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Institutional adjustment and change at the firm level: A varieties of capitalism perspective

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Summary This paper contributes to a better understanding of global corporate and industrial change at the firm level. Our focus is on convergence vs. divergence of national institutional systems. Data are drawn from a survey of German and UK firms. Our results for adaptation behavior of British subsidiaries in Germany suggest that at the firm level the primacy of national institutions and institutional complementarity as determinants of the organizational behavior of MNEs may be overstated. Nonetheless, evidence that German MNEs in Britain seek to choose strategic choices for which there is institutional support in the host country suggests that complementarity is functional enough to incite adjustment even in the absence of strong formal pressure. The evidence that both German and British firms seem to prefer practices characteristic of liberal market economies may pose a problem for institutional stability in Germany and generates implications for the likely pathways of institutional change.

Introduction and problem setting

The issue of how core institutions of advanced political economies shape the behavior of economic actors has been attracting the attention of scholars for some time now. An important debate has developed around ideas advanced by varieties of capitalism theory (VoCT) that emphasizes the role of the so-called social systems of production and social institutions as the source of dissimilarities between different types of national economic systems (national capitalisms) and contends that these dissimilarities generate systematic variations in corporate strategy across countries (Hall & Soskice, 2001; Hollingsworth & Boyer, 1997; Sabel & Zeitlin, 1997). VoCT argues that pressures for convergence are counteracted by idiosyncratic national institutional arrangements, complementarily interlinked in a complex whole and persistent over time (Chizema & Buck, 2006; Hall, 1986; Lane, 1995; Wullweber, Graf, & Behrens, 2013).

The objective of this paper is to contribute to the literature on global convergence by analyzing links between intra-organizational adaptation and institutional variation across countries. A debate has erupted over how to reconcile the VoCT view on institutional complementarities and inertia with empirical

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observations of widespread institutional incoherence, diversity and change (Jackson & Deeg, 2008; Morgan, Whitley, & Moen, 2006). The institutional complementarity hypothesis (ICH) is one of the central postulates of VoCT and a key to understanding configurations of capitalisms. It defines complementarity as a specific interplay of elements of institutional systems that creates benefits that would not exist if the configuration of the institutional environment were different (Aoki, 2001; Streeck, 2010). The presence of complementarity should reinforce differences between market economies and create resistance to changes of non-evolutionary nature, i.e., those provoked by pressures from outside the national institutional setup (Hertig, 2006). This conclusion, however, appears to contradict reality as in the modern globalized economy the impact of the external environment as a factor of change plays a prominent role. Consequently, scholars increasingly call for research agendas that proceed from a mere description of different types of capitalisms toward the investigation of the pathways of institutional change at macro, meso and micro levels (Crouch et al., 2005; Deeg & Jackson, 2007).

This paper attempts to respond to these calls. Going beyond existing empirical studies of complementarity that are primarily located at the macro-level (Hall & Gingerich, 2009; Kenworthy, 2006), we investigate complementarities at the micro level by making transnational firms the focal point of analysis. Our intention is to investigate the adaptation pattern of foreign subsidiaries from liberal market economies in coordinated market economies and vice versa. We seek to reveal how the forces of internationalization penetrate the national institutional environment in the face of resistance created by existing complementarities. We conjecture that at the micro level some coordination dimensions in host economies are more open, i.e., show more receptiveness to external influences which multinational firms bring with them, thus triggering changes that may result in the reconfiguration of institutional complementarity at the macro level over time. We infer that this may lead to conclusions regarding the global convergence of business systems and reveal the degree to which the fundamental theoretical idea of complementarity may be supported empirically.

Methodologically our objective is, in the interest of consistency, to expand VoCT theory using its own fundamental premises as a starting point of analysis. Specifically we adopt the basic bi-polar model characteristic of VoCT in its pure form that assumes the existence of just two distinct institutional settings — the liberal market economies (LME) and the coordinated market economy (CME). We also accept axiomatically the complementarity hypothesis in the form developed within this theory. Both postulates are contested in literature. The bi-polar model is often criticized for being too simplistic as in reality the distinction between capitalisms is never as clearly cut as VoCT seems to suggest. In turn, in the eyes of some authors, the treatment of the idea of complementarity, while intuitively very appealing, lacks necessary intellectual rigor (Crouch et al., 2005). In this paper we seek to demonstrate that some of the well publicized limitations of the concept may be rectified without leaving the platform on which the concept itself is built. Specifically, this paper seeks to reveal the possible path for the forces of internationalization to penetrate the national institutional environment in the face of resistance created by existing institutional complementarities. We conjecture that at the micro level some elements of national institutional setups in host economies are more receptive to external influences that multinational firms bring with them, thus triggering changes that ultimately result in the reconfiguration of national institutional setups as we know them today.

There is substantial literature investigating adaptation processes involving MNEs. So far analysis has been somewhat one-dimensional, centering on case study evidence, predominantly in the domain of human resource management (Ferner, Quintanilla, & Varul, 2001; Tüselmann, McDonald, & Thorpe, 2006; Von Glinow, Drost, & Teagarden, 2002), but also contracting arrangements (Grimshaw & Miozzo, 2006), competence development and learning practices (Geppert, 2005), and work systems and manufacturing approaches (Geppert & Matten, 2006). By contrast, this paper takes a holistic and quantitative approach. While qualitative studies rely on specific examples of adaptation behavior, we seek to reveal generalizable statistical evidence of such behavior and identify the paths through which pressures coming from internationalization may undermine the pulling force of complementarity within a national institutional setup. To achieve our objectives we apply an original 'ratio of institutional impact' (*ii*Ratio), a novel quantitative measure of the qualitative characteristics of compliance with host country institutions.

Our findings allow identifying elements in the institutional setup that are more susceptible to change and as a result are likely to trigger systemic transformation in the production system as a whole. We document evidence that both German and British multinational firms seem to prefer business practices characteristic of the liberal market economy environment. This may pose a problem for institutional stability in Germany and, more generally, generates important implications for the likely pathways of institutional change and global convergence dynamics.

Theoretical background and hypotheses

For the purpose of this study, we define institutions as the rules of behavior normatively founded and backed up by social norms and the enforcement capacities related to them (Aoki, 2001; North, 1990). Institutions represent constraints, resources and opportunities for specific sets of actors and their activities. VoCT (Hall & Soskice, 2001) focuses on firms as such actors and their role in the process of economic adjustment and distinguishes five principal spheres of firm endeavor ('coordination dimensions'): corporate governance (CG); industrial relations (IR); training and education (TE); inter-firm relations (IFR), and firm-employee relations (ER). VoCT maintains that the degree of market and strategic coordination varies within a continuum of institutional systems (Hall & Gingerich, 2009). At one end are LMEs, in which relations between firms and other actors are coordinated primarily through competitive markets. The prime examples are Great Britain, USA, Australia, Canada, New Zealand, and Ireland. At the other end stand CMEs, in which firms typically have greater strategic interaction with stakeholders such as suppliers, trade unions, employees, and sponsors. To this group gravitate, among others, Germany, Japan, Switzerland, Netherlands, Belgium, Austria and the Nordic countries. Figs. 1 and 2 summarize distinctive characteristics of the two political economies that we scrutinize in this paper.