.

Some studies from economics offer some explanations on third-party enforcement. For instance, Spulber (1999) argues that the involvement of a third-party is able to increase efficiency of transacting. Barzel (1997, 1998, 2001) highlights that the third-party is more effective in transactions’ enforcement. Certainly the most powerful third-party is the state according to Barzel’s *state theory*. But he also indicates that many organizations have the advantages of undertaking a third-party role, as the state often lack enforcement power (Barzel, 1997, 1998, 2001). Such arguments also help to explain the situation in this study. From the earlier discussion, it can be seen that the inefficient legal system and contract obligations fail to enforce export

transactions in China, and generate additional enforcement costs for buyers. Therefore Chinese ETCs, as one more effective third-party, more efficiently enforce the export transactions than domestic manufacturers and foreign buyers.

Finally, the reselling system in China also enables ETCs to become the *hub* of information, which is further used in their transaction-costs-economizing activities. As stated above, the ETCs act as the co-ordinators of export transactions under the reselling system. As a result, the reselling system actually places the ETC in the central position of the export transaction not only between domestic manufacturers and foreign buyers, but also all organizations involved in export, such as government departments during the pre-/post-export procedures, materials suppliers, international classification societies, external agents for off-shore companies, and so on. These connections help the ETC to accumulate extensive information about export transactions, especially on these export-related institutional constraints. In addition, export-supplements and export-facilitated activities also increase the ETCs' information resource. In previous parts of this study, this kind of information has already been proved to be of great value to these ETCs' methods for solving institution-related problems and costs in China's export markets. In the end, the information, which is commonly considered as the most important resource for trading companies (Peng, 1998; Peng et al., 1998; Peng & Ilinitich, 1998; Roehl, 1982, 1998), is considerably enhanced in the Chinese ETC by this reselling trading system. As a result, the last proposition is generated as follow.

***Proposition 13 The reselling system helps Chinese ETCs to more effectively reduce the institution-related transaction costs in China, compared with domestic manufacturers and foreign buyers***

Table 8-10 Summary of propositions in this study

No.	Proposition
1	The bureaucratic procedures and administrative approvals, as the main former formal institutional constraints on China's export market, generate additional transaction costs for domestic manufacturers
2	Being equipped with specific and updated knowledge of bureaucratic procedures and



	administrative approvals in China's export market, Chinese ETCs are able to reduce relative transaction costs for domestic manufacturers
3	The inefficient legal system, as the current formal institutional constraints on China's export market, generates additional enforcement costs for foreign buyers' direct transaction with local manufacturers
4	Inefficient contract obligation, as the current informal institutional constraints on China's export market, generates additional enforcement costs for foreign buyers' direct transaction with local manufacturers
5	By mastering the information on production, Chinese ETCs are able to reduce institution-related enforcement costs for foreign buyers.
6	By vertical integration into production, Chinese ETCs are able to reduce institution-related enforcement costs for foreign buyers
7	By establishing brand and applying for well-known industrial certificates for tradable products, Chinese ETCs are able to reduce institution-related enforcement costs for foreign buyers
8	By effectively using appropriate legal assistance in China, Chinese ETCs are able to reduce institution-related enforcement costs for foreign buyers
9	The long-term OEM trading method, as the main former formal institutional constraints in China's export market, generates additional transaction costs for domestic manufacturers
10	By mastering the capabilities, which the domestic manufacturers miss, Chinese ETCs are able to reduce institution-related transaction costs for domestic manufacturers
11	By taking advantage of economies of scale, Chinese ETCs are able to more effectively reduce the institution-related transaction costs in China, compared with domestic manufacturers and foreign buyers
12	The monopoly of export authority helps Chinese ETCs to more effectively reduce the institution-related transaction costs in China, compared with domestic manufacturers and foreign buyers
13	The reselling system helps Chinese ETCs to more effectively reduce the institution-related transaction costs in China, compared with domestic manufacturers and foreign buyers

## 8.4 Chapter Summary

In this chapter, the findings of the cross cases analysis are included, in order to comprehensively answer the research questions in this study. In section 8.2 four unique institutional constraints and mechanisms that generate difficulties and

additional costs for exporters and foreign buyers in China's export market, are highlighted. In the meanwhile, the proposed analytical framework is supported by these findings as well. Following the description of these institutional constraints, Chinese ETCs' countermeasures in different cases are included and compared with existing studies. By doing these, it is found that these unique countermeasures developed by Chinese ETCs effectively and efficiently ease these institution-related problems and costs. Section 8.3 sets out the three explanations of Chinese ETCs' advantages in achieving economies in institution-related transaction costs in China. Moreover, thirteen propositions are developed after the conclusion and discussion of findings across the six cases.

## **Chapter 9 Conclusion**

### **9.1 Introduction**

This final chapter aims to develop the conclusion of this study. Silverman & Marvasti (2008) suggest that the final chapter of a PhD thesis can include the relationship between the new findings and existing works, the contribution to knowledge, the implications for policy and practice, the limitations and lessons for further research from the current study (Shown in table 9-1). Therefore, this chapter is organized as follows: 9.2 is a review of this study, while section 9.3 summarizes the main findings in this study. Then the main contribution of this study is elaborated in section 9.4, which is followed by the practical implications in 9.5. At the end, 9.6 discusses the limitations of this study and suggestions for further study.

### **9.2 Thesis overview**

Trading companies have played and continue to play significant and strategic roles in past and current international business (Jones, 1998b). They efficiently facilitate and mediate international trade, by offering a series of cost-reducing services and functions (Peng, 1998). But while most extant studies on trading companies are about the developed countries, less attention has been paid to the transitional economies, such as China, which have become the most important players in international trade. Therefore, this study aims to undertake one original study on trading companies from one of these regions and countries, China.

Among all the studies of trading companies, a couple of research studies use the agency theory and resource-based view. However, the transaction costs' economics (TCE) is the most important theory indicating that the role of trading companies in trade is to reduce the transaction costs in international trade (Casson, 1998). The extant TCE analysis on trading companies only focuses on trading companies and their manufacturers, but overlooks another important stakeholder, the foreign buyers. More importantly, transition economies have a reputation for institutional problems, which generate some different transaction costs (Estrin et al., 2008; Meyer, 2001a,

2001b), which have not been referred to in previous studies. Therefore, the institutional perspective should be added into the TCE analyses, when new studies try to explore trading companies from these countries. As a result, the research questions in this study are 1) what are the institutions, which generate transaction costs for domestic manufacturers and foreign buyers, in China's export market? And 2) how do Chinese exporting trading companies respond to such institution-related costs as an intermediary between domestic manufacturers and foreign buyers?

In order to fill in these gaps and explore the two research questions on Chinese ETCs, one new analytical framework is developed by adding the buyers' perspective and the institutional perspective. This framework integrates the institutional perspective into the TCE analysis. Under the TEC analysis, the direct market operated by manufacturers and buyers, and the indirect market operated by ETCs, are indicated as two different export channels. The ETCs must manage to reduce the transaction costs on the indirect export market in order to compete with direct export market. From the institutional perspective, these transaction costs are influenced by three main institutional constraints, which are included by Peng and Heath (1996) and other studies on emerging markets and transition economies. In the end, one integrative analytical framework is developed, whilst the institution-related transaction costs are highlighted.

Following such an analytical framework, six ETCs constituting the sample of cases, are explored and analysed to seek the answers to the research questions. The specific institutional constraints in China's export markets and resulting methods, by which Chinese ETCs are able to reduce these institution-related costs, are explored and analysed according to the ETCs' specific export transaction processes in each case. In the end, four specific institutional constraints in China's export market, the various unique countermeasures undertaken by Chinese ETCs, and three relevant explanations are found. Afterwards, a summary of general structure of this thesis is presented.

Chapter one, as the introduction, briefly illustrates the objective of this study

Chapter two offers an overview of trading companies in extant literature. It initially reviews the trading companies' history, characteristics and methods for facilitating exports according to three main countries and areas. Then three related theories on trading companies are discussed and critiqued, followed by a statement of the gaps in the research and the research questions.

Chapter three develops a new analytical framework, based on the TCE and institutional perspective in international business, in order to guide the subsequent explanation of institutional constraints in China's export market and Chinese ETCs.

Chapter four is an overview of the history of Chinese trading companies since 1949. This chapter offers an original introduction to unknown Chinese trading companies. Within each historical account, the main developmental periods, significant events, relevant institutions are described in detail.

Chapter five is the research strategy and methodology, which offers the logical link between the evidence and research questions in this study. It includes the philosophical stance in this study, the justification for the use of qualitative case studies, and detailed case study design.

During chapter six, the first part of pilot study A, is presented. By interviewing ten experienced practitioners from the domestic manufacturers, foreign buyers and ETCs, this chapter aims to pre-test and modify the previous integrative framework, and to specify the institutional constraints on China's export market. In the end, three formal and informal institutional constraints, which influenced export transactions in China, are identified.

Applying the proposed analytical framework for the main field work in chapter seven, the within case studies of Cases A, B, C and D are presented and analysed. During each case, three proposed and one emergent institutional constraint are tested and

explored, while ETC's different countermeasures are stated according to the export transaction process inside each case.

Following that, the chapter eight is the cross-case analysis, which aims to include and consolidate the findings from the previous parts, and to further generate patterns about China's export-related institutions and ETCs. As a result, thirteen propositions are generated according to the four main institutional constraints and the mechanisms, that generate difficulties and additional costs for exporters and foreign buyers in China's export market. Moreover, this chapter also discusses three explanations of Chinese ETCs' advantages for economizing institution-related transaction costs in China.

Finally, the chapter nine is the conclusion of this study. It summarizes the whole research, main findings and contributions, practical implications, limitations and suggestions for further study.

### **9.3 Summary of main findings**

There are two research questions in this study: 1) what are the institutions, which generate transaction costs for domestic manufacturers and foreign buyers, in China's export market? And 2) how do Chinese exporting trading companies respond to such institution-related costs as an intermediary between domestic manufacturers and foreign buyers?

#### ***9.3.1 Answers to research question one***

In this study, four main institutional constraints in China's export market were found, including, bureaucratic procedures and administrative approvals (former formal institutional constraints), the inefficient legal system (current formal institutional constraints), inefficient informal contract obligations (informal institutional constraints), and long-term OEM trading methods (current formal institutional constraints).

The *bureaucratic procedures and administrative approvals* specifically represent a series of administrative procedures for applications for export authority and many other business licences and registrations before normal export transaction, which are compulsory for domestic exporters wishing to start-up an export business. Moreover, it also refers to the necessary submissions to and registration with many different official approvals, which are compulsory for domestic exporters' for each export transaction. Due to the involvement of many different government departments, these procedures are inevitably complex, time-consuming and continuously changing. Therefore they cost domestic exporters both in resources and time.

The *inefficient legal system and contract obligations* are another two institutional constraints, which jointly influence enforcement of export transactions for domestic manufacturers. The legal system in China fails to efficiently enforce manufacturers to keep to original export transactions. The actual execution of the lawsuit is unsatisfactory in the context of manufacturers' breach of transactions. The buyers are unwilling to use the legal system to safeguard their export transactions, as they are worried about the high costs (time and money) within the legal system and unsatisfactory implementation. Under such legal systems and lack of the tradition of contract spirit in China (Luo, 2002), the domestic manufacturers fail to efficiently self-enforce the transactions. They often freely receive orders without considering their capabilities, ignore the issue of quality control and production schedule, and even intentionally raise prices. As a result, the inefficient legal system and contract obligations in China's export market jointly generate considerable problems of enforcement of export transactions, and increase enforcing costs for buyers.

The long-standing *OEM trading method* became the last institutional constraints in China's export market. OEM trade is one major trading method in China and makes up half of China's export volume (Fu, 2008; Yu, 2012). It enables domestic manufacturers, especially the SMEs, to quickly participate in international trade (global supply chain) without developing the whole range of necessary production and marketing functions. But these manufacturers also lose some functions, which are necessary for their direct export. In some cases, their main missing functions

include the supply of materials, branding and application for some industrial certificates. Without these capabilities, the domestic manufacturers fail to directly transact with foreign buyers, or where there are relatively higher costs.

These four institutional constraints bear the typical characteristics of transition economies, where formal and informal institutions are comprehensively and fundamentally changing, particularly from central planning to the market-based economic reform (Peng, 2003, p275). The bureaucratic procedures and administrative approvals and OEM trading method represent the formal institutions, which were inherited from the previous planned economy system (Estrin et al., 2008), but still exist in many forms during the period of the collapse of previous institutions under the central planning system, and therefore belong to the former formal institutional constraints in the previous analytical framework. The inefficient legal system and contract obligations represent the lack of market-supporting institutions, which are hard to establish quickly, during the stage of the emergence of new institutions corresponding to the marketing system in these countries, and therefore falls into the current formal and informal institutional constraints in the previous analytical framework.

### ***9.3.2 Answers to research question two***

Faced with these institutional constraints in China's export market and related costs on export transactions, Chinese ETCs design efficient and effective methods to reduce these institution-related transaction costs. First of all, Chinese ETCs are able to reduce the costs, generated by bureaucratic procedures and administrative approvals, by mastering knowledge of these procedures in China's export market.

Second, Chinese ETCs are able to reduce the costs of enforcing the domestic manufacturers' opportunistic behaviour during export transaction despite the inefficient legal system and informal contract obligations by utilizing information on production, vertical integration into production, establishing brand and applying for well-known industrial certificates for tradable products, and effectively using appropriate legal assistance in China.



In addition, by offering certain supplementary functions, Chinese ETCs are able to help dysfunctional domestic manufacturers to successfully finish export transaction, when they fail to independently finish whole production process due to long-standing work under the banner of “OEM trading method” described in earlier chapters

Compared with the direct market trading between domestic manufacturers and foreign buyers, Chinese ETCs are able to more efficiently operate an indirect market due to three advantages: economies of scale, the monopoly of export authority, and reselling trading methods. Specifically, Chinese ETCs are able to achieve economies of scale in the processing of export transactions. As they have more in-house manufacturers and buyers, and process more exporting deals than individual manufacturers and buyers, and so they reduce the costs of each transaction. These costs include human resources and time costs related to bureaucratic procedures and administrative approvals, and enforcement costs related to the inefficient legal system and contract obligations. Then the historical monopoly of export authority enables Chinese ETCs to accumulate extensive knowledge, which is then used to reduce institution-related transaction costs. Finally, the long-standing reselling system in China enables ETCs to take comprehensive responsibility for export transactions, thus becoming a neutral third-party, and the “hub” of information. By assuming the whole responsibility, Chinese ETCs are able to coordinate with each part, even including those non-trade units, in one export transaction. As the neutral third-party, Chinese ETCs are able to more effectively enforce the export transactions than are domestic manufacturers and foreign buyers. By gathering massive information related to export transactions in China, Chinese ETCs develop their various transaction-costs-economizing activities.

By answering question two, this study illustrates the unique characteristics of Chinese ETCs, which are developed to bypass institutional constraints in China’s export market and to reduce related costs of export transactions for domestic manufacturers and foreign buyers.

#### **9.4 Contribution to knowledge**

### ***9.4.1 Practical contribution***

This study extends the extant knowledge on trading companies to one of transition economies. These countries and areas make up considerable proportion of international trade, yet their export-related institutions and organizations have remained a mystery. In order to fill in this gap, this study chooses China as one representative of these countries and areas, given its significant economic power and quick growth.

In general, this study presents Chinese ETCs' characteristics and export processes, and developmental history, and export-related institutions and institutional change in China's export market. Specifically, Chapter 4 in this study describes the history of Chinese trading companies and related institutional change during three sequential periods since 1949. It displays the entire historical development of Chinese trading companies that is in line with related institutional change and reform since the establishment of the new China. In chapter 6, the interviews from ten practitioners, which have long-standing involvement in the export business in China, further describes more specific export-related institutions during their business practice in China's export market, especially those institutional constraints which disturb their export transactions in China. Then chapter seven and eight jointly offer detailed and practical illustration of Chinese ETCs' current characteristics, export transaction processes and methods for facilitating their export transactions. In the end, the practical findings in this study contribute to one historical and contemporary picture of Chinese ETCs and export-related institutions in China.

### ***9.4.2 Theoretical contribution***

First of all this study contributes to extant transaction costs economics (TCE) analysis of trading companies. TCE is the dominant theory in the field of trading companies due to its powerful explanation of how trading companies' exist and conduct business (Casson, 1998). It clearly indicates the transaction-costs-economizing role of trading companies in international trade. However, the extant TCE analysis on trading companies only includes the domestic manufacturer and trading company, and overlooks the foreign buyer, which is reported as another

important player during export transactions by many export-related articles (Perdue & Summers, 1991; Quintens et al., 2005). In order to modify such a shortcoming, therefore, this study designs a two-sided TCE analysis, which subsequently constructs the analytical framework together with an institutional perspective for this study, by including three main participants in the export transactions: domestic manufacturers, foreign buyers and ETCs.

Second, this study contributes to the extant studies using an institutional perspective in the field of international business. The institutional perspective has prevailed in recent literatures in international business, such as its adaptation in cross-institution studies (Peng et al., 2008). However, the concepts, terminology and classifications in these studies, especially those related to transition economies, are disorganized, ambiguous and overlapping. Such problems seem to be inherited from higher-level institutional research. Scott (2008) has found that the institutional research in social science, economics and political studies show large distinctions and conflicts, and lack a general framework. Based on Peng & Heath's (1996) institutional framework and other studies, therefore, this study classifies the institutions in transition economies into three main institutional constraints appearing in two stages during institutional transitions. Such classification also offers one feasible framework for future institutional studies on transition economies.

Furthermore, this study theoretically integrates institutional perspectives into the transaction costs economics, and therefore combines their strengths, and offsets different weaknesses. As it emerged from western countries with sound marketing institutions, TCE is not effective in the study of transition economies, where institutions are singular, complex and uncertain, at least different (Gelbuda et al., 2008; Meyer, 2001a, 2001b; Meyer & Peng, 2005; Peng, 2001, 2006). As Peng stated, these extant theories need modification when applied to these countries (Peng, 2006). In turn, the institutional perspective has the advantage of possessing powerful explanatory capacity in the study of transition economies, as local unique institutions' exert considerable influence on involved firms (Child, 2009; Hoskisson et al., 2000; Meyer, 2001a, 2001b; Meyer & Peng, 2005; Peng, 2005). As referring to all

environmental and contextual factors, however, institutional perspectives have too broad a scope, though this study has simplified institutions into three groups. Therefore it is more likely to include excessive and unnecessary institutional factors, or/and to overlook the most significant ones. The inadequate extant literatures on Chinese ETCs and the inexperience of the PhD researcher in this study increase such a risk of losing control of the research. As a result, the integration of the institutional perspective and TCE has two advantages. First, the institutional perspective enables the TCE to become adaptable to the study of transition economies. Second, the TCE enables the institutional perspective to focus on the institutions related to export transaction costs.

Finally, it is worth mentioning that this study uses an original way of integrating institutional perspectives into TCE analysis. This study attempts to logically integrate the institutional perspective into TCE analysis, by illustrating institutional influence on transaction costs, and thereby further develops the concept of institution-related transaction costs. In the end, the integrative framework of the institutional perspective and TCE, and the invention of institution-related transaction costs jointly offer a new approach for future studies on TCE-related topics in transition economies.

## **9.5 Practical implications**

Practitioners involved with exporting/importing from/to China and other transition economies can benefit from this study. For the practitioners from the ETCs, this study benefits them in many ways. They can capitalize on the significance of their existence in international trade activities; consider how they can improve and enhance their capabilities and what threats exist for them. The finding of institution-related transaction costs helps these ETCs to clarify the significance of their existence in international trade. They should treat these institutional constraints as business opportunities rather than obstacles, which are reflected in these ETCs' complaints during the interviews. The findings relating to the various methods of reducing transactions costs and the three reasons why Chinese ETCs' indirect markets are more efficient than direct markets, clarify their advantages and direction of progress. Moreover, they also have to realize that these advantages are also challenged, when these institutional constraints gradually withdraw.

This study also benefits the practitioners from domestic manufacturers and foreign buyers. Being the “merchant” between domestic manufacturers and foreign buyers, trading companies are playing strategic roles (Jones, 1998b) for manufacturers’ export (Peng & Ilinitch, 1998) and purchasing companies’ import (Quintens et al., 2005). The findings from this study also support this statement. From this point, this study has some implications for domestic manufacturers and foreign buyers’ exporting/importing channel choice. In particular, these implications are helpful for the firms with different transaction amounts, products and industries and also the ones facing challenges from formal and informal institutions.

First of all, the transaction amount is one fundamental consideration for the exporting/importing channel choice of domestic manufacturers and foreign buyers. The economies of scale on large amount of transactions have been proved to be one significant advantage of ETCs in this multiple cases study, particularly on economizing institution-related transaction costs. This finding is consistent with and extends the explanation in previous studies on trading companies’ advantages on economizing normal transaction costs (Carlos & Nicholas, 1988, 1996; Roehl, 1983, 1998; Roehl et al., 1984). It implies that both domestic manufacturers and foreign buyers with less export/import transactions should consider ETCs as their exporting/importing channel choices, which are able to economically bypass the unfamiliar and unfavourable local institutions. When they have more transactions, in turn, they should use in-house exporting/importing departments, which enable them to reduce costs of each transaction and avoid some disadvantages of employing trading companies, such as additional monitoring costs of agents (Peng, ) . Several additional implications for domestic manufacturers and foreign buyers with fewer transactions are given in next several paragraphs.

The local bureaucratic procedures and administrative approvals should be another consideration for domestic manufacturers with less export amount. This study finds that there are many bureaucratic procedures and administrative approvals on Chinese exporting markets, which obstruct exporting transactions. These procedures are

issued by central and local governments and official departments at all levels, and tend to be bureaucratic and uncertain. Such situation requires direct exporters to invest more resource to finish transaction costs, which are difficult and uneconomic for large number of small exporters and start-up businesses in China. In turn, ETCs are able to process export transactions through these institutions with lower costs via professional and updated knowledge on these bureaucratic procedures and administrative approvals, because of their larger amount of transactions, professional staff and long-term participation in trading industry. Even if the employment of professional staff is available, these small manufacturers still face with disadvantage on costs due to fewer transactions. By comparison with two costs of direct and indirect (through ETCs) transactions, the indirect export channel become more economic choice for these domestic manufacturers.

In addition, the foreign buyers with less importing amount from China should take local informal institutions into account in their import channels decision. This study finds that weaker legal system and informal contract obligation largely interfere in export transaction enforcement, resulting in the problems with quality and delivery, and therefore increasing their costs of importing directly from local manufacturers. The use of ETCs inclined to be one solution for them. These ETCs master information to reduce information asymmetry and manufactures' opportunistic behaviours, such as those on production, current production conditions, on production processes and products, and manufactures' characteristics. Many foreign buyers are usually unfamiliar with, lack of resource to adapt to, or difficult to master and use these unique institutions. Due to economies of scale from larger number of export transaction, and long-time participation in both exporting and related industries, such as manufacturing, Chinese ETCs are able to obtain these knowledge and experience with lower costs than these foreigners. As a result, it is more economic for these foreign buyers to adopt local ETCs' service than newly establishing own importing departments.

In particular, one situation should be considered for the foreign buyers importing certain special products. As found in this study, weaker legal system and informal

contract enforcement jointly lead to more serious opportunistic problems for the exporting of the products with intellectual property from China, including trademark, patent and special certificates. Both this and previous studies have proven that the intellectual property protection turns out to be difficult and costly in China for the owners. The foreign buyers with fewer import transactions face with a dilemma, which is finding and monitoring reliable manufacturers on their own being less economic trades off the risk of uncertain intellectual property protection from distrustful manufacturers. The ETCs are able to help these foreign buyers in this situation. The long standing reselling system on China's export market enables ETCs work as more responsible trading partners, the interest-neutral third-party and the hub of information, which make them enforce these special terms on export transactions more effectively and efficiently. As a result, the author advises the small foreign buyers with the issue of protection IP to choose reliable ETCs as their trading partners rather than unfamiliar manufacturers.

Last, the domestic manufacturers, which are currently working under the OEM-like trading method, should consider ETCs as one helpful mean for their exporting channel choice. As stated previously in this study, Original Equipment Manufacturing (OEM) is the most important trading method and makes up to half of total export until recently in China (Fu, 2008; Yu, 2012). It enables a lot of incompetent small and medium-sized manufacturers participate in international trade much earlier, as they only need to concentrate on partial and essential production (Hobday, 2000). Nevertheless, it also makes manufacturers lose some important functions (Hobday, 2000), such as material purchase, which are necessary for direct exporting, and thereby generate problems for their direct export. In turn, ETCs are able to effectively and efficiently fill in these missing functions by leveraging their knowledge, which accumulated through their long stand in exporting industry. Therefore, this study suggests the domestic manufacturers, which are unable to independently finish whole production process, especially the small and medium-sized manufacturers and manufacturers from the industries with long history of OEM trading system, to use experienced ETCs as their export channel.

Policymakers in these transition economies can also benefit from this study. The discovery of institutional constraints show them that these institutional constraints do generate additional transition costs in export transactions in China, which further consume the total gains from export transactions. Therefore, future policies should lead to the withdrawal of these institutional constraints. In addition, new policies should encourage ETCs' development in these countries, as they increase efficiency and gains of export transactions through effective methods, and therefore facilitate domestic exports.

## **9.6 Research implication**

The theoretical analysis and empirical findings in this study can benefit the relevant researches in other economies, such as emerging markets and developing countries. First, this study mainly focuses on the transition economies, which is typically considered as one subset of emerging markets and developing countries (Peng, 2003). Second, this study takes China as the context of research, which is also commonly accepted as the most important and representative country of emerging markets and developing countries (Child & Yuan, 1996; Peng, 2005). Therefore, similar context-related factors, especially institutional factors among these countries enable the theoretical analysis and empirical findings from this study to offer one general reference to relevant researches on emerging markets and developing countries, where the institution-related problems also influence the involved firms' business activities (Meyer & Nguyen, 2005; Wright, Filatotchev, Hoskisson, & Peng, 2005). In the end, from institutional perspective, this study can benefit more researches, even those on developed countries. North(1990) indicated that the institutional change takes place in all countries. Moreover, Khanna et al (2005) mentioned that the institution-related problems, such as institutional voids, could appear in any country, including developed countries like US, only varying in the extent. Thus the theoretical analysis and findings in this study, especially the ones related to institutions, are able to benefit more researches.



## **9.7 Limitation and future direction**

Like all research, this study has several limitations as well. First of all, as a qualitative study, this study has limited generalizability. It adopts a qualitative approach, in order to explore the unknown Chinese ETCs, especially their transaction processes, and complex institutions in China's export market. However, qualitative study has the reputation of lacking generalizability (Creswell, 2008). To improve such a weakness, this study adapts multiple cases study that do enhance generalizability (Yin, 2003b) to the best possible extent. But it is still not as statistically significant as a quantitative study. In addition, the limited resources and time at the disposal of a PhD thesis also contribute to this situation.

Many studies recommend that qualitative and quantitative approaches are complementary, as the former one is useful for generating new propositions, while the latter can test significance. Therefore, a quantitative study on the propositions developed in this study is recommended for the further in order to consolidate and/ or critique the findings from this study.

The second limitation related to the case selection, which could not encompass all trading institutions in China. As stated in chapter four, the trading companies in China are classified into three groups: large centrally state-owned trading companies with diversified businesses, state-owned trading companies with pure trading businesses and private trading companies. The cases involved in this study mainly come from the last two groups. The reasons for avoiding the first group are threefold. First, these trading companies have gone far from traditional export business, which is the target in this study, due to considerable diversification. Second, their export businesses mainly concentrate on several commodities, which have monopoly power in China. Therefore, the competitive framework in this study is not suitable for these export businesses. Finally, though the case study approach does not aim to seek the most representative ones (Yin, 2003b), this study attempts to offer most and most significant knowledge on Chinese trading companies. Considering the majority of trading companies fall into the last two groups and given the limited space in this study, the lower number of these centrally state-owned trading companies does not

become problematic. However, the recommendation for future study is to undertake a new investigation on these trading companies to complete the whole picture of trading companies in China. In particular, the comparison between Chinese large state-owned trading companies and Japanese GTCs could be most attractive.

Finally, this study has another limitation in so far as little attention is given to informal institutions. The introduction of the institutional perspective is one key contribution of this study. The institutions include formal and informal ones (North, 1990). This study highlights three formal institutions, while only one is informal. Apparently, more attention is paid to formal institutions. More importantly, some informal institutions, such as the popularity of personal networks, have been considered important for studies on transition economies. This is partly because the limited data cannot show these informal institutions, which are normally hard to detect compared with formal institutions (North, 1990). Moreover, the institutional economics, which generates analytical framework in this study, mainly focuses on the formal institution (Scott, 2008), though the recent research has begun to turn to informal institutions. In other words, in order to effectively explore the informal institutions in China's export market, some other relevant institutional theories, such as the legitimacy of institutions from a social science perspective (Scott, 2008), should be considered in future study.

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## **Appendix 1: Multiple case studies protocol**

### **1. Purpose of case studies**

Research objectives and research questions:

First objective: this study aims to explore and investigate the export-related institutions, which generate costs for export transactions in China.

1) What are the institutions, which generate transaction costs for domestic manufacturers and foreign buyers, in China's export market?

Second objective: this study aims to explore and investigate how Chinese ETCs operate a more efficient indirect export market compared with a direct market between domestic manufacturers and foreign buyers.

2) How do Chinese exporting trading companies respond to such institution-related costs as an intermediary between domestic manufacturers and foreign buyers?

### **2. Research design**

#### *The unit of analysis*

The unit of analysis is the Chinese ETCs' business activities, which are institution-related transaction costs during their export transaction process. The exporting transaction process inside ETCs is chosen as the embedded unit. Therefore, the data related to export transaction processes and institutions, which can generate costs during the transaction process, should be collected in each case.

#### *Case selection criteria*

Cases are selected according to following criteria:

1. Location: Mainland China
2. Ownership: Chinese-owned companies
3. Function: The main business of these companies must be exports: the turnover from the export business must be over 50%; according to their own assessment, exporting is their main business
4. Maximum variation strategy: pure and hybrid export trading companies; small and large export trading companies

### *Informant selection criteria*

Key informant: the owners and CEOs in the case, who are clearly the individuals more likely to have acquired knowledge on trading companies and export transactions.

Ordinary informants: department managers, ordinary staff, who can offer information on specific transaction unit procedures, and on their related parts in the case; relevant staff from external organizations, such as manufacturers, who can offer supplementary information from a non-ETC's perspective.

### *Data collection*

Methods for data collection are as follows:

Observation: This is mainly used in pilot study B (Case A). Content includes the ETC's working site, each staff's daily work, the transactional process, communications and business transactions with external organizations. In addition, formal interviews and informal chats were processed during the observation period.

Interviews: This is the main method across cases. They are in-depth and semi-structured interviews. The interviews are guided by a series of question lists and brief structure guide, and open-ended questions at the same time.

Documentation: this contains background documentations related to the company and relevant documentation for triangulation.

### **3. Field procedure**

The place and time of interviews are largely arranged according to the informants' convenience, but a quiet place is preferred in order to avoid interruption and for the purposes of digital recording. As a result, the informants' work places, such as offices, are mainly chosen. Then the interview normally lasts about two hours. The interview guide offers the general flow, while some new questions emphasise emergent items. All interviews are recorded by digital recorder, assisted by some



notes. Before the interview, the research content is briefly introduced to the informants.

*The process of the field research is as follows:*

As a general rule it is timely to update all information in documents throughout the whole data collection process. The information refers to the formal interviews and informal chats, enquiries by email and telephone, secondary data from the internet and published works.

*Pre-interview*

- Establish connection and obtain permission for the interview with interviewees by email and/or telephone
- Process the preliminary investigation of the case company and relevant industry by considering the company website, articles, journals, reports and news
- Book a specific time and place for the interviews with interviewees
- Ask for permission for recording interview with interviewees

*Post-interview*

- Re-listen to the record in case of any failure
- Store and copy the record into specific files in the computer for each case
- Transfer records and field notes into transcripts, which are then also stored in the same file
- Translate transcripts into an English edition, which is then also stored
- Process early data analysis
- List new questions according to certain data, if any
- Ask back the current and previous interviewees for any new questions by email or telephone, or make notes on new questions for the next round of interviews with the same interviewee
- Modify the interview guide for the new interview, if any

## Appendix 2: Interview guide

Interview

No.....Organisation/department:.....

Name of interviewee and title:.....

Date & Time of Interview:.....

Duration of Interview:.....

*The questions below are only trigger ones*

### 2. Firm information

#### 2.1 Can you briefly introduce the firm?

- Date of establishment?
- How was it established?
- What is the nature of its ownership, state-owned or private?
- How many departments/staff are there, their names/titles and responsibilities?
- For SMEs, can you tell me about the owners' working experience?
- What are the important periods and events in the development of your firm?

#### 2.2 Can you tell me about your export products?

- What are your main products and their percentage of the total exporting volume?
- Do you have other products and what is their percentage of the total exporting volume?
- Do your products have any unique features? Such as brands, certificates, standard, special technical ?approvals?requirements?,etc

#### 2.3 Can you tell me something about your manufacturers?

- Do you know the number of the manufacturers?
- Do you know the amount of supply from each manufacturer and their percentage of the total export volume?
- Information about the main manufacturers?
  - Location of the main manufacturers?
  - Scale (number of employees)

- Their production capability?
- Information about their products, including the quality and style?
- The punctuality of the product delivery?
- How long have you collaborated with these manufacturers?

### 2.3 Can you tell me about foreign buyers?

- The number of foreign buyers?
- The percentage of each foreign buyer's purchase amount in the total export volume of the company?
- Information about the main foreign buyers?
  - Their location?
  - The information about the purchased products, including the quality and style?
  - The preference of purchasing, such as delivery time, punctuality, quality?
- How long have you collaborated with these foreign buyers?

## 3. Export transaction information

### 3.1 Can you generally describe the whole export transaction process in your company, step by step?

- -who or which departments in your company are involved in this part?
- -what are their responsibilities?

3.2 I have one brief export transaction flow chart (developed from Case A). Is it the same as the export transaction in your company? What are the differences between your transaction process and the one in this flow chart? And why and how do you do it this way?

### 3.3 Pre-/post-export procedures

- Some people would say that exporters had to apply for many different official approvals for the start-up of an export business, that these applications are quite complex and time-consuming, and that the government policy on these procedures has been changing. What is your opinion about that? What other

problems did you encounter in these procedures? How do you deal with these problems?

- Some people would say that exporters had to submit/receive/register different official approvals to/from/with many departments, and that these applications are quite complex and time-consuming, and that the government policy on these procedures has been changing. What do you say about that? What other problems did you encounter in these procedures? How do you deal with these problems?

3.4 Can you briefly introduce how to transact with foreign buyers, step by step? (3.4 and 3.5 depending on how detailed his/her response to 3.1)

- how did you find the foreign buyers?
- how did you negotiate and sign contracts with them?
- how did you monitor their enforcement of your contracts?

3.3 Can you describe how you transact with domestic manufacturers, step by step?

- How did you find the manufacturers?
- How did you negotiate and sign contracts with them?
- How did you monitor their enforcement of your contracts?
- Some ETCs would say that there were always some problems with these manufacturers, such as poor product quality, postponement of delivery times, etc. What do you say about that? What other problems did you encounter in transactions with your manufacturers? How do you deal with these problems?
- Some people would say that they would not appeal for the legal assistance, if their manufacturers fail to comply with the contract, as they do not trust the legal system in China, and believe that the costs of doing it is too high. What is your view about that?

4 What problems did you encounter when processing export transactions, apart from the ones you have mentioned before?