

**Institutions and International Business**

How do institutions (WTO) effect Firms in Developed and Emerging Economies differently

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Supervisor 1:

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A thesis submitted for the degree of

*Master of Science in Business Studies*

July 9, 2013

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**Acronyms**

**ACM** Autoriteit Consument en Markt. [4](#_bookmark13)

**BoD** Boards of Directors. [7](#_bookmark18)

**CA** Competitive Advantage. [2](#_bookmark8), [3](#_bookmark11)

**CMA** Competition and Markets Authority. [4](#_bookmark13)

**IB** International business. [5](#_bookmark15), [7](#_bookmark18)

**IBV** Institutional Based View. [1](#_bookmark5), [4](#_bookmark13)–[7](#_bookmark18), [9](#_bookmark21)

**Industry Based View** Industry Based View. [3](#_bookmark11), [5](#_bookmark15)

**MNE** Multinational Enterprises. [1](#_bookmark5), [7](#_bookmark18)–[9](#_bookmark21)

**NGO** Non-Governmental Organisation. [7](#_bookmark18)

**NMA** Nederlande Mededingings Authoriteiten. [4](#_bookmark13)

**OFT** Office of Fairtrade. [4](#_bookmark13)

**RBV** Resourced Based View. [1](#_bookmark5), [3](#_bookmark11)–[5](#_bookmark15), [7](#_bookmark18), [9](#_bookmark21)

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**Literature Review**

**1.1**

**International Business Strategy Literature**

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

national Enterprises (MNE)have extended. It is no longer just resources and industries that dictate the strategies that companies employ. According to [Peng, Sun, et al. (2009)](#_bookmark45), the market- based institutional framework 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)](#_bookmark45) calls the ‘third leg’ of the strategy tripod. Institutional Based View (IBV) has been an addition to the theories of Resourced Based View (RBV) introduced by [Barney (1991)](#_bookmark27) and industry based view by [Porter (1980)](#_bookmark46). Since being introduced by [Porter (1980)](#_bookmark46) (Industry based view) and [Barney (1991)](#_bookmark27) ( RBV) strategic management (theory) or strategy in short, has gained a lot of momentum in the international

business community.

**1.1.1**

**Industry Based View**

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

(See figure [1.2](#_bookmark10)) and his five forces (see figure [1.1](#_bookmark9)).

The five forces model shows how to determine a company’s competitive environment, and

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**1 Literature Review**

Threat of substitutes

Bargaining power of

suppliers

Rivalry among existing

competitors

Bargaining power of

users

Threat of new entrants

**Figure 1.1:**

Five Forces Diagram source: [Porter (1980)](#_bookmark46)

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 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 1.2:** Porter’s Diamond source: [Porter (1980)](#_bookmark46)

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

2



**1 Literature Review**

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.

**1.1.2**

**Resourced Based View**

RBV came as a response to [Porter (1980)](#_bookmark46) a decade earlier. RBV argued that a firms strategic

advantage is depended on it’s heterogeneous resources (a bundle of all assets, knowledge, and 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)](#_bookmark27). In contrast to Industry Based View (Industry Based View) the theory of [Barney (1991)](#_bookmark27) is *extrospective* and does not consider the company itself.

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**1 Literature Review**

**1.2**

**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)](#_bookmark46)) and resources (similar to [Barney (1991)](#_bookmark27)) 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)](#_bookmark37). 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)1 for price fixes deals on mobile

calling costs2.

[Kraaijenbrink et al. (2009)](#_bookmark34) 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)](#_bookmark48) concluded that the contexts are missing from RBV, where [Du˜ng (2012)](#_bookmark30) 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.

1 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))

2

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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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)](#_bookmark37). 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)](#_bookmark43).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)](#_bookmark43).

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)](#_bookmark43).

Both effects (a) and (b) can be summarised in the word ‘Context’. Context is the third leg [Peng,](#_bookmark45) [Sun, et al. (2009)](#_bookmark45) that influences the various decisions that firms have decide on in International business (IB). The institutions (which are part of the context) present themselves in two forms ‘formal’ and ‘informal’ [Peng (2002)](#_bookmark41). The latter are things like accepted social behaviour and come into play when formal constraints fail [DiMaggio and Powell (1983](#_bookmark29)); [North (1990](#_bookmark38)); [Scott](#_bookmark49) [(1995](#_bookmark49)). The first include political rules, judicial decisions, and economic contracts. More on the

theory of institutions will be investigated in Section [1.3](#_bookmark19).

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

specific resources, that traditional strategy research emphasises ( [Barney (1991](#_bookmark27)); [Porter (1980](#_bookmark46))), but are also a reflection of the formal and informal constraints of a particular institutional framework that decision makers confront ([Oliver (1997](#_bookmark39)); [Scott (1995](#_bookmark49))). 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](#_bookmark38)); [Oliver (1997](#_bookmark39))).

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

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Dynamic

Organisations

Institutions

interaction

Industry conditions

and firm-specific resources

Formal and informal

constraints

Strategic

Choices

**Figure 1.3:** Institutions, organisations, and strategic choices. Source: [Peng (2000)](#_bookmark40)

Strategic literature does not discuss the specific relationship between strategic choices and insti-

tutional frameworks [Peng and Khoury (2008)](#_bookmark44). In contrast to earlier theories, IBVdoes not exist on it’s own. It is merely an extension on earlier theories.This figure ([1.3](#_bookmark16)) shows the dependance on both the theories of [Barney (2001)](#_bookmark28) and [Porter (1980)](#_bookmark46) for IBV. Obviously IBVis not an at- tempt to dismiss other theories more an attempt to complete theories on strategy as they exist 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 1.4:** The Institution-Based View as a Third Leg for a Strategy Tripod. Source: [Peng, Sun, et al.](#_bookmark45)

[(2009)](#_bookmark45)

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

siders strategic choices as the outcome of such an interaction (see figure [1.3](#_bookmark16)) [Peng (2002)](#_bookmark41). Not only have more scholars come to realise that institutions matter [Powell and DiMaggio (1991](#_bookmark47)); [Scott (1995](#_bookmark49)), but also that strategy research cannot just focus on industry conditions and firm

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**1 Literature Review**

resources. [Khanna and Palepu (1997)](#_bookmark32) Although firms take decisions on the individual resources

and capabilities [Barney (1991)](#_bookmark27) 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](#_bookmark33)); [Meyer et al. (2009](#_bookmark36)); [Wang et al. (2012](#_bookmark50)).

**1.3**

**Institutional Theory**

Following [North (1990)](#_bookmark38), we understand institutions as “humanly devised constraints that struc-

ture human interaction“. Organisations can be seen as technical and social structures and pro- cesses. However they cannot be seen as rational [Westney (2005)](#_bookmark51). A basic premise of institutional theory is that the “environment“ is socially organised. The point is organisations consist of rela- tions not of transactions [Westney (2005)](#_bookmark51). This changes the dynamic of organisations. Institutions are pervasive in that they are capable of shaping the behaviours of multiple organisations (i.e. individuals, firms, industries, and Non-Governmental Organisations (NGOs)) [Peng and Khoury](#_bookmark44) [(2008)](#_bookmark44). [North (1990)](#_bookmark38) defines the same phenomena as: 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.

More broadly speaking, institutions serve to reduce uncertainty for different actors by con- ditioning the ruling norms of firm behaviours and defining the boundaries of what is considered legitimate [Peng and Khoury (2008)](#_bookmark44).

The formal and informal institutions can be summarised as in table [1.1](#_bookmark20) Firms do not only have to look at their resources and capabilities [Barney (1991)](#_bookmark27), but have to look at “the rules of the game” [Scott (1995)](#_bookmark49). 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)](#_bookmark38). These institutions are influencing the decision making process in IB.

The actions of institutions can be divided into three pillars. Compliance from the firms occurs

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**1 Literature Review**

**Table 1.1:** Dimensions of Institutions. Source [Peng (2008)](#_bookmark43)

Degree of Formality

Examples

Supportive Pillars

Formal Institutions

Laws

Regulations Rules Norms Cultures Ethics

Regelatory (coercive)

Informal Institutions

Normative

Cognitive

through

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

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

uncertainty by adopting patterns of other organisations that are deemed ‘successful’ [DiMaggio](#_bookmark29) [and Powell (1983](#_bookmark29)); [Kostova and Zaheer (1999](#_bookmark33)); [Peng and Khoury (2008](#_bookmark44)); [Scott (1995](#_bookmark49)); [Westney](#_bookmark51) [(2005](#_bookmark51))

MNEs conform to these pillars or isomorphisms because these provide legitimacy [Powell and](#_bookmark47) [DiMaggio (1991)](#_bookmark47). 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](#_bookmark47)); [Scott (1995](#_bookmark49)). Nowadays institutional theory appears to be a highly insightful approach when probing into organisational strategies in Asia [Hoskisson et al.](#_bookmark31)

[8](#_bookmark31)



[**1 Literature Review**](#_bookmark31)

[(2000)](#_bookmark31).

[Westney (2005)](#_bookmark51) 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 invisible“. [McMillan (2008)](#_bookmark35) The effect of institutions on strategy can be seen most obviously in the asian economies [Peng (2002)](#_bookmark41). 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)](#_bookmark42) unfortunately, little is known about how organisations make strate-

gic choices when confronting such large-scale institutional transitions.

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