Exploring institutional uncertainty by knowledge-based entrepreneurial firms in emerging economies

Abstract:

This article applies the convergent insights of institutional and entrepreneurial theories and demonstrates the institutional uncertainty caused by weak formal institutions and how emerging economy international entrepreneurial firms respond to institutional ambiguity and risks with their specific institutional capacity and experiential knowledge. We use export intermediary firms in China in our investigation. It reveals that entrepreneurial firms acquire particular knowledge about institutional voids, products and producers, production process and production conditions, to enable them to reduce costs and facilitate a business transaction for domestic manufacturers and foreign buyers.

1. Introduction

Emerging markets are characterized as economies with the low level of institutionalization and high level of institutional uncertainty, and therefore managing institutional change is a critical issue in these economies (Peng, 2003). In the light of increasing business activities of firms from emerging economies, there has been a surge of interest in the notion of institutional voids and institutional uncertainty on management and international business studies and institutional theory has been identified as a potentially useful way of conceptualizing emerging markets (Tracey and Phillips, 2011). The applications of institutional theory in international business have primarily focused on institutional challenges for foreign entrepreneurial firms at home or abroad, the role of multinational enterprises (MNEs) in bridging the market distance and institutional distance in international operations, and the MNE subsidiary's adaption of home-country practices responding to local institutional settings (Kostova and Roth, 2002). There is, however, limited institutional theory research investigating local start-ups in emerging economies (Wright et al., 2005, Tracey and Phillips, 2011). More specifically, it is not completely clear how local entrepreneurial firms in emerging economies respond to institutional complexity and ambiguity when internationalization.

While most literature establishes that the high degree of institutional uncertainty often acts as a barrier to entrepreneurial activities, thus increasing costs in doing business at home or abroad (Regner and Edman, 2014), recent studies posit that institutional uncertainty can also produce opportunities that entrepreneurial firms can create value. Possible strategies may be adopted to solve the institutional problems such as institutional brokering, spanning institutional voids, and bridging institutional distance (Tracey and Phillips, 2011). Being motivated by the observations, this paper aims to explore the following questions: What are the institutional settings that put off emerging economy entrepreneurial firms' internationalization? How do emerging economy knowledge-based entrepreneurial firms create value by exploring institutional uncertainty associated with weak formal institutions?

We use export intermediary firms in China in our investigation. Export intermediary firms, as the "merchants" between domestic manufacturers and foreign buyers (Perry, 1992; Jones, 2002, Peng and Ilinitch, 1998; Quintens et al., 2005), represent typical examples as institutional entrepreneurs who "act as institutional brokers by creating ventures that reduce the risk for other actors" (Tracey and Philips, 2011, p62). The institutional environment in China is markedly different as compared to situations in the developed world and other emerging economies where international intermediary firms are typically studied. The lack of attention on Chinese export intermediary firms is surprising given that these firms have made the remarkable contribution to China's export performance accounting over one-third of the total exports (Yao and Chen, 2001). An examination of such less explored settings enables scholars to develop new theoretical insights with new empirical evidence, into the role of the entrepreneurial firms playing in unique institutional environments. It may also allow us to answer the call for a more conceptual and practical investigation that enhance our knowledge of the internationalization processes of emerging economy entrepreneurial firms.

This article applies the convergent insights of institutional and entrepreneurial theories and demonstrates the institutional uncertainty caused by weak formal institutions and continuously institutional reforms and how emerging economy international entrepreneurial firms respond to institutional ambiguity and risks with their specific institutional capacity and experiential knowledge. Institutional entrepreneurial perspective is particularly appropriate for our purpose because it has established a rich basis for understanding export behaviour of entrepreneurial firms in emerging economies by contending that institutional theory can provide insights into the export performance and export-driven growth of emerging economies like China. More specifically, it captures the unique traits that offer export intermediary firms with institutional advantages over local manufacturers and foreign buyers.

The paper is organized as follows. After the introduction, the section two will review the relevant literature about the entrepreneur and institutional theories and develop an integrative approach. Section three presents the methods and data collection. Section four and five present the findings and discussions. Section six concludes.

2. Literature review

2.1 Intuitional uncertainty and entrepreneurial firms in emerging economies

Institutions, as the rules of the game containing formal laws and informal rules that "come from socially transmitted information" (North, 1990, p37), offer the stable structure for human interaction and influence transactions and the level of transaction costs. Institution by definition implies permanence and stability, and one of the key characteristics is that it is resistant to change (Strang & Sine, 2002). The most institutions researched can reduce transaction costs; however, 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). Therefore, institutions can impede certain business actors from doing business transactions, while simultaneously enable others to benefit from the institutional constraints, for example, through acquiring licenses and special powers (North, 1990; Scott, 2008).

Emerging economies are defined as “low-income, rapid growth countries using economic liberalization as their primary engine of growth” (Tracey and Philips, 2011). Transition economies refer to those countries and regions where formal and informal institutions are comprehensively and fundamentally changing, mainly from central planning to market-based economic reforms (Peng, 2003, p275). In general, it is accepted that emerging economies include the transition economies of East Asia, Central and Eastern Europe, and the newly independent states of the former Soviet Union (Peng, 2003). Being different from developed economies where stable and effective institutions are as norms, however, emerging or transition economies unavoidably experience a particular period of mixed institutions (Nee, 1992), where institutional voids (Miller et al., 2009; Khanna et al., 2005), institutional change and uncertainty (Child and Tse, 2001), misalignment between institutional supply and firm demand (Witt and Lewin, 2007), and proactive reactions between institutional environment and organizations (Peng, 2003), jointly construct a distinctive institutional environment.

As a results, “pervasive changes” remain the most notable characteristics of emerging economies (Peng, 2003, p277), where less efficient and less stable institutions which support the normal market exchanges and functions (Mair and Marti, 2009; Khanna et al., 2005), pervasively present in many areas such as legal framework, political structures and factor markets. Researchers have attributed the slow economic growth of developing countries to the absence of effective market-based institutions to protect property rights, fair competition, and financial discipline, leading to the excessively high costs of doing business (e.g. Cuervo-Cazurra & Dau, 2009). They also reveal that the institutional environment shapes the structure of political, social, and economic incentives, and thereby limits the scope of strategic choices available to individuals and organization (DiMaggio and Powell, 1983; Scott and Meyer, 1991) that act to maximize their utility with the "rules of the game" (Meyer and Peng, 2016).

One of the essential outcomes of the low degree of institutionalization is the high level of institutional uncertainty, which increases costs of doing business and hence poses severe challenges for entrepreneurs in emerging markets (Manolova et al., 2010). The high costs resulting from the regulatory regime and institutional reforms create institutional hiatus (Meyer and Peng, 2005; Peng, 2001), which not only deter the entry but also severely constrain the growth of new and small entrepreneurial firms in emerging economies. For example, empirical evidence reveals that the shape and pace of entrepreneurship in the Eastern and Central Europe economies are significantly determined by the dominant influence of the institutional environment (Ahlstrom and Bruton, 2002; Peng and Heath, 1996).

Although much of the institutional theory literature establishes that additional costs and challenges occur along with institutional reforms, institutional reforms can also provide business opportunities for entrepreneurs who can identify ways to create values (Tracey and Philips, 2011). The firm is defined as the market-maker to create and run the market (Spulber, 1999), under which entrepreneurs act as intermediaries offering a series of market-making services/functions with their specialized judgment and information (Casson, 2003, 2005), and their success comes from their intermediates' role to reduce uncertainty for different actors in business (Peng et al., 2014; Peng, 2001). This may apply to emerging economy entrepreneurial firms. In the context of emerging economies, uncertainty resulted from institutional instability and intuitional inefficiency can also create business opportunities for intermediate-style entrepreneurship. In other words, entrepreneurs may develop specific knowledge and skills that help them discover opportunities derived from information asymmetries (Peng et al., 2014).

Given that institutions have the remarkable influence on entrepreneurship and its characteristics, it is reasonable to observe much uniqueness of emerging entrepreneurial firms, compared with those in developed countries (Estrin et al., 2008). Researchers found that entrepreneurs in emerging economies may possess high educational attainments but low levels of entrepreneurial knowledge and skills (Welter & Smallbone, 2006); they may receive training and professional and managerial experience that bring technology and legitimacy to their entrepreneurial initiatives (Peng, 2001) and that proves to be less relevant to a market environment (Lyles, Saston, & Waston, 2004). Estrin, Meyer, & Bytchkova (2008) re-defined entrepreneurship in emerging markets as those individuals who a) perceive and create new economic opportunities through innovative activity; b) introduce their ideas in the market in the face of uncertainty and other obstacles; c) undertake efforts that result in a viable business that contributes to national economic growth and personal livelihood, and d) engage in this activity at opportunity cost of pursuing other occupations.

Emerging economy entrepreneurial firms are likely to involve a different set of skills because they are doing business in an environment with the relatively low level of institutionalization. For example, the weak formal institutions are usually filled by informal ones (Puffer et al., 2004); therefore it is reasonable to observe that emerging economy entrepreneurial firms develop relatively comprehensive skills and knowledge dealing with informal institutions. In doing so, they would be even more likely to resort to intimate ties and relationship governance to fill the "institutional voids" left in the formal institutional infrastructure (Khanna & Palepu, 1997; Ma, Yao, & XI, 2006; Manolova, et al., 2010; Peng & Heath, 1996) and use network embeddedness to decrease transaction and information-acquisition costs (Zhu, Hitt, & Tihanyi, 2006).

Puffer and McCarthy (2003) reveal that entrepreneurs in transition economies like China and Russia develop unique balances between informal and formal institutions that better fit their circumstances, relying more on traditions and informal institutions, specifically trust and blat/guanxi to fill the formal institutional voids. This may well apply to the internationalization process of emerging economy entrepreneurial ventures like export intermediary firms that possess competitive advantages by exploring institutional ambiguity and mitigating transaction costs through institutional knowledge and informal institutions, and we will discuss that in the following section.

2.2. Export intermediary firms as institutional entrepreneurial firms in emerging economies

Export intermediary firms, as the “merchants” between domestic manufacturers and foreign buyers, are essential players in the international trade (Jones, 2002; Perry, 1992; Peng and Ilinitch, 1998, Quintens et al., 2005). They support local export by assisting domestic manufacturers to search for and negotiate with foreign buyers (Peng, 1998), providing a range of transaction-creating and physical-fulfilment services, such as market research, production adaptation, customer selection, negotiation and communication, packaging and warehousing, documentation, and financing and so on (Balabanis, 2005). Early studies applying transaction cost theory and resource-based perspectives posit that market distance and product complexity are the key drivers that make exporters choose to use export intermediaries in their export strategy (Peng and Ilinitch, 1998).

Transaction costs perspectives, with its centrality of making or buy decisions, is the traditional theory in the studies of trading companies for its power in explaining trading companies' positive role in reducing costs incurred in the international transaction (Casson, 1998; Peng and Ilinitch, 1998). There are two primary markets in international trade, and they are the "direct market" containing domestic manufacturers and foreign buyers, and the “indirect market” containing intermediary firms, domestic manufacturers and foreign buyers. Either the direct or indirect market involves numerous transaction issues among sellers, buyers, and intermediaries and thus inevitably incurs various transaction costs associated with searching, negotiating, monitoring, and enforcing activities. Also, the transaction costs in international business may be considered high because of uncertainty, information asymmetry and complications due to different time zones, locations and culture (Casson, 1998).

The high costs and the smaller profits usually discourage sellers and buyers to engage in direct export unless they possess more senior levels of productivity or use intermediaries to mitigate this (Ahn et al., 2011). Peng and Ilinitch (1998) posit that exporters are more likely to use intermediaries if the markets are distant and the searching and negotiation costs are high, and if the products have a commodity content and the costs associated with quality monitoring and contract enforcement are high. The exporters help low-profiled, small and medium-sized firms to initiate their overseas sales by searching for and negotiating with foreign buyers (Peng, 1998); they also help relatively large manufacturers enter nonessential, marginal markets (Balabanis, 2005), thus creating values by leveraging intangible knowledge that bridge the domestic and overseas markets which both manufacturers and foreign buyers find too costly to handle on their own (Peng and Ilinitch, 1998). In some cases, the intermediaries in a strong financial position may solve the agency problem by taking title to the goods.

The rationale for working with export intermediaries is based on the fact that these firms are equipped with specialized and experiential knowledge about products and foreign markets (Mahoney et al., 2001). Also they have excellent marketing skills and the capability to possess relational asset such as trust (Ma, 2006, Gripsrud et al., 2006), which can assist in effectively lowering their clients' export-related transaction costs (Peng, 1998), and in identifying initial internationalization opportunities (Styles and Genua, 2008). For example, information and knowledge acquisition are vital handles to overcome in the pre-export stage (Coviello, 2006; Mathews and Zander, 2007; Tan, Brewer, and Liesch, 2007), and the collection of formal and informal advice contacts that entrepreneurs establish outside of their organizations provide them with information, knowledge, and resources (Gulati & Gargiulo, 1999) that may be drawn to explore foreign markets (Manolova et al., 2010).

In the emerging environment with the low level of institutionalization and high level of institutional uncertainty, entrepreneurs have to develop specific capacity and skills that enable them to identify business opportunities and sustain business growth. One of the roles is to create values by reducing costs associated with inefficient institutions and exploit institutional ambiguity that other actors find too costly to do. This is particularly true for international business actors, who are skilful in handling with traditional inefficient bureaucratic and formal institutions in less opened economies, who have shown excellent networking capacity in bridging the local markets and international markets. Yet, there is a tentative understanding of how emerging economy entrepreneurial firms deal with the complex nature of institutional uncertainty and what kinds of skills and knowledge intermediary firms possess to serve domestic manufacturers and international buyers. This study aims to examine the influence of institutional uncertainty on the emerging economy entrepreneurial firms and how entrepreneurial firms, specifically, Chinese export intermediary firms develop knowledge and create values for local manufacturers and foreign buyers.

3. Research method and data collection

This paper uses multiple-case study research. The case study approach is especially appropriate for addressing "how" and "why" questions in new topic areas (Yin, 2003), and for gaining the deeper understanding about Chinese entrepreneurial firms and institutional environment, which is one "empirical investigation of a contemporary phenomenon" (Yin, 2003). Meanwhile, the institutions, as a "real-life context," that influence the level of transaction costs in China's export markets, will be explored. The institutional uncertainty and export intermediaries in China will be illustrated as a combination, which is in line with the statement that "boundaries between phenomenon and context are not evident."

Chinese export intermediary firms were chosen as case-studies, and six firms were selected (coded C1, C2, C3, C4, C5, and C6). The local institutional uncertainty in China dramatically impedes export transactions among domestic manufacturers and foreign buyers, and the export intermediary firms bridge the two actors, with experiential knowledge, at lower costs that local manufacturers and international buyers fail to do so. Also, this study will pay more attention to the institutional uncertainty associated with formal institutional changes in China's export market. In the last three decades, the programmatic economic reform and export-oriented development have made China one of the largest exporters, despite the obvious competitive disadvantages regarding internal resources and marketing capability that local manufacturers suffered (Gao et al., 2009). Although foreign investors' contribution to export performance was remarkably high in China, local manufacturers still accounted for 43 % of total exports in 2014 (SSB, 2014).

A three-stage data collection process was undertaken including the pilot study C1, pilot case study C2 and significant case studies. The pilot study C1 was based on the interviews conducted with the domestic manufacturers, foreign buyers and export intermediary firms, while the pilot case study C2 was undertaken through two-month participant observation in C2 during June and July 2009 in Tianjin, China. The first two stages aimed to obtain the specifications of the formal institutional complexity and uncertainty on China's export market. The third stage engaged with the intensive interviews with the other four cases.

Direct participant observations and semi-structured interviews were the primary data collection methods. The secondary data, such as company websites and booklets, also contributed to the context of the cases. The first author spent two months in one export intermediary firm (C1) located in Tianjin, observing the daily work, the transactional process, communications and business transactions with external organizations, followed by the formal interviews and informal contacts with managers and consultants. The second author had more than 6-year work experience as a consultant in a big state-owned trading company and a start-up export intermediary in China. The 2-hour interviews with international business managers of the firms were conducted in Chinese between June and September 2010 in Beijing, Tianjin, Qingdao, Shanghai, and Guangzhou. Interviewees were guaranteed with anonymity and were asked to answer the institution-related questions concerning export process and task modes. The transcripts were translated into English.

The interviews were guided by a list of questions and a brief outline, and the open-ended questions. The interview questions started with context-related questions, including historical and background information about the firms and the individuals, followed by the problems related to the theoretical concepts, such as exporting transaction process, transactional procedure mainly associated with local institutions. The interviews were concluded with the open-ended questions such as the interviewees' opinions on the institutional uncertainty in their exporting process. Besides, the interviews were supplemented with other sources of data, including direct observations, field notes, and research journals, company documentation, and archival data. Information and data from different sources have been cross-checked continuously for triangulation purpose to ensure the reliability and accuracy of our explanations. Table 1 summaries the details of selected cases.

Table 1. Case summary

		C1	**C2**	**C3**	**C4**	**C5**	**C6**
Firm Name		Guangzhou H-Sentury Imp&Exp Co., Ltd	Tianjin Minmetal	Hua Kang International Trade Ltd	Fulu exporting trading companies	Lueyuan Imp&Exp Co., Ltd	Aomeite Exp Co., Ltd
Location		Guangzhou	Tianjin	Shanghai	Beijing	Qingdao	Qingdao
Ownership		Private	State-owned	Private	Private	Private	Private
Size (employees)		10	120	9	15	17	17
Establishment		2005	1955	2004	1997	2000	2007
Product		Apparels	Welding consumables, hardware, steel products	ferroalloy, iron hardware, and machinery	Bedding products	Tableware	Wooden furniture
Foreign markets		Spain, France and The United Arab Emirates	Worldwide	Thailand, Malaysia, South Korea and Taiwan	worldwide	Worldwide	US (60%), Spain (30%) and Australia (10%)
Performance in 2010	**Annual sales**	$5,000,000	$60,000,000	$30,000,000	$7,000,000	$7,000,000	NA
	Per capital	$625,000	$500,000	$3,000,000	$466,666	$411,746	NA
	Profit Margin	15%	2.5%	1%	10%	12%	NA

4.Findings

This section analyses the results by identifying institutional uncertainty caused by formal institutional ambiguity in China's export market that can be exploited by export intermediary firms. It then examines experiential knowledge export intermediary firms possess to create values for both local manufacturers and foreign buyers.

4.1 Institutional uncertainty caused by formal institutional changes in China's export market

4.1.1 Institutional uncertainty associated with administrative approval and bureaucratic procedures

It is found that formal institutional changes concerning bureaucratic procedures and administrative approvals consistently present in all cases which, in turn, lead to high level of institutional uncertainty. The pre-export procedure involves the intensive interactions with the export authorities and bureaus before export transactions take place, ranging from business licenses applications to registrations. The applications procedures are complex, time-consuming and subject to constant changes in China. Most of the licenses and registrations require annual renewal. The post-export process involves submissions of transaction documents/receipts to different government departments when the transactions are closed. For example, the Chinese government maintains strict control over the foreign currency exchanges and every single export transaction needs to be inspected. Exporters are requested to register with local foreign exchange bureaus and customs and to submit a series of documents related to sales after each export transaction.

Another example is that the tax rebating procedures are under constant change due to the frequent export policy changes. The rates of tax rebating vary across products, and some can be up to 10% of the sales, therefore receiving the tax refund is essential for business. The Chinese Customs usually issue an annual brochure listing the tax rebating rates for all products category; however, they may change the type and rate from time to time in conformity with the policy changes. Exporters must pay very close attention to the changes and get the right tax codes to avoid potential losses. In case they fail to make the appropriate application within three months, they must bear the losses. The tax rebating process involving intensive scrutiny is time-consuming and the regular processing time is three months after submitting documents to the local taxation bureau and customs. Some managers claimed that slow tax rebating system had reduced the capital turnovers and the potential transactions, which increased the transaction costs for the exporters. The accountant in C1 recalled:

> "*The rebating tax rate for clothes is 7%, which means 7% of the transaction value is held for 2-3 months. If the money can be reimbursed immediately, we could have been able to use it for the next orders [such as purchasing raw materials, paying deposits to manufacturers]. So, our profits will increase*".

Government policies on export procedures are constantly changing, and these changes take place at various levels of government departments, leading to the high level of ambiguity. It is common to see that the provincial governments modify the policy initiated by the central government and then this is further modified by the municipal governments. Moreover, it often happens that a policy initiated in one region was applied to other areas where the officers were given with little time to make the proper adjustment. As a result, domestic exporters have to keep learning, acquiring timely information to avoid potential losses from unexpected changes. The owner of C1 admitted that he had spent much time on understanding administrative procedures and trade policies. His company once relied on the agency dealing with departmental approvals and annual renewals, but later on, he did this on his own, because "it is vital to maintain the networks and relationships in the house and to improve the ability to acquire critical information." Institutional uncertainty associated with approval and administrative procedures generates additional costs for Chinese exporters who have to respond timely to the changes to avoid potential losses.

4.1.2 Institutional uncertainty associated with contract enforcement and the legal system

One of the critical barriers for foreign buyers to work with Chinese manufacturers was the potential costs and risks caused by the weak enforcement of contracts. The transaction enforcement problems are highly related to opportunistic behaviours in the poor market-based economy and low credibility and reliability of the legal system in China. All the cases experienced difficulties in contract obligations and gave various examples of problematic contract enforcement they had encountered when the domestic manufacturers failed to commit to their contracts as they sometimes accept orders without considering their actual production capacity. More specifically, the opportunistic behaviors refer to product quality problems (in C1, C2, C3, C4, and C5), production and delivery delay (in C1, C2, C3, C4, and C5), and breach of contract (in C3), which become the most significant problems in China's export market. In some cases, manufacturers deliberately increase prices because of the market conditions have changed, and even sell branded products to others illegally (in C2). To protect its intellectual property and patent, C4 had to set up its own factory producing these products. The manager of C4 recalled:

> *"After we found our delivery had been delayed, I visited the factory. When we arrived, I found that the manufacturer was producing products for other clients, instead of ours. We pervaded them to switch to the production line for our orders, and then pretended to leave. In 30 minutes we came back and found that they resumed the previous production line. In the end, one of our staff members had to stay in the factory until the order was finished. Also, we never work with that manufacturer again."*

All cases reveal that relying on the arbitrary local process for contract obligation is time-consuming and risky. The owner of C3 recalled his experience in a legal process.

> *"One of our suppliers, with whom we have had a couple of transactions before, refused to deliver the contract as promised. The reason was the delayed schedule of production. We knew they were supplying the products to other buyers at a higher price but could do nothing to stop them and we made a big loss at the end. [then] We brought a lawsuit against this supplier to the international arbitration located in Hong Kong, as we knew the local court would not treat us fairly. We won the case, and the supplier was requested to carry the liabilities and costs incurred.*
>
> *However, the* implementation *[of the result of arbitration] was problematic, so we visited the administrative division of the local court and asked for help. One officer told me it would take a very long time to execute. It might be one year, two years or forever. Who knows? I knew his meaning and did not want to wait. So, I sought for help with a local friend who introduced us to another officer in the executive division. Finally, that supplier agreed to compensate half of our loss. We thought that was the best we could get and accepted the solution".*

4.2 Entrepreneurial knowledge to reduce institutional uncertainty

4.2.1. Knowledge of institutional complexity

It is found that all export companies in this study possess adequate specialty and experiential knowledge that assist them in effectively dealing with bureaucratic procedures and administrative approvals. The specific knowledge includes knowledge about license and registration requirement, documentation preparation, trade, and export policy. In particular, it is vital to know how to acquire updated and valuable information like policy and regulatory changes to create values for the business. Furthermore, the rational resources can be developed as the distinctive competitive resources.

The manager of C1 admitted that his knowledge was obtained through long-term exporting practices and through employing professional staffs with both the degrees majoring in international business and working experience in the field. Human capital is essential assets for the company. It helped the firm to increase transactional efficiency and reduce uncertainty. For instance, the trading merchandiser of the company, whose work involves dealing with the local Bureau of Quality and Technical Supervision, and Registration with Customs, had two years of relevant experience before joining the company. The accountant had ten years' experience in the field. The firm used to rely on an agency to assist with the initial applications and annual renewals, but it soon engaged in administrative approvals after programmatic learning.

All cases show that they capture specific knowledge and information about bureaucratic procedures and administrative approvals. The knowledge is acquired by well-trained and experienced staff from daily routines embedded within the firms. Besides, they pay great attention to relationship and networking development, particularly with local bureaucrats and relevant parties. By doing so, they can update their knowledge of the institutional changes of the bureaucratic procedures and administrative approvals that ultimately reduce relative uncertainty.

Table 2 Summary of institutional uncertainty occurred in the export procedures.

Institutional uncertainty	Bureaucratic procedures and administrative approvals
Evidence in case	Licenses 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
Specific evidence in cases	Staff educational background in exporting
	Staff experience in such administrative procedures
	Networking and relationship development
	Regular routines for such administrative procedures
Supporting cases	C1, C2, C3, C4, C5, and C6.
Methods to reduce instructional uncertainty	Acquiring Knowledge (information and experience) of these bureaucratic procedures and administrative approvals, networking

4.2.2. Knowledge of products and production

The knowledge of products and production generally contains two aspects: products and producers, production conditions and processes. The information on products, such as quality, types, and styles of the product, increases the firms' capabilities for quality control and for identifying potential opportunistic behaviors during the production process.

The information on producers, which refer to the manufacturers' product quality, capacity, credibility, output and so on, helps the firm choose the most reliable and suitable producers. Knowledge of producers is also important, and can help the firm choose the "right" and reliable manufacturers before committing to final production, and to change manufacturers in emergency context. The owner of C3 recalled how he selected the manufacturers:

"Our current manufacturers had been filtered from previous many collaborative transactions……. Indeed we had withdrawn from some bad manufacturers. We knew their productive capabilities, such as their favorite 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 that require higher quality. Another one is suitable for the UAE's order, as their price is lower……I will try to understand the personality of the owner of factories if he is a reliable person if his factory has a poor track record so that I can decide how to collaborate……We would check their production schedule before we choose the manufacturer. We usually have some backup manufacturers, who can work for some special orders."

The information on products such as the progress of production enables Chinese export intermediaries to control the production schedule better, minimizing the problems, and reducing the manufacturers' opportunistic behaviors during the production process. The firms in this study acquired massive amounts of information on production, which reduced the information asymmetry between manufacturers and buyers, decreases opportunistic behaviors and uncertainty, and reduces enforcement costs. All cases in this study have paid great attention to enforcing export transactions and have acquired relevant knowledge to monitor the contracts. For instance, C3 systematically collected, updated the pricing information that enabled it to ease the uncertainty and manufacturers' opportunistic behaviors and to be in upper-hand position when re-negotiating any new transactions.

We use C1 to illustrate the importance of product information. The owner and the manager of the TMs team regularly visited their manufacturers during the production period for various purposes like sample making, modification, and material supply. A considerable amount of *information on the production process and production conditions*, such as workers' number, production schedule, and technical problems, was collected after numerous visiting. Knowledge about production process also helped them to deal with the quality problems. Before the shipping, the leading owners and others regularly check the production schedule and product quality to avoid any potential problems. The owner admitted that he even had to stay in the factory for a couple of weeks in some extreme occasions to monitor the production process closely. The owner recalled a recent case how he had rescued one large order just one day before the shipment. He spotted out the wrong neck labels in the garment and had to ask the factory to replace them overnight. The owner also confirmed that it was critical to employ the TMs manager who had work experience in enforcing production.

In general, the information on production helps Chinese export intermediaries reduce the information asymmetry and the possibilities of opportunistic behaviors and uncertainty during production, and finally to reduce the enforcement costs.

4.2.3. Knowledge on business governance and contract obligation

As stated in previous cases, the asymmetric information is one primary reason for the difficulty in identifying product quality and other resulting problems to stop transactions, such as adverse selection and moral hazard (Akerlof, 1970, Stiglitz and Weiss, 1981). In this case, the products' price and continuously-appearing *re-negotiation*s with suppliers in this industry, is similar to the problems of product quality in the transaction, as it has resulted from suppliers' opportunistic behaviors. Therefore, this firm*'s knowledge of updated pricing* becomes the tool and stake of these re-negotiations to for reducing suppliers' opportunistic behaviors, and the costs of re-negotiating with manufacturers. According to the owner of C3:

> *"TMs' daily tasks are to check the price with many 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 provide international pricing."*

Also, the owner also exchanged the price information with his friends in this field. With the simple "dataset" for the updated price information, the firms possessed important price information when negotiating with manufacturers. Similar to the C1, the *knowledge of producers* helps to reduce these enforcing costs of contract obligation. According to the interviews with the C3 owners, he managed to filter out those unreliable suppliers through trial orders (small amounts) as much as possible in the past several years. In this way, he could choose the reliable manufacturers with relatively low costs if needed.

The knowledge of how to effectively use appropriate legal assistance in China, especially the international and local legal and enforcement systems, helped C3 reduce enforcement costs. As discussed earlier, this firm went for the international arbitration in the court in HK rather than the local court, which was usually the most convenient solution for a small firm. Although this firm obtained a reasonable external legal assistance with their "foreign" identity, the execution of the adjudication was made by the local court with problems. The owner of C3 reported:

"But the execution (of the result of arbitration) was still a problem. We then visited the administrative division of local court with this result. One officer told me it would take a very long time to execute. It might be one year, two years or forever. Who knows? I did not want to wait. So I found one local friend to help us, who introduced another officer in the executive division. Finally, with the help of this friend, that local supplier agreed to compensate half of our loss. We thought it would be the best way at that time and accepted the solution".

Chinese firms rely on the specific knowledge they learned from experience about how to deal with contract breaches and minimize losses. The expertise includes the possible approaches to fair treatment and efficient execution, and how to find the right contacts among the formal and informal networks. Therefore, the experience of products and producers, and of how to effectively use appropriate legal assistance in China jointly help them reduce the costs of enforcing business contracts. In emerging markets, there appear to be increased opportunistic behaviors, such as a great deal of breach of contract. In turn, it is found that export intermediary's knowledge of products and producers, and how to effectively use appropriate legal assistance in China dramatically helps to solve these problems.

Table 3 Summary of institutional uncertainty occurred in contract enforcement

<table>
<tr><td>Institutional uncertainty</td><td colspan="2">Inefficient legal system and contract obligation</td></tr>
<tr><td rowspan="3">Evidence in case</td><td colspan="2">Quality problems</td></tr>
<tr><td colspan="2">Delivery problems</td></tr>
<tr><td colspan="2">Price changes</td></tr>
<tr><td>Supporting cases</td><td colspan="2">C1, C2, C3, C4, C5 and C6</td></tr>
<tr><td rowspan="4">Methods for reducing regulative institutional uncertainty</td><td>Acquiring information on products and producers, production conditions and production processes</td><td>C1, C2, C3, C4, C5 and C6.</td></tr>
<tr><td>Acquiring information on updated prices of the product</td><td>C3</td></tr>
<tr><td>Vertical integration</td><td>C2, C4</td></tr>
<tr><td>Brand creation, special certificates</td><td>C2</td></tr>
</table>

Table 4 Summary of institutional voids and EI's responses

Institutions	**Former formal institutional**	**Current formal**	**Informal institutional**

	voids	institutional voids	voids
Institutional voids	**Bureaucratic procedures and administrative approvals**	**Inefficient legal system**	**Inefficient contract obligation**
Procedures in export transaction	The pre-export and post-export procedures	The procedure of enforcing manufacturers	The procedures for enforcing manufacturers
Specific examples	● Licenses 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	● Quality problems ● Delivery problems ● Changed price	● Quality problems ● Delivery problems
Methods for reducing institutional uncertainty	Knowledge (information and experience) of these bureaucratic procedures and administrative approvals	● Information on products and producers, production conditions and production processes ● Information on updated prices of the product ● Vertical integration Brand, special certificates	

5. Discussion

In the past century, almost all socialist economies demonstrated many problems and are difficult to maintain, while other capitalist countries show more productive economies (Ingram and Silverman, 2002). With the increasing seriousness of the issues in these economies, the transition from the former to latter is inevitable. The transitional process includes the collapse of previous institutions under the central planning system and the emergence of new institutions corresponding to the marketing system (Meyer, 2001b; Peng, 2003). However, the process of replacement is incremental (Peng, 2003; North, 1990), due to path dependency and bounded rationality. Therefore, many problems related to institutional changes take place in these countries. This section provides further analysis of findings with the comparison of existing literature on institutional uncertainty in the export market in emerging economies. Studies from transaction costs economies have indicated that the uncertain and complex information, which generates bounded rationality, is the primary reason for transaction costs (Williamson, 1975, 1985). Moreover, asymmetric information is the primary reason for the difficulty in identifying product quality and other resulting problems that stop transactions, such as adverse selection and moral hazards (Akerlof, 1970; Stiglitz and Weiss, 1981).

The bureaucratic procedures and administrative approvals, as additional processes, bear the typical characteristics of the central-planning system and become the formal institutional voids. During the transition, export-related institutions in China were changing from being entirely bureaucratic commanding centrally state-owned trading companies, to being friendly to open and market economy working with smaller private entrepreneurial firms (Li and Liu, 2012). The transition and reform of the formal institution are incomplete. Most bureaucratic procedures and administrative approvals still affect the transaction efficiency on the current export market by generating additional costs for domestic exporters and foreign buyers, especially for SMEs.

The inefficient bureaucratic procedures and administrative approvals in transitional economies have been criticized by many related studies (Meyer, 2001a; Estrin et al., 2008; Zou et al., 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 find that some “administrative barriers” obstruct businesses in these transitional economies and there are the lengthy timescales and massive procedures for starting up businesses. The evidence found in all our case-study observations and interviews leads to our first proposition:

> ***P1***. *Bureaucratic processes and administrative approvals generate institutional uncertainty for emerging economy entrepreneurial firms.*

The inefficient legal system, including formal law and legal enforcement (Meyer, 2001b), is the most commonly reported obstacle for doing business in transitional economies (Meyer, 2001a; Khanna et al., 2005; Khanna and Palepu, 1997). 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 agreements, as part of the inefficient judicial system in China, are not adequately enforced in China. Ultimately, such problems and costs in import/export practice are reflected in the massive issues of product quality, delivery time and other contact-breaking behaviors from Chinese exporters. The charge of enforcing contracts is one crucial sub-cost in transaction costs theory (Furubotn and Richter, 2005, p25), and is closely related to international trade in practice (Peng, 1998). The extant literature on global purchasing and importing indicates that the quality and timely delivery of products become the most concerning problems for purchaser's decisions as to the selection of suppliers (Katsikeas and Dalgic, 1995; Kannan and Tan, 2002; Leonidou, 1999).

The potential explanation of domestic manufacturers' inefficient contract obligations can be two-fold. On the one hand, the inefficient formal legal system magnifies the potential for opportunistic behaviors of trading partners. The manufacturers behave opportunistically, as they feel free from such an ineffective judicial system in China. For example, the domestic manufacturers get used to unexpected price changes and contract breaches, 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.

On the other hand, being affected by the tradition and culture, the contract obligation in China become distinct and require trading partners to understand completely, 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. Also, Luo (2002) argues that the commercial contracts, as part of the inefficient legal system in China, fail to enforce contracts in China effectively. Instead, the contract obligations mainly rely on other social norms, such as personal relationships. However, the tradition of building on personal relationships will result in inadequate contract obligations in typical 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 enforce export transactions in China's export market effectively.

The cost of enforcing contracts is one crucial sub-cost in transaction costs theory (Furubotn and Richter, 2005, p25), and is closely related to international trade in practice (Peng, 1998). The extant literature on global purchasing and importing indicate that the quality and timely delivery of products become the most concerning problems for purchaser's decisions as to the selection of suppliers (Katsikeas and Dalgic, 1995; Kannan and Tan, 2002; Leonidou, 1999). In China, this condition, particularly the problems of the unreliable supplier, on-time delivery and product quality, is even more significant (LFRC, 2010; Nassimbeni and Sartor, 2006). The findings in this study echo these existing literature. The enforcement of the export contract is one of the main problems for foreign buyers and trading companies. The inefficient formal legal system and informal contract obligation are the sources of such problems. The evidence leads to our second proposition:

> ***P2***. *The inefficient judicial system and weak contract enforcement generate institutional uncertainty for emerging economy entrepreneurial firms*.

Knowledge, in term of information and experience, has always been the trading companies' advantages on economizing trade-related transaction costs. Peng & York (2001) state American export intermediaries' performance rely on their knowledge on the foreign market and export process. The significance of knowledge, information and experience on foreign markets for chartered trading companies is intensively researched (Carlos and Nicholas, 1988, Carlos, 1992, Carlos and Nicholas, 1996). For example, for Japanese general trading companies, information turns out to be the most important determinant of their diversified businesses (Kojima and Ozawa, 1984; Young, 1974).

For this study, knowledge is the significant determinant for Chinese export intermediaries' advantages on reducing these institution-related uncertainty. As discussed earlier, the specific and updated knowledge on the bureaucratic procedures and administrative approvals has played an essential role, helping firms increase transactional efficiency and frequency. From the findings across the six cases, all the firms acquired sufficient knowledge about institutional ambiguity and risk to enable them to deal with administrative procedures effectively. The evidence in the circumstances leads to our third proposition:

> ***P3***: *Emerging economy entrepreneurial firms obtain specific knowledge about institutional complexity to reduce institutional uncertainty caused by bureaucratic procedures and administrative approvals.*

Many studies indicate that the information acquisition becomes an effective method to counter *opportunistic behaviors, uncertainty,* and relative high monitoring costs generated by local deficient institutions 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 behaviors. 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. Moreover, asymmetric information is the primary reason for the difficulty in identifying product quality and other resulting problems that stop transactions, such as adverse selection and moral hazards (Akerlof, 1970; Stiglitz and Weiss, 1981).

All the firms acquired massive amounts of *information on production*, enabling them to reduce the *information asymmetry* between manufacturers and buyers, *opportunistic behaviors and uncertainty*, and enforcement costs. The information on production generally contains three aspects: *production conditions, production process and products, and manufacturers' characteristics;* this was initially found and concluded in C1, and confirmed by subsequent cases. The information on *production conditions and the production* progress enables Chinese export intermediaries to have effective control over production, quality, and delivery, minimizing the problems caused by the manufacturers' *opportunistic behaviors* and uncertainty during the production process. It is worth mentioning that the information on products may not limit to quality and operations and can include more. According to C3, pricing is important information and is systematically collected, updated and used by the firm to reduce the *uncertainty* and manufacturers' *opportunistic behaviors*, and for re-negotiation post-transaction. Finally, the acquisition of manufacturer information such as product quality, capacity, and credibility enables the export intermediaries to choose the most reliable and appropriate manufacturers for repeated transactions.

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 extensive 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 manufacture products for further export independently. Both Yoshino & Lifson's (1986) study and Kojima & Ozawa's (1984) study on Japanese GTCs mention the second situation.

However, the findings in this study extends the line by arguing that such activity does not only take place in large trading companies, but also in small trading companies and export intermediary firms. Furthermore, the acquisition of such information on production aims to enforce manufacturers' output better and avoid their opportunistic behaviors, at least in the countries where institutions are weak and opportunistic behaviors are pervasive. Chinese firms actively obtain information on production through employing staff with experience in manufacturing, to improve information asymmetry and reduce the enforcement costs on domestic manufacturers during export transactions. The evidence in the cases and interviews leads to our fourth proposition:

> ***P4***. *Emerging economy entrepreneurial firms obtain specialized knowledge about production and products to respond to institutional uncertainty coursed by the inefficient legal system and weak contract enforcement.*

6 Conclusion

In this study, the institutional uncertainties in China's export market associated with formal institutions such as bureaucratic procedures and administrative approvals, and the inefficient legal system and weak contract obligations, were identified. These institutional uncertainties bear the typical characteristics of transition economies, where institutions are continually changing, mainly from central planning to the market-based economic reform (Peng, 2003). The bureaucratic procedures and administrative approvals inherited from the previously planned economy system (Estrin et al., 2008), were under radical transformation, though they still exist in many forms during the period of the collapse of previous institutions under the central planning system. 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.

Faced with these formal institutional uncertainty in China's export market and related costs on export transactions, Chinese entrepreneurial firms like export intermediaries equip themselves with the specialized and experiential knowledge that enable them to respond institutional uncertainty and create values by reducing institution-related costs for domestic manufacturers and foreign buyers. Their success is highly determined by acquisition of knowledge, in term of information and experience, on institutional complexity, products and producers, production conditions and production processes. This paper also sheds light on the prominent role of informal institutions that emerging economy entrepreneurial firms may rely to facilitate business transactions when they encounter the low level of institutionalization and the high level of institutional uncertainty at home.

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