
Article

Understanding the Uniqueness of Emerging Markets and Their Firms: Institutional Voids–Based Dynamic Capabilities in the Chinese Automotive Sector

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AIB Insights

IB scholars are interested in understanding the uniqueness of emerging markets and their firms and argue that firms operating in environments characterized by institutional voids are likely to face higher costs due to reduced information flows and limited market intermediaries. We argue that institutional voids drive the dynamic capabilities of emerging market multinational enterprises. Taking the Chinese auto industry as an example, this article integrates institutional voids and dynamic capabilities to provide insight into how Chinese EMNEs have moved from technology followers to technology leaders to integrate, build, and reconfigure internal and external competencies and address a rapidly changing environment.

INSTITUTIONAL VOIDS AND DYNAMIC CAPABILITY

The arguments supporting the uniqueness of emerging markets often revolve around institutional voids, encompassing governance-related challenges such as political instability, corruption, and policy uncertainty (Doh, Rodrigues, Saka-Helmhout, & Makhija, 2017; Khanna & Palepu, 2010). While institutional voids undoubtedly pose significant obstacles and increase transaction costs for firms operating in emerging markets (Doh, Rodrigues, Saka-Helmhout, & Makhija, 2017; Khanna & Palepu, 2010), we argue that these voids also drive the development of dynamic capabilities in emerging market firms (EMNEs), enhancing their competitiveness (Liedong, Peprah, Amartey, & Rajwani, 2020). EMNEs possess a natural advantage in leveraging institutional voids due to their deeper understanding of local clients, established production facilities and distribution networks in their home markets, familiarity with challenging institutional conditions, and strong support from their governments (Cuervo-Cazurra & Genc, 2008). Therefore, it is unsurprising that institutional voids shape the dynamic capabilities of EMNEs, fostering unique competitive advantages for Chinese enterprises. Therefore, our objective is to integrate these two concepts to understand how institutional voids have shaped the dynamic capabilities of the Chinese auto industry.

North (1991: 97) defined institutions as “humanly devised constraints that structure economic, political, and social interaction,” including both formal and informal insti-

tutions. Institutional voids refer to the absence or weakness of formal institutions – such as regulatory frameworks, legal systems, or market intermediaries – that typically support business operations, as well as informal institutions – norms, customs, and culture (Dieleman, Markus, Rajwani, & White, 2022; North, 1991). Institutional voids occur when these structures are weak, absent, or inefficient, creating challenges for market transactions and economic activities (Liedong et al., 2020). They can be regulatory, arising from a lack of clear and enforceable laws and regulations, leading to uncertainties in legal and business environments. They can also be normative, characterized by the absence of widely accepted norms and ethical standards, which can result in unpredictable business conduct and practices. Finally, voids can be cognitive, meaning there is insufficient understanding and shared knowledge about market operations, hindering effective business decisions and strategies (Liedong et al., 2020). Therefore, in emerging markets, institutional voids require firms to develop dynamic capabilities to address the unique challenges and opportunities.

‘Dynamic capabilities mean the firm’s ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments’ (Teece, 2018a: 360). The literature on strategic management argues that dynamic capabilities are reflected in the organization’s ability, as manifested in the decisions of senior management, to respond to the external business environment while reconfiguring existing assets and developing the new skills needed to address emerging threats and opportunities (Teece, 2018a, 2018b). Dynamic capabilities are reflected

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at three levels. First, sensing capabilities refer to the capability of examining business environments. Therefore, managers at different levels must predict consumer demand, market changes, and other forces that affect the firm's future, such as the challenges and opportunities of the institutional environment. Second, seizing capabilities highlight how quickly the firm's processes can respond to opportunities and threats once they have been identified and prioritized, including the reconfiguration of business models and offering new value propositions. Finally, 're-configuration (or transformation) is the realignment of the organization's resources and assets, and it draws on management leadership skills' (Teece & Petricevic, 2021: 63–64). These three levels of capabilities can help explain differences in managerial decisions, especially when significant changes occur in an industry or when there are alterations in customer demand, such as when an established firm adopts a new strategy that requires changes in the firm's existing operations and tasks.

Firms that operate in an environment characterized by greater institutional voids are likely to face higher costs due to reduced information flows, underdeveloped factor markets, and limited market intermediaries (Khanna & Palepu, 2010). When there is an absence of reliable market information or strong regulatory bodies, firms may find it difficult to accurately sense opportunities and threats. However, this is not the case in China, where domestic firms have a deep understanding of both the formal and informal rules of the game. This understanding enables them to build strategic relationships with the government, understand local consumer preferences, regulatory environments, and competitive dynamics. They also have access to informal networks and personal connections (*guanxi*) that play a significant role in gathering real-time data and insights to navigate the uncertainties and challenges posed by weak institutions. This includes not only adapting to the regulatory landscape but also aligning with working attitudes and local business practices. Therefore, in China, institutional voids shape the dynamic capabilities of domestic firms. Rather than considering institutional voids as merely increasing transaction costs, we argue that Chinese firms can utilize weak institutions and turn "institutional voids into opportunities" (Liedong et al., 2020: 6).

THE ANALYTICAL APPROACH

A qualitative approach, underpinned by a case study of the Chinese Auto industry, was employed to gain an in-depth 'real-life' context (Yin, 2009). Data was collected from four managers working in the Chinese auto industry and a guest lecture given by a China based SVP of a successful German

luxury automotive company with three decades of experience in the automotive industry, 10 in the Chinese market. Figure 1 outlines the key themes that emerged from our analysis: (1) Chinese firms' regulatory voids-based *sensing* capability associated with openness to change; (2) their cognitive voids-based *seizing* capability associated with China speed; and (3) their normative voids-based *transforming* capability associated with Juan culture. These three themes illustrate how institutional voids shape the dynamic capabilities and unique characteristics of firms in China, highlighting the unique characteristics of emerging markets and their firms.

THE CHINESE AUTO INDUSTRY

"Institutional voids are not always bad, mainly as they may present 'opportunity spaces' for firms" (Liedong et al., 2020: 15). For example, as an emerging market, China and its auto industry undergo a continual process of evolution, adaptation, and alteration. China has transitioned from a weak player in technology development within the automotive industry to a prominent innovator in producing battery electric vehicle (BEV) cars. Take BYD, a Chinese company established in 1995 by Wang Chuanfu and originally focused on battery production. By 2023, BYD had taken the leading position in the Chinese BEV market, producing and selling more vehicles than other leading Western automotive firms and had expanded its presence to encompass over 30 industrial parks in more than 400 cities and 70 countries across six continents (BYD, 2023). In the fourth quarter of 2023 its BEV worldwide sales surpassed Tesla.¹² This transformation underscores three crucial organizational capacities: sensing capability; seizing capability; and transforming capability that were shaped by institutional voids.

REGULATORY VOIDS–BASED SENSING CAPABILITY: OPENNESS TO CHANGE

First, the sensing capability is reflected in the word *change*, enabling the firm to predict external business environment, consumer demand and response to regulatory voids. Since the Biden administration wants half of all new cars sold in the United States to be electric by 2030, and the European Union has mandated all new cars and vans sold after 2035 to emit zero emissions (Sebastian, 2023; Singleton, 2023), BYD has strategically aligned with Beijing's vision of fostering 'going global' (Sebastian, 2023: 84), addressing "energy security, air quality, and carbon emission control and the upgrading of the industrial chain" (Auto_3). In addition, recognizing that Chinese consumers prioritize cost-effectiveness (Auto_2), "BYD prioritizes value for money by keeping the prices of their new energy vehicles low and

1 The interviews last from 25 to 35 minutes. The lecture and discussion lasted for 60 minutes, offering in-depth insights into the Chinese auto industry. All interviews and lecture data were recorded, transcribed by the authors, and coded as 'Auto' followed by a number representing the participant count to maintain data anonymity.

2 BBC News, 2 January 2024, 'China's BYD overtakes Tesla's electric car sales in last quarter of 2023'

Figure 1. Institutional Voids Based Dynamic Capabilities in Chinese Auto Industry

	Openness to change	China speed	Juan culture
Regulatory voids-based sensing capability	Adapting through strategic alliances moving from technology follower to technology leader		
Cognitive voids based seizing capability		Customer focussed rapid new product development	
Normative voids-based transforming capability			Harnessing data, working attitudes and culture of innovation to adapt rapidly

Source: Authors.

emphasizing a customer-first, product-oriented approach” (Auto_3). The lack of regulations and transparency regarding IP protection and competition has transformed BYD from ‘a technology follower into a technology leader’ (Cote, Estrin, Shapiro, & Nunner, 2020: p, 2). Our interview data highlighted how the Chinese auto industry utilized weak institutions to its own advantage. For example, Auto_1 argued that:

BYD had no technology in the 1990s and they relied on technology purchased from a Japanese and Korean resource. A decade after the initial phase, they began a process of copying, notably adopting the Japanese model Lexus RX. BYD then emerged as the largest player in the BEV market in terms of volume during the 2000s. Their journey began by copying technology and Japanese car models but a decade later, they developed their own Chinese brands.

This reflects regulatory voids, where a lack of enforceable laws and regulations, leads to uncertainties in legal and business environments. However, “weak institutions are not always bad” (Liedong et al., 2020: 15) as starting with neither a heritage brand nor proprietary technology, BYD managed to ascend as the biggest player in the BEV market through an initial strategy of copying and replication.

Since institutional voids hinder business operations, firms must adapt their strategies to navigate these challenges, such as forming strategic alliances in response to uncertainties. For instance, the strategic alignment between the BEV firm and the Chinese government, which controls almost half of the global supply of electric vehicle batteries (Sebastian, 2023), is further evidenced by BYD’s receipt of governmental support. This support includes local government protection, advantages in the protected home market, access to cheap state financing, subsidies, upstream support, and partnerships with state-owned enterprises (Sebastian, 2023). ‘In turn, BYD is also helping Beijing achieve its industrial policy goals’ (Sebastian, 2023: 85) and aim to develop a world leading electric vehicle industry.

COGNITIVE VOIDS–BASED SEIZING CAPABILITY: CHINA SPEED

Second, cognitive voids enabled the seizing capability of the Chinese auto industry and is associated with *China speed*, allowing them to quickly reconfigure their business models and offer new value propositions. For example, “in August 2023, BYD produced its five millionth vehicle and its productivity has reached the top globally” (Auto_3). BYD has also scaled up for growth, which involves planning and building more factories to be able to produce 10 million cars by 2028.” (Auto_5). However, the Chinese auto industry is heavily data-driven, and local firms have privileged access to data for innovation, resulting in very customer focussed and rapid new product development. In contrast, “foreign automotive companies typically lack this direct interaction with Chinese customers” (Auto-2). For example, “between 2020 and 2023, Li Auto introduced 3 models, while NIO, established in 2014, launched 7 models during the same period. Similarly, Xpeng, founded in July 2014, introduced 5 models from 2020 onwards” (Auto_1). *China speed* of innovation intensifies brutal competition, so foreign firms need to localize their R&D (Cote et al., 2020) because “it is not possible to bring data out of China, so you have to work here” (Auto_1). But BYD can access data in China and overseas. Therefore, BYD benefits from its comfort operating under weak institutions, while foreign firms need to strike a balance between de-risking and localization (Sebastian, 2023). BYD ‘was already fully in line with Beijing’s aspirations for the electric vehicle market and enjoyed extensive procurement favouritism, local subsidies, and a wide range of other incentives as it has skyrocketed in the home market, even while securing a global export and investment footprint’ (Sebastian, 2023: 10). “The degree of internal competition in China’s automotive industry is the highest in the world, with one price war after another, unparalleled worldwide” (Auto_3). This showcases BYD’s dynamic capability in sensing internal changes through data-driven market analysis, swiftly adopting technological advancements, integrating innovative functionalities, and seizing external opportunities amid fierce competition at ‘China speed’ (Cote, Estrin, Shapiro, & Nunner, 2020).

NORMATIVE VOIDS–BASED TRANSFORMING CAPABILITY: JUAN CULTURE

The normative voids-based transforming capability fostered by the *Juan culture* and underpinned by the 996 working attitudes (working from 9 am to 9 pm, 6 days a week), has catalysed the transformation of the Chinese auto industry. “‘Juan’ culture means intense internal competition, characterized by the 996 work schedule that emphasizes continuous improvement and innovation” (Auto_3). Auto_4 emphasized that the ‘Juan’ culture is crucial for competitiveness and survival. Therefore, Chinese firms feel pressure to innovate, with their workforce adhering to the 996 schedule, driving organizational changes as noted:

In China, success is deeply linked to the ability to adapt to changes, with permanent change seen as something good and deeply embedded in the life of the Chinese people, and something which always leads to a better life. The attitude toward change is totally different amongst Chinese people and those from the west. This adaptability not only leads to a better quality of life but also contributes to further accelerating the pace of change. The concept that ‘the only constant in China is change’ explains why it is not just Chinese companies and disruptors embodying this adaptability but also why Chinese individuals within these companies are under such pressure. The term ‘Juan’ characterizes the working conditions in China, referred to as 996. (Auto_1)

CONCLUSIONS AND RECOMMENDATIONS

This article contributes to our understanding of the unique capabilities of Chinese firms, which have been developed based on their dynamic capabilities in response to institutional voids alongside the concepts of *change*, *China speed*, and *Juan culture*.

The Chinese auto industry thrives within intense competition. For international companies eyeing success in this market or more generally in China, three lessons are recommended. First, addressing regulatory voids is crucial when operating and competing in the Chinese market, requiring a comprehensive understanding and a willingness to adapt or *change* to the unique industry dynamics. This is often best achieved with local partners who understand how to align with the Chinese government’s agenda. Second, prioritizing speed in innovation, functionality, cost-efficiency, and cutting-edge technology is essential to maintain a competitive edge. It is crucial that international companies address cognitive voids that foster *China speed*, which will often require influencing the more traditional mindset and slower pace of Western head office senior management. Finally, addressing normative voids and understanding the *Juan* culture will require international companies to adapt work practices in their China operations which may differ greatly from the cultural norms which govern their home country practices.

In summary, the three dynamic capabilities observed in the Chinese auto industry and their firms demonstrate their adeptness at integrating, building, and reconfiguring both internal and external assets shaped by institutional voids. This agility is crucial in addressing the rapidly changing environments within China, particularly concerning regulatory voids. The implications of our study suggest that for firms entering emerging markets, rather than perceiving institutions as fixed constraints and institutional voids as mere sources of increased transaction costs, they should develop dynamic capabilities to overcome and capitalize on these institutional voids.

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