

**Coevolution of the WTO and**

**international business**

How do institutions effect DE and EE firms

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**Acronyms**

**ACM** Autoriteit Consument en Markt. [7](#_bookmark15)

**BoD** Boards of Directors. [10](#_bookmark19)

**CA** Competitive Advantage. [4](#_bookmark9)–[6](#_bookmark14)

**CMA** Competition and Markets Authority. [7](#_bookmark15)

**GATT** General Agreement on Tariffs and Trade. [2](#_bookmark5)

**IB** International business. [3](#_bookmark7), [8](#_bookmark17), [11](#_bookmark22)

**IBV** Institutional Based View. [3](#_bookmark7), [4](#_bookmark9), [7](#_bookmark15)–[10](#_bookmark19), [12](#_bookmark24)

**IMF** International Monetary Fund. [2](#_bookmark5)

**Industry Based View** Industry Based View. [6](#_bookmark14), [8](#_bookmark17)

**IP** Intellectual Property. [3](#_bookmark7)

**MNE** Multinational Enterprises. [3](#_bookmark7), [11](#_bookmark22), [12](#_bookmark24)

**NGO** Non-Governmental Organisation. [11](#_bookmark22)

**NMA** Nederlande Mededingings Authoriteiten. [7](#_bookmark15)

**OFT** Office of Fairtrade. [7](#_bookmark15)

**RBV** Resourced Based View. [4](#_bookmark9)–[6](#_bookmark14), [8](#_bookmark17), [10](#_bookmark19), [12](#_bookmark24)

**WTO** World Trade Organisation. [2](#_bookmark5), [3](#_bookmark7)

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Five Forces Diagram source: [Porter (1980)](#_bookmark51) . . . . . . . . . . . . . . . .

Porter’s Diamond source: [Porter (1980)](#_bookmark51) . . . . . . . . . . . . . . . . . Institutions, organisations, and strategic choices. Source: [Peng (2000)](#_bookmark45) .

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The Institution-Based View as a Third Leg for a Strategy Tripod. Source: [Peng,](#_bookmark50)

[Sun, et al. (2009)](#_bookmark50)

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Dimensions of Institutions. Source [Peng (2008)](#_bookmark48)

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**1 |**

**Introduction**

Trade has been as old as the Middle Paleolithic (300.000 to 30.000 years ago) and originated

with the start of communication in prehistoric times. The first signs of trade have been dis- covered from around 150.000 years ago [Miller et al. (2006)](#_bookmark39) [Watson (2005)](#_bookmark56) [Fernández-Armesto](#_bookmark29) [(2003)](#_bookmark29) [Mayell (2003)](#_bookmark36) [Henahan (2002)](#_bookmark31). These first trades were in ochre, an earth pigment, used to dye fabrics. These trades were mainly in the form of bartered goods and services [O’Sullivan](#_bookmark44) [and Sheffrin (2003)](#_bookmark44) from each other before the innovation of the modern day currency [Watson](#_bookmark56) [(2005)](#_bookmark56).

The innovation of money mend that barter 1 was not longer a necessity to trade goods or services.

With money medium common between the supplier and the demander became available. This facilitated a wider market and created the possibility of mercantilism [Heckscher (1936)](#_bookmark30).

That trade is an important aspect in our history, can be observed from the fact the silk route is

still a well known aspect, although this route has been out of commission in the way that was used.

In some way money changed from a means to an objective. Amidst the financial turmoil that

engulfed the world in 2012 and 2013, one may assume that ”*Money makes the world go round* ”. The quote has been around for some time now, dating back to the musical *Caberet* from the 1960s.

From a trade perspective money is still a means As [Mises (2009)](#_bookmark40) has defined: “The function of

money is to facilitate the business of the market by acting as a common medium of exchange“.

1according to [Merriam-Webster](http://www.merriam-webster.com/): barter is *to trade by exchanging one commodity for another*

1



**1 Introduction**

By this line of thought the underlying motivation of money is the exchange of goods and later

services.

After World War II much needed to change. The world had to come together. Hence two global albeit of truly global organisations have For this purpose the International Monetary Fund (IMF) and World Bank were founded in 1944.

The World Trade Organisation (WTO) was established on January 1 1995. The WTO came into existence after the General Agreement on Tariffs and Trade (GATT) had been dissolved

into the WTO.

2

**2**

**| Literature Review**

In an time of austerity and double dips in the economy, International business (IB) is play-

ing ‘the game’ not only over products and customers but also with institutions. Companies like Apple and Samsung are fighting in court over Intellectual Property (IP) in a multitude of countries. The cell phone department of Motorola was bought by Google solely because of it’s numerous IPs. The field not limited to IPs. Next to the fight over IP subsidies are at the forefront of the public debate as well. Boeing and Airbus have been fighting over subsidies for decades where on more than one occasion the WTO has ruled on the validity of these subsidies. More recently solar panels have become a topic of tariffs between the European Union and China.

The field of play is governed by governments, trade blocks and the WTO on the one hand

and IB on the other. A multitude of forces are acting on this playing field and the different actors on this pitch have to cooperate. Different Multinational Enterprises (MNE) will cope differently with the challenges that are set by the institutions and the environment that they are operating in. That this environment is of importance is explained by Institutional Based View (IBV) [Kostova and Zaheer (1999](#_bookmark34)); [Meyer et al. (2009](#_bookmark38)); [Wang et al. (2012](#_bookmark55))

**2.1**

**History of Strategy in IB Literature**

Using the examples of Google, Apple, Samsung, Boeing and Airbus strategies of the large MNE-

have extended. It is no longer just resources and industries that dictate the strategies that

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companies employ. According to [Peng, Sun, et al. (2009)](#_bookmark50), the market-based institutional frame-

work has been taken for granted, and formal institutions (such as laws and regulations) and informal institutions (such as cultures and norms) have been assumed away as“background”.

This trent has given rise to what [Peng, Sun, et al. (2009)](#_bookmark50) calls the ‘third leg’ of the strategy tripod. IBV has been an addition to the theories of Resourced Based View (RBV) introduced by [Barney (1991)](#_bookmark25) and industry based view by [Porter (1980)](#_bookmark51). Since being introduced by [Porter](#_bookmark51) [(1980)](#_bookmark51) (Industry based view) and [Barney (1991)](#_bookmark25) ( RBV) strategic management (theory) or strat-

egy in short, has gained a lot of momentum in the international business community.

**2.1.1 Industry Based View**

Threat of substitutes

Bargaining power of

suppliers

Rivalry among existing

competitors

Bargaining power of

users

Threat of new entrants

**Figure 2.1:**

Five Forces Diagram source: [Porter (1980)](#_bookmark51)

To understand the early thinking in strategy research we have to look at Porter’s diamond

model (See figure [2.2](#_bookmark12)) and his five forces (see figure [2.1](#_bookmark11)).

The five forces model shows how to determine a company’s competitive environment, and thus it’s Competitive Advantage (CA), which affects profitability. The bargaining power of buy- ers and suppliers affect ability to increase prices and manage costs, respectively. Vise versa a supplier can have bargaining power over its customers. Low-entry barriers attract new competi- tion, while high-entry barriers discourage it. Industry rivalry is likely to be higher when several

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companies are vying for the same customers, and intense rivalry tend to have a price eroding

effect.

Firm strategy,

structure and rivalry

Factor

Conditions

Demand

Conditions

Related and

Supporting industries

**Figure 2.2:** Porter’s Diamond source: [Porter (1980)](#_bookmark51)

The four blocks in Porter’s ‘Diamond’ show the factors at work that shape the CA of dif-

ferent industries in various nations. Factor endowments refer to resources that are available for the companies. This is not just the human part of resources but also natural resources (such as oil in Saudi Arabia or Educated people in India) Countries that invest in education have a skilled workforce, which helps companies engage in research and development. The presence of supporting industries can act as an catalyst for related industries Supporting industries in- clude raw materials suppliers and component manufacturers. A competitive industry structure is also important because companies that can survive tough competition at home are usually able to withstand even tougher competition in a global business environment. Finally, there should be domestic demand. At least in the pre-internet era firms were born locally and than internationalised. The local demand can propel industries to new nights before going global.

**2.1.2**

**Resourced Based View**

RBV came as a response to [Porter (1980)](#_bookmark51) a decade earlier. RBV argued that a firms strategic

advantage is depended on it’s heterogeneous resources (a bundle of all assets, knowledge, and

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capabilities) which have to be the following:

(a)

must be valuable, in the sense that it exploit opportunities and/or neutralises threats in a

firm’s environment

(b)

must be rare among a firm’s current and potential competition,

(c)

must be imperfectly imitable

(d)

there cannot be strategically equivalent substitutes for this resource that are valuable but

neither rare or imperfectly imitable

The list of that is itemised is also known by the acronym VRIN. This unique combination of

resources will lead to CA [Barney (1991)](#_bookmark25). In contrast to Industry Based View (Industry Based View) the theory of [Barney (1991)](#_bookmark25) is *extrospective* and does not consider the company itself.

Both theories of Porter and Barney made their respective impressions in Strategic literature. However RBV, which in introspective in nature and Industry Based View is extrospective cannot account for the entire spectrum of conscious decision making. Considering the theories of Barney and Porter the Dutch ‘Plofkip’1 would be a highly successful product.

In the 2010s in the Netherlands a new breed in chicks (a broiler) was bread. From a scientific

standpoint this was a very successful product with regard to sustainability and food conversion. This ‘plofkip’ as it was rebranded by the media and animal welfare organisations has certain traits that are very positive2,3 These broilers had noticeable advantages:

* The broiler grows faster than the free-range chicken’s carcass (40 days vs. 56 days) and

needs to be fed far less and therefore less manure needs to be removed

* The broiler grows better with less food than the free-range chicken (has better feed con-

version). Thus the free-range chicken needs more food to gain one kilogram of meat.

1Loosely translated in English as BangChick

2Source taken from websites (<http://fransvdst.wordpress.com/2012/10/28/het-duurzame-vleeskuiken>)

3Source

Dutch

newspaper

‘Trouw’

([http://www.trouw.nl/tr/nl/5948/Dierenwelzijn/](http://www.trouw.nl/tr/nl/5948/Dierenwelzijn/article/detail/3267278/2012/06/07/De-voordelen-van-de-plofkip.dhtml)

[article/detail/3267278/2012/06/07/De-voordelen-van-de-plofkip.dhtml](http://www.trouw.nl/tr/nl/5948/Dierenwelzijn/article/detail/3267278/2012/06/07/De-voordelen-van-de-plofkip.dhtml))

([http://www.trouw.nl/tr/nl/4332/Groen/article/detail/3324936/2012/10/01/](http://www.trouw.nl/tr/nl/4332/Groen/article/detail/3324936/2012/10/01/Vanuit-het-milieu-gezien-is-er-niets-mis-met-plofkip-en-megastal.dhtml) [Vanuit-het-milieu-gezien-is-er-niets-mis-met-plofkip-en-megastal.dhtml](http://www.trouw.nl/tr/nl/4332/Groen/article/detail/3324936/2012/10/01/Vanuit-het-milieu-gezien-is-er-niets-mis-met-plofkip-en-megastal.dhtml))

and

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•

The broiler has less stable space at his disposal including what should be heated

•

The manure of a broiler remains in the stable and is thus more environmentally friendly

processes

•

The broiler is more tender and cooks faster

Despite all these advantages, the disadvantages (cleverly supported by pictures) that the chickens

had such difficulties as supporting their own bodyweight and their harts having issues coping with the high growth rate 4, the broiler had to be abandoned and is no longer ‘in play’ as a food source.

The aforementioned example can not be explained by the theories by [Barney (1991](#_bookmark25)); [Porter](#_bookmark51) [(1980](#_bookmark51)), they cannot explain for this phenomenon. The lack of context in with this product has

to ‘operate’ and the power of institutions are not catered for in the theories of Barney and Porter.

**2.2**

**Institutional Based View**

Context and institutions are the prevalent terms when it comes to IBV. This IBVconsiders not

only the firms (similar to [Porter (1980)](#_bookmark51)) and resources (similar to [Barney (1991)](#_bookmark25)) but also en- gages in considering the institutional constraints.

The lack thereof of considering institutions and context is part of the critiques in that have emerged [Narayanan and Fahey (2005)](#_bookmark41). Under certain circumstances for example, the pursuit of cost leadership can be deemed unethical in that the raising broilers however sustainable were seen as cruel by modern animal welfare standards. Some times the cost-leadership strategy can drive companies to engage in (illegal) price fixing actions. In the Dutch mobile phone market, the telecom providers (KPN, Vodafone and T-mobile) have been reprimanded twice in the last

decade or so by the Autoriteit Consument en Markt (ACM)5 for price fixes deals on mobile

4Source taken form [http://www.wakkerdier.nl/actueel/plofkip-campagneandtranslatedfreelybytheauthor](http://www.wakkerdier.nl/actueel/plofkip-campagne%20and%20translated%20freely%20by%20the%20author) 5 The ACM is the new name for the Nederlande Mededingings Authoriteiten (NMA) witch is the Dutch regulatory agency for competitions, comparable tot the British Office of Fairtrade (OFT) (soon to be Competition

and Markets Authority (CMA))

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calling costs6.

[Kraaijenbrink et al. (2009)](#_bookmark35) also summarised RBV critiques in his 2009 paper. He concluded that it is mainly the definition of ‘resource’ and ‘valuable’ in combination with the lack of ac- knowledgement of the combination of bundling resources and the human involvement, that is undermining strength of RBV. Likewise [Priem and Butler (2001)](#_bookmark53) concluded that the contexts are missing from RBV, where [Du˜ng (2012)](#_bookmark28) states that the “resource-based view often neglects the issues of strategy implementation, i.e., various activities through which competitive advantage is directly created. Some resources may be valuable and rare at some point in time, this can change in an instant“. Take a look at the operating system that Nokia used in its mobile phones in the early 2000s. This was considered the peak of user-friendliness; until the iPhone came along. The rare resource of a user-friendly operating system and user interface became defacto obsolete hence non-valuable.

The internal forces that underpin IBV are a reaction to criticisms on the theory of Industry

Based View (and RBV) of a lack of awareness of context [Narayanan and Fahey (2005)](#_bookmark41). The IBV dictates that firms performance and choices do not only depend on resources and the indus- try the firm is competing in, but also depends on the (a) environment (institutional constraints) in which managers and firms pursue their interest [Peng (2008)](#_bookmark48).The institutional framework can have a positive effect on innovations (in the US for example) and a negative effect in Japan. In this case old drug are more profitable than new drugs in Japan [Peng (2008)](#_bookmark48).

On the other hand IBVproposed that (b) formal and informal institutions combine to govern firm behaviour, in situations where formal constraints fail, informal constraints play a larger role in reducing uncertainty and providing consistency to managers and firms [Peng (2008)](#_bookmark48).

Both effects (a) and (b) can be summarised in the word ‘Context’. Context is the third leg [Peng,](#_bookmark50) [Sun, et al. (2009)](#_bookmark50) that influences the various decisions that firms have decide on in IB. The

institutions (which are part of the context) present themselves in two forms ‘formal’ and ‘infor-

6

Sourced from [http://www.volkskrant.nl/vk/nl/2844/Archief/archief/article/detail/3067315/2011/](http://www.volkskrant.nl/vk/nl/2844/Archief/archief/article/detail/3067315/2011/12/07/Mobiel-bellen-blijkt-te-duur-door-kartel.dhtml)

[12/07/Mobiel-bellen-blijkt-te-duur-door-kartel.dhtml](http://www.volkskrant.nl/vk/nl/2844/Archief/archief/article/detail/3067315/2011/12/07/Mobiel-bellen-blijkt-te-duur-door-kartel.dhtml)

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mal’ [Peng (2002)](#_bookmark46). The latter are things like accepted social behaviour and come into play when

formal constraints fail [DiMaggio and Powell (1983](#_bookmark27)); [North (1990](#_bookmark42)); [Scott (1995](#_bookmark54)). The first include political rules, judicial decisions, and economic contracts. More on the theory of institutions will be investigated in Section [2.3](#_bookmark21).

So IBV takes into account not only strategic choices driven by industry conditions and firm-

specific resources, that traditional strategy research emphasises ( [Barney (1991](#_bookmark25)); [Porter (1980](#_bookmark51))), but are also a reflection of the formal and informal constraints of a particular institutional framework that decision makers confront ([Oliver (1997](#_bookmark43)); [Scott (1995](#_bookmark54))). Given the influence of institutional frameworks on firm behaviour, any strategic choice that firms make is inherently affected by the formal and informal constraints of a given institutional framework ([North (1990](#_bookmark42)); [Oliver (1997](#_bookmark43))).

So IBVfocusses not only on strategy and the firms that make these strategic choices but takes

Dynamic

Organisations

Institutions

interaction

Industry conditions

and firm-specific resources

Formal and informal

constraints

Strategic

Choices

**Figure 2.3:** Institutions, organisations, and strategic choices. Source: [Peng (2000)](#_bookmark45)

into account the institutions that govern the playing field. Moreover the interaction between the

firms, institutions and the strategic choices is what IBVis all about.

Strategic literature does not discuss the specific relationship between strategic choices and insti- tutional frameworks [Peng and Khoury (2008)](#_bookmark49). In contrast to earlier theories, IBVdoes not exist on it’s own. It is merely an extension on earlier theories.This figure ([2.3](#_bookmark18)) shows the dependance on both the theories of [Barney (2001)](#_bookmark26) and [Porter (1980)](#_bookmark51) for IBV. Obviously IBVis not an at- tempt to dismiss other theories more an attempt to complete theories on strategy as they exist

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**2 Literature Review**

at the moment. Strategy is about making the right choices at the correct moment.

Treating institutions as independent variables, an institution-based view on business strategy,

Industry-Based

Competition

Firm Specific Resources

and Capabilities

Strategy

Performance

Institutional Condi-

tions and Transitions

**Figure 2.4:** The Institution-Based View as a Third Leg for a Strategy Tripod. Source: [Peng, Sun, et al.](#_bookmark50)

[(2009)](#_bookmark50)

therefore, focuses on the dynamic interaction between institutions and organisations, and con-

siders strategic choices as the outcome of such an interaction (see figure [2.3](#_bookmark18)) [Peng (2002)](#_bookmark46). Not only have more scholars come to realise that institutions matter [Powell and DiMaggio (1991](#_bookmark52)); [Scott (1995](#_bookmark54)), but also that strategy research cannot just focus on industry conditions and firm resources. [Khanna and Palepu (1997)](#_bookmark33) Although firms take decisions on the individual resources and capabilities [Barney (1991)](#_bookmark25) the influence of institutions can no longer be ignored. This is where IBVextends strategic literature. When introduced the RBV in international business lit- erature this view gained a lot of support. The theory has been expanded upon and IBV was introduced by [Kostova and Zaheer (1999](#_bookmark34)); [Meyer et al. (2009](#_bookmark38)); [Wang et al. (2012](#_bookmark55)).

**2.3**

**Institutions**

Following [North (1990)](#_bookmark42), we understand institutions as “humanly devised constraints that struc-

ture human interaction“. Institutional factors function as the formal and informal “rules of the game“ that socially constrain contracting practices between the Boards of Directors (BoD) and executives [North (1990)](#_bookmark42). These formal en informal constraints operate in structures for both

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social and economic exchanges. Institutions are pervasive in that they are capable of shaping the

behaviours of multiple actors (i.e. individuals, firms, industries, and Non-Governmental Organ- isations (NGOs)). More broadly speaking, institutions serve to reduce uncertainty for different actors by conditioning the ruling norms of firm behaviours and defining the boundaries of what is considered legitimate [Peng and Khoury (2008)](#_bookmark49).

The formal and informal institutions can be summarised as in table [2.1](#_bookmark23) Firms do not only have to look at their resources and capabilities [Barney (1991)](#_bookmark25), but have to look at “the rules of the game” [Scott (1995)](#_bookmark54). These so called rules include the environment that the firm MNE has to adhere to. Institutions are the formal and informal rules of the game [North (1990)](#_bookmark42). These institutions are influencing the decision making process in IB.

**Table 2.1:** Dimensions of Institutions. Source [Peng (2008)](#_bookmark48)

Degree of Formality

Examples

Supportive Pillars

Formal Institutions

Laws

Regulations Rules Norms Cultures Ethics

Regelatory (coercive)

Informal Institutions

Normative

Cognitive

The actions of institutions can be divided into three pillars.

through

1. expedience (regulative or coercive pillar),
2. social obligation (normative pillar), or
3. on a taken for granted basis (cognitive pillar)

Compliance from the firms occurs

The cognitive pillar mentioned as the mimetic isomorphism where organisations respond to

uncertainty by adopting patterns of other organisations that are deemed ‘successful’ [DiMaggio](#_bookmark27) [and Powell (1983](#_bookmark27)); [Kostova and Zaheer (1999](#_bookmark34)); [Peng and Khoury (2008](#_bookmark49)); [Scott (1995](#_bookmark54)); [Westney](#_bookmark57) [(2005](#_bookmark57))

MNEs conform to these pillars or isomorphisms because these provide legitimacy [Powell and](#_bookmark52)

[11](#_bookmark52)



[**2 Literature Review**](#_bookmark52)

[DiMaggio (1991)](#_bookmark52). The terms pillar and isomorphismare used interchangeable in strategic litera-

ture. For the sake of clarity in here the term isomorphismwill be used as defined as: “correspond- ing or similar in form and relations”. Here the term is used to state that firms adopt similar structures and strategies.

The central argument with regard to institutions is that “organisations conform to the rules

and beliefs systems in the environment because this isomorphism (regulatory, cognitive and nor- mative) earns them legitimacy. Not only have more scholars have come to realise that institutions matter and, that strategy research cannot just focus on industry conditions and firm resources alone [Powell and DiMaggio (1991](#_bookmark52)); [Scott (1995](#_bookmark54)). Nowadays institutional theory appears to be a highly insightful approach when probing into organisational strategies in Asia [Hoskisson et al.](#_bookmark32) [(2000)](#_bookmark32).

[Westney (2005)](#_bookmark57) The Organisational field may be coterminous with industry, on the other hand it may be applied to a more circumscribed field such as regional economies or a range of organisations such as the Fortune 500.

When markets work smoothly in developed economies, “the market-supporting institutions are almost invisibl“. [McMillan (2008)](#_bookmark37) The effect of institutions on strategy can be seen most obviously in the asian economies [Peng (2002)](#_bookmark46). Where RBV looked solely at the firm in a set environment IBV also takes the surroundings into account. These surroundings are the institu-

tions that govern the environment the MNE is playing the game.

According to [Peng (2003)](#_bookmark47) unfortunately, little is known about how organisations make strate-

gic choices when confronting such large-scale institutional transitions.

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