National institutional systems, foreign ownership and firm performance: The case of understudied countries

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ABSTRACT

We analyse the relationship between institutional systems (configurations of countries with similar institutional characteristics) and firm performance. We use a large sample of firms from understudied countries to explore whether the performance impact of these configurations is the same (“equifinality”), whether this holds across different measures of firm performance (“Tversky effect”), and whether some institutional configurations better support foreign-owned firms. We find that it is possible to rank institutional systems according to their impact on firm performance, but the ranking differs according to the performance measure. Although foreign ownership on average confers performance advantages, the magnitude of the impact depends on the configuration. Our findings contribute to the understanding of the importance of institutional similarities across countries, and to the implications of these similarities for the theory of the MNE.

1. Introduction

A central tenet of the international business (IB) literature is that institutions matter (Dunning & Lundan, 2008b; Peng, Wang, & Jiang, 2008; Peng, Sun, Pinkham, & Chen, 2009). In particular, institutional differences across countries can help explain the existence of “country effects” as determinants of differential firm performance (Bamiatzi, Bozos, Cavusgil, & Hult, 2016; Gao, Murray, Kotabe, & Lu, 2010; Makino, Isobe, & Chan, 2004) as well as location (Bevan, Estrin, & Meyer, 2004; Bénassy-Quéré, Coupet, & Mayer, 2007; Globerman & Shapiro, 2002) and entry mode choices by multinational firms (Brouthers, 2002; Meyer, Estrin, Bhamik & Peng, 2009). These institutional differences have arguably become more important as emerging markets add heterogeneity to the institutional spectrum (Hoskisson, Wright, Filatotchev, & Peng, 2013; Peng et al., 2008).

At the same time, there is a long intellectual history built around the analysis of the performance effects of economic systems: groupings of countries that share similar institutional characteristics (Koopmans & Montias 1971; Ostrom, 2009). One prominent example is the Varieties of Capitalism (VOC) perspective (Hall & Soskice, 2001) where it is argued that even within a single economic system, capitalism, countries could usefully be grouped in typologies based on institutional similarities, resulting in a “remarkable convergence on just a few configurations (Boyer, 2005, p. 13). Hall and Soskice looked at a relatively small group of developed economies in North America and Europe and identified two main variants of capitalism, Liberal Market (LME) and Coordinated Market (CME) economies. Importantly, in their approach, the two systems can generate the same levels of national and company performance, resulting in an outcome termed equifinality.

Subsequent scholarship on capitalist variety relies less on establishing typologies such as the VOC, and more on the development of empirically derived taxonomies of institutional systems (Hall & Gingerich, 2009; Schneider & Paunescu, 2012; Witt & Redding, 2013). To date, most scholars have restricted their analysis to developed countries, where institutions are stronger and arguably have a different impact from those in emerging markets (Peng et al., 2008). The major exception is Fainshmidt, Judge, Aguilera, and Smith (henceforth FJAS, 2016) who exploit known features of institutional structures in understudied and emerging developing countries to create a novel framework, which they refer to as Varieties of Institutional Systems (VIS). FJAS’s focus on understudied countries is a welcome addition to the literature on capitalist variety, as scholars have criticized the VOC for
its almost exclusive focus on mature OECD member economies (Allen, 2004). The VIS taxonomy consists of seven distinct, empirically derived national institutional systems, henceforth termed configurations, and incorporates factors considered to be relevant to the emerging market context such as the role of the state and diversified family business groups (Estrin, Meyer, Nielsen, & Nielsen, 2016; Carney, Van Essen, Estrin, & Shapiro, 2017). However, to date, the performance implications of these systems have not been addressed.

In this paper, we pursue two related broad research questions that both extend and link the literature on institutional systems and international business. Our first research question asks whether the institutional systems defined by FJAS exhibit equifinality, and if so whether that outcome holds for all performance measures (which we refer to as the Tversky effect). We argue that, in contrast to VOC, when we extend the scope of the analysis to emerging markets, equifinality as measured by firm performance across national systems, will not hold. We hypothesize that in the context of these understudied countries, some configurations are better at supporting firm performance than others – (H1) – and we test this hypothesis using firm-level data. Our results establish that performance does vary across configurations and equifinality is therefore rejected.

We extend the analysis in our first research question by building on an insight of Tversky (1977) that the ranking of alternatives is context dependent. We apply this argument to the relationship between firm performance and institutional configurations. This extension leads us to offer a novel theory-based hypothesis suggesting that the relative impact (ranking) of the configurations on firm performance will differ according to the performance measure chosen. Specifically, we propose that there will be variation in the extent to which different configurations support alternative dimensions of firm performance (H2). We also find evidence confirming this hypothesis from our sample of understudied countries.

Our second research question asks whether national institutional systems affect the performance of foreign-owned firms in these understudied countries. Here, we both extend the IB literature and link it to the literature on institutions. Specifically, we first draw on the familiar OLI (eclectic) paradigm, and its variations (Dunning, 1988; Henmart, 2009; Rugman & Verbeke, 1990) to explore whether the firm-specific advantages associated with foreign-owned firms (FOEs) and internally transferred through majority ownership provide these firms with performance advantages in understudied countries (H3). This proposition has been widely supported for developed economies (Caves, 1996; Estrin, Hanousek, Kočenda, & Svejnar, 2009) but has not been tested in a cross-national sample of emerging market countries, where institutional heterogeneity is greater, institutional voids and regulatory barriers are higher and therefore the liability of foreignness is higher (Khanha & Palepu, 2010; Wright, Filatotchev, Hoskisson, & Peng, 2005; Zaheer, 1995). Our results suggest that FOEs do display performance advantages over domestic firms, even in these understudied economies. On this basis, we then extend the framework to account for the effects of national institutional systems, by proposing that magnitude of the positive foreign ownership performance effects are contingent on the configuration to which the host economy belongs (H4). Thus we suggest and find empirical support for the argument that, that some configurations provide better institutional support for the ownership advantages of FOEs than others. Our findings indicate that institutional similarities among countries as captured in our configurations, are important determinants of both domestic and foreign-owned firm performance, and should therefore be considered in addition to measures of institutional distance as a component of host country location (L) advantage.

From an empirical perspective, we develop a unique dataset that combines the seven FJAS configurations (see Table 1) with firm-level data from the World Bank Enterprise Survey (WBES), resulting in a sample of over 50,000 firms from 57 understudied countries, including emerging capitalist, former socialist and socialist ones. Thus, we pursue the suggestion of FJAS that they provide an ‘improved platform for scholars examining the implications of cross-national institutional differences for organizations embedded in different types of institutional systems’ (FJAS, p. 2). In bringing together the FJAS taxonomy and the World Bank microdata, we not only extend the theoretical and empirical understanding of institutional systems, but we also link that understanding to the theory of the MNE.

We conclude that the study of national institutional systems, when extended to understudied economies, reveals a considerable variation in institutional architectures, which differentially affect the performance of firms, both foreign and domestic, embedded in them. While we find that some systems better support firm performance than others, we also find heterogeneity among the better-performing systems. Our findings caution against the use of oversimplified categories to describe these countries, but also suggest the theoretical and empirical relevance of national institutional systems in analysing the country-specific (location) advantages of emerging markets.

2. Theory and hypotheses

National institutional systems provide the formal and informal rules of the game to which domestic and foreign firms must adapt their governance and ownership structures (North, 1990). One strand of the corporate governance literature suggests that national and firm-level systems of corporate governance were converging on a single ‘best’ form of economic governance, as manifested in an Anglo-Saxon, capital market-driven investment regime characterized by a sharp separation between ownership and control and secure legal protection for minority investors (Hansmann & Kraakman, 2004). Related to this, a shareholder value model emerged prescribing codes of best corporate governance practice: a vigilant board of independent directors; the separation of key leadership roles; and compensation systems aligning shareholder and top management interests (Lazonick & O’Sullivan, 2000). This liberal market economy (LME) view of national and firm-level corporate governance configuration encapsulates the notion of unifinality, in which across the variety of possible institutional arrangements there exists an optimal configuration of institutions for economic performance (Fiss, 2007). In contrast, Hall and Soskice (2001) argue that within the developed capitalist world, other institutional systems, notably what they refer to as coordinated market economies (CME), can be as high performing as LMEs, consistent with equifinality, whereby different systems produce similar economic outcomes (see also Judge, Fainshmidt, & Brown, 2014).

An earlier example of this type of debate arose in the 1920s over whether socialist states could design an economic system that would match the capitalist system (see Levy & Pert, 2008, for a summary). At its heart was the question of whether two fundamentally different economic systems could perform equally well; that is, whether there could be equifinality of economic outcomes. The tenor of the argument did not support the idea of equifinality, and neither did the actual comparative performance of the systems, which suggested unifinality (Kornai, 1992).

2.1. Institutional configurations and firm performance

We first consider why differences in institutional and governance systems might explain cross-national differences in firm performance (Aguilera & Crespi-Cладера, 2016). The VOC literature (Hall & Soskice, 2001; Amable, 2003; Hancké, Rhodes, & Thatcher, 2007) identifies a social democratic economic model of capitalism in north European countries as a viable alternative architecture of national competitiveness to liberal market economies. There are two ideas at the heart of the VOC model: complementarity and isomorphism. First, a nation-state can provide a performance advantage to its firms if it achieves complementarity between institutional spheres, including the financial sector, the labor, and industrial relations regime, and the educational
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