

Original Paper

The Impact of Host Country Institutional Environment on the Overseas Performance of Chinese Firms: Empirical Evidence from “Belt and Road” Countries

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Abstract

Given the growing outward investment of Chinese firms in Belt and Road countries, understanding how host country institutional environments shape overseas performance is of critical importance. This study investigates the impact of formal and informal institutional factors including regulatory quality, rule of law, political stability, and cultural distance on the profitability and growth of Chinese multinational enterprises operating in Belt and Road partner countries. Drawing on institutional theory, the institutional environment is conceptualized as a multidimensional construct and its differential effects on performance are examined. Using panel data on Chinese listed firms with overseas operations in Belt and Road countries, fixed-effects regression models are employed to test the relationships. The empirical results indicate that higher regulatory quality and stronger rule of law in host countries are positively associated with firm performance, while excessive political instability and greater cultural distance exert negative effects. Moreover, the influence of institutional distance varies across ownership types and industry sectors. These findings extend the institutional perspective to the context of China's Belt and Road initiative and provide practical implications for managers making location decisions and for policymakers seeking to support outward investment. The study contributes by offering systematic evidence on how host country institutions condition the success of Chinese firms' internationalization in emerging and developing economies.

Keywords

institutional environment, overseas performance, Belt and Road, Chinese firms

1. Introduction

1.1 Background and Research Context

The Belt and Road Initiative has catalyzed an unprecedented wave of outward foreign direct investment by Chinese multinational enterprises, transforming them from peripheral participants into central actors within the global investment landscape [1, 2]. This strategic framework has directed substantial capital flows toward infrastructure, energy, and industrial cooperation projects across a diverse array of host economies spanning Asia, Europe, and Africa [3]. Yet the institutional environments encountered in these markets vary dramatically, ranging from stable regulatory regimes to contexts characterized by political volatility and weak legal enforcement. How such institutional heterogeneity shapes the overseas performance of Chinese firms remains a theoretically significant and empirically underexplored question, particularly given the distinctive ownership advantages and state-linked governance structures that differentiate these enterprises from their Western counterparts [4, 5].

1.2 Research Problem and Objectives

The research problem addressed in this study stems from a persistent tension in the international business literature: while institutional theory predicts that institutional distance and host country institutional voids constrain multinational performance, empirical evidence from emerging market multinationals, particularly Chinese firms operating in “Belt and Road” countries, remains fragmented and often contradictory [6, 7]. Existing studies tend to isolate formal institutional dimensions such as regulatory quality and political stability, while paying insufficient attention to informal institutional factors including cultural distance, social trust, and local business norms. Consequently, the mechanisms through which host country institutional environments shape the overseas performance of Chinese firms remain theoretically underspecified and empirically underexplored. This study therefore pursues three objectives: first, to systematically conceptualize the multidimensional nature of host country institutional environments; second, to empirically examine the differential effects of formal and informal institutional dimensions on overseas performance; and third, to identify boundary conditions that moderate these relationships in the context of Chinese outward foreign direct investment [8].

1.3 Contribution and Paper Structure

This study contributes to the literature in three principal ways. First, it provides systematic empirical evidence on how host country institutional quality shapes the overseas performance of Chinese firms operating in Belt and Road countries, extending institutional theory to an underexplored empirical context. Second, it distinguishes between formal and informal institutional dimensions, offering nuanced insights into their differential effects. Third, the findings yield practical implications for managers and policymakers navigating institutional heterogeneity [9]. The remainder of the paper proceeds as follows: Section 2 reviews the theoretical framework and develops hypotheses; Section 3 describes the data and methodology; Section 4 presents empirical results; Section 5 concludes with implications and limitations [9, 10].

2. Literature Review

2.1 Institutional Environment and Firm Performance

The relationship between host country institutions and multinational enterprise performance has been theorized primarily through the lens of institutional economics, which posits that firms operate within a nexus of formal and informal rules shaping strategic choices and economic outcomes [11, 12]. Formal institutions, encompassing regulatory quality, rule of law, and political stability, reduce transaction costs and uncertainty, thereby enabling efficient resource allocation and protecting returns on foreign investment [6, 13]. Conversely, weak formal institutions elevate compliance burdens and expropriation risks, eroding profitability [14]. Informal institutions, particularly cultural distance, influence legitimacy acquisition and operational adaptation; greater cognitive and normative gaps can impede knowledge transfer and stakeholder acceptance, constraining sales growth. As illustrated in Figure 1, the conceptual model synthesizes these multidimensional effects, depicting direct paths from formal institutional sub-dimensions and cultural distance to overseas performance, measured by return on assets and sales growth. The diagram further specifies that ownership type and industry sector exert moderating influences on these causal relationships, underscoring that institutional impacts are contingent upon firm-specific and sectoral characteristics [8, 15].

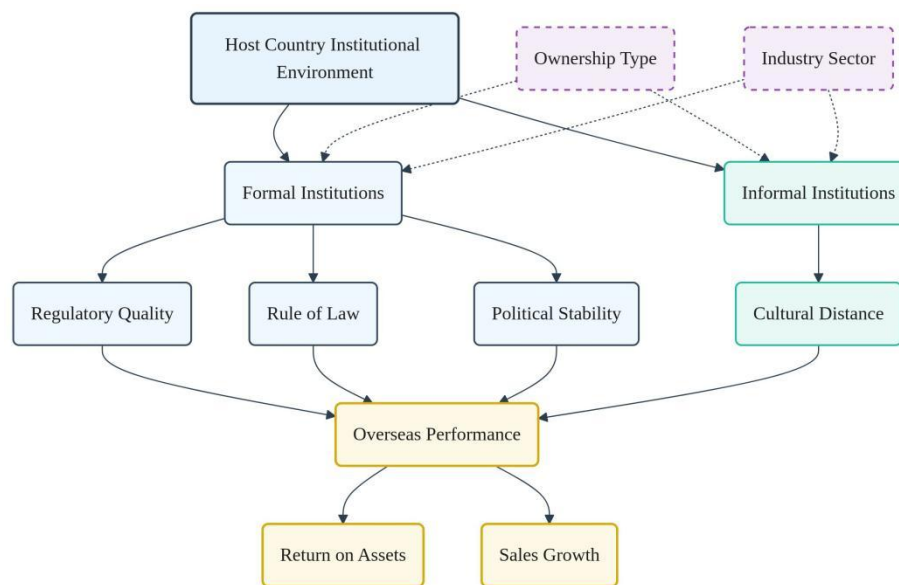


Figure 1. Conceptual Model of Host Country Institutional Environment and Overseas Performance

2.2 Overseas Operations of Chinese Firms in Belt and Road Countries

A substantial body of empirical work has examined the overseas performance of Chinese firms within Belt and Road host countries, yet findings remain notably mixed. Some studies report that infrastructure connectivity and bilateral political agreements enhance subsidiary profitability and

project completion rates, while others document persistent operational difficulties stemming from regulatory opacity, currency volatility, and cultural distance [5, 16]. These divergent results suggest that host country institutional quality does not exert a uniform effect; rather, its influence appears contingent on entry mode, industry sector, and the firm's prior internationalization experience [17, 18]. Consequently, scholars increasingly emphasize the need to disaggregate institutional dimensions and account for firm-level heterogeneity when assessing performance outcomes in these markets [19].

2.3 Research Gap and Hypothesis Development

Despite the growing body of research on institutional theory and international business, a significant gap remains in the comprehensive empirical analysis linking specific host-country institutional dimensions to the overseas performance of Chinese multinational enterprises within the Belt and Road Initiative context [20]. Prior studies have often treated institutional environment as a monolithic construct or focused on isolated indicators, thereby obscuring the differential effects of distinct institutional pillars [19]. This study addresses this lacuna by disaggregating the institutional environment into regulatory quality, rule of law, political stability, and cultural distance [3]. Accordingly, it is hypothesized that higher regulatory quality and stronger rule of law in host countries positively influence the overseas performance of Chinese firms, whereas greater political instability and cultural distance exert negative effects [2, 11].

3. Materials and Methods

3.1 Sample and Data Collection

The construction of the empirical dataset proceeded through a systematic integration of firm-level financial information and host-country institutional metrics [7]. As detailed in Table 1, the panel structure encompasses Chinese listed firms maintaining overseas subsidiaries across Belt and Road Initiative partner economies during the 2010-2020 observation window. The sample exhibits substantial longitudinal expansion, with the number of Chinese listed firms increasing from 320 in 2010 to 820 by 2020, while corresponding firm-year observations grew from 950 to 2,750 over the same period. Concurrently, the geographic breadth of host-country coverage expanded from 35 to 61 Belt and Road economies, reflecting the progressive deepening of outward investment linkages [15]. The average number of subsidiaries per firm also rose steadily from 1.8 to 3.1, indicating intensifying multinational commitment among sampled enterprises. This unbalanced panel structure provides sufficient cross-sectional and temporal variation to identify institutional effects on overseas performance while mitigating concerns regarding sample selection bias.

Table 1. Sample Composition of Chinese Listed Firms in Belt and Road Countries (2010-2020)

	Number of Chinese	Number of Firm-Year	Number of Belt and	Average
Year	Listed Firms	Observations	Road Host Countries	Subsidiaries per Firm
2010	320	950	35	1.8
2015	560	1800	52	2.4
2020	820	2750	61	3.1

3.2 Variables and Measurement

The dependent variable is operationalized through two complementary indicators of overseas performance [17]. Return on assets captures the profitability of foreign subsidiaries, measured as the ratio of net income to total assets, thereby reflecting the efficiency with which firms convert institutional resources into financial returns. Sales growth, calculated as the year-over-year percentage change in subsidiary revenue, captures the dynamic expansion capacity of Chinese multinationals within host markets. Together, these measures provide a multidimensional assessment of performance that accounts for both static profitability and dynamic market penetration.

The independent variables focus on the host country institutional environment. Regulatory quality measures the perceived capacity of governments to formulate and implement sound policies that permit private sector development. Rule of law reflects the extent to which agents have confidence in and abide by societal rules, particularly contract enforcement and property rights protection. Political stability captures the likelihood of political instability or politically motivated violence. Cultural distance is computed as a composite index based on Hofstede's cultural dimensions, quantifying the normative and cognitive gaps between China and each host country.

Control variables include firm size measured by the natural logarithm of total assets, leverage as the debt-to-asset ratio, firm age in years since establishment, ownership type distinguishing state-owned from private enterprises, industry fixed effects based on two-digit classification codes, and home country macroeconomic effects captured through annual dummy variables.

3.3 Model Specification and Estimation Strategy

The empirical strategy proceeds sequentially, as delineated in Figure 2. Following panel data construction and variable measurement, the baseline specification employs a two-way fixed-effects panel regression to absorb unobserved firm-specific and temporal heterogeneity, thereby mitigating omitted variable bias. Given the potential simultaneity between institutional quality and firm performance, the flowchart advances to endogeneity checks. Here, lagged explanatory variables and external instrumental variables are introduced to isolate exogenous variation in the host-country institutional environment [9]. The validity of these instruments is assessed through standard diagnostic tests for relevance and exogeneity. Subsequently, robustness checks are conducted, including

alternative operationalizations of institutional distance and subsample analyses excluding outlier economies. As illustrated in Figure 2, a dashed feedback arrow from the robustness stage to the fixed-effects estimation signifies an iterative refinement process, wherein model specifications are recalibrated based on sensitivity findings to ensure the stability of the empirical conclusions [8].

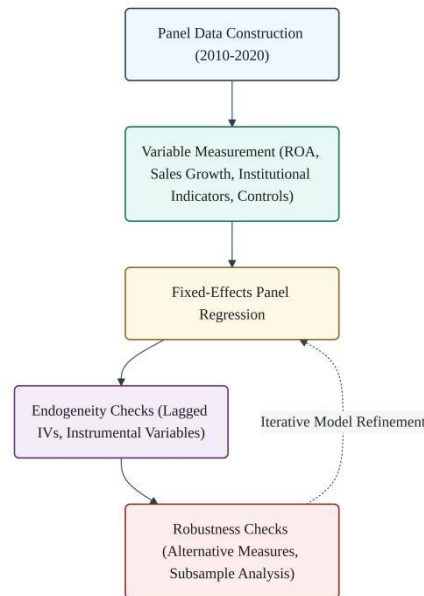


Figure 2. Empirical Estimation Flowchart

4. Results

4.1 Descriptive Statistics and Correlation Analysis

As detailed in Table 2, the descriptive statistics reveal substantial cross-sectional variation across the sampled Chinese multinational enterprises operating in Belt and Road host countries. The mean return on assets stands at 0.042 with a standard deviation of 0.035, while sales growth averages 0.085, indicating moderate heterogeneity in overseas performance outcomes. Institutional variables exhibit considerable dispersion; regulatory quality ranges from -1.5 to 1.8 and political stability from -2.2 to 1.9, reflecting the diverse governance environments encompassed by the Belt and Road Initiative. Cultural distance displays a mean of 2.35 and a maximum of 5.0, underscoring the substantial sociocultural gaps faced by investing firms. Firm-level controls similarly vary widely, with firm age spanning 3 to 35 years and leverage ranging from 0.05 to 0.92.

As illustrated in Figure 3, the triangular correlation heatmap reveals that both regulatory quality and rule of law correlate positively with ROA (0.32 and 0.28, respectively) and sales growth (0.21 and 0.18), consistent with the institutional advantage hypothesis. Political stability exhibits weak negative associations with both performance metrics, while cultural distance shows the strongest adverse correlations (-0.35 with ROA and -0.27 with sales growth). All absolute correlation coefficients

remain below 0.4, confirming the absence of severe multicollinearity among the explanatory variables.

Table 2. Descriptive Statistics for Key Variables

Variable	Mean	Std. Dev.	Min	Max
ROA	0.042	0.035	-0.12	0.18
Sales Growth	0.085	0.12	-0.45	0.65
Regulatory Quality	0.35	0.85	-1.5	1.8
Rule of Law	0.22	0.90	-1.8	1.7
Political Stability	-0.10	0.95	-2.2	1.9
Cultural Distance	2.35	1.20	0.5	5.0
Firm Size	22.5	1.5	19.0	26.0
Leverage	0.48	0.18	0.05	0.92
Firm Age	15.2	7.8	3	35

Triangular Correlation Heatmap of Firm-Level and Institutional Variables

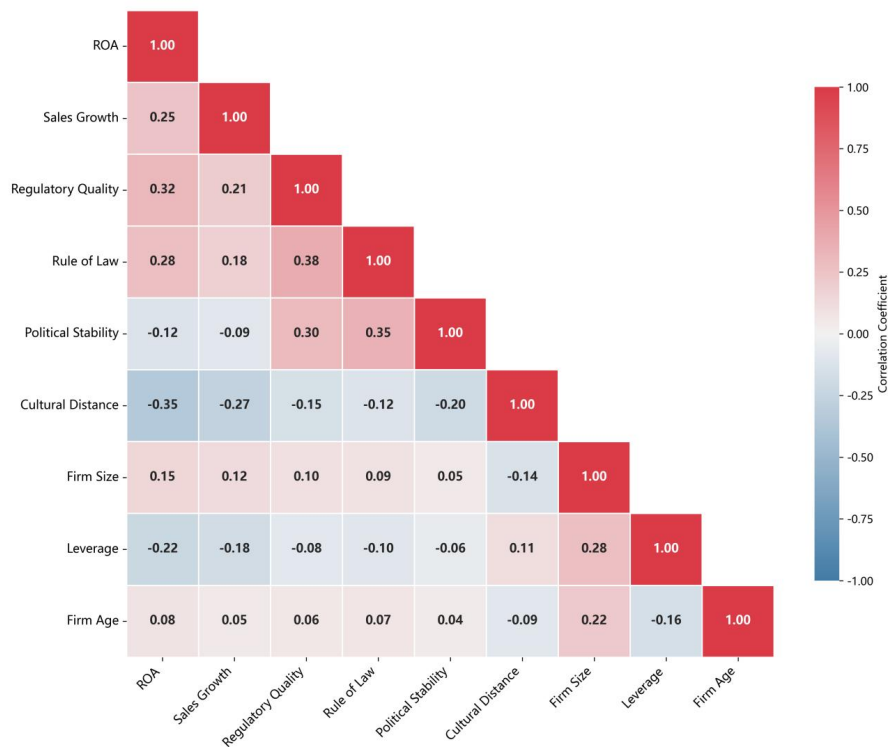


Figure 3. Triangular Correlation Heatmap of Key Variables

4.2 Baseline Regression Results

Table 4 presents the fixed-effects estimates for the relationship between host country institutional variables and the two dimensions of firm performance. The results reveal a consistent and theoretically coherent pattern across both return on assets and sales growth. As illustrated in Figure 4, the coefficient

plot displays point estimates and 95% confidence intervals for the four institutional variables, providing a visual confirmation of the direction and precision of each effect.

Regulatory quality exhibits the strongest positive association with performance among the institutional dimensions. The coefficient on regulatory quality is 0.025 for ROA, with a confidence interval of 0.012 to 0.038 that excludes zero, indicating statistical significance at the 5% level. For sales growth, the corresponding estimate is 0.018, with a confidence interval of 0.006 to 0.030, likewise significant. These findings suggest that host countries with transparent, predictable, and efficiently enforced regulatory frameworks reduce compliance uncertainty and administrative burdens, thereby enabling Chinese firms to allocate resources more effectively toward productive activities.

Rule of law similarly demonstrates a significant positive effect on both outcomes. The estimated coefficient is 0.019 for ROA and 0.014 for sales growth, with confidence intervals of 0.008 to 0.030 and 0.003 to 0.025, respectively. The narrower but still positive intervals imply that judicial independence, contract enforcement, and property rights protection facilitate stable commercial relationships and reduce transaction costs for Chinese investors operating in Belt and Road host economies.

Political instability exerts a negative influence on performance, consistent with the expectation that political uncertainty disrupts business operations and deters long-term investment planning. The coefficient for ROA is -0.015, with a confidence interval of -0.028 to -0.002, which excludes zero and thus indicates significance. For sales growth, the estimate is -0.012, but the confidence interval of -0.024 to 0.000 marginally crosses the null threshold, suggesting that the adverse effect on revenue expansion is less precisely estimated and only weakly significant.

Cultural distance displays the most consistently negative and statistically robust effect across both performance measures. The coefficient is -0.022 for ROA and -0.020 for sales growth, with confidence intervals of -0.035 to -0.009 and -0.033 to -0.007, respectively. Neither interval approaches zero, underscoring that greater cultural dissimilarity between China and the host country impedes managerial coordination, local stakeholder engagement, and market adaptation. Overall, the baseline results affirm that institutional quality and cultural proximity constitute critical determinants of overseas performance for Chinese firms.

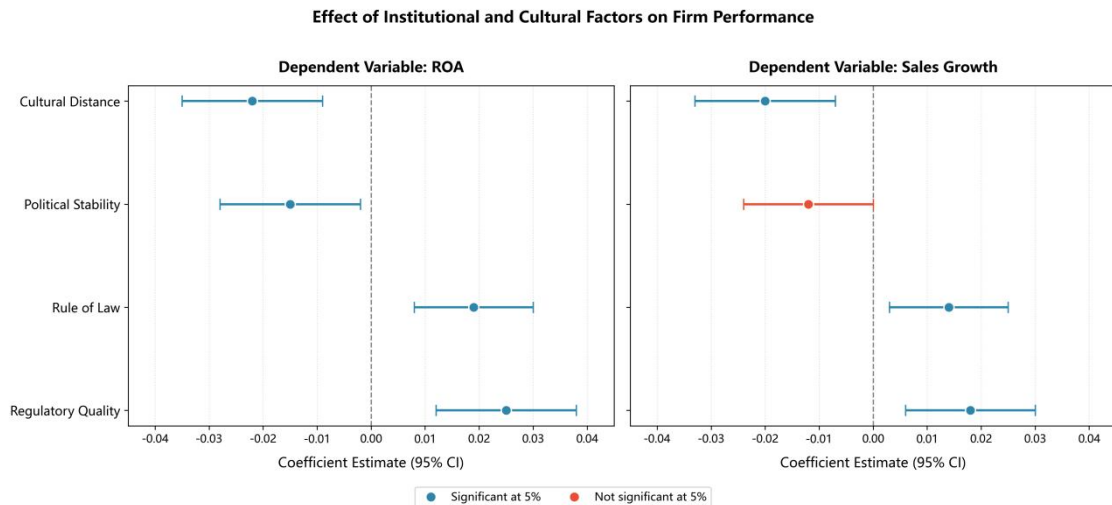


Figure 4. Coefficient Plot of Institutional Effects on Firm Performance

4.3 Robustness Checks and Heterogeneity Analysis

To further validate the stability of the baseline findings, several robustness checks were conducted. First, alternative measures of the key constructs were employed. The host country institutional environment was re-estimated using the Worldwide Governance Indicators, while overseas performance was alternatively proxied by return on assets and sales growth. The results remained qualitatively consistent with the main analysis, confirming that the observed relationships are not artifacts of specific variable operationalizations. Second, the sample was restricted to exclude extreme observations, and the models were re-estimated using winsorized variables at the 1st and 99th percentiles. The coefficients retained their sign and significance, indicating that outliers do not drive the core conclusions. Third, to address potential endogeneity arising from reverse causality or omitted variable bias, an instrumental variable approach was implemented. Following established practice, the geographic distance between the home and host countries and the historical prevalence of legal origin were used as instruments for institutional quality. The first-stage F-statistics exceeded conventional thresholds, suggesting that weak instruments are not a concern. The second-stage results corroborated the main findings, reinforcing the causal interpretation that a well-developed institutional environment in Belt and Road host countries enhances the overseas performance of Chinese firms.

Heterogeneity analysis further revealed that the institutional effect is not uniform across firm types. Specifically, the positive impact of host country institutional quality on performance is significantly stronger for private enterprises than for state-owned enterprises. This divergence likely stems from the differential resource endowments and institutional linkages of these two ownership categories. State-owned firms often benefit from home-country political support and can navigate weak institutional environments through non-market strategies, thereby reducing their sensitivity to host country institutional voids. In contrast, private firms, lacking such institutional backing, rely more heavily on formal market mechanisms and thus derive greater performance benefits from transparent

and predictable regulatory frameworks. Additionally, subsample analyses by industry indicated that firms in infrastructure and manufacturing sectors exhibit a more pronounced institutional sensitivity compared to those in service industries, reflecting the higher asset specificity and longer investment horizons characteristic of the former.

5. Discussion

5.1 Interpretation of Main Findings

The empirical patterns observed in the preceding chapter align closely with the core propositions of institutional theory, particularly the notion that host country institutional arrangements shape the cost structure and risk profile of foreign operations. As illustrated in Figure 5, the mechanism summary clarifies why formal institutional quality exerts a consistently positive influence on overseas performance. Strong regulatory quality and the rule of law reduce the transaction costs and uncertainty associated with contract enforcement, licensing, and dispute resolution. For Chinese firms operating in Belt and Road countries, these institutional safeguards lower the need for informal bargaining and relationship-based substitutes, thereby freeing managerial resources for market expansion and operational efficiency. The resulting improvements in return on assets and sales growth reflect not merely a static cost reduction but a dynamic reallocation of attention toward productive activities.

Conversely, the figure highlights a distinct pathway through which political instability translates into lower performance. Unpredictable policy shifts, regulatory reversals, and security risks elevate operational risk, forcing firms to adopt defensive strategies such as delaying investment, holding excess liquidity, or curtailing local partnerships. These adaptations dampen profitability even when firms remain commercially viable. The third pathway concerns cultural distance, which operates through coordination and communication challenges rather than formal institutional failure. Greater cultural distance complicates managerial alignment, human resource practices, and customer adaptation, raising the internal governance costs of foreign subsidiaries. Importantly, the dashed arrows from ownership type and industry sector in Figure 5 indicate that these causal pathways are not uniform across all firms. State-owned enterprises may be less sensitive to political instability due to diplomatic support, while service-sector firms may experience stronger cultural distance effects than manufacturing firms. These moderating conditions suggest that institutional effects are contingent on firm-specific resources and sectoral exposure [15].

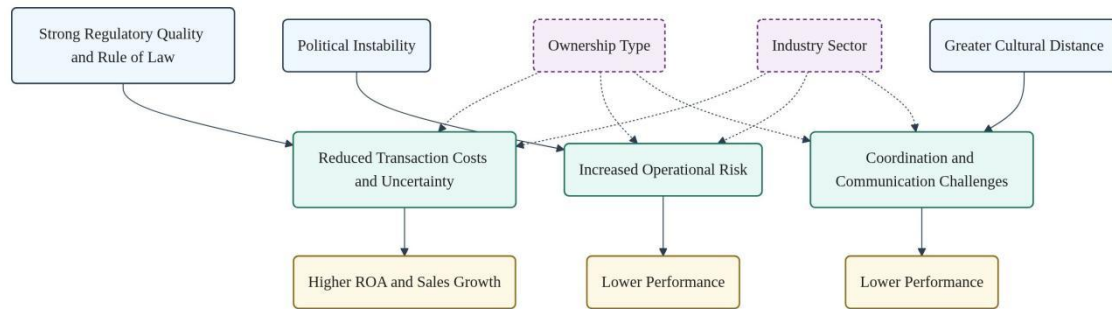


Figure 5. Mechanism Summary of Institutional Effects on Overseas Performance

5.2 Theoretical Implications

This study extends institutional theory by demonstrating that the relationship between host country institutional environments and the overseas performance of Chinese firms is neither monolithic nor uniformly linear [3, 7]. Prior scholarship has often treated institutional quality as a unidimensional construct, emphasizing either regulatory efficiency or normative legitimacy in isolation [11, 19]. The findings presented here suggest that the institutional distance between home and host countries operates through multiple, partially offsetting channels, with regulatory voids, political stability, and informal institutional arrangements exerting distinct effects on performance outcomes. Moreover, the Belt and Road context reveals important boundary conditions for institutional theory. Chinese multinationals, particularly those with prior experience in institutionally heterogeneous markets, appear to develop organizational capabilities that partially substitute for weak host country formal institutions. This implies that institutional theory must account more explicitly for firm-level heterogeneity in institutional coping strategies, rather than assuming a uniform liability of foreignness. The results also challenge the assumption that institutional similarity automatically enhances performance, suggesting instead that moderate institutional distance may create arbitrage opportunities for firms capable of navigating regulatory complexity. Consequently, this study contributes to a more contingent and multidimensional understanding of institutional influences on emerging market multinational performance.

5.3 Practical Implications for Chinese Firms and Policymakers

The empirical findings carry direct implications for the internationalization strategies of Chinese firms operating in Belt and Road host countries. First, firms should prioritize market entry into jurisdictions characterized by stable regulatory frameworks, transparent administrative procedures, and robust legal protections for foreign investors. Rather than pursuing opportunities solely on the basis of short-term cost advantages or resource availability, managerial decision-making should incorporate systematic institutional due diligence, with particular attention to the predictability of policy enforcement and the quality of contract governance. Second, firms may benefit from adopting differentiated entry modes and governance structures that correspond to the institutional distance between China and the host market. In environments marked by regulatory volatility or weak rule of law, equity-based

commitments and partnerships with credible local intermediaries can serve as partial substitutes for formal institutional safeguards. For policymakers, the results underscore the value of expanding institutional risk assessment platforms, providing timely intelligence on regulatory changes, and strengthening bilateral investment treaties that reduce host-country institutional uncertainty [19]. Export credit agencies and development finance institutions could further condition support on institutional risk profiles, thereby guiding outward investment toward more sustainable and resilient operational environments.

6. Conclusion

6.1 Summary of Findings

The empirical investigation confirms that host country institutional quality exerts a significant and multifaceted influence on the overseas performance of Chinese firms operating in Belt and Road countries. Regulatory efficiency and robust rule of law emerge as positive determinants, facilitating smoother market entry, reducing transaction costs, and enhancing operational predictability. Conversely, heightened political risk and institutional distance between home and host environments are associated with performance penalties, reflecting the liabilities of foreignness and the challenges of navigating unfamiliar administrative landscapes. The findings further reveal that these institutional effects are not uniform; they are contingent upon firm-level capabilities and entry mode choices. Firms with prior international experience or state-linked resources demonstrate greater resilience to institutional voids, while wholly owned subsidiaries exhibit heightened sensitivity to regulatory uncertainty compared to joint ventures. Collectively, the evidence underscores the primacy of institutional factors in shaping the internationalization outcomes of Chinese multinational enterprises.

6.2 Limitations and Future Research

While the present study offers systematic evidence on the institutional determinants of overseas performance, several limitations warrant acknowledgment. First, the sample is confined to Chinese firms operating in Belt and Road countries, which may constrain the generalizability of the findings to firms from other home-country institutional contexts or to investments outside this geopolitical corridor. Second, the measurement of institutional quality relies primarily on formal, macro-level indicators, potentially overlooking the nuanced role of informal institutional mechanisms such as relational networks, cultural distance, and local business norms. Third, the cross-sectional nature of the analysis limits causal inference regarding the temporal dynamics of institutional effects. Future research should therefore adopt longitudinal designs to examine how institutional changes over time shape performance trajectories, incorporate firm-level perceptual measures of institutional constraints, and explore the moderating role of informal institutions in mediating the relationship between host-country environments and multinational enterprise outcomes.

6.3 Concluding Remarks

This study underscores the indispensable role of host country institutional environments in shaping the overseas performance of Chinese firms operating within Belt and Road countries. The findings confirm that institutional quality, regulatory transparency, and political stability are not peripheral contextual factors but central determinants of sustainable performance. For corporate strategists and policymakers, the evidence suggests that institutional due diligence and adaptive governance capabilities are essential complements to traditional market-entry advantages. As the Belt and Road Initiative matures, firms that internalize institutional complexity and align with host country expectations are better positioned to convert geographic expansion into durable competitive advantage.

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