



# Differentiated effects of formal and informal institutional distance between countries on the environmental performance of multinational enterprises<sup>☆</sup>

Javier Aguilera-Caracuel<sup>a,\*</sup>, Nuria Esther Hurtado-Torres<sup>b</sup>, Juan Alberto Aragón-Correa<sup>c</sup>, Alan M. Rugman<sup>d</sup>

<sup>a</sup> Pablo de Olavide University, Department of Management and Marketing, School of Economics and Business, Carretera de Utrera, Km. 1, 41013, Seville, Spain

<sup>b</sup> University of Granada, Spain

<sup>c</sup> University of Surrey, United Kingdom

<sup>d</sup> University of Reading (Henley Business School), United Kingdom

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## ABSTRACT

This research examines the influence of environmental institutional distance between home and host countries on the standardization of environmental performance among multinational enterprises using ordinary least-squares (OLS) regression techniques and a sample of 128 multinationals from high-polluting industries. The paper examines the environmental institutional distance of countries using the concepts of formal and informal institutional distances. The results show that whereas a high formal environmental distance between home and host countries leads multinational enterprises to achieve a different level of environmental performance according to each country's legal requirements, a high informal environmental distance encourages these firms to unify their environmental performance independently of the countries in which their units are based. The study also discusses the implications for academia, managers, and policy makers.

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## 1. Introduction

Institutional theory establishes that organizations are embedded within broader social structures, comprising different types of institutions that exert significant influence on the decision-making of corporations (e.g., Campbell, 2007; Campbell, Hollingsworth, & Lindberg, 1991). Because multinational enterprises (MNEs) operate in different countries, they face challenges in strategically deciding whether their approaches should be similar given the diversity of the countries and regions in which they operate (Kostova & Roth, 2002). In the environmental arena, previous works have generated broad debate, and while some works have proposed that environmental differences between countries may generate incentives for maintaining differentiated approaches to reduce costs where possible (e.g., Chang & Rosenzweig, 2001; King & Shaver, 2001; Stewart, 1993; Vernon, 1992), other works have claimed that firms may prefer a standardized approach to reinforce credibility

(e.g., Christmann, 2004; Delmas & Montes-Sancho, 2011; Orlitzky, Siegel, & Waldman, 2011; Rivera & deLeon, 2008).

International business researchers have mostly used institutional theory (e.g., DiMaggio & Powell, 1983; North, 1990; Scott, 1995) to study the impact of institutional distance on the different strategies of MNEs. The extent of similarity or dissimilarity between the institutional environments of home and host countries may influence multiple strategic decisions of international firms, such as location choice (Holburn & Zelner, 2010; Xu & Shenkar, 2002), ownership (Eden & Miller, 2004), or entry strategies (Arslan & Larimo, 2010; Estrin, Baghdasaryan, & Meyer, 2009; Xu & Shenkar, 2002). In general, Kostova (1999) and Kostova and Zaheer (1999) suggested that the greater the institutional distance between home and host countries, the more difficult it will be for the MNE to transfer organizational practices from the parent firm to the foreign subsidiary.

The institutional literature in the international field has given much attention to the influence of national and international regulations (e.g., Gunningham & Kagan, 2005; Hoffmann, Trautman, & Hamprecht, 2009; Kostova, Roth, & Dacin, 2008). Within the green context, the body of literature connecting international business and corporate environmental strategies has also widely analyzed the impact of environmental regulations (e.g., Bansal, 2005; Christmann, 2004; Darnall, 2006; King & Shaver, 2001; Rugman & Verbeke, 1998a, 1998b), but recent work has recognized that the results are still inconclusive (e.g., Christmann & Taylor, 2006; Darnall, 2006; Darnall, Henriques, & Sadorsky, 2008; Delmas & Montes-Sancho, 2011). This work concerning regulations is directly related to the formal dimension in North's proposal to

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\* Corresponding author. Tel.: +34 954 977322; fax: +34 954 348353.

E-mail addresses: jagucar@upo.es (J. Aguilera-Caracuel), nhurtado@ugr.es (N.E. Hurtado-Torres), jaragon99@gmail.com (J.A. Aragón-Correa), a.rugman@henley.reading.ac.uk (A.M. Rugman).

delimitate the national environment (North, 1990), but research has not considered the informal dimension in North's proposal (which is more related to values and culture in the country) so far.

Previous contradictory findings regarding the relation between institutional distance and the level of homogeneity in the MNEs' environmental approaches may be due to their focus on formal institutions, with little regard for informal ones. For example, similar national environmental regulations do not necessarily imply a similar degree of environmental development in the two countries because they may place different levels of social priority on the enforcement of environmental regulations (Christmann & Taylor, 2001; Dasgupta, Hettige, & Wheeler, 2000). Little effort has been made to take into account informal institutional elements at the country-level as they relate to environmental issues (e.g., Darnall, 2006, 2009; Delmas & Montes-Sancho, 2011; Hoffman, 1999).

The study here makes at least two contributions. First, this study extends previous literature on the influence of institutional distance by showing that different institutional dimensions should be taken into consideration to explain the strategies of MNEs and that each one may have a specific impact on the firms' approaches. Explicit attention will not only be given to the formal aspects of institutional distance but also to the most informal features.

Second, this research answers the call to analyze the influence of institutional dimensions on specific domains. Previous literature emphasizes that institutional distance must be measured with reference to the related institutional context (e.g., Busenitz, Gomez, & Spencer, 2000). The study here focuses on the green context; the study extends recent attention in this field (Aguilera-Caracuel, Aragón-Correa, Hurtado-Torres, & Rugman, 2012) by offering a general framework that includes differentiated analysis of the effects of the formal and informal environmental distances between home and host countries. In addition, we incorporate the term, "environmental performance standardization," to refer to a scenario in which the MNEs' facilities operating in different countries reach similar levels of environmental impact.

Based on a sample of 128 MNEs in three different industries with headquarters and subsidiaries based in the USA, Canada, France, and Spain, the results show that not all the dimensions of environmental institutional distance have the same influence on the standardization of environmental performance within an MNE. A high informal environmental distance between home and host countries encourages the MNEs to standardize their environmental performance, whereas a high formal environmental distance drives the MNEs to adapt their environmental performance according to each country's institutional requirements.

This paper proceeds with a theoretical review in Section 2. Section 3 proposes the hypotheses. The fourth and fifth sections report on the methodology and describe the empirical results, respectively. Section 6 offers a discussion and conclusions.

## 2. Conceptual framework

Managers of MNEs make strategic decisions that take into account both firm-specific advantages (FSAs) and country-specific advantages (CSAs) (Rugman & Verbeke, 2003). As a result, MNEs need to consider the specific conditions of their home and host countries and take into account their internal resources and capabilities in developing their management policies and practices (Kolk & Pinkse, 2008).

In addressing environmental issues, MNE managers must decide whether they wish to implement advanced environmental approaches using the dynamic capacity of their firms to design or alter their operations, processes, and products to voluntarily prevent the negative environmental impacts the firms would otherwise generate (Aragón-Correa & Sharma, 2003; Hart, 1995). Toward this end, MNE managers must consider whether the generation of specific green advantages associated with advanced environmental performance levels can only be developed and used within individual countries (location-bound) or if they

can be used globally through environmental standards (non-location-bound) (Rugman & Verbeke, 1998a, 1998b, 2001). MNEs that decide to generate non-location-bound green initiatives are able to transfer advanced environmental management practices to the rest of their units. As a result, the MNE self-regulates its environmental conduct worldwide due to a commitment that extends beyond what the law requires (King & Lenox, 2000; Rivera & deLeon, 2008) through voluntary environmental initiatives (Christmann & Taylor, 2006; Delmas & Montes-Sancho, 2011). Several studies have shown that pressures by various stakeholders (governments, industry, and customers) contribute to the global standardization of different dimensions of MNEs' environmental policies (e.g., Christmann, 2004; Orlitzky et al., 2011).

MNEs do not only face different national institutional dimensions in the various contexts in which they operate, they also create their own internal profile. Because these firms face complex institutional pressures and act on a large scale, they need to reinforce their own internal institutional profiles (DiMaggio & Powell, 1983; Kostova et al., 2008), which include internal procedures, principles, and organizational cultures that make certain practices and structures more acceptable and desirable than others (Kostova & Zaheer, 1999). An MNE's internal institutional profile can reduce ambiguity within organizational units, increase trust, and transfer a set of capacities and competences within the firm (Bartlett & Ghoshal, 1989). Consequently, MNEs are able to promote their own legitimacy in each country and increase their transparency (Christmann, 2004).

The literature on international management has used different dimensions to analyze the institutional characteristics of specific countries (e.g., Arslan & Larimo, 2010; Bae & Salomon, 2010; Estrin et al., 2009; Gaur & Lu, 2007; Salomon & Wu, 2012; Xu, Pan, & Beamish, 2004). North (1990) proposed a classification of formal and informal institutional distances. Formal institutional distance refers to the differences between the legal institutions, laws, and regulations of the home and host countries of the MNE (Salomon & Wu, 2012). Informal institutional distance results from the differences in values, beliefs, customs, traditions, and codes of conduct of the home and host countries of MNEs (Arslan & Larimo, 2010; Salomon & Wu, 2012).

North's framework offers three advantages for the analysis of how the differences between international contexts influence the management approaches of MNEs. The boundaries of institutional distance are clearly defined and avoid any confusing overlap (Arslan & Larimo, 2010). North's framework focuses on national institutions and thus lends itself to country-level analysis (Gelbuda, Meyer, & Delios, 2008; Kostova & Roth, 2002). The approach is suitable for international business studies and allows for consistency and clarity in analyzing differences within the national and international contexts (Estrin et al., 2009; Peng & Khoury, 2009).

Consequently, this research follows the call of Peng (2002, 2003) and Peng, Wang, and Jiang (2008) to use North's framework to the classification of institutional dimensions. The next section will examine the different impacts of the formal and informal institutional distance dimensions on environmental performance standardization for MNEs.

## 3. Hypotheses

Environmental initiatives of MNEs may be highly conditioned by the institutional profiles of the different countries where these firms operate. High environmental institutional distance between home and host countries may lead MNEs to achieve a different level of environmental performance and, hence, to develop opportunistic behavior with regard to the natural environment (Aguilera-Caracuel et al., 2012). Alternatively, the MNE may create its own environmental performance standards by reinforcing its internal institutional profile independent of those of the countries in question. Thus, the formal and informal dimensions of environmental institutional distance may have differing impacts on the generation of location- and non-location-bound green firm-specific advantages within the MNE.

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