



Faculty of Business and Law



GSBS6481 International Business Strategy

Week 4: The Institution-Based View of International Business Strategy

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Reference & Readings

- Peng, Mike W (2017), *Global Strategy*, 4th ed. USA: Cengage Learning.
 - Chapter 4 Emphasizing Institutions, Cultures, and Ethics
- Fuentelsaz, L., Garrido, E., Maicas, J. P. 2020. The effect of informal and formal institutions on foreign market entry selection and performance. *Journal of International Management*, 26, 1-17.
- DiMaggio, P. J., Powell, W. W. 1983. The iron cage revisited: Institutional isomorphism and collective rationality in organizational fields. *American sociological review*, 48, 147-160
- Li, W., Hendrischke, H. 2020. Chinese outbound investment in Australia: From state Control to entrepreneurship. *The China Quarterly*, 243, 701-736.

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Key concepts

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- Institutions
- Formal institutions
- Informal institutions
- Transaction costs
- Institutional distance
- National cultural differences



Outline

- Historical development of institutional theory
- The institution-based view in international business strategy
 - What do institutions do?
 - Formal vs. Informal institutions
- Institutions and culture
- Case study: Chinese Outbound Investment in Australia

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Early institutional theory in economics

- Early institutional economists challenged the conventional cannon that economics could be reduced to a set of universal laws
- Instead they insisted that economic processes operated within a social framework that was in turn shaped by a set of cultural and historical forces
 - Individual behaviour as governed by habit and convention (Thorstein Veblen)
 - 'Transaction' as a more appropriate of analysis for individual choice (John Commons)
 - Time and space in economics (Westley Mitchell)



Early institutional theory in sociology

- Max Weber and bureaucracy

- What is bureaucracy?

A model for a rational and efficient large organization: an ideal form of organizational structure

- Characteristics of bureaucracies

Hierarchy of authority; impersonality, written rules of conduct, promotion based on achievement, specialized division of labor, efficiency

- Cost of bureaucracies

Loss of individuality, loss of autonomy, lack of individual freedom, specialization

- “Bureaucracy, the rational spirits’ organizational manifestation, was so efficient and powerful a means of controlling men and women that, once established, the momentum of bureaucratization was irreversible” (DiMaggio & Powell 1983)



Neoinstitutional theory in economics

- Transaction cost economics
- Institutions and the transaction cost theory
 - What is transaction costs?
 - Why is transacting increasing costly?
 - Institutions for reducing uncertainty and thus transaction costs

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Neoinstitutional theory in sociology

- From 'iron cage' to 'institutional isomorphism' (organizations / firms are becoming more and more similar)
- Three mechanisms of institutional isomorphic change
- *Please refer to DiMaggio, P. J. and W. W. Powell (1983). "The iron cage revisited: Institutional isomorphism and collective rationality in organizational fields," American sociological review: 147-160. (supplementary reading of this session), especially its introduction (p.147) and the section "Three Mechanisms of Institutional Isomorphic Change" (pp.150-152); and discuss the following questions*
 - What do coercive, mimetic, normative mechanisms mean?
 - Can you identify any examples of those mechanisms?



An Institutional Framework

- Formal and informal institutions govern individual and firm behavior
- Formal and informal institutions are supported by three “pillars” (Scott)

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DEGREE OF FORMALITY	EXAMPLES	SUPPORTIVE PILLARS
Formal institutions	<ul style="list-style-type: none">■ Laws■ Regulations■ Rules	<ul style="list-style-type: none">■ Regulatory (coercive)
Informal institutions	<ul style="list-style-type: none">■ Norms■ Cultures■ Ethics	<ul style="list-style-type: none">■ Normative■ Cognitive



Institution-based view of strategy

- “Institutions are the rules of the game in a society.” (North)
- Institutions are more than background conditions
- Formal and informal institutions
- Institutions directly impact a firm’s formulation and implementation of strategy
 - Institutions matter.
 - But, how do they matter?



What Do Institutions Do?

- Institutions affect the strategy of firms by:
 - Reducing uncertainty.
 - Signaling conduct as acceptable or not, which constrains the range of acceptable actions.
- Uncertainty can lead to transactions costs
 - Transaction costs: Costs associated with economic transactions—or more broadly, costs of doing business
 - A major source of transaction costs: Opportunism
 - The possibility of opportunism introduces uncertainty

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How to Reduce Uncertainty?

- Two kinds of institutions—informal and formal— reduce uncertainty in economic transactions
- Arm's-length transaction: based on formal institutions
 - Formal, rule-based exchange with third-party enforcement
- Relational contracting transaction: based on informal institutions - Informal, relationship-based, personalized exchange



Formal v.s. Informal Institutions

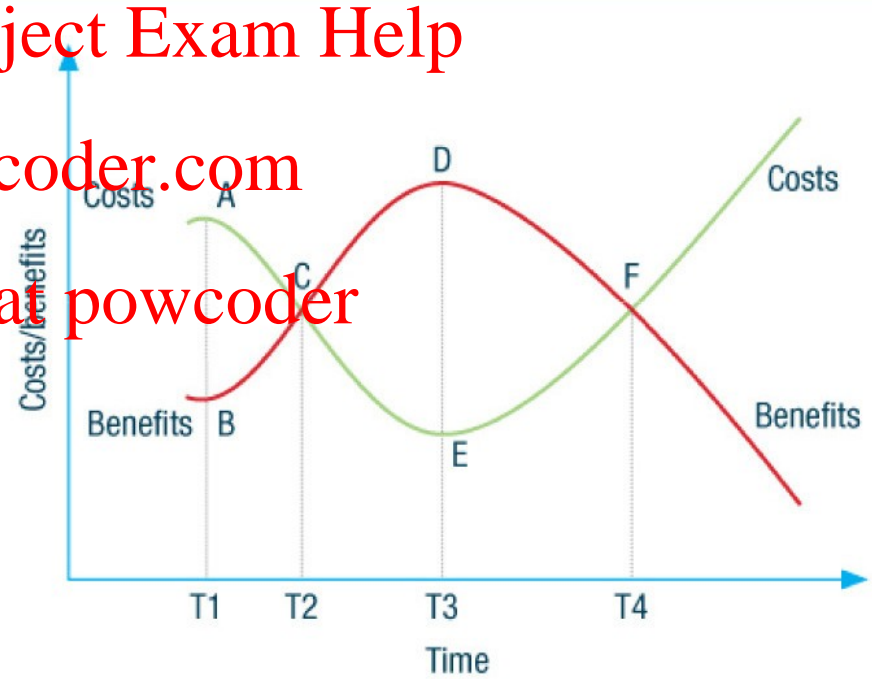
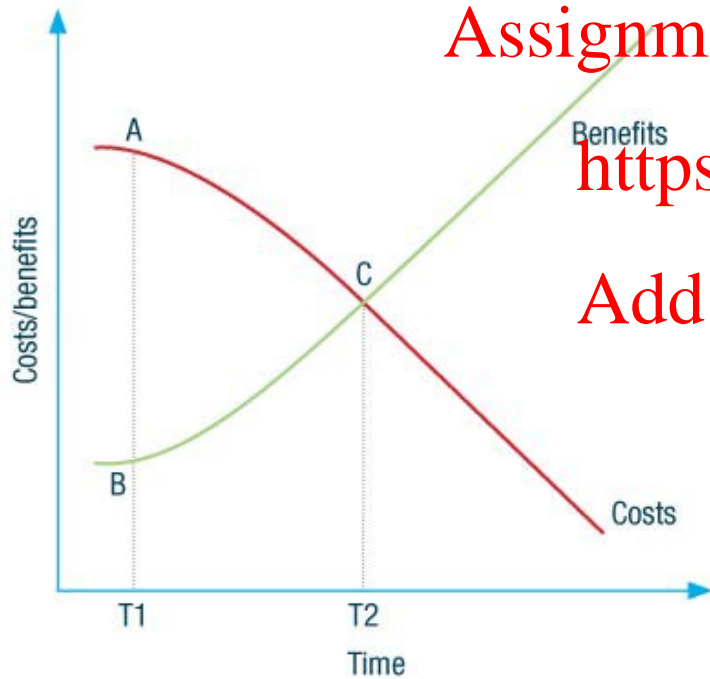
- **Formal Institutions**
 - An expensive legal and regulatory framework of courts, lawyers, regulators, and other mechanisms that enforce laws and regulations to facilitate the widening of markets
- **Benefits of formal Institutions**
 - Support arm's-length transactions by bringing distant parties (strangers) together.
 - Foster rule-based transactions that attract new players into a global economy that cannot operate on informal institutions alone.
 - Facilitate economic expansion and growth
- **Informal institutions.**
 - Constraints on socially sanctioned norms of behavior
 - Norms, cultures, ethics etc.
- Informal institutions suggest expected behaviours
 - Unwritten “rules”
 - If formal constraints fail, informal constraints play a larger role in reducing uncertainty
 - E.g. Guanxi in the Chinese culture
 - Especially important during transitions



Formal versus informal institutions: Costs and Benefits

Formal, Rule-Based,
Impersonal Exchange

Informal Relationship-Based
Personalized Exchange



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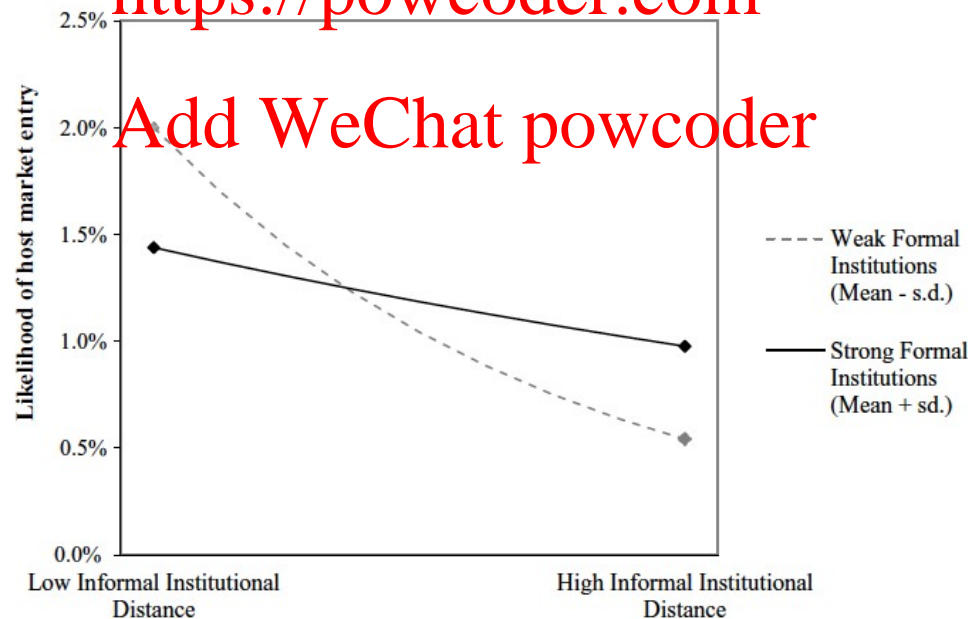
Institutional distance and foreign market entry selection

- Institutional distance refers to the extent of similarity or dissimilarity between the regulatory, cognitive and normative institutions of two countries
- There are a number of strategic implications to multinational corporations, e.g. their market entry selection

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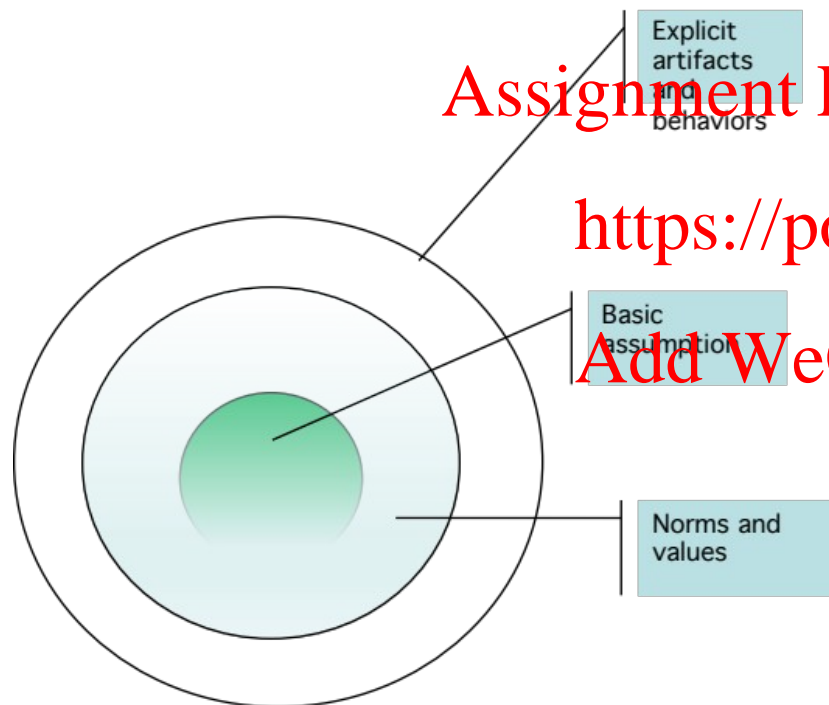
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The model of culture



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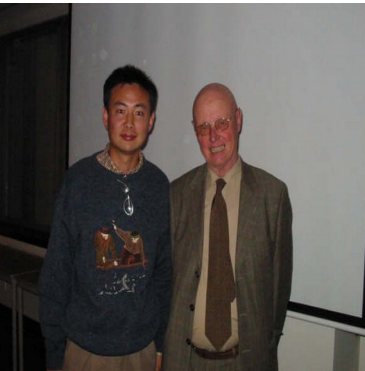
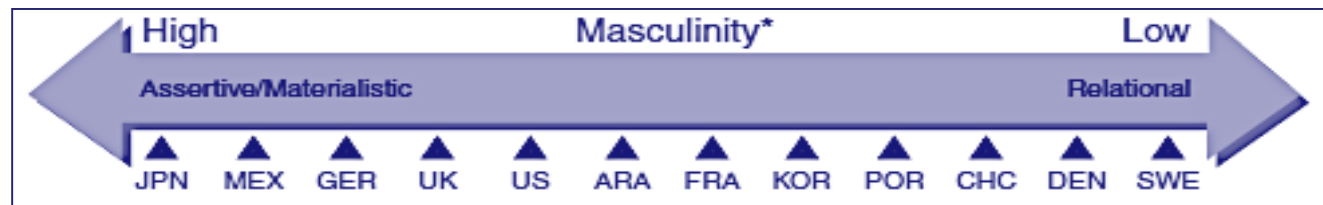
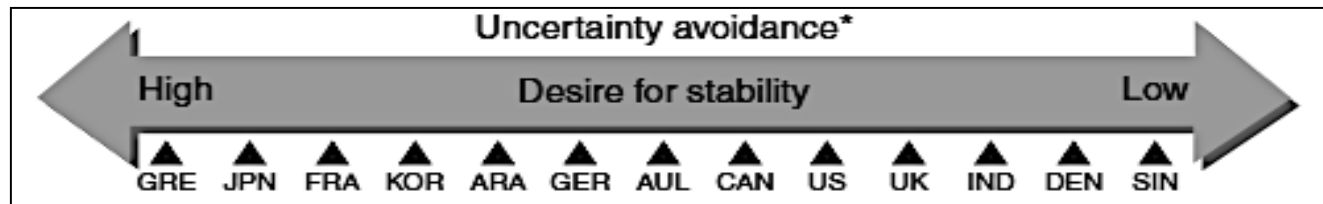
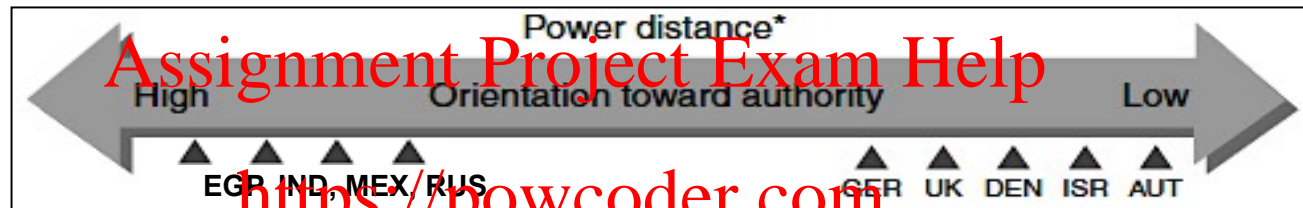


Culture is like an iceberg. Much is hidden from sight, even for its members.



Hofstede's cultural dimensions

- Hofstede was one of the first researchers to measure national culture and analyze the influence of NATIONAL culture on management practices





Comparing cultural differences across nations

- The website that enables you to easily compare cultural differences across nations based on Hofstede's cultural model

<https://www.hofstede-insights.com/country-comparison/>

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