Journal of International Business Studies (2009) 40, 339–352

www.jibs.net

Competitive position, managerial ties, and profitability of foreign firms in China: an interactive perspective

Julie Juan Li[1], Kevin Zheng Zhou[2] and Alan T Shao[2]

[1]*Department of Marketing, City University of Hong Kong, Kowloon Tong, Hong Kong;* [2]*Department of Marketing, Belk College of Business, University of North Carolina at Charlotte, Charlotte, USA*

Correspondence:
JJ Li, Department of Marketing, City University of Hong Kong, Kowloon Tong, Hong Kong.
Tel: +852 2788 7865;
Fax: +852 2788 9146;
E-mail: julieli@cityu.edu.hk

Abstract
Despite the prominence of the competitive strategy perspective, it remains unclear whether foreign firms entering China can still adopt a differentiation or low-cost position to achieve superior performance, given the unique market and institutional environments in China. Alternatively, should foreign firms follow conventional wisdom and actively build managerial ties with government officials and business community to enhance their performance? This study develops and tests an interactive perspective that highlights the moderating effects of managerial ties on competitive position–performance relationships. The results indicate that though both differentiation and low-cost positions foster foreign firm profitability, the benefit of a differentiation position is conditional on political and business ties in different directions: political ties impede and business ties strengthen the positive effect of a differentiation position on foreign firms' profitability. Moreover, foreign firms benefit from their use of business ties, but their profitability suffers when they rely increasingly on the heavy use of political ties.
Journal of International Business Studies (2009) **40,** 339–352.
doi:10.1057/jibs.2008.76

Keywords: competitive strategy perspective; social network theory; strategic choice; managerial ties; emerging economy; China

INTRODUCTION

How to achieve competitive advantage and superior performance represents a central issue in strategy literature (Day, 1994; Porter, 1985). Scholars have proposed alternative theoretical views to explain the development of competitive advantage: of these, the competitive strategy perspective is one of the most influential (Porter, 1980, 1985). According to this perspective, competitive advantage results from a firm's correct positioning in an attractive market based on its analysis of opportunities and threats in the competitive environment. Two primary positions of competitive advantage exist: differentiation and low cost. A *differentiation position* is achieved when buyers consistently perceive a firm's offerings as unique in the market, whereas a *low-cost position* arises when the firm becomes the lowest-cost producer in the industry (Porter, 1985). A substantial body of empirical literature supports the contention that differentiation and low-cost positions lead to superior performance (e.g., Miller, 1988; Miller & Friesen, 1986; Phillips Chang, & Buzzell, 1983; Song & Perry, 1997).

Received: 31 March 2006
Revised: 15 July 2007
Accepted: 19 February 2008
Online publication date: 6 November 2008

Despite this prominence, most research on the competitive strategy perspective pertains to developed economies, especially the United States, which leaves the question of whether it applies in emerging economies under-researched (Spanos, Zaralis, & Lioukas, 2004: 140). Although in recent years foreign firms have invested substantially in emerging economies such as China, they continue to encounter serious strategic challenges from the unprecedented and rapid changes in those markets (Zhou, Tse, & Li, 2006). In particular, firms face challenges from turbulent market conditions characterized by low levels of economic structure, rapid economic growth, and fundamental restructurings of industry composition (Peng, 2003). The massive changes in institutional environments pose another severe challenge. Constraints associated with China's previous institutional systems have been greatly weakened by massive and complex reforms, but new, market-based mechanisms have yet to be established. The lack of market-based institutions makes it unknown whether foreign firms can adopt market-oriented strategies to enhance their performance in China. Many suggest that firms must actively rely on managerial ties (*guanxi* in Chinese) – executives' personal connections and ties with external entities – with government officials (i.e., *political ties*) and/or business communities (i.e., *business ties*) to conduct business and coordinate exchanges (Peng & Luo, 2000; Tsang, 1998; Xin & Pearce, 1996).

In short, though it is well established in Western literature that a differentiation or low-cost position is vital for superior performance, the unique market and institutional environments in China make it unclear whether foreign firms entering China can adopt a differentiation or low-cost position to achieve superior performance. Moreover, despite the prevalence of managerial ties in Chinese business environments, it remains unknown how political and business ties may affect foreign firms' performance, and how they could enhance or impede the effects of differentiation and low-cost positions on performance in China.

To address these research gaps, this study develops and tests an interactive perspective that highlights the moderating role of managerial ties in the relationships between competitive positions and performance. Because business as a social phenomenon is embedded in a system that consists of both economic and social factors, interpersonal relations always exist and affect the effectiveness of firm strategies (Granovetter, 1985; Uzzi, 1997). However, no study examines the effects of managerial ties and competitive positions simultaneously or interactively (Gulati, 2007), which prevents theoretical completeness and limits our understanding of strategic choices in emerging economies. Our study not only examines the roles of competitive positions and managerial ties independently but also advances an alternative, interactive position that may describe more accurately how foreign firms achieve better performance in China. Our focus on how competitive positions and managerial ties interact to affect firm performance represents the first attempt to examine the interdependent nature of market- and network-based strategies. Figure 1 depicts our conceptual model.

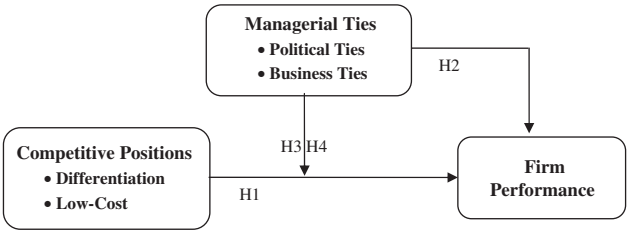

Figure 1 The conceptual model.

THEORY AND HYPOTHESES

Competitive Strategy Perspective

Michael Porter's (1980, 1985) theory of generic competitive strategy undoubtedly is one of the most influential and dominant paradigms in strategy literature (Campbell-Hunt, 2000; Hill, 1988). According to this perspective, the most critical factor for a firm's success is its ability to occupy an attractive *position* in the industry, which can arise from either differentiating its offerings and charging a premium price or selecting a cost base lower than that of its competitors but still offering a comparable product. Accordingly, differentiation and low-cost positions represent two fundamentally different routes to competitive advantage and superior performance. Prominent differentiation activities include superior service, innovative features, strong brand names, effective promotion programs, and so on. The primary low-cost activities involve the "aggressive construction of efficient-scale facilities, vigorous pursuit of cost reductions …, and cost minimization in [various] areas" (Porter, 1980: 35).

Early empirical examinations of the competitive strategy perspective concentrate on developed economies, especially the United States. For

example, using PIMS data, Phillips et al. (1983) show that product differentiation positively affects firm performance. Miller and Friesen (1986) find that US firms pursuing either a differentiation or a low-cost position outperform those that follow neither. Miller (1988) also develops a contingent view, such that product differentiation fosters performance in a volatile environment, whereas a low-cost position is more effective in a stable environment. Song and Perry (1997) indicate that product differentiation leads to superior new product performance for both US and Japanese firms. Recent studies extend this stream of research to emerging economies. For example, Aulakh, Kotabe, and Teegen (2000) examine the effects of the export strategies of firms from emerging economies on their performance in foreign markets. They report that when firms from emerging economies go after a low-cost position in developed countries their performance improves; in contrast, firms pursuing a differentiation position achieve better performance in developing countries. Brouthers and Xu (2002) document that Chinese exporters are less satisfied with their performance if they focus on low price, but their performance satisfaction increases when they aim to develop a name brand. More recently, Spanos et al. (2004) find that low cost appears to be the key ingredient of the most profitable positioning in Greece. These efforts undoubtedly have enriched existing understanding of the role of the competitive strategy perspective in developed and emerging economies. However, because most studies focus on the domestic firms, left unexamined is the issue of whether differentiation and low-cost positions also benefit foreign firms[1] pursuing success in China, given its unique market and institutional environments.

Differentiation position. A differentiation position aims to provide offerings that are specifically tailored to a target market (Porter, 1985). It enables firms to create unique images for their market offerings and achieve high levels of customer loyalty and satisfaction (Miller, 1988). Because loyal customers are less sensitive to price changes, firms can command premium prices or sell more of their products at a given price, which increases profits (Porter, 1985). A unique image also enables the firm to attract new customers, introduce new products, and withstand short-term environmental fluctuations more easily, in addition to enjoying lower costs to service existing customers (Anderson, Fornell, & Rust, 1997). Therefore a differentiation position should enhance firm profitability.

We expect that the benefits of differentiation may be particularly salient for foreign firms in China. Owing to their relatively short experience with market exchanges, weak related and supporting industries, and lack of reliable market information, firms in emerging economies tend to rely primarily on low-cost production factors such as cheap labor to drive growth (Porter, 1998). Many Chinese firms (especially small- to medium-sized firms) have adopted this practice to help enhance productivity, utilize capacity, cut costs, and expand market share (Zhou & Li, 2007), as signified by the recent trade disputes between China and the United States and China and the European Union (BusinessWeek, 2006). However, the trade-off inherent in such a low-cost focus is the oversupply of homogeneous products in the market, which seriously limits customer choices and their satisfaction. Rapid economic development during the past two decades has made China the second economy, after only the United States, in terms of purchasing power parity (World Bank, 2007). With their rapidly growing disposable income, Chinese customers have stronger desires than ever before to attain quality products that can meet their particular needs, which creates a golden opportunity for foreign firms. Foreign firms often have more resources that they can use to build a unique brand, and they typically have much more experience building their brands and brand equity, some of which are more than a century old (Brouthers & Xu, 2002). As a result, consumers in developing markets tend to perceive the products of foreign firms as superior in quality, and are willing to pay a price premium for them (Hulland, Todino, & Lecraw, 1996). Therefore:

> **Hypothesis 1(a)**: A differentiation position has a positive effect on the profitability of foreign firms in China.

Low-cost position. A low-cost position aims to provide comparable products at a lower cost. It leads to above-average returns because firms can charge a lower price than competitors but still earn profits (Porter, 1985). However, Porter (1985: 13) cautions that a low price alone is not sufficient to achieve better performance; rather, the firm must "achieve *parity* or *proximity* in the bases of differentiation relative to its competitors," in which case the firm can use a low-cost position to

achieve a competitive advantage. That is, the firm must provide a comparable or equally desirable product to the target market before it can translate its low cost into higher profits.

In this sense, a low-cost position may be a desirable choice for foreign firms. As a transitional economy, the Chinese market is less efficient, because effective legal systems and market-based institutions have yet to be established (Peng, 2003). Malpractices, such as deceptive advertising or unethical business practices (e.g., selling fake or very poor-quality products), have aroused particular concerns among customers (Ho, 2001). Therefore Chinese customers are very concerned with the availability of quality products. At the same time, despite the rapidly growing economy, Chinese consumers have relatively less purchasing power than their counterparts in developed countries. As a result, they still prefer quality products with a low price (Zhou, Su, & Bao, 2002). However, many industries in China are fragmented, within which many small-scale companies exist and compete merely on price but provide few quality guarantees (Ho, 2001). Because foreign firms tend to have a stronger reputation and often represent quality assurance, if they pursue a low-cost position (e.g., based on economies of scale) to cater to the purchasing power of the Chinese market, they likely can achieve superior performance. That is:

Hypothesis 1(b): A low-cost position has a positive effect on the profitability of foreign firms in China.

An Interactive Perspective

The effect of any strategic position is subject to the influence of the context surrounding the business. During the initial stages of economic transition, business in emerging economies is predominantly coordinated through ties-based mechanisms because of the lack of formal, market-supporting institutions (North, 1990). As emerging economies progress, market-based strategies, such as competitive positions or firm resources, begin to gain prominence (Peng, 2003). Because economic activities are always entrenched in networks of human beings, the effectiveness of a competitive position is shaped by managers' connections with the external community. That is, competitive positions and managerial ties necessarily intertwine to affect firm performance. However, extant literature has not assessed this interplay, which represents a significant research gap (Gulati, 2007). In the following, we first examine the direct effects of ties and then investigate how ties moderate the competitive position – firm profitability relationship.

Direct effects of ties. According to social network theory, economic actions are deeply embedded in networks of interpersonal relations, and managers can use the social capital inherent in their managerial ties to influence the allocation of resources and shape economic actions (Batjargal, 2003; Granovetter, 1985; Uzzi, 1997). The role of ties is more evident in emerging economies, in which formal institutional constraints (e.g., laws, regulations) remain relatively weak: thus firms must rely on informal institutional constraints, such as interpersonal ties, to facilitate their economic exchanges (Xin & Pearce, 1996). In other words, managerial ties substitute for reliable government and the established rule of law to support transactions and exchanges. Empirically, Peng and Luo (2000) find that political ties positively affect market share and return on assets (ROA), whereas business ties foster market share but not ROA for Chinese firms. Park and Luo (2001) further report that political and business ties enhance sales growth but have no effect on profits.

Despite the growing attention to the role of ties, existing literature focuses almost exclusively on the positive consequences, such that their possible negative consequences are seriously neglected (Gulati, 2007). Only recently have researchers begun to examine the downside. For example, Chen, Chen, and Xin (2004) find that the practice of ties in human resource management reduces employees' trust in management. Warren, Dunfee, and Li (2004) report that Chinese businesspeople perceive the practice of ties as harmful to individuals, businesses, and communities because it may lower ethical standards, result in the hiring of unqualified employees, and hinder the development of legal systems. Fan, Wong, and Zhang (2007) also document that publicly listed firms with politically connected CEOs underperform those without politically connected CEOs by almost 18% in 3-year post-IPO stock returns and suffer worse 3-year post-IPO earnings growth, sales growth, and change in returns on sales. Siegel (2007) shows that the political ties of South Korea companies decrease their chances to form international strategic alliances if the political regime changes. However, because empirical research focuses primarily on local firms, little is known about whether foreign firms can benefit from ties in

China. We therefore extend this literature by suggesting that whereas foreign firms can realize better returns from business ties, their profitability likely suffers from their use of political ties.

Political ties represent managers' connections with government officials, including political leaders in various levels of government, officials in industry bureaus, and officials in regulatory and supporting organizations (Peng & Luo, 2000). In emerging economies in which market mechanisms and market-supporting institutions are underdeveloped or under-enforced, top managers resort to networking to seek the institutional support that is taken for granted in most developed economies (Xin & Pearce, 1996). Thus political ties help firms achieve more institutional support – such as interpreting regulations, enforcing contracts, settling negotiations, and erecting entry barriers – to counter the threats and uncertainties inherent in a transitional economy (Peng & Luo, 2000). Because state regulatory regimes still exert considerable influence on resource allocations, political ties also help firms obtain scarce resources, such as access to capital, land, and human resources (Li, 2005). For these reasons, a commonly held notion is that foreign firms must actively build political ties to succeed in China (Tsang, 1998).

However, the practice of political ties is not without costs. The most severe consequence is intervention from the government. When a firm uses its political ties to obtain scarce resources or gain permission to enter certain businesses, in return it must accommodate or yield to requests from those political ties. For example, many firms hire unqualified employees who are relatives of government leaders and place them in important positions, even though their skill is poor or unprofessional (Warren et al., 2004). To maintain their political ties, firms also must fulfill politically oriented goals, such as improving the employment rate for the local government. Fan et al. (2007) further document that firms with politically connected CEOs are more likely to have current or formal government bureaucrats on their boards, whose low degree of professionalism severely impairs firm performance. Moreover, the practice of political ties often involves bribery: firms must offer money or other forms of compensation to establish relations with the local authorities (Warren et al., 2004). Such practices not only incur substantial costs to the firm but also lower its ethical standards. Local firms may take these practices for granted, because the use of ties is heavily rooted in traditions and customs that span thousands of years (Xin & Pearce, 1996), but foreign firms may find them incompatible with their value maximization orientation.

Taken together, it appears a certain level of political ties is necessary for foreign firms to gain access to the Chinese market; however, a high level of political ties may induce substantial costs and decrease their profitability. Because of the significant influence of the conventional notion that foreign firms must actively build political ties in China (Tsang, 1998), we suspect that foreign firms' reliance on political ties is *overall* quite high. Our hypothesis, which focuses on the high use of political ties, therefore predicts a negative relationship between political ties and profitability.

> **Hypothesis 2(a)**: The utilization of political ties has a negative effect on the profitability of foreign firms in China.

Business ties are managers' connections with their counterparts at other firms such as buyers, suppliers, and competitors (Peng & Luo, 2000). A major challenge for foreign firms operating in a local market is the liability of foreignness, in that additional costs may arise because foreign firms are not familiar with the market and institutional environments that shape business transactions (Zaheer, 1995; Zou & Cavusgil, 2002). The rapidly changing nature of emerging economies makes this challenge even more critical. Building ties with the local business community provides a great opportunity for overcoming the liability of foreignness because the ties facilitate local knowledge transfer, shared learning, and resource exchange. For example, tight linkages with suppliers enable a firm to acquire quality materials and services and timely delivery, which often is not widely available in emerging economies; connections with top managers at other firms in the same industry also facilitate information exchange, which can reveal scarce "insider" information (Boisot & Child, 1996; Xin & Pearce, 1996). Close ties with buyers also help foreign firms understand the tastes and preferences of local customers and thereby enable them to serve their customers better and win customer loyalty (Li, 2005).

Although the cultivation of business ties entails obligations and costs, these ties are more equally reciprocal in nature than are political ties. Business ties generally rely on personal relations and

exchanges of favors, which can be repaid at some point in the future (Yang, 1994). Unlike political ties, which involve demands from the government, business ties have more flexibility with regard to how the obligations or favors should be repaid. For example, firms may recruit employees in response to requests from companies with which they have good connections, but they can place those employees into unimportant positions and enjoy the advantage of providing a big favor to the other party (Chen, 2001). In other words, business ties do not involve mandatory requests or interventions from the business community. As a result, the benefits of business ties should outweigh their costs.

Hypothesis 2(b): The utilization of business ties has a positive effect on the profitability of foreign firms in China.

Moderating effects of ties. Political ties may negatively moderate the relationship between competitive positions and profitability of foreign firms for several reasons. First, when foreign firms use political ties in their business operations, they rely on favorable treatment from the government to achieve their business success (Li, 2005). This high level of dependence decreases their motivation to pursue a unique position or find ways to lower their costs to achieve better performance. Second, foreign firms tend to excel at market-oriented strategies and efficiency-based routines, which are accumulated through their competition experience based on the rule of the "invisible hand". A heavy reliance on political ties, however, often involves the "grabbing hand" of government. The incompatibility of the two rules and mindsets likely disrupts foreign firms' normal operations and their efforts to build a unique image or minimize costs (Shleifer & Vishny, 1998). Third, the ultimate goal of the Chinese government is to build globally competitive Chinese firms (Nolan, 2001). Siegel (2007) similarly observes that Korean politicians target their support to local Korean firms rather than foreign companies; in fact, politicians and government officials often want to avoid being seen as even indirectly supportive of foreign companies. At the same time, in many emerging economies, the government's extensive bureaucracy never fully codifies the information it uses to control enterprises. The interpretation and reinforcement of rules and regulations becomes subject to local authorities' discretion (Boisot & Child, 1996). As a result, foreign firms may find it particularly difficult to grasp the real meaning of communications with local government officials, who may purposely offer ambiguous information. Therefore foreign firms may not be able to use the information they obtain from political ties effectively, which inhibits their organizational processes and routines for maximizing the efficiency and implementation of their competitive positions.

Hypothesis 3: The utilization of political ties negatively moderates the effects of (a) differentiation and (b) low-cost positions on the profitability of foreign firms in China.

In contrast, business ties may strengthen the effects of competitive positions on performance. To implement their differentiation positions successfully, foreign firms must thoroughly understand the preferences of local customers, which is often problematic because foreign firms are unfamiliar with the host country (Zaheer, 1995). Business ties fill this void by facilitating the exchange of valuable information about the local market. In particular, close ties with buyer companies provide foreign firms with insights into how to develop products specifically for local demand. With this knowledge, foreign firms can better implement their differentiation positions and increase profits. Similarly, the successful implementation of a low-cost position depends on whether reliable resources are available, yet a salient feature of emerging economies is the shortage of production factors, skilled labor, and reliable market information (Khanna & Palepu, 1997). Close ties with suppliers enable the firm to acquire production inputs at a lower cost, which grants it a cost advantage. Moreover, the referral trust it gains from its business ties offers a foreign firm legitimacy in doing business in the local market and reassurance in transactions with external parties. Such social capital generated from ties signifies the strong reputation of and goodwill toward a firm, which helps it conduct its business more efficiently than others in rapidly transitioning environments, in which opportunistic behavior is a common threat (Adler and Kwon, 2002). Therefore:

Hypothesis 4: The utilization of business ties positively moderates the effects of (a) differentiation and (b) low-cost positions on the profitability of foreign firms in China.

METHOD

Sampling and Data Collection

Our sample consists of foreign-invested enterprises (FIEs) in manufacturing sectors located in three major areas (Beijing, Guangzhou, and Shanghai) in China. On the one hand, managerial ties are deeply embedded in Chinese history and highly influential in business conduct (Xin & Pearce, 1996). On the other hand, the influx of foreign firms has created new forms of competition, marketing, and management that make competitive positions more important for businesses (Zhou, Yim, & Tse, 2005). Therefore our research context provides a rich setting to test the role of competitive positions and managerial ties in emerging economies.

We selected a random sample of 600 FIEs from a list of manufacturing firms with four-digit standard industrial classification codes 2011–3899, which span diverse industries such as electronics, computer equipment, chemicals, apparel, furniture, and plastics. On the basis of previous studies and our fieldwork, we first developed an English-language version of the questionnaire, translated it into Chinese, and then commissioned a back-translation by two independent translators. We also asked an expert on Chinese business to review our Chinese version of the questionnaire and conduct five in-depth interviews with senior marketing managers to gather comments about the relevance and validity of the measurement items. On the basis of their responses, we revised a few questionnaire items to enhance their clarity. We next conducted a pilot study with 20 senior managers. In the personal interviews, we asked these respondents to answer the questionnaire items and provide feedback about their design and wording; their responses prompted us to refine the questionnaire further and finalize the survey.

For the formal survey, we selected a local senior manager (e.g., CEO, vice president, senior marketing manager) from each firm to serve as the key informant, because foreign firms rely heavily on their local managers to cultivate network ties (Ralston, Terpstra-Tong, Terpstra, Wang, & Egri, 2006: 827). Our field interviews also revealed that these managers are familiar with their firm's competitive positions and managerial ties. We recruited trained interviewers to conduct on-site personal interviews, because this method is more likely to generate valid information in emerging economies (Hoskisson, Eden, Lau, & Wright, 2000). To test the causal link of the model and reduce common method bias, we undertook a two-stage design. In Stage 1 (in February/March 2004), we collected information about competitive positions and managerial ties. Specifically, the trained interviewers contacted the senior managers via telephone to solicit their cooperation, informed respondents of the confidentiality of their responses and the academic purpose of the project, and promised them a summary report of the survey and a souvenir as a reward for participating. These initial telephone contacts prompted 228 senior managers to agree to participate. The interviewers then interviewed 188 respondents successfully onsite, for a response rate of 31.1%. A comparison of responding and nonresponding firms indicates no significant differences in terms of the key firm characteristics (e.g., firm ownership, size, location, industry), so nonresponse bias is not a concern. In Stage 2, 1 year later (i.e., 2005), we obtained information about ROA (2004) from archival data to indicate firm profitability. These lagged performance data help us examine the causal relationships between competitive positions/managerial ties and performance. However, because one firm's ROA was not available, our final sample size is 187.

Of the 187 FIEs, most (63.7%) had between 100 and 1000 employees, and 78.5% had annual sales revenues of more than US$3 million. Furthermore, 46.5% were joint ventures, and 53.5% were wholly foreign-owned firms. In terms of industry, 47.1% were high-tech companies, such as computer equipment, electronics, and biotech, whereas 52.9% were others, such as transportation equipment, apparel, furniture, and plastics. On average, the respondents had been working for 9.4 years in the industry and 4.8 years with their company.

Measures

In the Appendix, we provide the measurement items and their validity assessments. All items, unless otherwise indicated, use seven-point Likert scales (1 = strongly disagree; 7 = strongly agree).

Competitive position. We drafted a set of five items for differentiation and low-cost positions from previous theoretical and empirical works, including Porter (1980, 1985), Narver and Slater (1990), Pelham and Wilson (1996), and Song and Perry (1997). On the basis of our in-depth interviews with five senior managers, we modified the measures and reduced the number of items to four. In particular, our measure of differentiation position relies on Porter's (1985) and Song and Perry's (1997)

work, and the measure of low-cost position stems from research by Narver and Slater (1990) and Pelham and Wilson (1996).

Managerial ties. Name and position generators represent two popular measures of network ties in network literature (Batjargal, 2003; Burt, 1992; Lin, Fu, & Hsung, 2001). However, in our research context, employing these approaches is difficult because, in China, network structures constitute top business secrets, so managers are very protective of this sensitive information (Peng & Luo, 2000: 491). Our field interviews also indicated that managers are reluctant to reveal details about their network structures. Therefore, similar to Batjargal and Liu (2004) and Peng and Luo (2000), we used perceptual measures of tie utilization that featured two components: a three-item scale for top managers' ties with managers at other firms (i.e., buyers, suppliers, and competitors) and a three-item scale for ties with government officials (i.e., political leaders in various levels of government, officials in industrial bureaus, and officials in regulatory and supporting organizations).

Profitability. We used ROA to indicate firm profitability, and obtained this information from the archival data supplied by a local research company.

Cross-validation. Because our measures of competitive positions and managerial ties were perceptual, we undertook two approaches for cross-validation. First, we conducted additional interviews with 50 senior managers from 25 firms that had participated in the previous survey (two managers from each firm). The interrater reliability between the two managers was 0.810 for differentiation position, 0.871 for low-cost position, 0.875 for political ties, and 0.833 for business ties: all are well above the 0.60 benchmark (James, 1982). Second, we asked the managers of the 25 firms to refer us to a senior manager from a key customer company, and then telephone-interviewed the identified manager regarding tie utilization with the focal firm, the differentiation position of the focal firm, and whether the focal firm used a low-cost position. These responses are largely consistent with the comments from the managers of the focal firms (interrater reliability is 0.735 for tie utilization, 0.756 for differentiation position, and 0.709 for low-cost position). These results support the validity of our perceptual measures.

Construct validity. We assessed the construct validity of our perceptual measures by estimating an overall four-factor confirmatory measurement model (see the Appendix). The model provides a satisfactory fit to the data (goodness-of-fit index [GFI] = 0.92, comparative fit index [CFI] = 0.94, incremental fit index [IFI] = 0.94; root mean square error of approximation [RMSEA] = 0.05) (Anderson & Gerbing, 1988). Moreover, all factor loadings are highly significant ($p < 0.001$), and the composite reliabilities of all constructs (0.71–0.90) exceed the 0.70 benchmark. All average variances extracted (AVE) except one are greater than 0.50. Thus the measures demonstrate adequate convergent validity and reliability (Fornell & Larker, 1981).

We assessed the discriminant validity of the measures by running chi-square difference tests for all constructs in pairs (six tests) to determine whether the restricted model (correlation fixed at 1) is significantly worse than the freely estimated model (correlation estimated freely). All chi-square differences are highly significant (e.g., political ties *vs* business ties: $\Delta\chi^2$ (1) = 204.08, $p = 0.000$), in support of discriminant validity. We also followed Fornell and Larker (1981) to calculate the shared variance between all possible pairs of constructs to determine whether they are lower than the AVE of the individual constructs. For each construct, the AVE is much higher than its highest shared variance with the other constructs, in additional support of discriminant validity (see the Appendix). These results indicate that our measures possess adequate reliability and validity.

Control variables. To account for the effects of extraneous variables, we included firm size, firm age, firm ownership, industry, and market growth as control variables (Narver & Slater, 1990; Zhou et al., 2006). We used the logarithm of the number of employees to indicate firm size. Firm age refers to the number of years the firm has been in operation. Firm ownership represents a dummy variable that controls for potential variations between international joint ventures (coded 1) and foreign wholly owned firms (coded 0). We also measured industry as a dummy variable, where 1 = high-tech (e.g., computer and electronic equipment) and 0 = otherwise (e.g., apparel, furniture). For market growth, we asked respondents to indicate "the average annual growth rate of total sales in the served market segment over the past three years" (1 = very low, 7 = very high) (Narver & Slater,

Table 1 Basic descriptive statistics of the constructs

Construct	*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*
1. Differentiation position	1.00									
2. Low-cost position	0.37**	1.00								
3. Political ties	0.16*	0.11	1.00							
4. Business ties	0.24**	0.18*	0.43**	1.00						
5. ROA	0.25**	0.27**	−0.15*	0.21*	1.00					
6. Firm size	0.09	0.06	−0.02	−0.10	−0.07	1.00				
7. Firm age	0.04	−0.04	−0.08	−0.11	−0.02	0.29**	1.00			
8. Firm ownership	−0.06	−0.09	0.11	0.07	−0.02	0.01	−0.03	1.00		
9. Industry	0.04	0.09	−0.06	0.05	−0.01	0.03	−0.15*	−0.04	1.00	
10. Market growth	0.26**	0.23**	0.21**	0.29**	0.20**	−0.02	−0.26**	0.00	0.14	1.00
Mean	5.12	4.49	5.28	5.29	0.16	5.49	9.56	0.47	0.47	4.98
Standard deviation	0.95	0.86	1.08	0.81	0.15	1.05	14.33	0.50	0.50	1.10

Sample size = 187.
**p < 0.01, *p < 0.05 (two-tailed).

1990). We present the basic descriptive statistics and correlations of the measures in Table 1.

ANALYSES AND RESULTS

Because our hypotheses suggest interaction terms composed of competitive positions and managerial ties, a moderated regression analysis is appropriate for testing the effects (Aiken & West, 1991). To deal with possible multicollinearity between the interaction terms and their components, we mean-center each scale that constitutes an interaction term and create the interaction terms by multiplying the relevant mean-centered scales (Aiken & West, 1991). We take a hierarchical approach, in which we first include the control variables in the model, then add the focal variables, and finally include the interaction terms. This hierarchical procedure results in three models, labeled M1–M3 (Table 2).[2] In the models, the largest variance inflation factor, a multicollinearity indicator, is 1.94, well below the usual 10.0 benchmark. Thus multicollinearity is not a concern in our analysis.

With Hypothesis 1, we consider the effects of competitive positions. As we show in Table 2, a differentiation position (DP) relates positively to ROA (M2: $b = 0.15$, $p < 0.05$; M3: $b = 0.14$, $p < 0.05$), in support of Hypothesis 1(a). A low-cost position (LCP) also relates positively to ROA (M2: $b = 0.19$, $p < 0.01$; M3: $b = 0.19$, $p < 0.01$), in support of Hypothesis 1(b).

In Hypothesis 2, we address the role of managerial ties, and consistent with our prediction in Hypothesis 2(a), political ties (PT) negatively affect ROA (M2: $b = -0.20$, $p < 0.01$; M3: $b = -0.17$, $p < 0.05$). In contrast, business ties (BT) have a positive effect on ROA (M2: $b = 0.16$, $p < 0.05$; M3: $b = 0.15$, $p < 0.05$), in support of Hypothesis 2(b).

Hypotheses 3 and 4 assess the moderating role of managerial ties. The interaction between PT and DP is negatively associated with ROA (M3: $b = -0.17$, $p < 0.05$), in support of Hypothesis 3(a). However, the interaction between PT and LCP is not significant (M3: $b = 0.12$, $p > 0.10$), providing no support for Hypothesis 3(b). In addition, the interaction between BT and DP positively affects ROA (M3: $b = 0.20$, $p < 0.05$), in support of Hypothesis 4(a). However, the interaction between BT and LCP is not significant (M3: $b = -0.06$, $p > 0.10$) and provides no support for Hypothesis 4(b). Thus both Hypothesis 3 and Hypothesis 4 receive mixed support.

Additional analysis. As discussed earlier, a curvilinear, inverted U-shaped relationship may exist between political ties and foreign firms' profitability. However, we suspect that the heavy use of political ties makes the relationship fall into the high-end of the political ties and therefore become negative. We run two additional analyses to confirm our reasoning. First, we run descriptive analyses of political ties and find that its mean is 5.28 on a seven-point scale: among the 187 sample firms, only 21 (11.2%) have a mean value lower than 4, and the remaining 166 (88.8%) have a mean value higher than or equal to 4, with a mode value of 6 (23.5%). These results confirm that the

Table 2 Results of regression analysis: standardized coefficient estimates (*t*-values)

Variables	*ROA*					
	M1		*M2*		*M3*	
	b	*t-value*	*b*	*t-value*	*b*	*t-value*
Control variables						
Firm size	−0.08	−1.08	−0.09	−1.24	−0.08	−1.06
Firm age	0.05	0.61	0.02	0.33	0.03	0.34
Firm ownership	−0.02	−0.30	0.02	0.23	0.03	0.42
Industry	−0.03	−0.46	−0.07	−0.93	−0.08	−1.06
Market growth	0.21**	2.79	0.14*	1.97	0.14*	1.96
Independent variables						
H1(a): Differentiation position (DP)			0.15*	1.98	0.14*	1.96
H1(b): Low-cost position (LCP)			0.19**	2.53	0.19**	2.54
H2(a): Political ties (PT)			−0.20**	−2.54	−0.17*	−2.21
H2(b): Business ties (BT)			0.16*	1.99	0.15*	1.97
Interactions						
H3(a): PT × DP					−0.17*	−2.07
H3(b): PT × LCP					0.12	1.32
H4(a): BT × DP					0.20*	2.21
H4(b): BT × LCP					−0.06	−0.62
R^2	0.05		0.15		0.19	
ΔR^2			0.10**		0.04*	
Model *F*	2.79*		3.60**		3.15**	
d.f.(*p*, *n*−*p*−1)	5, 181		9, 177		13, 173	

**p < 0.01, *p < 0.05 (two-tailed).

use of political ties is quite high overall. Second, we add PT^2 to the regression model and find that it is not significantly related to ROA ($b = 0.05$, $p = 0.54$). These results support our reasoning that a high level of political tie utilization makes its effect on profitability negative.

DISCUSSION

This article develops and tests an interactive perspective that highlights the interplay of competitive positions and managerial ties in affecting foreign firms' profitability in China. We find that though both differentiation and low-cost positions foster the profitability of foreign firms, the benefit of a differentiation position is conditional on political and business ties in different directions. In particular, political ties impede and business ties strengthen the positive effect of a differentiation position on foreign firms' profitability. Moreover, foreign firms benefit from their use of business ties, but their profitability suffers when they rely increasingly on the heavy use of political ties. Our study thus contributes to the literature in two major ways.

First, despite the prominence of the competitive strategy perspective, few researchers have examined its role in emerging economies for foreign firms (Spanos et al., 2004). Given the fast-transition nature of the Chinese market and institutions, can a differentiation and/or low-cost position still enhance firm performance? How are the effects of competitive positions affected by the prevalent practice of managerial ties in China? Compared with their counterparts in developed economies, foreign firms in emerging economies face greater challenges because the market-support institutions, such as the legal system and strategic factor markets, have not been well developed yet (Hoskisson et al., 2000). Do generic strategic positions still matter in such market? Our findings suggest the answer is "yes", because both differentiation and low-cost positions lead to higher levels of profitability. Foreign firms tend to have more resources and experience in building a strong

brand, which meets the increasing demand of Chinese customers for high-quality and unique products. Foreign firms also have a high reputation for quality assurance. With such quality assurance, a low-price position can cater to the relatively low purchasing power of the local market, which leads to superior performance.

More important, we predict and confirm that the effect of competitive positions is moderated by the firm's political and business ties in different directions. Political ties impede the impact of a differentiation position on firm profitability. Possibly, a heavy reliance on political ties may reduce managers' motivation to compete on unique differentiation, as well as conflict with the market-oriented processes normally practiced by foreign firms. As a result, foreign firms may lose their competitive edge when relying heavily on political connections. In contrast, business ties strengthen the effect of a differentiation position on the profitability of foreign firms. Because foreign firms are unfamiliar with the local market environments, business ties are critical for generating local knowledge, which enables them to differentiate their products meaningfully from those of other firms. Therefore the application of Western knowledge to an emerging market must take into account market and institutional uniqueness. In this aspect, our study represents an initial effort to examine how competitive positions and managerial ties interact to affect performance, and thus fills a significant gap in extant literature (Gulati, 2007).

Second, our research enriches social network theory by showing the potential downside of ties in emerging economies. To date, most research highlights the positive role of managerial ties, calling them key to firm success in emerging economies (e.g., Batjargal, 2003; Park & Luo, 2001; Peng & Luo, 2000; Xin & Pearce, 1996). Conventional industry wisdom also urges foreign firms to build ties actively to function effectively in China (e.g., Financial Times, 2004; Tsang, 1998). Our findings confirm the prevalent practice of ties, because even foreign firms use political ties at a rather high level. However, our findings challenge this conventional wisdom and reveal instead that foreign firms should be cautious when using ties in China. Although ties with the business community can help enhance their performance, political ties are detrimental to their profitability. These results differ from Peng and Luo's (2000) findings that political ties have a positive effect but business ties have no effect on ROA. This inconsistency may pertain to sample differences: whereas they consider Chinese firms, we investigate foreign firms. The other reason relates to the time difference: their data were collected in 1996/1997, whereas ours come from 2004. During these years the Chinese market has evolved steadily toward a market economy, especially after it joined the World Trade Organization in 2002. As a result, the role of political ties, which were prominent in 1996/1997, appears to have declined over time and even become detrimental to foreign businesses. Relying heavily on political ties initiates intervention by the government, which severely disrupts foreign firms' operations and causes the costs of political ties to outweigh their benefits. In contrast, business ties gain in importance, because they help foreign firms overcome the liability of foreignness and grow familiar with the local market. Such local knowledge is critical for foreign firms to compete in a new market. Consistent with recent evidence that publicly listed Chinese firms suffer from their political connections (Fan et al., 2007), our findings add to social network theory on the negative consequences of network ties.

Managerial Implications

So on what should foreign firms focus in China: competitive positions or managerial ties? Our findings suggest that foreign firms can adopt either a differentiation or a low-cost position to achieve superior performance. However, foreign firms must understand that the benefits of a differentiation position are conditional on their use of managerial ties. If they rely too heavily on political ties, their efforts to pursue a differentiation position will be fruitless. Instead, foreign firms must actively build ties with local business communities, such as buyers, suppliers, and competitors, to differentiate themselves and achieve higher returns.

Moreover, foreign firms must be cautious in their use of managerial ties. Practitioners have long believed that "who you know is more important than what you know" in terms of business conduct in emerging economies (e.g., Chen, 2001; Financial Times, 2004; Tsang, 1998). Foreign firms seem to follow this suggestion and actively build ties with government officials. However, foreign firms must be very careful about their heavy use of political ties because this intense level of political ties dampens their profitability. Political ties may be necessary to gain permission to enter certain markets, but foreign firms should refrain from a heavy reliance on political ties; otherwise, their profitability will suffer.

Rather, foreign firms should strengthen their connections with local business communities to overcome the liability of foreignness and pay greater attention to market-based strategies and competences to capture opportunities in emerging economies.

Limitations and Further Research

Our findings must be interpreted within the limitations of this study. First, our results demonstrate the importance of considering the market and institutional uniqueness when applying established Western theories to an emerging economy. However, we do not measure such uniqueness. It would be intriguing to examine how the underdeveloped legal system and strategic factor markets affect firm operation and strategic implementation. For example, further research could identify those institutional characteristics that are associated with greater or lesser degrees of effectiveness for competitive positions and managerial ties in emerging economies.

Second, our measure of firm profitability employs a 1-year lag, which only captures the short-term effect of political ties, though political ties may take longer to pay back. Initially, firms have to invest substantially to build ties with political authorities, but the investment may be paid back gradually. A longer time period, such as 3 or 5 years, is therefore necessary to assess how political ties affect performance more accurately. Moreover, during the market transition processes, reliance on ties may give way to market-based strategies that are more suitable for large-scale, complicated exchanges (Peng, 2003). A longitudinal study could examine the dynamics or co-evolution of market- and network-based strategies.

Third, our measures of competitive positions and managerial ties are perceptual. Although our cross-validation supports the use of perceptual measures, managers' perceptions may differ from reality. Objective measures are therefore needed to validate our findings. Further research could also take a cross-country approach to examine whether our findings hold in other countries, and how the relationships may differ in emerging *vs* developed economies.

As the Chinese economy continues to expand and transition, understanding how to compete in this huge, rapidly changing market represents a critical challenge for foreign firms. Our study informs this intriguing topic by demonstrating how competitive positions interact with managerial ties to affect the profitability of foreign firms. We hope that further research continues to explore and document the interplay of market- and network-based strategies in the fast-changing market and institutional environments.

ACKNOWLEDGEMENTS

This study was supported by a Strategic Research Grant from City University of Hong Kong (Grant No. 7002147) and a research grant from the Belk College of Business, University of North Carolina at Charlotte. The authors thank the Departmental Editor, Professor Shaoming Zou, and the anonymous *JIBS* reviewers for their insightful and constructive comments.

NOTES

[1]Because Sino-foreign joint ventures usually structure their operations and management in parallel with foreign partners, researchers tend to classify them together with wholly foreign-owned firms within the category "foreign firms" (Ralston et al., 2006).

[2]We also conduct subgroup regressions for joint ventures and wholly foreign-owned firms. The results are similar for both groups.

REFERENCES

Adler, P., & Kwon, S. 2002. Social capital: Prospects for a new concept. *Academy of Management Review*, 27(1): 17–40.

Aiken, L. S., & West, S. G. 1991. *Multiple regression: Testing and interpreting interactions*. Newbury Park, CA: Sage Publications.

Anderson, E. W., Fornell, C., & Rust, R. T. 1997. Customer satisfaction, productivity, and profitability: Differences between goods and services. *Marketing Science*, 16(2): 129–145.

Anderson, J. C., & Gerbing, D. W. 1988. Structural equation modeling in practice: A review of recommended two-step approach. *Psychological Bulletin*, 103(3): 411–423.

Aulakh, P. S., Kotabe, M., & Teegen, H. 2000. Export strategies and performance of firms from emerging economies: Evidence from Brazil, Chile, and Mexico. *Academy of Management Journal*, 43(3): 342–361.

Batjargal, B. 2003. Social capital and entrepreneurial performance in Russia: A longitudinal study. *Organization Studies*, 24(4): 535–556.

Batjargal, B., & Liu, M. 2004. Entrepreneurs' access to private equity in China: The role of social capital. *Organization Science*, 15(2): 159–172.

Boisot, M., & Child, J. 1996. From fiefs to clans and network capitalism: Explaining China's emerging economic order. *Administrative Science Quarterly*, 41(12): 600–628.

Brouthers, L. E., & Xu, K. 2002. Product stereotypes, strategy and performance satisfaction: The case of Chinese exporters. *Journal of International Business Studies*, 33(4): 657–677.

Burt, R. S. 1992. *Structural holes: The social structure of competition*. Cambridge, MA: Harvard University Press.

BusinessWeek. 2006. US-China trade: Too much talk? http://www.businessweek.com/globalbiz/content/apr2006/gb20060404_396047.htm?chan=search.
Campbell-Hunt, C. 2000. What have we learned about generic competitive strategy? A meta-analysis. *Strategic Management Journal*, 21(2): 127–154.
Chen, C., Chen, Y., & Xin, K. 2004. Guanxi practices and trust in management: A procedural justice perspective. *Organization Science*, 15(2): 200–209.
Chen, M. 2001. *Inside Chinese business: A guide for managers worldwide*. Boston, MA: Harvard Business School Press.
Day, G. S. 1994. The capabilities of market-driven organizations. *Journal of Marketing*, 58(4): 37–52.
Fan, J. P. H., Wong, T. J., & Zhang, T. 2007. Politically connected CEOs, corporate governance, and post-IPO performance of China's newly partially privatized firms. *Journal of Financial Economics*, 84(2): 330–357.
Financial Times. 2004. Good "guanxi" is commercial sense in China. October 22: 8.
Fornell, C., & Larker, D. F. 1981. Evaluating structural equation models with unobservable variables and measurement error. *Journal of Marketing Research*, 18(1): 39–50.
Granovetter, M. 1985. Economic action and social structure: The problem of embeddedness. *American Journal of Sociology*, 91(3): 481–510.
Gulati, R. 2007. *Managing network resources: Alliances, affiliation, and other relational assets*. New York: Oxford University Press.
Hill, C. W. L. 1988. Differentiation versus low cost or differentiation and low cost: A contingency framework. *Academy of Management Journal*, 13(3): 401–412.
Ho, S. C. C. 2001. Growing consumer power in China: Some lessons for managers. *Journal of International Marketing*, 9(1): 64–83.
Hoskisson, R. E., Eden, L., Lau, C. M., & Wright, M. 2000. Strategy in emerging economies. *Academy of Management Journal*, 43(3): 249–267.
Hulland, J., Todino, H. S., & Lecraw, D. J. 1996. Country-of-origin effects on sellers' price premiums in competitive Philippine markets. *Journal of International Marketing*, 4(1): 57–79.
James, L. R. 1982. Aggregation bias in estimates of perceptual agreement. *Journal of Applied Psychology*, 67(2): 219–229.
Khanna, T., & Palepu, K. 1997. Why focused strategies may be wrong for emerging markets. *Harvard Business Review*, 75(4): 41–48.
Li, J. J. 2005. The formation of managerial networks of foreign firms in China: The effects of strategic orientations. *Asia Pacific Journal of Management*, 22(4): 423–443.
Lin, N., Fu, Y., & Hsung, R. 2001. The position generator: Measurement techniques for investigations of social capital. In N. Lin, K. Cook, & R. Burt (Eds), *Social capital, theory and research*: 57–81. New York: Aldine de Gruyter.
Miller, D. 1988. Relating Porter's business strategies to environment and structure. *Academy of Management Journal*, 31(2): 280–308.
Miller, D., & Friesen, P. H. 1986. Porter's (1980) generic strategies and performance: An empirical examination with American data. *Organization Studies*, 7(1): 37–56.
Narver, J. C., & Slater, S. F. 1990. The effect of a market orientation on business profitability. *Journal of Marketing*, 54(4): 20–35.
Nolan, P. 2001. *China and the global economy*. New York: Palgrave.
North, D. C. 1990. *Institutions, institutional change, and economic performance*. Cambridge: Cambridge University Press.
Park, S. H., & Luo, Y. 2001. Guanxi and organizational dynamics: Organizational networking in Chinese firms. *Strategic Management Journal*, 22(5): 455–477.
Pelham, A. M., & Wilson, D. T. 1996. A longitudinal study of the impact of market structure, firm structure, strategy, and market orientation culture on dimensions of small-firm performance. *Journal of the Academy of Marketing Science*, 24(1): 27–43.
Peng, M. W. 2003. Institutional transitions and strategic choices. *Academy of Management Review*, 28(2): 275–296.
Peng, M. W., & Luo, Y. 2000. Managerial ties and firm performance in a transition economy: The nature of a micro-macro link. *Academy of Management Journal*, 43(3): 486–501.
Phillips, L. W., Chang, D., & Buzzell, R. D. 1983. Product quality, cost position, and business performance: A test of some key hypotheses. *Journal of Marketing*, 47(1): 26–43.
Porter, M. E. 1980. *Competitive strategy*. New York: The Free Press.
Porter, M. E. 1985. *Competitive advantage*. New York: The Free Press.
Porter, M. E. 1998. *The competitive advantage of nations*. New York: The Free Press.
Ralston, D., Terpstra-Tong, J., Terpstra, R., Wang, X., & Egri, C. 2006. Today's state-owned enterprises of China: Are they dying dinosaurs or dynamic dynamos? *Strategic Management Journal*, 27(9): 825–843.
Shleifer, A., & Vishny, R. 1998. *The grabbing hand: Government pathologies and their cures*. Cambridge, MA: Harvard University Press.
Siegel, J. 2007. Contingent political capital and international alliances: Evidence from South Korea. *Administrative Science Quarterly*, 54(4): 621–666.
Song, M. X., & Perry, M. E. 1997. A cross-national comparative study of new product development processes: Japan and the United States. *Journal of Marketing*, 61(2): 1–18.
Spanos, Y. E., Zaralis, G., & Lioukas, S. 2004. Strategy and industry effects on profitability: Evidence from Greece. *Strategy Management Journal*, 25(2): 139–165.
Tsang, W. K. 1998. Can *guanxi* be a source of sustained competitive advantage for doing business in China? *Academy of Management Executive*, 12(2): 64–73.
Uzzi, B. 1997. Social structure and competition in interfirm networks: The paradox of embeddedness. *Administrative Science Quarterly*, 42(1): 35–67.
Warren, D. E., Dunfee, T. W., & Li, N. 2004. Social exchange in China: The double-edged sword of guanxi. *Journal of Business Ethics*, 55(4): 355–372.
World Bank. 2007 *PPP GDP 2006.* http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP_PPP.pdf. Accessed 18 January 2008.
Xin, K., & Pearce, J. L. 1996. Guanxi: Connections as substitutes for formal institutional support. *Academy of Management Journal*, 39(6): 1461–1568.
Yang, M. M. 1994. *Gifts, favors and banquets: The art of social relationships in China*. Ithaca, NY: Cornell University Press.
Zaheer, S. 1995. Overcoming the liability of foreignness. *Academy of Management Journal*, 38(2): 341–363.
Zhou, K. Z., & Li, C. B. 2007. How does strategic orientation matter in Chinese firms? *Asia Pacific Journal of Management*, 24(4): 447–466.
Zhou, K. Z., Su, C., & Bao, Y. 2002. A paradox of price-quality and market efficiency: A comparative study of the US and China markets. *International Journal of Research in Marketing*, 19(4): 349–365.
Zhou, K. Z., Tse, D. K., & Li, J. 2006. Organizational changes in emerging economies: Drivers and consequences. *Journal of International Business Studies*, 37(2): 248–263.
Zhou, K. Z., Yim, C. K., & Tse, D. K. 2005. The effects of strategic orientations in technology- and market-based breakthrough innovations. *Journal of Marketing*, 69(2): 42–60.
Zou, S., & Cavusgil, S. T. 2002. The GMS: A broad conceptualization of global marketing strategy and its effect on firm performance. *Journal of Marketing*, 66(4): 40–56.

APPENDIX

See Table A1.

Table A1 Measurement items and validity assessment

	SFL
Differentiation position: Based on Porter (1985) and Song and Perry (1997). CR = 0.90, AVE = 0.70, HSV = 0.22	
(1) We take great efforts in building a strong brand name – nobody can easily copy that.	0.815
(2) We successfully differentiate ourselves from others through effective advertising and promotion campaigns.	0.765
(3) Compared to competing products, our products offer superior benefits to customers.	0.800
(4) Our products are unique and nobody but our company can offer them.	0.946
Low-cost position: Based on Narver and Slater (1990) and Pelham and Wilson (1996). CR = 0.82, AVE = 0.54, HSV = 0.22	
(1) Our manufacturing costs are lower than our competitors'.	0.630
(2) Our efficient internal operation system has decreased the cost of our products.	0.753
(3) Our economy of scale enables us to achieve a cost advantage.	0.770
(4) We have achieved a cost leadership position in the industry.	0.781
Political ties: From Peng and Luo (2000). CR = 0.88, AVE = 0.70, HSV = 0.28	
Top managers at our firm have heavily utilized personal ties, networks, and connections with	
(1) Political leaders in various levels of the government.	0.713
(2) Officials in industrial bureaus.	0.927
(3) Officials in regulatory and supporting organizations such as tax bureaus, state banks, commercial administration bureaus, and the like.	0.862
Business ties: From Peng and Luo (2000). CR = 0.71, AVE = 0.44, HSV = 0.28	
Top managers at our firm have heavily utilized personal ties, networks, and connections with	
(1) Top managers at buyer firms.	0.492
(2) Top managers at supplier firms.	0.787
(3) Top managers at competitor firms.	0.694

Overall model fit: $\chi^2(71) = 131.25$, $p < 0.001$; GFI = 0.92, CFI = 0.94, IFI = 0.94; RMSEA = 0.05.
Notes: SFL = standardized factor loading; CR = composite reliability; AVE = average variance extracted; HSV = highest shared variance with other constructs.

ABOUT THE AUTHORS

Julie Juan Li is Assistant Professor at the Department of Marketing, City University of Hong Kong (julieli@cityu.edu.hk). Born in China, she is a Chinese citizen and a Hong Kong resident. She received her doctorate degree in business from the University of Hong Kong. Her main research interests include managerial ties and knowledge transfer in international joint ventures.

Kevin Zheng Zhou is the Reese Distinguished Scholar in International Business and Associate Professor of Marketing at the Belk College of Business, University of North Carolina at Charlotte (k.zhou@uncc.edu). Born in China, he is a Chinese citizen. He received his doctorate degree in marketing from Virginia Tech. His research focuses on strategic orientation, innovation, and relational governance, with a focus on emerging economies.

Alan T Shao is Associate Dean for Professional and Global Programs at the Belk College of Business, University of North Carolina at Charlotte (atshao@uncc.edu). Born in the United States with US citizenship, he received his doctorate degree in marketing from the University of Alabama. His research focuses on global advertising, marketing strategy, and business development in emerging economies.

Accepted by Shaoming Zou, Departmental Editor, 19 February 2008. This paper has been with the authors for one revision.