The Renaissance of State-Owned Multinationals

By
Xiaoming He
Lorraine Eden
Michael A. Hitt

State-owned multinational enterprises (SMNEs) have significant levels of state ownership and value-adding activities outside their home countries. SMNEs are undergoing a renaissance, highlighted by their numbers in the global economy and their heightened importance; as a result, they are gaining new attention in the academic literature and in the popular press. This work discusses the reasons for this renaissance and examines the challenges involved in managing SMNEs. SMNEs represent a hybrid organizational form with the dual characteristics of both the state-owned enterprise (SOE) and the multinational enterprise (MNE). When compared with private MNEs, SMNEs are generally less profit oriented and have a more complex corporate governance structure. They have less autonomy to establish their strategies, but also experience a lower level of uncertainty in their external environment. As a result, SMNEs have more difficulty than private MNEs in developing strategies and making organizational changes. Our study concludes with recommendations to managers for improving SMNE performance. © 2015 Wiley Periodicals, Inc.

Introduction

State-owned enterprises (SOEs)[1] flourished in the 1970s and 1980s, with many based in developing countries whose governments were interested in generating new competitive advantages through foreign-based production (Lall, 1983). During this time period, some SOEs engaged in value-adding activities outside their home country, qualifying them as state-owned (or controlled) *multinational enterprises (MNEs)* or *SMNEs*. In the 1970s and 1980s almost all SMNEs were under government control, strongly committed to government, and had the state's approval to enter international markets (Mazzolini, 1979). In general, SMNEs had only limited management autonomy to develop corporate strategies or to make decisions more broadly (Anastassopoulos, Blanc, & Dussauge, 1987).

Correspondence to: Xiaoming He, Department of Management, School of Economics and Management, Beijing Jiaotong University, Beijing, China 100044, 86 10 51687183 (phone), 86 10 51687162 (fax), xmhe@bjtu.edu.cn

Published online in Wiley Online Library (wileyonlinelibrary.com)
 • DOI: 10.1002/tie.21711

After the fall of the Berlin Wall in 1989, partly in response to these negative views, waves of economic liberalization, privatization, and deregulation swept through Europe, Asia, Latin America, and the former Soviet Union.

International business scholars argued that state ownership led to inefficient, badly managed and excessively large firms, with high agency costs (e.g., Aharoni & Seidler, 1986). State-owned enterprises were also seen as extensions of their home-country governments, viewed as suspicious potential "Trojan horses." Host-country nationals were concerned that foreign SMNEs might engage in actions to further the interests of their home country to the disadvantage of the host country (i.e., engage in extraterritorial activities; Vernon, 1977).

After the fall of the Berlin Wall in 1989, partly in response to these negative views, waves of economic liberalization, privatization, and deregulation swept through Europe, Asia, Latin America, and the former Soviet Union. Market-enhancing policy changes significantly reduced the number of SOEs relative to private MNEs in the global economy, leaving a smaller number of SMNEs. For example, the government of China announced policies to privatize small and medium-sized SOEs, leaving less than 30,000 SOEs in 2006 compared to more than 100,000 SOEs in 1986 (China Statistics Bureau, 2007). SOEs contributed less than 30% of China's gross domestic product (GDP) in 2006 versus 80% in 1978. In Mexico, the SOE share of GDP dropped to 5% in 2001 from 15% in 1982 (Kikeri & Kolo, 2006).

The state-owned enterprise, however, never disappeared. In the twenty-first century, SOEs continue to exist in many if not most countries (Kikeri & Kolo, 2006; United Nations Conference on Trade and Development [UNCTAD], 2011). In 2011, more than 10% of the world's largest firms were SOEs, and SOEs worldwide contributed 10% of global GDP (Bruton, Ahlstrom, Stan, Peng, & Xu, 2014).

We follow UNCTAD (2011) in defining a *state-owned multinational (SMNE)* as an organizational form that is both a multinational enterprise (MNE) (i.e., the firm has one or more foreign affiliates engaged in value-adding activities in one or more foreign countries) and a state-owned (or controlled) enterprise (i.e., the firm has a minimum of 10% government ownership). The 10% cutoff is high enough that the state likely influences corporate governance and thereby affects firm performance.[2] In 2010, according to UNCTAD (2011, p. 28), there were at least 650 SMNEs around the world with more than 8,500 foreign affiliates, and more than 40% of these SMNEs were majority owned by their governments. UNCTAD (2011) lists 19 SMNEs among the largest 100 companies in the world. SMNEs now control approximately US$2 trillion in foreign assets (Sauvant & Strauss, 2012) and are based in both developed and developing countries.

With the growing influence of SMNEs in international markets (Christiansen & Kim, 2014), we believe that it is important for international business scholars to better understand the phenomenon of SMNE renaissance; with this purpose in mind, we address three research questions about SMNEs:

1. How have changes in the global economy led to the renaissance of SMNEs?
2. What challenges affect the management of today's SMNEs?
3. What managerial changes are needed to improve the performance of SMNEs?

These questions are important for both SMNE managers and government policymakers because both groups need to make complex decisions when confronting changes in international environment (Teagarden, 2015). From a managerial perspective, the SMNE is an important organizational form because it represents an alternative means of achieving higher profitability while simultaneously satisfying national objectives. Accordingly, the SMNE has unique corporate characteristics and engages in strategic decisions and implementation modes that are different from those of the SOE and the MNE. From a political perspective, SMNEs are crucial for their home countries because the firms often have a significant influence on national economic status and national competitiveness, especially in emerging economies. Also, because of the nature of SMNEs and specifically their home country of origin, there can be serious questions related to national security and competitiveness in host countries (Vernon, 1977). Herein, we focus on managerial issues of SMNEs; that is, managerial complexities of SMNEs in the current global economy and how to deal with them. Finally, understanding how changes in the global economy have led to the renaissance of SMNEs while simultaneously increasing the complexities involved in their management, leads us to also recommend several ways to improve the management of SMNEs and their performance.

Because of the importance of globalization for country economic growth and development, SOEs have been less able than in the past to depend on governments for protection, such as special resource allocations and compensation for significant losses from the increased foreign competition in their local markets.

How Have Changes in the Global Economy Led to the Renaissance of SMNEs?

Since the fall of the Berlin Wall in 1989, the world has changed dramatically. These changes at the international and national levels have influenced the development of state-owned multinationals.

At the global level, the trend toward greater globalization and changes in international regulations has influenced the growth of SMNEs in at least two ways.

First, because of the importance of globalization for country economic growth and development, SOEs have been less able than in the past to depend on governments for protection, such as special resource allocations and compensation for significant losses from the increased foreign competition in their local markets (Tan & Tan, 2005). Enhanced competition and the lack of protection in local markets have forced SOEs to engage in outward foreign direct investment (FDI), seeking other markets and sources of revenues and income, thus accelerating their evolution to SMNE status by adding foreign value adding activities. In addition, collaboration with firms based in other countries has become more crucial for MNEs from developed, emerging, and developing economy countries. Thus, SMNEs now often engage in a significant amount of international strategic alliances.

Second, international institutions have established new codes and regulations to guide the growth of SMNEs in the changing environment. The United Nations, World Bank (WB), and International Monetary Fund (IMF) regularly establish rules to guide and monitor the flow of FDI and the operations of MNEs. Moreover, these formal international institutions have acknowledged the importance of state ownership in fostering economic growth. For instance, the Organization for Economic Cooperation and Development (OECD, 2005, p. 13) reported that "SOEs may represent up to 40% of value added, around 10% of employment, and even 50% of market capitalization in different OECD countries." Since the 1990s, both the IMF and the WB have assisted in financing privatization in developing countries, accelerating the privatization process in these countries (Bortolotti & Perotti, 2007). As a result, government ownership (and control) of SMNEs has decreased, although leading to mostly partial and not total privatization of SMNEs.

At the national level, three trends—privatization, changing home-country institutional environments, and institutional voids—have affected the development of SMNEs.

First, privatization brings in private equity ownership that reduces state ownership in SMNEs. Some SMNEs remain majority owned by the state, while others are only controlled by the state with significant influence on SMNEs' operations and management (Kikeri & Kolo, 2006; OECD, 2005); private ownership often transforms their organizational cultures and strategies.

Since the first wave of SOE privatizations in the 1990s, partial privatization of SOEs by selling stock to foreign MNEs has been perhaps the most common route for the ownership transformation of SOEs, which has facilitated their engagement in FDI and thus progress to SMNEs (Vaaler & Schrage, 2009). After at least partial privatization, managers have had to confront market forces and have responsibility for increasing shareholder value. In turn, they are more willing to take risks and engage (invest) in entrepreneurial activities because they see the opportunities for these actions to enhance the firm's profitability. Therefore, the inclusion of different types of ownership through privatization promotes greater efficiency in SMNEs (Uhlenbruck & De Castro, 2000).

Second, many countries are trying to both consciously attract inward FDI and encourage outward FDI through improvements in their formal institutional environment involving regulations, legal systems, and infrastructure (Holmes, Miller, Hitt, & Salmador, 2013; UNCTAD, 2006). In order to attract more FDI, governments in host countries have improved their macroeconomic and institutional environment and upgraded their infrastructure, technology, and human competences (Globerman & Shapiro, 2002). Additionally, to augment national competitiveness, governments have encouraged technology transfer and international trade through economic liberalization and deregulation. As a result, SMNEs have improved host and home environmental conditions, therefore encouraging further expansion into international markets.

Third, national governments have been using state ownership as a lever for stabilizing their economies. For instance, governments in developed, emerging, and developing economy countries have fully or partially nationalized or provided financial support to firms in the banking, finance, and other industries (e.g., automobiles) in an attempt to reverse the 2008 global financial crisis (São, 2010). Many of these nationalized and partially nationalized firms were already MNEs and the bailouts therefore created new SMNEs. In addition, many emerging economy governments are encouraging their SOEs to enter global markets thereby becoming SMNEs, for example, China's "go global" policy (Hemphill & White, 2013; UNCTAD, 2006, 2011).

In developing and emerging-economy countries, the situation is somewhat different than in developed countries. In emerging and developing economies, a formal set of institutions to help domestic markets function smoothly often are not fully operational due to institutional weaknesses or voids. Government support for SMNEs can provide an alternative mechanism to deal with problems generated by institutional voids, such as lack of financial support and lack of intermediaries to effectively connect firms with their customers (Vaaler & Schrage, 2009). For instance, SMNEs can obtain funds from state owned banks (Zheng & Scase, 2013) and/or take advantage of their government relations to secure contracts (Cui & Jiang, 2012). Therefore, in countries with institutional voids, government agents providing oversight may help SMNEs overcome problems related to the voids.

Government support for SMNEs can provide an alternative mechanism to deal with problems generated by institutional voids, such as lack of financial support and lack of intermediaries to effectively connect firms with their customers.

Finally, some SMNEs continue to operate in key industries. Before privatization and market liberalization, state ownership was pervasive in many industries such as the oil and gas industry in western Europe and in developing countries. Even after two decades of privatization, in strategic sectors such as infrastructure and finance, government ownership and involvement through direct governance activities still widely exist (Desvaux, Wang, & Xu, 2004; UNCTAD, 2011). First, governments sometimes restrict the entry of private and foreign enterprises into some key sectors, such as aerospace and railways, for the sake of national security or to ensure the competitive capability and survival of local firms. In addition, governments in developing countries still engage in strong initiatives to support national economic growth and control key industry sectors such as natural resources (e.g., oil and gas) (Kikeri & Kolo, 2006), while governments in developed countries often exercise control over industry sectors in

 DOI: 10.1002/tie

public utilities such as transportation, telecommunications, gas, and water (OECD, 2014; UNCTAD, 2011). Thus, SMNEs now tend to be concentrated in selected industries.

As a result of these changes in the global markets, SMNEs have been undergoing a renaissance. However, they face new challenges (complexities) in managing their external environments, to which we now turn.

What Challenges Affect the Management of Today's State-Owned Multinationals?

The dual nature of state-owned multinationals, with characteristics of both the SOE and the MNE, generates potential internal tensions in the management of SMNEs related to their goals, corporate governance, external environment, strategy, and organizational change. Due to these tensions, we expect SMNEs to evidence a high level of managerial complexity and challenges because of the coexistence of challenges of international markets and competition and the external demands and constraints placed on them. We explore these challenges below by comparing SOEs and MNEs. Our arguments are illustrated in Figure 1 and Table 1.

Goals: SOE versus MNE

First, the SOE is an instrument for achieving national objectives and highly guided by the state (Zheng & Scase, 2013). SOEs were created to achieve government goals rather than the economic goals (profit maximization, shareholder returns) that motivate private enterprises. Governments have used SOEs to stimulate economic growth and innovation, leading to more employment and social welfare when resources were limited and needed reconstruction. As a result, SOEs are largely nonprofit-oriented socioeconomic organizations constrained to achieve government objectives, such as higher employment and output and more taxes and additional investment (see Table 1).

FIGURE 1 Challenges in Management of the SMNE

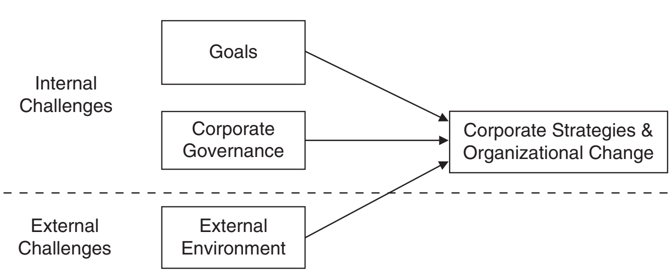

TABLE 1 Comparing the SOE, MNE, and SMNE

Key Features	SOE	SMNE	MNE
Goals			
Objectives	State driven	State and market driven	Market driven
Corporate Governance			
1. Internal conflict	State vs. management	Both, but at different organizational levels	Parent vs. subsidiaries
2. Management autonomy	Low	Medium	High
External Environment			
1. Expectation	Stability	Both, but at different organizational levels	Legitimacy
2. Uncertainty	Low	Medium	High
3. Industry distribution	Key sectors	Key sectors	Various
Strategies and Change			
1. Risk taking	Low	Medium	High
2. Degree of flexibility and organizational inertia	Low	Medium	High

In contrast, most MNEs are profit oriented (Caves, 1996) and focused on achieving at least an acceptable level of efficiency (Tan & Tan, 2005). Involved in business activities across national boundaries, MNEs experience the costs of doing business abroad, including both economic and social costs. MNEs must have ownership advantages that increase their revenue and/or reduce their costs in order to compete with local firms in the host country. The more ownership advantages a firm has, the more likely the firm is to internalize its investment in foreign markets (Dunning & Lundan, 2008). Similarly, the greater the amount of market imperfections (e.g., transaction costs, government-imposed market distortions) affecting cross-border transactions, the more likely is the firm to internalize its transactions. Thus, the goal of the MNE is to maximize returns from its investments in international operations (see Table 1).

With both characteristics of MNEs and SOEs, an SMNE seeks to improve its performance when the enterprise expands internationally. However, because the SMNE has some level of state ownership, it is restrained by government objectives, which may conflict with the activities needed to earn profits (Luo & Tung, 2007). This tension embedded in the SMNE is likely to prevent it from purely targeting profits in its management and operations. This tension also poses challenges for the

Conflicts of interest between the state and the SOE often lead managers to try to satisfy opposing objectives while having a low level of power and autonomy in pricing, investment, and control decisions.

managers of the SMNE trying to balance and satisfy the different stakeholder objectives.

Corporate Governance: SOE versus MNE

The relationship between the state and the SOE potentially manifests conflicts of interest due to divided loyalties. Divided loyalties are created when the SOE's interests are not consistent with the state's interests; thus, state ownership generates potentially high agency costs (Zou & Adams, 2008). Conflicts of interest between the state and the SOE often lead managers to try to satisfy opposing objectives while having a low level of power and autonomy in pricing, investment, and control decisions. Because managers in SOEs lack incentives for high performance and are poorly monitored, subsequent agency costs generally lead to firm inefficiency. Moreover, senior managers of the SOE are generally selected by government officials (Lin, 2004; Zou & Adams, 2008). The enterprise is committed to inform the government of the SOE's strategies to obtain approval and support. Thus, government generally plays an important role in the governance of the SOE.

There are three major means used by governments to control the management of SOEs: (1) general oversight (nonintervention), for example, in Britain and Germany where the government nominates all the directors but has no direct role in decision making (OECD, 2005); (2) direct and continuous intervention, which is common in the Third World (Zheng & Scase, 2013); or (3) commercial decisions to support national economic development, for example, in France (OECD, 2005). Thus, there is a trade-off between performance and government control of SOEs in terms of "whether, when, and how to intervene" (Lamont, 1979, p. 77) (see Table 1).

MNEs, on the other hand, operate in multiple environments to which they have to adapt in order to survive, which imposes additional demands on their corporate governance (Dunning & Lundan, 2008). MNEs face challenges in understanding and dealing with different cultural and formal institutional environments and thus must attempt to achieve internal coordination across multiple foreign subsidiaries. As a result, the MNE experiences a significant central management challenge. Ownership structure and board structure are the main influences in monitoring the MNE's management team in the corporate governance system. For instance, the separation of chairperson and CEO in the board can mitigate agency issues in managing some of the challenges experienced by MNEs (Filatotchev & Wright, 2011). Due to greater dispersion of power, the level of managerial discretion in the MNE is lower, resulting in a reduction of agency costs (Sanders & Carpenter, 1998). Moreover, different types of owners may execute their control over the MNE in different ways due to their unique motivations. Tihanyi, Johnson, Hoskisson, and Hitt (2003) find that although professional investment funds and pension funds have their own rationale for investing in MNEs, both types of institutional investors encourage international expansion. Further, different board-of-director structures also influence the MNE's corporate governance, for example, the nomination of the management team (Tihanyi et al., 2003). Due to the separation of ownership and control, top managers implement corporate and international strategies within the boundaries established partly because of the monitoring by the board and commonly have a high degree of autonomy.

For most current SMNEs, their corporate governance is more effective than that of SMNEs in the 1970s and 1980s due to monitoring by other equity shareholders. Moreover, in the new global economic environment, current SMNEs generally have a higher level of management autonomy than SMNEs did historically because governments have reduced their interference in corporate governance, thereby encouraging SMNEs to improve their profitability (OECD, 2005). For example, Petrobras, a Brazilian oil SMNE, was experiencing major problems in the 1980s and early 1990s. To enable the firm to compete in global markets, in 1997, the Brazilian government reduced its ownership of Petrobras to 51%, partially privatizing the SMNE. Petrobras is now more accountable and competitive in international markets, and engaged in implementing new technologies (Flores-Macias & Musacchio, 2009; see Table 1).

However, SMNEs still suffer from bureaucratic obstacles and political intervention from governments (Luo & Tung, 2007; Zheng & Scase, 2013). Political interventions in the firm's decision-making processes are easier when the SMNE is operated as a part of a ministry, with managers directly appointed by the ministry leaders rather than by the board of directors. Moreover, an SMNE has to remain committed to the government in addition to its commitment to other types of shareholders. Continuation of agency problems due to state ownership can be especially troubling when competing in a changing international environment with challenges from increased competition, complex institutional environments and dynamism (see Table 1). Thus, the challenges existing in the corporate governance of many SMNEs are often more complex than those for private MNEs.

Large differences across environments generate external pressures on firms, resulting in potentially significant conflicts and difficult challenges in gaining and maintaining legitimacy for subsidiaries.

External Environment: SOE versus MNE

Stability is generally preferred by SOEs (Zahra, Ireland, Gutierrez, & Hitt, 2000). Under the protection of governments, SOEs generally experience limited competition their local markets (Uhlenbruck, Meyer, & Hitt, 2003), have less pressure to generate profits, and are compensated for operational losses; instead of income and growth, they focus on output and production (Ralston, Terpstra-Tong, Terpstra, Wang, & Egri, 2006). Thus, SOEs are less likely to experience high levels of external uncertainty (Tan & Tan, 2005) or typical environmental risks (e.g., macroeconomic and policy changes, competition, and resource constraints).

MNEs, on the other hand, often must deal with economic, political, legal, and cultural environments that vary significantly between home and host countries—and across host countries as well (Rugman & Verbeke, 2009). Large differences across environments generate external pressures on firms, resulting in potentially significant conflicts and difficult challenges in gaining and maintaining legitimacy for subsidiaries. These challenges are influenced by the number of countries in which the firm operates and the institutional distances between host countries and the home country. When competition in global markets and unfamiliarity with host-country institutions are higher, the level of uncertainty experienced can be significant (Rugman & Verbeke, 2009; see Table 1).

For organizational legitimacy, SMNEs have to abide by both home country and host country policies and regulations (as do MNEs). However, due to the existence of state ownership, SMNEs are more constrained by their home country governments than are private MNEs (Lin, 2004). On the other hand, they can obtain government support (Wu, Hoon, & Zhang, 2011) by accessing privileged resources such as investment capital (Zheng & Scase, 2013). Nevertheless, when SMNEs invest overseas, host countries may exert discriminatory policies that constrain their subsidiaries to gain legitimacy (Cui, Jiang, & Sterning, 2011). Thus, SMNE parent firms have a more certain home-country environment than do MNEs, but their subsidiaries have less flexibility to adapt to the foreign country environments. Moreover, SMNEs are more likely than MNEs to obtain state support to help them compete successfully in international markets (Luo & Tung, 2007). SMNEs in industries that are still largely controlled by the government but are also active in international markets are generally located in key sectors such as infrastructure and finance (Christiansen & Kim, 2014). Thus, SMNEs have at least a partial buffer against the uncertainty relative to private MNEs in host countries.

Strategies and Organizational Change: SOE versus MNE

The ability to change, which enables a firm to adapt to a dynamic environment, depends on the firm's degree of flexibility and its level of organizational inertia (Shimizu & Hitt, 2005). In general, the strategic decisions of SOEs need state approval. When they make strategic decisions, SOEs have to follow state requirements that are based on government goals (Lin, 2004). Moreover, due to their bureaucratic structure, SOEs' strategic plans may not be efficiently implemented in practice. Further, SOE managers face little pressure for profitability but experience pressure for achieving state objectives. Moreover, due to restrictions on operations and management in SOEs, managers do not commonly respond to environmental changes (Zheng & Scase, 2013). Because of the lack of management incentives, managers are generally risk averse and not proactive in trying to develop innovation (Tan & Tan, 2005; Table 1).

SOEs are typically characterized with a high level of structural inertia, and thus resist change (Tan & Tan, 2005). As a result, strategic change comes slowly, if at all (e.g., bureaucratic procedures cause sluggishness in operations, multiple layers of management, and an inefficient means of coordination). The SOE has goals established primarily by the government, which represent constraints on their actions and contribute to high organizational inertia (Tan & Tan, 2005). For similar reasons, organizational flexibility, "the capability of the firm to proact or respond quickly to changing competitive conditions and thereby develop and/or maintain competitive advantage" (Hitt, Keats, & DeMarie, 1998, p. 27), is a major challenge for SOEs not only due to the aforementioned problems but also because of the relationships of the SOE to multiple government units and other SOEs (Zheng & Scase, 2013). For instance, even the process to revise operational procedures is likely to be slow. Under the monitoring of government agents, planned strategic change is likely to be more difficult to achieve (Lin, 2004; see Table 1).

MNEs often must deal with a high level of dynamism in their external environment, even when they remain stable in their international operations, but especially if they continue to expand internationally.

For MNEs, on the other hand, pressures for global integration and local responsiveness are strong influences on their strategic decisions (Festing, Knappert, Dowling, & Engle, 2012). MNEs often must deal with a high level of dynamism in their external environment, even when they remain stable in their international operations, but especially if they continue to expand internationally. Thus, flexibility in strategy and processes—the flexibility to deal with environmental volatility—is crucial. Therefore, MNEs endeavor to speed effective changes to avoid inertia, maintain flexibility, and ensure their profitability (Rugman & Verbeke, 2009; see Table 1).

In order to compete in international markets, current SMNEs are more likely to take risks and have a lower level of organizational inertia than the SMNEs in the past. However, a tension exists when SMNEs need to be more proactive, but are restrained by government monitoring and interference, when they are making strategic decisions and trying to implement changes (Zheng & Scase, 2013). The tensions in their goals and corporate governance generate managerial challenges for SMNEs; the conditions they confront in their external environment exacerbate these challenges. Both the internal complexity and external challenges experienced by MNEs make them less flexible and harder to change than private MNEs. Thus, SMNEs have more difficulty in making strategic decisions and implementing organizational changes than do private MNEs (see Table 1).

Outcomes: SOE versus MNE

As explained earlier, SOEs, especially those where the level of state ownership is very high, are not likely to be profit oriented; rather, they focus on government goals such as employment and national security. Due to their corporate governance structures, SOE agency costs are generally high and managers lack of incentives to achieve profitability. The organizational structure of SOEs is typically hierarchical, with multiple levels of management (Ralston et al., 2006). Because of the lack of managerial incentives, effective monitoring, and government subsidization of poor firm performance (Aharoni, 1986; Zou & Adams, 2008), the productivity of SOEs is typically much lower than in private firms, sometimes by as much as a third or more (Kikeri & Kolo, 2006). Prior empirical studies provide support for the significant differences in firm performance between SOEs and private firms (Goldeng, Grunfeld, & Benito, 2008; Parker & Hartley, 1991). Consequently, SOEs are generally inefficient due to intervention of government policies both in strategies and operations (e.g., Anastassopoulos et al., 1987; Goldeng et al., 2008; Mazzolini, 1979; White, 2000).

 DOI: 10.1002/tie

In contrast, as an economic organization (Caves, 1996), the MNE internalizes markets across national boundaries (Buckley & Casson, 2009). The MNE enters and operates in foreign countries in order to generate added value (Dunning, 1993), greater competitiveness and increased profitability (Hitt, Ireland, & Hoskisson, 2012). During international expansion, the MNE continuously creates and exploits advantages for economic returns from foreign markets (Buckley & Casson, 2009). Thus, from an economic perspective, the MNE is trying to achieve greater efficiency and higher profitability (Anastassopoulos et al., 1987). Research suggests that with advanced technology and stronger managerial skills, MNEs on average have higher levels of efficiency than SOEs (Park, Li, & Tse, 2006; Tan, 2002; Tan & Tan, 2005).

Research in strategic management tells us that firms can achieve strategic competitiveness and improve firm performance when they formulate appropriate strategies and implement them effectively (Hitt et al., 2012). We see this with SMNEs where, compared to SMNEs in the 1980s and 1990s, many current SMNEs have achieved higher performance (Flores-Macias & Musacchio, 2009), despite being generally less profit oriented than MNEs. Moreover, compared to MNEs, they encounter challenges in making strategic decisions, significant complexity in the corporate governance system, and a lower level of autonomy, all of which reduce managerial efficiency (Cui & Jiang, 2012; Park et al., 2006). In addition, SMNEs must balance the interests of the state and their private shareholders. Considering these attributes, we conclude that SMNEs are generally at a comparative competitive disadvantage to MNEs and thus are less profitable.

The governments owning equity in SMNEs, particularly in emerging economies such as China, are providing direct support to these firms, encouraging them to internationalize.

What Managerial Changes Are Needed to Improve the Performance of SMNEs?

How should state-owned multinationals be managed so as to reduce the level of management complexity and increase their efficiency and profitability? Perhaps the most important change would be efforts that can mitigate different types of tensions discussed earlier, which result in the complexities and management challenges in SMNEs. Several suggestions are provided below, although we recognize that SMNEs experience different levels of challenges under divergent institutional environments.

Offer More Encouragement to SMNEs to Better Align Interests

Although managers experience divided loyalties between achieving SMNE efficiency and profits and accomplishing the state's objectives, in the competitive landscape of the twenty-first century, many home governments depend on their SMNEs to improve the nation's international economic position and to acquire overseas resources that help them to upgrade national technological capabilities (Zeng & Williamson, 2003). International diversification by SMNEs, especially those that are viewed as national champions (Nolan, 2001), is therefore often encouraged by home-country governments (Cui & Jiang, 2012). Thus, the governments owning equity in SMNEs, particularly in emerging economies such as China, are providing direct support to these firms, encouraging them to internationalize. To lower the level of divided loyalty among managers in SMNEs and take advantage of SMNEs' international activities, such encouragement should continue to better align interests of SMNEs with those of the state.

Design Mechanisms to Effectively Mitigate Corporate Governance Problems

When operating in multiple country environments, SMNEs face challenges understanding and meeting the requirements of different cultural and formal institutional environments. In addition, the difficulties of coordinating resource allocation and strategies across multiple foreign subsidiaries result in a significant central management challenge.

The state is the concentrated owner of SMNEs, which exerts influence on firms' strategic decisions through its control over corporate governance (Dalton, Hitt, Certo, & Dalton, 2008). Still suffering from bureaucratic obstacles and political intervention from the state, SMNEs

When interests between SMNEs and the state are better aligned to help firms compete successfully in international markets, the state will be more aware of internal coordination challenges confronted by SMNEs and willing to endow the SMNE's board with more rights and autonomy in the corporate governance system.

should design a corporate governance system that can mitigate governance concerns where possible. Doing so would help SMNEs deal more effectively with internal coordination challenges and improve their efficiency.

First, SMNEs need to negotiate with the state for the right to clarify boundaries in the power distribution within the corporate governance system. When interests between SMNEs and the state are better aligned to help firms compete successfully in international markets, the state will be more aware of internal coordination challenges confronted by SMNEs and willing to endow the SMNE's board with more rights and autonomy in the corporate governance system.

Second, in such a system, CEO duality should be avoided. The separation of chairperson and CEO in the board is considered to be an effective governance mechanism in the west (Sanders & Carpenter, 1998). While as a concentrated owner, the state has the right to influence top executive nomination in SMNEs, it should allow the board to balance the state influence on behalf of needs of the firms when formulating and implementing the strategies that can help them to achieve and sustain global competitiveness (OECD, 2013).

Third, independent directors with expertise can help SMNEs' efficiency (OECD, 2013). Independent directors should be encouraged to provide their international experience and professional expertise to SMNEs, in areas such as identifying the best international markets to enter, how to best enter them, and how to effectively manage the internationalization process. With effective corporate governance mechanisms, boundaries can be established, within which top managers formulate and implement successful corporate and international strategies.

Provide More Management Autonomy and Incentives to Top Managers

Agency problems can be mitigated by a progressive state's efforts (i.e., forward-looking) to reduce its direct participation (e.g., interference) in SMNE governance. A state may be selective in its interventions and more open to market opportunities, encouraging its SMNEs to expand into international markets. If the state believes that SMNEs need autonomy and flexibility to successfully compete in international markets, they should loosen their control and possibly even reduce their ownership levels to encourage private ownership and governance. With the reduction in state intervention, managers of SMNEs have more autonomy and may be more willing to proactively invest in innovative and riskier activities, such as international expansion.

The loosening of state control and granting of greater autonomy has other advantages as well. We noted earlier that home countries in our view SMNEs as "Trojan horses" that have entered host countries to further the geopolitical interests of their home government at the expense of the interests of the host government. When SMNEs are viewed in this way, the host government may apply burdensome restrictions or even prevent their entry, making successful entry more difficult for SMNEs. If the home-country government reduces its control of the SMNE, this reduces the probability that the host country will view the SMNE as a Trojan horse. Also, if SMNE managers have more autonomy, they can take actions to enhance trust between them and the host-country government. Thus, lower control and granting more autonomy to SMNE by the state can contribute to SMNEs' success in international markets.

Moreover, the state can go further to encourage managers to devote more to internationalization by providing incentives to do so. Earlier, we suggested that because managers of SOEs are rarely evaluated on the firm's financial performance, they lack incentives to take risky

 DOI: 10.1002/tie

actions (Zou & Adams, 2008). Thus, in order to promote internationalization of SMNEs, managers should also be given incentives such as stock options and bonuses perhaps tied to their international strategies and actions.

Bring in Other Types of Owners

As long as the SMNE is publicly traded, other organizations and agencies (e.g., foreign and institutional investors) are incentivized to monitor state owners and SMNE managers, to achieve their own goals. Moreover, public listings provide investors with more comprehensive information about the SMNE, which should restrain agency problems (Pargendler, Musacchio, & Lazzarini, 2013). Thus, listing on public stock exchanges and thus adding other types of owners leads to greater monitoring, and thereby reduces agency problems in SMNEs (i.e., publicly traded) compared to nonlisted SMNEs. Excessive interference by politicians and bureaucrats, or poor decisions by self-aggrandizing SMNE managers, will be reflected in a discounted stock price. Still, the state keeps its majority-owned or a concentrated equity stake in the SMNEs to achieve its national objectives. Active stock markets should therefore reduce agency costs of SMNEs during international expansion, encouraging international diversification with the intent of achieving higher returns.

Adapt to Home and Host Countries

At home, while SMNEs can enjoy government support, they are constrained by the state. To continuously gain government support while weakening the negative effects of state constraints during their international expansion, SMNEs need to balance their commercial and noncommercial objectives (Christiansen, 2013). Moreover, because of the nature of SMNEs and specifically their home country origin, there are serious questions related to national security and competitiveness for host countries (Wu, Hoon, & Zhang, 2011). Thus, discriminatory policies and regulations may be exerted by host countries, which constrain SMNE subsidiaries to gain legitimacy (Cui et al., 2011). To alleviate these concerns, SMNEs must take special actions to build local trust and adapt to the host-country environment.

Be Flexible and Innovative

If internal complexity and external challenges can be mitigated by adopting the preceding recommendations, the outcome should be SMNEs that are more profit oriented. Their top managers should have higher levels of autonomy, and corporate governance should be more effective; as a result, SMNE managers should begin to face greater pressure for profitability. Managers should be endowed with more incentives and thus more willing to be proactive to invest in and encourage the development of innovation. Moreover, flexibility in strategy, structure, and processes, in order to deal with environmental volatility, is important for SMNEs to successfully compete in international markets. With better alignment of interests, SMNEs should be able to cope with and hopefully reduce structural inertia. Thus, being flexible and less inert, SMNEs can initiate the necessary strategic changes to adapt to a dynamic global environment and ensure their long-run profitability and success.

Flexibility in strategy, structure, and processes, in order to deal with environmental volatility, is important for SMNEs to successfully compete in international markets.

Conclusions

In this article, we have argued that state owned multinationals are a hybrid organizational form that shares the characteristics of both the state-owned enterprise and the multinational enterprise. The number and weight of SMNEs in the global economy are growing; as a result, it is important for management and international business scholars to study the strategy and structure of SMNEs. We hope that our article has provided some useful steps in this direction that will encourage other scholars to work in this fruitful area. Our article also offers useful policy recommendations to SMNE managers and government regulators interested in improving the competitiveness and performance of state-owned multinationals.

Notes

1. SOEs are firms that are fully, majority, or significantly minority owned by the state, which has controlling power in SOEs (OECD, 2005). OECD

(2014) defines minority owned by shares or voting rights between 10 and 50%.

2. In 2010, among 650 SMNEs, only 10% had less than 10% state ownership; however, "the government is often the largest of the minority stakeholders, or holds so-called 'golden shares' and therefore exerts a significant … influence on the composition of the board of directors and the management of the enterprise" (UNCTAD, 2011, p. 29).

Xiaoming He is an associate professor of strategic management at the School of Economics and Management, Beijing Jiaotong University. She received her PhD from Texas A&M University. Her research interests focus on dynamic capability of organizations, corporate governance, resource management, institutional environment, and international management. She has published in journals such as the *Strategic Management Journal* and the *IEEE Transactions on Engineering Management.*

Lorraine Eden is a professor of management at Texas A&M University. She received her PhD from the Dalhousie University. Her research focuses on multinational enterprises, particularly in the areas of transfer pricing (the pricing of intrafirm transactions within multinational enterprises), multinational-state relations, and economic integration. She teaches courses on multinational enterprises, transfer pricing, and the economics of international business. She has published in journals such as the *Academy of Management Journal* and the *Journal of International Business Studies*. Professor Eden is a former editor-in-chief of the *Journal of International Business Studies* (2008–2010).

Michael A. Hitt is currently a University Distinguished Professor at Texas A&M University and holds the Joe B. Foster Chair in Business Leadership. Michael received his PhD from the University of Colorado. A recent article listed him as one of the 10 most cited authors in management over a 25-year period. The *Times Higher Education* in 2010 listed him among the top scholars in economics, finance, and management, and he is the first among management scholars with the largest number of highly cited articles. He has served on the editorial review boards of multiple journals and is a former editor of the *Academy of Management Journal* and a former co-editor of the *Strategic Entrepreneurship Journal*. He received awards for the best article published in the *Academy of Management Journal* (2000) and the *Journal of Management* (2006). In 2004, Dr. Hitt was awarded the Best Paper Prize by the Strategic Management Society.

References

Aharoni, Y. (1986). The evolution and management of state owned enterprises. Cambridge, MA: Ballinger.

Aharoni, Y., & Seidler, L. K. (1986). Foreign subsidiaries of state-owned enterprises: Host country responses. In A. R. Negandhi, H. Thomas, & K. L. Rao (Eds.), Multinational corporations and state-owned enterprises: A new challenge in international business (Vol. 1, pp. 151–161). London, England: JAI Press.

Anastassopoulos, J.-P., Blanc, G., & Dussauge, P. (1987). State-owned multinationals. Chichester, England: Wiley.

Bortolotti, B., & Perotti, E. (2007). From government to regulatory governance: Privatization and the residual role of state. World Bank Observer, 22, 53–66.

Bruton, G., Ahlstrom, D., Stan, C., Peng, M., & Xu, K. (2014). State-owned enterprises as hybrid organizations. Academy of Management Perspectives. Advance online publication. doi:10.5465/amp.2013.0069

Buckley, P. J., & Casson, M. (2009). The internalization theory of the multinational enterprise: A review of the progress of a research agenda after 30 years. Journal of International Business Studies, 40, 1563–1580.

Caves, R. (1996). Multinational enterprise and economic analysis (2nd ed.). New York, NY: Cambridge University Press.

China Statistics Bureau. (2007). Statistical year book and annual report. Beijing, China: Author.

Christiansen, H. (2013). Balancing commercial and non-commercial priorities of state-owned enterprises. OECD Corporate Governance Working Papers, No. 6. Paris, France: Author.

Christiansen, H., & Kim, Y. (2014). State-invested enterprises in the global marketplace: Implications for a level playing field. OECD Corporate Governance Working Papers, No. 14. Paris, France: Author.

Cui, L., & Jiang, F. (2012). State ownership effect on firms' FDI ownership decisions under institutional pressure: A study of Chinese outward-investing firms. Journal of International Business Studies, 43, 264–284.

Cui, L., Jiang, F., & Sterning, B. (2011). The entry-mode decision of Chinese outward FDI: Firm resources, industry conditions, and institutional forces. Thunderbird International Business Review, 53, 483–499.

Dalton, D. R., Hitt, M. A., Certo, T. S., & Dalton, C. M. (2008). The fundamental agency problem and its mitigation: Independence, equity, and the market for corporate control. In J. P. Walsh & A. P. Brief (Eds.), Academy of management annals (pp. 1–64). New York, NY: Routledge.

Desvaux, G., Wang, M., & Xu, D. (2004). Spurring performance in China's state-owned enterprises. McKinsey Quarterly, special issue, 96–105.

Dunning, J. H. (1993). Multinational enterprises and the global economy (1st ed.). Wokingham, Berkshire, England: Addison-Wesley.

Dunning, J. H., & Lundan, S. M. (2008). Multinational enterprises and the global economy (2nd ed.). Cheltenham, England: Edward Elgar.

Festing, M., Knappert, L., Dowling, P. J., & Engle, A. D. (2012). Global performance management in MNEs: Conceptualization and profiles

 DOI: 10.1002/tie

of country-specific characteristics in China, Germany, and the United States. Thunderbird International Business Review, 54, 825–843.

Filatotchev, I., & Wright, M. (2011). Agency perspectives on corporate governance of multinational enterprises. Journal of Management Studies, 48, 471–486.

Flores-Macias, F., & Musacchio, A. (2009). The return of state-owned enterprises: Should we be afraid? Harvard International Review. Retrieved from http://hir.harvard.edu/archives/1854

Globerman, S., & Shapiro, D. (2002). Governance infrastructure and US foreign direct investment. Journal of International Business Studies, 33(1), 1–21.

Goldeng, G. E., Grunfeld, L., & Benito, G. R. G. (2008). The performance differential between private and state owned enterprises: The role of ownership, management and market structure. Journal of Management Studies, 45, 1244–1273.

Hemphill, T. A., & White, G. O. (2013). China's national champions: The evolution of a national industrial policy—or a new era of economic protectionism? Thunderbird International Business Review, 55, 193–212.

Hitt, M. A., Ireland, R. D., & Hoskisson, R. E. (2012). Strategic management: Competitiveness and globalization (10th ed.). Mason, OH: South-Western.

Hitt, M. A., Keats, B. W., & DeMarie, S. M. (1998). Navigating in the new competitive landscape: Building strategic flexibility and competitive advantage in the 21st century. Academy of Management Executive, 12(4), 22–42.

Holmes, R. M., Miller, T., Hitt, M. A., & Salmador, M. P. (2013). The interrelationships among informal institutions, formal institutions, and inward foreign direct investment. Journal of Management, 39, 531–566.

Kikeri, S., & Kolo, A. (2006, February). State enterprises. Public Policy Journal. Retrieved from http://siteresources.worldbank.org/EXTFINANCIALSECTOR/Resources/282884-1303327122200/304Kikeri_Kolo.pdf

Lall, S. (1983). The new multinationals: The spread of third world enterprises. Chichester, England: Wiley.

Lamont, D. F. (1979). Foreign state enterprises: A threat to American business. New York, NY: Basic Books.

Lin, Y. (2004). Between politics and markets: Firms, competition, and institutional change in post-Mao China. Cambridge, England: Cambridge University Press.

Luo, Y., & Tung, R. (2007). International expansion of emerging market enterprises: A springboard approach. Journal of International Business Studies, 38, 481–498.

Mazzolini, R. (1979). Government controlled enterprises. New York, NY: Wiley.

Nolan, P. (2001). China and the global economy: National champions, industrial policy and the big business revolution. London, UK: Palgrave Macmillan.

Organization for Economic Cooperation and Development (OECD). (2005). Corporate governance of state-owned enterprises: A survey of OECD countries. Paris, France: Author.

Organization for Economic Cooperation and Development (OECD). (2013). Boards of directors of state-owned enterprises. Paris, France: Author.

Organization for Economic Cooperation and Development (OECD). (2014). The size and sectoral distribution of SOEs in OECD and partner countries. Paris, France: Author. doi:10.1787/9789264215610-en

Pargendler, M., Musacchio, A., & Lazzarini, S. G. (2013). In strange company: The puzzle of private investment in state-controlled firms. Harvard Business School Working Paper, No. 13–071.

Park, S. H., Li, S., & Tse, D. K. (2006). Market liberation and firm performance during China's economic transition. Journal of International Business Studies, 37, 127–147.

Parker, D., & Hartley, K. (1991). Do changes in organizational status affect financial performance. Strategic Management Journal, 12, 631–641.

Ralston, D. A., Terpstra-Tong, J., Terpstra, R. H., Wang, X., & Egri, C. (2006). Today's state-owned enterprises of China: Are they dying dinosaurs or dynamic dynamos? Strategic Management Journal, 27, 825–843.

Rugman, A. M., & Verbeke, A. (2009). Environmental policy and international business. In A. M. Rugman (Ed.), The Oxford handbook of international business (pp. 537–556). Oxford, England: Oxford University Press.

Sanders, W. G., & Carpenter, M. A. (1998). Internationalization and firm performance: The roles of CEO compensation, top team composition, and board structure. Academy of Management Journal, 41, 158–178.

São, P. (2010). Falling in love with the state. The Economist, 394, 37–38.

Sauvant, K. P., & Strauss, J. (2012). State-controlled entities control nearly US$2 trillion in foreign assets. Columbia FDI Perspectives, 64. Retrieved from http://ccsi.columbia.edu/files/2014/01/FDI_64.pdf

Shimizu, K., & Hitt, M. A. (2005). What constrains or facilitates divestitures of formerly acquired firms? The effects of organizational inertia. Journal of Management, 31, 50–72.

Tan, J. (2002). Impact of ownership type on environment, strategy, and performance: Evidence from China. Journal of Management Studies, 39, 333–354.

Tan, J., & Tan, D. (2005). Environment-strategy co-evolution and co-alignment: A staged model of Chinese SOEs under transition. Strategic Management Journal, 26, 141–157.

Teagarden, M. (2015). Anticipating complexity and chaos. Thunderbird International Business Review, 57, 1–2.

Tihanyi, L., Johnson, R. A., Hoskisson, R. E., & Hitt, M. A. (2003). Institutional ownership differences and international diversification: The effects of boards of directors and technology opportunity. Academy of Management Journal, 46, 195–211.

Uhlenbruck, K., & De Castro, J. O. (2000). Foreign acquisitions in central and eastern Europe: Outcomes of privatization in transitional economies. Academy of Management Journal, 43, 381–402.

Uhlenbruck, K., Meyer, K., & Hitt, M. A. (2003). Organizational transformation in transition economies: Resource-based and organizational learning perspective. Journal of Management Studies, 40(2), 257–282.

United Nations Conference on Trade and Development (UNCTAD). (2006). World investment report 2006: FDI from developing and transition economies (pp. 169–200). Geneva, Switzerland: Author.

United Nations Conference on Trade and Development (UNCTAD). (2011). World investment report 2011: Non-equity modes of international production and development. Geneva, Switzerland: Author.

Vaaler, P. M., & Schrage, B. N. (2009). Residual state ownership, policy stability and financial performance following strategic decisions by privatizing telecoms. Journal of International Business Studies, 40, 621–641.

Vernon, R. (1977). Storm over the multinationals. Cambridge, MA: Harvard University Press.

White, S. (2000). Competition, capabilities, and the make, buy, or ally decisions of Chinese state-owned firms. Academy of Management Journal, 43, 324–341.

Wu, F., Hoon, L. S., & Zhang, Y. (2011). Dos and don'ts for Chinese companies investing in the United States: Lessons from Huawei and Haier. Thunderbird International Business Review, 53, 501–514.

Zahra, S. A., Ireland, D. R., Gutierrez, I., & Hitt, M. A. (2000). Privatization and entrepreneurial transformation: Emerging issues and a future research agenda. Academy of Management Review, 25, 509–524.

Zeng, M., & Williamson, P. (2003, October). The hidden dragons. Harvard Business Review, 81(10), 49–56.

Zheng, P., & Scase, R. (2013). The restructuring of market socialism in China: The contribution of an "agency theory" perspective. Thunderbird International Business Review, 55, 103–114.

Zou, H., & Adams, M. B. (2008). Corporate ownership, equity risk and returns in the People's Republic of China. Journal of International Business Studies, 39, 1149–1168.