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Varieties of institutional systems: A contextual taxonomy of understudied countries

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ABSTRACT

We advance a new theoretical framework to capture the diverse and unique institutional context of understudied economies in Africa, Middle East, East Europe, Latin America, and Asia. Our framework encompasses the configurational context encapsulated by state, financial markets, human capital, social capital, and corporate governance institutions operating in these regions. Using qualitative data solicited from experts to compile the institutional profiles of 68 economies, we identify seven types of institutional systems. Ultimately, we offer a more comprehensive and up-to-date taxonomy of the national institutional context operating throughout the global economy. We call this taxonomy "Varieties of Institutional Systems."

1. Introduction

> Principally, all management scholars aspiring a theoretical contribution should be concerned about context (Meyer, 2015, p. 369).

National institutions have long been a central part of international business theory (Cantwell, Dunning, & Lundan, 2010). As the formal and informal "rules of the game," national institutions underpin much of the context in which international business and competition takes place. Recently, the field has witnessed the emergence of more holistic theoretical foundation for understanding the impact of institutional diversity on international business phenomena by focusing on how national institutions configure in complementary ways into *systems* of economic organization (e.g., Ioannou & Serafeim, 2012; Jackson & Deeg, 2008; Hotho, 2014; Judge, Fainshmidt, & Brown, 2014). This look at international business context through a systemic lens entails a departure from focusing on relationships between single institutions or isolated elements of "doing business" in a specific context (Redding, 2005).

The literature on institutional systems straddles two primary frameworks—Varieties of Capitalism (VOC) (Hall & Soskice, 2001) and National Business Systems (NBS) (Whitley, 1999). The VOC typology divides some advanced economies into liberal and coordinated market economies, based on the allocative mechanism of resources, profits and risk. Alternatively, the NBS typology focuses on "distinctive ways of structuring economic activities with different kinds of actors following contrasting priorities and logics" (Whitley, 1998: 449); and encompasses institutions pertaining to the state, financial markets, human capital, and social capital. While both typologies have proven useful in explaining the nature and consequences of systemic variation, especially in developed economies (e.g., Witt & Redding, 2013; Hotho, 2014; Schneider & Paunescu, 2012), they are often not well-suited for characterizing the increasingly significant group of newly-developed, emerging, and developing economies. Notably, emerging and developing economies encompass most of the world's population and, since 2013, the majority of global purchasing power (Economist, 2013). Furthermore, newly-developed economies often do not resemble well established advanced economies due to their unique trajectories (Schneider, 2013; Tsui-Auch & Lee, 2003).

Consequently, we go beyond the VOC and NBS frameworks in this study by considering additional unique institutional aspects, such as state and family salience, which have proven to be highly relevant to economies in Africa, Middle East, East Europe, Latin

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America, and Asia (Aguilera & Judge, 2014). Our new framework, "Varieties of Institutional Systems" (VIS), more comprehensively captures the institutional context provided by the state, financial markets, human capital, social capital, and corporate governance institutions in these important but understudied regions within the global economy. Then, we rely on rich qualitative data provided by a panel of regional experts to compile the institutional profiles of 68 national economies, and inductively identify seven distinct national institutional systems using a two-step cluster analysis technique.

Our study makes several important contributions to the international business literature. First, the VOC framework has been criticized for "its lack of attention to the developing world" as well as to the role of the state and social norms in how economic activity is organized within the national institutional context (Wilkinson, Wood, & Deeg, 2014, p. 2). Similarly, NBS is not well-suited to depict many economic systems around the world where different types of state and family capitalism have recently emerged (Musacchio, Lazzarini, & Aguilera, 2015; Lane, 2008; Tsui-Auch & Lee, 2003). Our framework remedies this omission by adding new institutional dimensions to VOC and NBS particularly relevant to Asian, East European, African, Middle Eastern, and Latin American contexts (e.g., Hearn, 2015; Nölke & Vliegenthart, 2009; Witt & Redding, 2013; Schneider, 2009).

Second, our approach offers a more comprehensive and systemic way to think about institutional context (Jackson & Deeg, 2008). Namely, it transcends geographical boundaries and allows for a parsimonious conceptual and operational mapping of nation-states that may not appear similar (or dissimilar) when looking at a single type of institution or variable (Aguilera, Filatotchev, Gospel & Jackson, 2008). To properly understand international business context, we need to combine a nation's "social, cultural, legal, and economic variables" (Cheng, 1994, p. 165). As stated by Peng, Wang, and Jiang (2008, p. 921), "Even among developed economies, there are significant differences in terms of how competition is organized."

Third, while acknowledging that organizational heterogeneity exists within nations (Walker, Brewster, & Wodd, 2014), we develop an improved platform for scholars examining the implications of cross-national institutional differences for organizations embedded in different types of institutional systems (Li, Cui, & Lu, 2014; Martin, 2014; Whitley, 1998). Because national institutions often shape the bundles of resources and capabilities firms possess (Berger & Dore, 1996; Soskice, 1999; Carney, Gedajlovic, & Yang, 2009), different types of organizational competitive advantages may emerge as distinct responses to different national institutional systems (Hall & Soskice, 2001).

Finally, while national institutions typically change slowly, research shows that institutional change does occur (Gingrich, 2015; Taras, Steel, & Kirkman, 2012; Berry, Guillén, & Hendi, 2014). As such, older typologies can become outdated as the institutional profile of nation-states shifts over time (Hotho, 2014; Hall & Gingerich, 2009). By drawing on current expert knowledge that is not available in extant archival datasets coupled with a broader consideration of institutional context, we are able to refine and extend prior typologies and begin to consider all regions of the global economy. According to Hotho (2014), such a taxonomical approach may stimulate the conceptual refinement of exiting typologies.

2. Institutional systems as international business context

The configurational approach to national institutions is a way of distilling a complex array of interdependent variables into a unified whole. It reflects the reality that within national boundaries, institutions tend to "hang together" as coherent entities or gestalts. According to Redding (2005, p. 131), "[the] reason why the nation-state often emerges as the most compelling among the various surrounding envelopes is that so much of the institutional fabric is set within its boundaries." The notion of institutional gestalts is predicated on the principle of complementarity, which emerges when two or more elements mutually reinforce one another's effects or because they compensate for one another's deficiencies (Crouch, 2005). In so doing, societal institutions combine to affect the organization of economic activities and, thereby, provide the context for a range of country-level and organizational outcomes (Morgan & Kristensen, 2014; Jackson & Deeg, 2008).

Prior studies have shown the usefulness of the configurational approach in explaining a variety of organizational outcomes such as outward and inward foreign direct investment (Pajunen, 2008; Witt & Lewin, 2007), internationalization of state-owned enterprises (Li et al., 2014), cross-national differences in CEO compensation (Greckhamer, 2015), export patterns (Schneider, Schulze-Bentrop, & Paunescu, 2010; Schnedier & Paunescu, 2012), human resource practices (Fenton-O'Creevy, Gooderham, & Nordhaug, 2008), corporate environmental performance (Hartmann & Uhlenbruck, 2015), percentage of women on corporate boards of directors (Grosvold & Brammer, 2011), and equitable wealth creation (Judge et al., 2014). For instance, Schnedier and Paunescu (2012) show that the institutional gestalts in the USA and Germany – both in which property rights are well protected – promote various levels of coordination among economic actors, and therefore are better positioned for radical and incremental innovation, respectively.[1] Reinforcing these insights, Hoskisson, Yiu, and Kim (2004, p. 301) argue that:

> . . . in the U.S. transactional capital market system, corporate control is often exercised through a change in the management by takeovers. Such a change is easier if firms are not hindered by long-term relational contracts with their managers, as such reorganization may lead to great internal organizational conflicts. As such, the absence of a relational managerial labor market is conducive to the arm's-length transactional capital market in the United States.

Within the institutional systems literature, the VOC (Hall & Soskice, 2001) and NBS (Whitley, 1999) frameworks are the two seminal theoretical perspectives seeking to explain how institutional combinations shape economic exchange within nation-states. Below, we begin by discussing these two typologies, and then refine and extend them into our new proposed taxonomy which we label "Varieties of Institutional Systems" (VIS).

2.1. The VOC and NBS frameworks

Hall and Soskice's (2001) work firms as the "crucial actors in a capitalist economy" (p. 6) and the firm's strategic interactions as the underlying mechanisms explaining systemic variation. Their VOC typology attempts to explain *how* economic activity is organized among capital, labor, and management within advanced economies. Within that framework, countries are divided into two main types—liberal market economies (LMEs) and coordinated market economies (CMEs).

In LMEs, companies coordinate their activities via competitive market arrangements, and the allocative mechanism is based primarily on market supply and demand. Most firms raise capital through the stock exchange or private equity markets, where

[1] This literature focuses on larger, dominant organizations, or those that control and account for dominant proportions of total economic activity and resources in the economy.