International Business Review 28 (2019) 104–118

Contents lists available at ScienceDirect

International Business Review

journal homepage: www.elsevier.com/locate/ibusrev

The performance impact of culture and formal institutional differences in cross-border alliances: The case of the microfinance industry

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ARTICLE INFO

Keywords:
Cross-border alliance
Performance
Informal institutional differences
Formal institutional differences
Microfinance industry

ABSTRACT

This study addresses the simultaneous and diverse effects of differences in informal and formal institutions on cross-border alliances' financial performance. We utilize data from 405 microfinance institutions (MFIs), based in 74 developing countries, that have alliances with partners from developed countries. We find that the impact of informal institutional differences between MFIs and their cross-border partners is sigmoid-shaped, with performance first increasing, then declining, before improving again as informal institutional differences grow large. By contrast, formal institutional differences appear to be detrimental to MFIs' performance. Consistent with our prediction, we find that MFIs' cross-border experience moderates both formal and informal institutional effects.

1. Introduction

Cross-border alliances typically involve the sharing and exchange of knowledge and resources between partners embedded in varied institutional contexts (Carlsson, 2006). In this paper, we extend this argument and draw performance implications for cross-border alliances. Past research on alliance performance has considered structural and relational aspects (Burt, 1992; Podolny, 1994; Rothaermel, 2001), while institutional differences among alliance partners have been considered largely from the narrow perspective of "cultural distance" (Kogut & Singh, 1988). Notwithstanding some notable exceptions (e.g., Filiou & Golesorkhi, 2016; Lavie & Miller, 2008), there is a dearth of knowledge on the distinct and potentially variable impact of informal and formal institutional differences on alliance performance. We redress this gap in the empirical context of vast institutional differences, where alliance partners come from developed and developing countries, respectively.

Past research has shown that differences in the nature of institutions shape alliance partners' attitudes and abilities to learn (Lyles & Salk, 1996; Parkhe, 1991; Simonin, 1999), which in turn affect their firms' financial performance. In addressing the role of national institutional settings in cross-border alliances, we draw a fundamental distinction between informal and formal institutions, in line with institutional economics (North, 1990). This growing body of research has highlighted the coevolutionary nature of informal and formal institutions, while calling for their distinct treatment (e.g., Alesina & Giuliano, 2015; Bowles, 1998; Tabellini, 2010). In this paper, we argue that informal and formal institutional differences *both* have an impact on performance returns from cross-border alliances, however much their impact varies.

To test our contention, we use a sample of 405 microfinance institutions (MFIs), based in 74 developing countries, that have alliances with partners from developed countries. The microfinance industry makes an interesting testing ground for our research agenda because of the many cross-border alliances between MFIs in developing countries and their partners in developed countries (Mersland, Randøy, & Strøm, 2011). Moreover, thanks to transparency guidelines introduced by international stakeholders like CGAP, which is a specialized microfinance branch of the World Bank, relevant and high-quality data are available for this industry, which is uncommon when it comes to data from developing economies in general (Beisland, Mersland, & Randøy, 2014).

In line with our hypotheses we find that the impact from informal institutional differences is sigmoid-shaped, with performance first increasing, then declining, before improving again as informal institutional differences grow large. By contrast, we find a clear negative firm-based performance effect from large formal institutional differences. A firm's cross-border experience has a positive moderating effect on both informal and formal institutional differences.

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https://doi.org/10.1016/j.ibusrev.2018.08.006
Received 4 December 2017; Received in revised form 30 July 2018; Accepted 13 August 2018
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Our study contributes to the international business literature in several ways. First, we enhance our understanding of the impact of institutional differences on the performance of cross-border alliances. Past research has highlighted the role of informal institutions at the expense of formal institutions (Fey & Beamish, 2001), and often produced inconsistent results, at times showing that domestic alliances outperform cross-border alliances (Hennart & Zeng, 2002; Mowery, Oxley, & Silverman, 1996), while at other times finding that alliances between partners hailing from different informal institutional settings perform better than domestic alliances (Park & Ungson, 2001). Using a global dataset, our study provides comprehensive and clear results: formal institutional differences between cross-border alliance partners have a negative effect on performance, whereas the effect of informal institutional differences on performance depends on the extent of the differences between the partners.

Second, we contribute to the alliance literature by simultaneously addressing the impact of informal and formal institutions. To do so, we investigate a matrix of interorganizational partnerships exhibiting large variations in informal and formal institutions between cross-border alliance partners across many heterogeneous countries (74 in this study) and continents.

Third, our study contributes to the literature on nonlinear performance effects from internationalization. Specifically, we are motivated by the sigmoid performance effects found in studies on internationalization through wholly owned subsidiaries (Contractor, Kundu, & Hsu, 2003; Lu & Beamish, 2004), internationalization of alliance portfolios (Lavie & Miller, 2008), and the effect of institutional differences on firms' innovation returns from alliances (Filiou & Golesorkhi, 2016). By extending these past studies, we also shed light on the debate on the curvilinear effect of informal institutional differences on the cross-border activities of firms (e.g., Barkema & Drogendijk, 2007; Björkman, Stahl, & Vara, 2007; Stahl & Tung, 2015).

Fourth, by comparing the impact of informal and formal institutional differences as the key contextual elements, we contribute to the growing body of literature emphasizing the need for understanding the distinct attributes and economic outcomes of informal and formal institutions (e.g., Alesina & Giuliano, 2015; Bowles, 1998; Tabellini, 2010). We strive to fill the gap in our understanding of the impact of informal and formal institutions on firms' financial performance. In particular in the context of developing countries, where informal institutions have a prominent role in enabling or hindering business transactions and formal institutions provide weaker business support (Khanna & Palepu, 1997, 2000; Verbeke & Kano, 2013). We also provide an understanding of the impact of firms' cross-border experience along each distinct dimension of informal and formal institutions. This gap especially exists in the context of alliances, a popular and important venue for economic and managerial transactions.

Finally, we contribute to the understanding of organizations working in a rapidly expanding global service industry (Ault & Spicer, 2014), whose financial returns from internationalization are yet to be thoroughly researched (one exception is Mersland et al., 2011). Moreover, we focus on the global microfinance industry, whose importance to economic and social development and modernization has been widely acknowledged, and which is deeply embedded in its respective home and host government systems, rendering national differences salient.[1]

2. Alliances and contextual diversity

We employ the institutional perspective (North, 1990) to argue that informal and formal institutions demarcated at the national level (Edquist & Johnson, 1997) give rise to different sources of enablers and constraints in cross-border alliances and have distinct effects on firms' financial performance. The differing nature of such institutions shapes partners' attitudes and abilities to coordinate the liabilities of such differences and to leverage the financial potential of cross-border alliances. Specifically, we argue that the tacit (informal) or explicit (formal) nature of institutions engenders distinct effects on partners' financial performance in cross-border alliances. Informal differences, typically unwritten, encompass socially shared rules and constraints (e.g., Sartor & Beamish, 2014; Sauerwald & Peng, 2013). Due to their tacit (Polanyi, 1966) and elusive nature, such differences have the potential to generate either the positive impact associated with, for example, resource complementarities, or the negative impact linked to conflicting values, norms, and practices between cross-border alliance partners (Parkhe, 1991). We posit that firms' performance varies with the level of informal institutional differences, following a sigmoid (S-shaped) pattern. When a firm encounters cross-border partners that are marginally different, its performance is likely to increase due to the partners' better understanding and appreciation of subtly different approaches; however, as differences increase, conflicts will surface, eroding performance. Once differences have reached a high level, awareness of the differences will emerge, and the urgency of collaboration will become apparent to the partners, prompting cooperation and improved performance.

By contrast, formal institutional differences, codified and explicit in nature (Polanyi, 1966), constitute "rules of the game" and are likely to produce differences between alliance partners that would be disruptive rather than complementary. More "incompatible" formal institutional pairs of cross-border alliance partnerships would increase the costs of conducting business, due to the unfamiliarity of each partner with the other partner's institutional setting (Brouthers, Brouthers, & Werner, 2008). Once set, such "rules of the game" cannot be easily changed and there are no established mechanisms with which to facilitate the rapprochement of the disparate formal institutional sets of rules (North, 1990).

Finally, we also argue that firms' cross-border experience helps bridge both informal and formal institutional differences since experiential learning can capture both codified and tacit knowledge. The theoretical driver of our argument also incorporates insights from the literature on absorptive capacity and organizational learning (e.g., Levitt & March, 1998), and is in line with the prediction of the internationalization (Uppsala) paradigm (Johanson & Vahlne, 1977).[2]

2.1. The impact of informal institutional differences

Informal institutions are systems of shared meanings, embedded in norms, values, beliefs, and the collective understanding of a society, that are not formulated into documented rules and standards (North, 1990). Furthermore, informal institutions consist of culture, which is responsible for shaping human cognition, perception, mental models, behavioral norms, traditions, customs, and belief systems. International business scholars have treated informal institution similar to culture (e.g., Estrin, Baghdasaryan, & Meyer, 2009; Filiou & Golesorkhi, 2016).

Cross-border alliances typically involve knowledge exchange between partners, and this sharing and learning process is shaped by institutional differences (Lyles & Salk, 1996; Parkhe, 1991; Simonin,

[1] Examples include the Dutch government-owned development bank FMO, with a microfinance portfolio of 8 billion USD in 85 countries (www.fmo.nl), the Belgium BIO, a private-public (50/50) company with more than 150 investments across the globe (www.bio-invest.be), and the Norwegian government-owned NORFUND with a portfolio of 1.7 billion USD, where banking and microfinance is one of the main asset classes (www.norfund.no).

[2] The Uppsala internationalization model highlights how firm-based accumulated knowledge and learning reduce the cost of doing international business by overcoming "psychic distance," and thus enhance the potential for profitable internationalization.

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