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PERSPECTIVE

An institution-based view of international business strategy: a focus on emerging economies

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Abstract

Leveraging the recent research interest in emerging economies, this Perspective paper argues that an institution-based view of international business (IB) strategy has emerged. It is positioned as one leg that helps sustain the ''strategy tripod'' (the other two legs consisting of the industry- and resource-based views). We then review four diverse areas of substantive research: (1) antidumping as entry barriers; (2) competing in and out of India; (3) growing the firm in China; and (4) governing the corporation in emerging economies. Overall, we argue that an institution-based view of IB strategy, in combination with industry- and resource-based views, will not only help sustain a strategy tripod, but also shed significant light on the most fundamental questions confronting IB, such as ''What drives firm strategy and performance in IB?''
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INTRODUCTION

What drives firm strategy in international business (IB)? What determines the success and failure of firms around the world? These are some of the most fundamental questions confronting the IB field (Peng, 2004a). Traditionally, there are two perspectives that address these two questions. An industry-based view, represented by Porter (1980), argues that conditions within an industry, to a large extent, determine firm strategy and performance. A resource-based view, exemplified by Barney (1991), suggests that it is firm-specific differences that drive strategy and performance. These influential views have been developed primarily in the field of strategic management. While IB and strategy are closely allied fields (Peng, 2006; Ricart, Enright, Ghemawat, Hart, & Khanna, 2004), what are the contributions of IB research that can add to our understanding of the two crucial questions raised earlier?

Insightful as the industry- and resource-based views are, they can be criticized for largely ignoring the formal and informal institutional underpinning that provides the *context* of competition among industries and firms studied with these lenses (Kogut, 2003). In other words, they assume institutions as ''background''. This is not surprising, because industry- and resource-based views arise primarily out of research on competition in the United States, in which it may seem reasonable to assume a relatively stable, market-based institutional framework. Once we study competition around the world, it is evident, as shown by decades of IB research, that the world is different. Even among developed economies, there are significant differences in terms of how competition is organized (Hall & Soskice, 2001; Lewin & Kim, 2004; Redding, 2005; Ring, Bigley, D'Aunno, & Khanna, 2005; Whitley, 1994). More recently, as researchers increasingly probe into emerging economies whose institutions differ significantly from those in developed economies, there is increasing appreciation that formal and informal institutions, commonly known as the "rules of the game" (North, 1990), significantly shape the strategy and performance of firms – both domestic and foreign – in emerging economies (Hoskisson, Eden, Lau, & Wright, 2000; Wright, Filatotchev, Hoskisson, & Peng, 2005). One visible piece of evidence of the upsurge of IB strategy research interest in emerging economies is a series of recent high-profile Perspective papers in the pages of this journal: London and Hart (2004), Meyer (2004), Ramamurti (2004), and Ricart et al. (2004).

This Perspective paper directly builds on several previous Perspective papers: Leung, Bhagat, Buchan, Erez, and Gibson (2005), London and Hart (2004), Meyer (2004), Ramamurti (2004), Redding (2005), Ricart et al. (2004), and Teegen, Doh, and Vachani (2004). Among these papers, Leung et al. (2005) and Redding (2005) make a compelling case that IB research should focus more on the context of institutions. However, other than introducing experimental methods (Leung et al., 2005) and adding thick descriptions (Redding, 2005), they fall short of channeling this new emphasis to tackle IB's most fundamental questions on the drivers of firm strategy and performance. Teegen et al. (2004) deal with a crucial but often neglected force in the institutional environment around the globe – nongovernmental organizations (NGOs). While calling IB researchers to "catch up" with other disciplines in incorporating NGOs (Teegen et al., 2004: 473), they are not clear on how the new NGO research may add directly to the core theory in IB (other than "enriching" it). Focusing on a crucial question, "Why do countries or locations differ?", Ricart et al. (2004) suggest "a fundamentally different way" to think about IB strategy. Yet, they have not parsimoniously articulated what this new way is. London and Hart (2004), Meyer (2004), and Ramamurti (2004) all focus on emerging economies, but they have not leveraged this new research to explicitly suggest the emergence of any particular new theoretical perspective. We take such research one step further, by (1) explicitly arguing for the emergence of an institution-based view of IB strategy, and (2) positioning it as one leg that helps sustain a "strategy tripod" (the other two legs being the industry- and resource-based views).

Of course, given the development of new institutionalism throughout the social sciences in recent decades (Hall & Soskice, 2001; March & Olsen, 1989; North, 1990; Oliver, 1997; Scott, 1995; Williamson, 2000),[1] the proposition that "institutions matter" is hardly novel or controversial.[2] What is interesting (Davis, 1971; Smith, 2003) is *how* institutions matter. We argue that IB strategy research, especially its recent focus on competition in emerging economies, affords us a wonderful opportunity to shed light on the "how" question and to contribute one leg – an institution-based view – to help sustain the "strategy tripod".[3]

The remainder of the article first sketches the contours of an institution-based view of IB strategy and raises a key question. Then we draw on four diverse areas of substantive research as examples of how the new institution-based view contributes to our understanding:

(1) antidumping as entry barriers;
(2) competing in and out of India;
(3) growing the firm in China; and
(4) governing the corporation in emerging economies.

A THIRD LEG IN THE STRATEGY TRIPOD

While using emerging economies as a new empirical context to test and extend existing theories is a time-honored tradition in IB research, it is imperative that IB research explicitly contributes to the *theoretical* development of the larger field of business disciplines and social sciences (Meyer, 2006, 2007). Specifically, we argue that research with a focus on emerging economies helps lead to the emergence of an institution-based view of strategy, in parallel with the traditional industry- and resource-based views.[4]

What exactly are institutions? Building on the "rules of the game" metaphor, North (1990: 3) more formally defines institutions as "the humanly devised constraints that structure human interaction". Similarly, Scott (1995: 33) defines institutions as "regulative, normative, and cognitive structures and activities that provide stability and meaning to social behavior''. In this sense, institutions can be broadly classified as formal and informal ones. Institutions govern societal transactions in the areas of politics (e.g., corruption, transparency), law (e.g., economic liberalization, regulatory regime), and society (e.g., ethical norms, attitudes toward entrepreneurship). A country's political environment has been emphasized in the political risk literature (Butler & Joaquin, 1998; Kobrin, 1982; Nigh, 1985). Nations differ in political risk, which affects the stability of their markets (Simon, 1984).

A substantial IB literature centered on culture has been developed (Leung et al., 2005). What is the relationship between cultures and institutions? While delineating their relationship is beyond the scope of this Perspective paper, it is helpful to cite Hofstede, Van Deusen, Mueller, Charles, and Business Goals Network (2002: 800), who suggest that culture is ''a substratum of institutional arrangements''. This is the perspective we will follow.[5] Specifically, we can view culture as a part of *informal* institutions in the environment that ''underpin formal institutions'' (Redding, 2005: 123; see also Hofstede, 2007; Singh, 2007).

This Perspective paper focuses on the political, legal, and societal aspects of institutions. To illustrate the legal aspect of the institution-based model, we discuss two important issues in IB: antidumping as entry barriers and corporate governance in emerging economies. To highlight the political and societal aspect in the institution-based model, we focus on two countries that have emerged as important players in the global economy: India and China.

To be sure, the influence of the ''environment'' (Lawrence & Lorsch, 1969) has long been featured in the industry- and resource-based views. However, what has dominated the research is a ''task environment'' view, which focuses primarily on economic variables such as market demand and technological change (Dess & Beard, 1984). Until recently, scholars had rarely looked beyond the task environment to explore the interaction among institutions, organizations, and strategic choices (as critiqued by Narayanan & Fahey, 2005; Teegen et al., 2004). Instead, a market-based institutional framework has been taken for granted, and formal institutions (such as laws and regulations) and informal institutions (such as norms and cognitions) have been assumed away as ''background'' conditions. While some argue that this treatment of institutions as background is insufficient to gain a deep understanding of strategic behavior and firm performance even in developed economies (Ingram & Silverman, 2002; Lewin & Kim, 2004; Oliver, 1997), its deficiency becomes more striking when probing into emerging economies (Narayanan & Fahey, 2005).

In other words, when markets work smoothly in developed economies, ''the market-supporting institutions are almost invisible'', according to McMillan (2007), who goes on to argue that when markets work poorly in emerging economies, ''the absence of [strong formal] institutions is conspicuous''. This problem has long been recognized. Kiggundu, Jorgensen, and Hafsi's (1983) early review of 94 studies published during the 1956–1981 period on the application of mainstream organizational and management theories in developing countries reports two interesting findings. First, studies focusing on the technical core (organizational tasks and technology) are most likely to find no significant problem in applying mainstream theories in these countries. Second, studies dealing with the organization's relationship with its broader environment – which would have been labeled as more ''context-based'' by the more recent work of Kogut (2003), Leung et al. (2005), Peng (2002, 2003, 2006), Redding (2005), and Teegen et al. (2004) – are more likely to find serious difficulties in applying mainstream theories in developing countries, thus necessitating major adjustments (Kiggundu et al., 1983).

Coinciding with the rise of emerging economies in the global economy, more and more scholars are becoming interested in these countries (Hitt, Ahlstrom, Dacin, Levitas, & Svobodina, 2004; Hitt, Dacin, Levitas, Arregle, & Borza, 2000; Lyles & Salk, 1996; Meyer, 2004; Newman, 2000; Peng & Heath, 1996; Ramamurti, 2004). Most of this new research resonates well with Kiggundu et al.'s (1983) earlier insight, which essentially calls for new theoretical tools, such as what we now call the institution-based view, to capture the complex and rapidly changing relationships between organizations and environments in emerging economies. Today, our field has become much more conscious of the importance of the relationships between institutions and organizations.

Treating institutions as independent variables, an institution-based view of strategy focuses on the dynamic interaction between institutions and organizations, and considers strategic choices as the outcome of such an interaction (Peng, 2003, 2006). Specifically, strategic choices are not only driven by industry conditions and firm capabilities, but are also a reflection of the formal and informal constraints of a particular institutional framework that managers confront (Bruton, Dess, & Janney, 2007; Carney, 2005; Chelariu, Bello, & Gilliland, 2006; Delios & Henisz, 2000; Hill, 2007; Khanna & Palepu, 2000, 2006; Lee & Oh, 2007; Lee, Peng, & Barney, 2007; Lu & Yao, 2006; Ma, Yao, & Xi, 2006; Meyer & Nguyen, 2005; Ring et al., 2005; Rodriguez, Uhlenbruck, & Eden, 2005; Teegen et al., 2004; Wan & Hoskisson, 2003; Zhou, Tse, & Li, 2006).

In other words, institutions are much more than background conditions. Instead, "institutions *directly* determine what arrows a firm has in its quiver as it struggles to formulate and implement strategy and to create competitive advantage" (Ingram & Silverman, 2002: 20, added italics). This proposition is certainly valid in developed economies (Ring et al., 2005), as demonstrated by recent research on political (nonmarket) strategies (Clougherty, 2005), the role of nation-states as influences on strategic change and innovation (Lewin & Kim, 2004), and the impact of institutions on diversification strategies (Peng, Lee, & Wang, 2005; Wan, 2005). However, it is research on emerging economies that has pushed the institution-based view to the cutting edge of strategy research, which is becoming the third leg in the strategy "tripod" (the other two legs being industry- and resource-based views) (see Figure 1). This is because the profound differences in institutional frameworks between emerging economies and developed economies force scholars to pay more attention to these differences in addition to considering industry- and resource-based factors (Chacar & Vissa, 2005; Doh, Teegen, & Mudambi, 2004; Hafsi & Farashahi, 2005; McMillan, 2007). For example, recent research on the determinants of multinational subsidiary performance documents that (1) in developed economies, corporate (firm-specific) effects are more critical in explaining the variation in foreign subsidiary performance (consistent with the resource-based view), and that (2) in emerging economies, country effects, which are proxies for institutional differences, are more salient (supportive of the institution-based view) (Makino, Isobe, & Chan, 2004: 1028).

The rise of the institution-based view as a dominant perspective in strategy and IB research on emerging economies can be seen in the collection of papers in two special issues that are influential on such research. In 2000, seven out of 13 papers (54%) in the *Academy of Management Journal* special issue on strategy research in emerging economies, edited by Hoskisson et al. (2000), rely primarily on institutional theory. Consequently, institutional theory is viewed by Hoskisson et al. (2000) as one of the top three most insightful theories when probing into emerging economies (the other two are transaction cost economics/agency theory and the resource-based view). However, Hoskisson et al. (2000: 263) predict that the importance of institutional theory may decline as emerging economies become more developed. This prediction has been *refuted* by the increasingly voluminous research that draws on the institution-based view to tackle IB strategy problems in emerging economies. Five years later, in 2005, seven out of eight papers (88%) in the *Journal of Management Studies* special issue on strategy research in emerging economies, edited by two of the same editors as for the *AMJ* special issue and two new editors (Wright et al., 2005), are institutional papers. The papers in

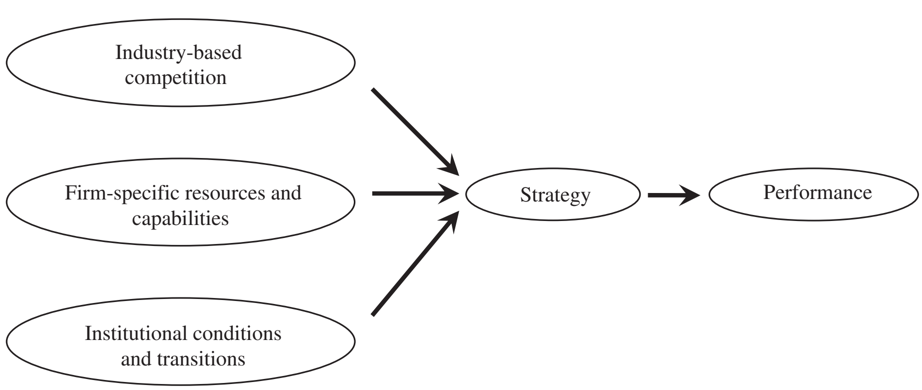

Figure 1 The institution-based view: a third leg of the strategy tripod.
Source: Peng, M.W. (2006) *Global Strategy* (p. 15). Cincinnati: South-Western Thomson

both *AMJ* and *JMS* special issues investigate a broad range of IB and strategy issues, such as:

(1) business groups (Chang & Hong, 2000; Guillen, 2000; Khanna & Palepu, 2000; Wan, 2005; Yiu, Bruton, & Lu, 2005);
(2) privatization (Filatotchev, Buck, & Zhukov, 2000; Uhlenbruck & De Castro, 2000);
(3) foreign investment strategies (Child & Tsai, 2005; Chung & Beamish, 2005; Delios & Henisz, 2000; Hitt et al., 2000; Isobe, Makino, & Montgomery, 2000; Meyer & Nguyen, 2005);
(4) domestic strategies in emerging economies (Peng & Luo, 2000; White, 2000); and
(5) internationalization strategies for firms based in emerging economies expanding abroad (Brouthers, O'Donnell, & Hadjimarcou, 2005).

It is important to note that the two *AMJ* and *JMS* special issues on emerging economies have no preconceived preference for any particular theoretical perspective. Instead, there is a rich and diverse repertoire in the theory tool bag for strategy and IB scholars, who are usually trained to draw on the most relevant and insightful tools to solve theoretical and empirical problems at hand (and not become slaves to any particular school of thought). The fact that institutional theory becomes the most frequently drawn upon theoretical tool speaks volumes about the particular usefulness of this perspective when seeking to better understand the unfolding competition in emerging economies (Hafsi & Farashahi, 2005). Such research, in turn, contributes to the larger field beyond the more specialized work on emerging economies by articulating the emergence of a third leg of the strategy tripod (see Figure 1).

THE KEY QUESTION

The rise of new institutionalism throughout the social sciences can be traced to the 1970s (Scott, 1995). Its penetration into the IB and strategy literature is a more recent phenomenon since the 1990s (see Oliver (1997) and Peng and Heath (1996) for some early examples, and Dunning (2004: 19) and Mahoney (2005: 223) for recent acknowledgments). There is significant path dependency (or historical coincidence) underpinning the rising interest in this perspective. The rise of emerging economies on the worldwide stage at about the same time affords great opportunities to extend and develop the institution-based view (Meyer & Peng, 2005). Since different fields embracing the new institutionalism pursue different questions, it is important to identify the key question for IB and strategy research (Peng, 2004a).

While it seems fair to suggest that the institutional framework in any given country is always in some sort of transition (e.g., consider the post-9/11 and post-Enron United States and the post-July 2005 London bombing Great Britain), a hallmark of emerging economies is that they tend to have more "fundamental and comprehensive changes introduced to the formal and informal rules of the game that affect firms as players", which are labeled "institutional transitions" (Peng, 2003: 275). In fact, the transitions in a subset of emerging economies, namely, former Eastern bloc countries such as China, Hungary, and Russia going through the transformation from communist to capitalist systems, are so significant and pervasive that they are collectively known as *transition economies* (Meyer & Peng, 2005; Roth & Kostova, 2003). Consequently, the key question for both domestic and foreign firms in emerging economies is: How to play the game, when the rules of the game are changing and not completely known?

IB STRATEGY IN EMERGING ECONOMIES

While answers to the key question identified above are tentative and sketchy at the moment, this section outlines four diverse areas of substantive research, which furthers our discussion on how an institution-based view, grounded in the context of emerging economies, adds to our understanding of IB strategy. These are (1) antidumping as entry barriers, (2) competing in and out of India, (3) growing the firm in China, and (4) governing the corporation in emerging economies. While the selection of these four areas is driven in part by the availability of an emerging body of literature on these topics, there are other interests at play. Specifically, such selection is also guided by an interest to first cover the more international (cross-border) aspects of dealings with firms from emerging economies (antidumping), then to focus on salient issues associated with two of the leading emerging economies (India and China), and finally to deal with less international, but nevertheless very important, issues of strategy in emerging economies (corporate governance). Certainly, there are numerous examples from other substantive areas[6] and geographic regions[7] that we can draw on (see Hafsi & Farashahi (2005) for a comprehensive review). Following Leung et al. (2005: 358), "it is not our purpose to be comprehensive; our goal is to spotlight a few highly promising areas" that represent a reasonably diverse yet focused set to illustrate the institution-based view.

Antidumping as Entry Barriers

One of the five forces governing the competitiveness of an industry is the height of entry barriers (Porter, 1980). In IB, entry barriers are so significant that they give rise to the term "liability of foreignness" (Zaheer, 1995). However, most research on entry barriers has focused on market-based variables such as economies of scale and product differentiation. Rarely have nonmarket-based, institutional variables such as antidumping laws been explicitly considered as entry barriers in IB.

Consider the following two scenarios concerning "dumping", legally defined in the United States as (1) an exporter selling below cost abroad and (2) planning to raise prices after eliminating local rivals. First, a steel producer in Canton, Ohio, enters a new market, Texas. In Texas, it offers prices lower than those in Ohio, resulting in a 10% market share in Texas. Texas firms have two choices. The first one is to initiate a lawsuit against the Ohio firm for "predatory pricing" (the domestic equivalent of dumping). However, it is difficult to prove (1) that the Ohio firm is selling below cost *and* (2) that its current pricing indicates its future plan to raise prices after eliminating rivals (legally known as an "attempt to monopolize", which is punishable by antitrust laws). Under US domestic antitrust laws, a case like this will have no chance of succeeding. Thus, Texas firms are most likely to opt for their second option – to retaliate in kind by offering lower prices to customers in Ohio, leading to lower prices in Texas and Ohio and benefiting consumers in both locations (Peng, 2006).

Now in the second scenario, the "invading" firm is not from Canton, Ohio, but Canton (Guangzhou), China. Holding everything else constant, Texas steel firms can argue that the Chinese firm is dumping, causing "material injury" in the form of lost sales, profits, and jobs. Under US antidumping laws, Texas steel producers "would almost certainly obtain legal relief on the very same facts that would not support an antitrust *claim*, let alone antitrust relief" (Lipstein, 1997: 408, original italics). Note that imposing antidumping duties on Chinese steel imports reduces the incentive for Texas firms to counter-attack by entering China, resulting in *higher* prices in both Texas and China, where consumers are hurt. These two scenarios are highly realistic. An OECD study reports that 90% of the practices found to be "unfairly" dumping in Australia, Canada, the EU, and the US would never have been questioned under their own antitrust laws if used by a domestic firm in making a domestic sale (OECD, 1996). In a nutshell, foreign firms are often discriminated against by the formal rules of the game in many countries (Peng, 2006).

Discrimination is also evident in the actual investigation of antidumping. A case is usually filed by a domestic firm with the relevant government authorities. Then these government agencies send lengthy questionnaires to accused foreign firms, requesting comprehensive, proprietary data on their cost – in the case of US government investigations, in English using US generally accepted accounting principles (GAAP) within 45 days. Many foreign defendants fail to provide such data on time simply because they are not familiar with US GAAP.

The investigation can have four outcomes. First, if no data are forthcoming from abroad, the data provided by the accusing firm become the evidence, upon which the accusing firm can easily win. Second, if foreign firms do provide cost data, the accusing firm can still argue that these "unfair" foreigners have lied – "There is no way their costs can be so low!" For example, in the case of Louisiana *vs* Chinese crawfish growers, the authenticity of the average $9 per *week* salary made by Chinese workers was a major point of contention. Third, even if the low-cost data are verified (as the Chinese crawfish growers were able to do), US (and EU) antidumping laws allow the complainant to argue that these data are not "fair". In the case of China, the argument goes, its cost data reflect huge distortions due to government intervention because China is still a "nonmarket" economy. Therefore it is only "fair" to calculate how much it costs to raise hypothetical crawfish in a market economy (in this particular case, for mysterious reasons, Spain was chosen). Because Spanish costs were about the same as Louisiana costs, the Chinese, despite their vehement objections, were found guilty of dumping (i.e., selling below *Spanish* costs in America). Consequently, 110–123% import duties were levied on Chinese crawfish. The fourth possible outcome is that the defendant wins the case. But this seems highly unlikely (Robin & Sawyer, 1998; Schuler, Rehbein, & Cramer, 2002).

Overall, when industry- and resource-based weapons fail, there is a direct implication for domestic firms under competitive pressures from imports:

launch an institution-based missile by filing an antidumping petition (Schuler et al., 2002). One study finds that, in the United States, simply filing such a petition (regardless of the outcome) resulted in a statistically significant 1% increase of the stock price of US-listed firms (an average of \$46 million increase in market value) (Marsh, 1998). For US firms, the capital market clearly understands that Uncle Sam is on "your side". It is thus not surprising that antidumping cases have now proliferated throughout the world. Although the US and the EU have initiated the largest number of cases (which is not surprising, given that these two regions are the largest importers), what is somewhat surprising is that actually a number of emerging economies on per dollar of imports are the most eager practitioners of setting up antidumping barriers. On per dollar of imports, Argentina and South Africa file 20 times more cases than the US, India seven times, and Brazil five times (Finger, Ng, & Wangchuk, 2001). China, whose firms lead the world by attracting 15% of antidumping cases worldwide, has recently returned the "favor" by enforcing its own antidumping laws since 1999.

In the 21st century, as tariff barriers are no longer tolerated in most parts of the world, nontariff barriers such as antidumping regimes become increasingly important (Schuler et al., 2002). While defending firms can obtain government assistance through antidumping penalties and entering firms may indeed engage in "dumping" (selling below cost) as a way to gain market share, entering firms may react to antidumping duties through "jumping" – that is, using foreign direct investment (FDI) to bypass (or "jump over") antidumping barriers (Blonigen, 2002). Overall, there is a great deal of strategizing on both sides through dumping, antidumping, and tariff-jumping strategies. The upshot is that IB strategy research, especially the literature concerning foreign market entry, needs to pay more attention to antidumping as entry barriers, which result in an institution-based liability of foreignness. Unfortunately, an online search of 35 years of *all* articles published in *JIBS* since its founding in 1970, using the two keywords "dumping" and "antidumping" in titles and abstracts, yields a grand total of one (!) such work (Flowers, 1976).[8] It seems imperative that a new generation of entry strategy research centered on the institution-based view devote substantial attention to the crucial strategic issue of antidumping if such research aspires to be globally relevant.

Competing In and Out of India

Societal-level institutions shape firm strategy in complex and changing ways (Dacin, Goodstein, & Scott, 2002). Political, legal, and societal changes in India affect strategies of Indian and non-Indian firms when competing in and out of India. India's phenomenal recent rise as a leading global player in information technology (IT) and related services has been documented (see Kapur & Ramamurti, 2001). As boundaries between software, IT services, and business processes become blurred, the term "IT" seems too limiting. A new jargon, "business process outsourcing" (BPO), is emerging.

Why has the Indian IT/BPO industry emerged as a global powerhouse (second only to the United States)? Most existing answers focus on the industry- and resource-based views, by highlighting the nature of this industry, whose work can be performed off-site, and the capabilities of certain Indian firms with the enviable combination of low costs and excellent skills (Ethiraj, Kale, Krishnan, & Singh, 2005; Garud, Kumaraswamy, & Sambamurthy, 2006; Gopal, Sivaramakrishnan, Krishnan, & Mukhopadhyay, 2003). While these answers are certainly insightful, they do not paint a complete picture. An institution-based answer, among other factors, would point to political, legal, and societal changes in institutions. Earlier decisions by the Indian government to invest in the higher education of approximately top 5% of the university-eligible population is one of the changes.[9] An institutional explanation would also probe into various legal and regulatory reforms that have liberalized the economy since 1991. Domestically, India's post-1991 economic reforms have made an open, competitive, and entrepreneurial environment possible (Kedia, Mukherjee, & Lahiri, 2006). Beyond India, the larger international environment in favor of globalization in the 1990s also helped.

However, as the political winds change, the phenomenal success of some Indian firms has more recently been under attack in the West, both formally and informally. Formally, in order to protect jobs, a number of American states have recently started to pass laws to ban Indian firms from being awarded official contracts. Informally, the backlash is more widespread. Facing the prospects of significant job losses, numerous politicians, journalists, union activists, and displaced employees in developed economies are unhappy and demand protectionist actions.

At the same time, Western MNEs, such as Cisco, GE, IBM, Microsoft, SAP, and TI, have increasingly appreciated the quality and the value of the work performed by Indian IT/BPO firms (Lewin & Peeters, 2006). Moreover, these Western firms have aggressively invested in India, performing some of this work by their own subsidiaries that tap into the same talent pool as the Indian IT/BPO firms do. The arrival of Western MNEs in India, in turn, has forced Indian IT/BPO firms to be more competitive. While these competitive interactions are certainly influenced by industry- and resource-based considerations, they are, no doubt, enabled by the market-opening reforms of the Indian government. From an institution-based standpoint, often left unacknowledged are the policies that encourage outward FDI by Western governments. For the time being, backlash in the West aims at creating *entry* barriers for Indian IT/BPO firms to do business in the West, but has not focused on creating *exit* barriers for Western MNEs to cut domestic investments and jobs and transfer funds, technology, and expertise from home countries to invest in India. Capital control for outbound FDI is not unthinkable, because as recently as the 1960s and 1970s the US and UK governments restricted outbound FDI, respectively. In other words, the era of relatively unrestricted outbound FDI has been with us for only approximately three decades. However, because outbound FDI (from developed economies to India and elsewhere) is now so extensive, market-supporting institutions such as pro-outbound FDI policies adopted by Western governments are now taken for granted and almost "invisible" (McMillan, 2007). Such market-supporting institutions may be invisible, but they certainly exist and assert a positive role in facilitating FDI strategies of Western MNEs. In theory, sufficiently strong political pressures in the West (such as concerns about job losses allegedly attributable to outbound FDI) can lead to a reversal of such pro-outbound FDI policies – although this does not seem likely in practice in the near future.

Overall, a more friendly domestic and international environment has enabled the Indian IT/BPO firms to flourish, by both enabling them to perform work appreciated by Western clients and forcing them to do better when Western MNEs increasingly invest in India. On the other hand, a less friendly institutional environment in developed economies may curtail the growth of Indian IT/BPO firms. In other words, institutions both enable and constrain IB. Moreover, such institutions are not static. Their changes and transitions over time have impacted on the success and failure of IT/BPO firms competing in and out of India (Khandwalla, 2002). A more comprehensive, and hence better, understanding of what is behind the international success (or failure) of the Indian IT/BPO firms will inevitably need to investigate the impact of both domestic and international institutional frameworks on these firms – in addition to industry- and resource-based factors (Khanna & Palepu, 2004; Ramaswamy, Li, & Petit, 2004).

Growing the Firm in China

It is long established that strong economic growth can hardly occur in poorly regulated economies. Yet, given China's sustained economic growth in the last three decades and its relatively underdeveloped formal institutions (such as a lack of effective courts),[10] scholars are puzzled: "How can China be achieving rapid rates of growth, while retaining such an institutional order?" (Boisot & Child, 1996: 607). Since it is the growth of the firm, in the aggregate, that leads to the growth of the economy, IB and strategy researchers have endeavored to provide firm-level answers to address this intriguing puzzle. Among many answers, a partial answer suggests that interpersonal networks (called *guanxi* in Chinese) cultivated by managers in the society may serve as informal substitutes for formal institutional support (Peng & Heath, 1996). In other words, micro, interpersonal relationships among managers are translated into a macro, interorganizational strategy of relying on networks and alliances to grow the firm, thus leading to a micro–macro link (Peng & Luo, 2000; see also Chung, 2006; Li, 2005; Wu & Leung, 2005). Overall, this research has supported and extended a key institutional proposition: while it is the combination of formal and informal institutional frameworks that shapes strategic choices (North, 1990), in situations whereby formal institutions are weak, informal institutions, such as norms governing interpersonal relationships, rise to play a *larger* role in driving firm strategies and performance (Peng & Heath, 1996).

While some suggest that the observed intensification of networks and relationships in China is due to the Chinese culture (Redding, 1990), similar evidence on the rise of networks and relationships has been reported from Argentina (Guillen, 2000), Chile (Khanna & Palepu, 2000), the Czech Republic (Newman, 2000), Hungary (Rona-Tas, 1994; Stark, 1996), India (Kedia et al., 2006), Poland (Spicer, McDermott, & Kogut, 2000), Russia (Guriev & Rachinsky, 2005; Perotti & Gelfer, 2001; Puffer &

McCarthy, 2003), and South Korea (Chang & Hong, 2000) during these countries' institutional transitions. Citing such globally corroborative evidence, Peng (2003: 284) argues that

> the broad range of these countries with different cultural traditions and transition trajectories suggests that the convergence on this network-based strategy is not likely to be driven by national culture alone but, rather, more significantly by common institutional characteristics – in particular, the lack of formal market institutions – during the transitions.

It is important to note that in China (and other emerging economies), not only are domestic firms eager players of the networking game, but foreign entrants have also enthusiastically cultivated their web of interorganizational networks and relationships, as evidenced by the numerous international strategic alliances with local firms (Hitt et al., 2000, 2004; Li, 2005; Luo & Peng, 1999; Xu, Pan, Wu, & Yim, 2006).

One interesting avenue to extend and deepen our understanding of the institutional drivers of strategic choices in an emerging economy such as China is to track the long-run evolution of interorganizational networks and relationships at the macro societal level (Peng & Zhou, 2005). On the one hand, if it is national culture that primarily drives strategic choices, the intense reliance on interpersonal relationships may last a long time or at least will not experience a noticeable decline as market reforms deepen, since culture changes relatively slowly (Hofstede, 2007). On the other hand, if it is institutional (under)development that shapes strategic choices, we will probably see a gradually reduced role of interpersonal relationships and a heavier reliance on market-based capabilities as formal market-supporting institutions are gradually implemented (Ahlstrom, Bruton, & Yeh, 2007; Dieleman & Sachs, 2006; Li, Sun, & Liu, 2006b; White, 2000; Xu et al., 2006; Zhou & Peng, 2006; Zhou, Li, Zhao, & Cai, 2003). Evidence supportive of the institution-based view, articulated in Peng (2003), is now emerging. For example, Guthrie (1998) documents the *reduced* role of interpersonal relationships acknowledged by Chinese managers. Peng and Luo (2000) find that connections are necessary but not sufficient for good firm performance, and that market-based capabilities more significantly drive firm performance. In an area particularly salient in IB, entry modes, there is now strong evidence that the propensity to form joint ventures (JVs), which rely on local partners to navigate the institutional idiosyncrasies, is reduced during China's more recent phase of transitions, and that wholly owned subsidiaries (WOS) established by foreign firms not only routinely outnumber JVs, but also by an increasing margin (Child & Tse, 2001). In 2001, 60% of the new FDI entries in China took the form of WOS, whereas 34% took the form of JVs – the ratio was less than 2:1. In 2005, 74 and 24% of the new entries in China were WOS and JVs, respectively – the ratio was over 3:1 (*China Business Review*, 2006: 65).

Governing the Corporation in Emerging Economies

Corporate governance research has historically focused on developed economies, in particular the United States and United Kingdom, collectively known as the Anglo-American system. Underpinned by agency theory, this research has long been based on the assumption of dispersed ownership and a pronounced separation of ownership and control. The key conflicts consequently are principal–agent conflicts between shareholders and managers (Jensen & Meckling, 1976). "Virtually everything we teach our students stems from this assumption", observes Morck (2000: 11), who continues, "this tends to be almost as true outside as within the United States, for the most important standard textbooks in the field are American". However, dispersed ownership is "actually an *exception* rather than the rule around the world … [and] most corporations around the world are controlled by a family or the state, characterized by *concentrated* ownership" (La Porta, Lopez-de-Silanes, & Shleifer, 1999: 498, added italics). This is especially true in emerging economies, where recent research suggests that the crucial corporate governance conflicts are not principal–agent conflicts. Rather, the key conflicts are *principal–principal* conflicts between two classes of principals, namely, controlling shareholders (often a family or the state) and minority shareholders (Young, Peng, Ahlstrom, Bruton, & Jiang, 2008; see also Chang, 2006; Jiang, 2006).

A failure to understand the institutional nature of principal–principal conflicts governing the corporation in emerging economies may make corporate governance reform policies irrelevant, counterproductive, and, in the worst case, disastrous. For example, a primary internal governance mechanism is the board of directors. A standard prescription to enhance corporate governance is to increase the number of outside (presumably independent) directors on the board, who are hypothesized to be able to help improve firm performance. However, studies in China (Peng, 2004b) and Russia (Peng, Buck, & Filatotchev, 2003) fail to detect an empirical link between outside directors and financial performance. While the board of directors serves three primary functions – (1) control, (2) service (advising the CEO), and (3) resource acquisition – the emphasis in Anglo-American corporations is on control and monitoring of management. However, in emerging economies, the control function is typically ''window dressing'', since controlling shareholders (often a family or the state), by definition, do not really want to share control with anybody (Bruton, Ahlstrom, & Wan, 2003). The important functions of the board of directors are often service and resource acquisition, namely, tapping into the resources embedded in the networks and connections of directors (Filatotchev, Lien, & Piesse, 2005; Morck, Wolfenzon, & Yeung, 2005; Yeung, 2006; Young et al., 2001, 2008).

Another suggestion, originated in the context of Anglo-American corporations with diverse shareholders but few blockholders (large shareholders) and with managers having too many *de facto* control rights, is to increase the shareholding of blockholders (who are usually defined as anyone having more than 5% of the equity). This suggestion, if implemented in emerging economies, is likely to be disastrous, because the main problem there is that controlling shareholders usually already have had too much concentrated ownership and control rights, which allow some of them to potentially expropriate minority shareholders (Chang, 2003). In emerging economies, governance reforms need to find ways to *reduce* (certainly not increase!) such concentrated shareholding in the hands of controlling shareholders (Morck et al., 2005; Young et al., 2008).

Overall, it seems imperative that researchers pay more attention to the institutional antecedents and consequences of corporate governance in emerging economies, instead of simply applying the Anglo-American assumption of dispersed ownership and control, which does not coincide with the empirical realities in much of the world, especially in emerging economies (Jiang, 2006).

DISCUSSION

Contributions

This Perspective paper has:

(1) suggested that an institution-based view of IB strategy has emerged;
(2) argued that this view complements the existing industry- and resource-based views to collectively sustain a strategy tripod; and
(3) outlined as exemplars four diverse areas of research on emerging economies that push the frontiers of such thinking.

Three contributions emerge. First, instead of arguing for ''a fundamentally different way'' of thinking about IB strategy (Ricart et al., 2004: 175), we believe that an institution-based view represents a great deal of continuity with existing research, and that it is best viewed as complementing – but not substituting – the industry- and resource-based views. Its novelty lies in its attempt to *explicitly* add a missing leg in the strategy tripod. An institution-based view channels Leung et al.'s (2005) and Redding's (2005) call for a heavier emphasis on thick descriptions of the context, such as cultures and institutions, toward a clear strategic focus: how do such institutions impact on firm strategy and performance? It accommodates Teegen et al.'s (2004) call for more NGO research by conceptualizing NGOs as a part of the informal (nongovernmental) institutional forces, which can assert greater influence on IB strategy and performance. It also raises the aspirations set out in the focused discussion on emerging economies in previous Perspective papers by London and Hart (2004), Meyer (2004), and Ramamurti (2004). As emerging economies become increasingly important core contributors to the global economy, IB strategy research on emerging economies needs to have the ambition to contribute to the core (mainstream) literature (Meyer, 2006, 2007; Meyer & Peng, 2005) – in this case, through the articulation of the political, legal, and societal aspects in the strategy tripod.

Second, in a broad theoretical sense, the institution-based view of IB strategy also complements transaction cost and internalization theories (Buckley & Casson, 1976; Williamson, 2000). Two points can be made. (1) Theorists such as North (1990) and Williamson (2000) have always explicitly positioned transaction cost theory as part of the new *institutional* economics – a simple look at both labels, which sport the word ''institutional'', would suggest the possible convergence of these ideas. (2) The majority of transaction cost research and internalization research, primarily in IB, has taken place in developed economies. Such research naturally focuses on the micro aspects of institutions governing individual and corporate behavior (such as opportunism) (Williamson, 2000). While the macro aspects of institutions (such as country-level laws and regulations) are widely acknowledged to be a source of transaction costs (Buckley & Casson, 1976), they are usually regarded as "background". North (1990), La Porta et al. (1999), and other institutional economists have reminded us that such "background" needs to be brought to the forefront. Yet, owing to their disciplinary background, North (1990), La Porta et al. (1999), and others have not focused on how firms respond to the institutional frameworks from a strategy perspective. Pushing this line of thinking one step further, the institution-based view of IB strategy therefore directly connects the firm-level strategy-making processes with both the micro and macro branches of transaction cost research.

Third, the institution-based view of IB strategy is also consistent with the thrust of the recent literature on coevolution (Teegen et al., 2004: 474). The key question of coevolution research, "How do firms coevolve with their environment?" (Lewin & Volberda, 1999: 520), is similar to our question, "How do firms play the game, when the rules of the game are not completely known and changing?" The difference seems to be a higher degree of uncertainty associated with institutional transitions and environmental changes permeating many emerging economies (Peng & Zhou, 2005). Nevertheless, these transitions and changes can be broadly conceptualized as evolution of the environment, thus suggesting a possible convergence of the institution-based work advocated here and the broader coevolutionary research (Lewin, Weigelt, & Emery, 2004). It is certainly true that "studies of simultaneous evolution or coevolution of organizations and their environments are still rare" (Lewin & Volberda, 1999: 526). Almost all the work reviewed earlier focuses on how domestic and foreign firms strategically respond to the opportunities and constraints of institutional frameworks. As research on political strategies in developed economies (Ring et al., 2005) indicates, some firms actively seek to shape the "rules of the game" in their favor. While it is natural to expect firms in emerging economies (including some foreign entrants) to act similarly, how they do that, in a generally nontransparent political and regulatory environment, is both a significant challenge and an interesting opportunity in pursuing this research further (Lee & Oh, 2007; Lewin & Kim, 2004).

Future Research Directions

While the institution-based view is certainly applicable in developed economies, a focus on emerging economies is likely to generate more mileage for future research in IB strategy (Hoskisson et al., 2000; McMillan, 2007; Meyer & Peng, 2005; Peng, 2003; Wright et al., 2005). A fundamental challenge confronting multinational enterprises (MNEs) from developed economies is whether their traditional "global strategy" (standardization of products and services) can be extended and adapted with minimal changes to emerging economies. The traditional "global strategy" is built on business models profiting from the top of the global economic pyramid, namely, the one billion or so people (including a small percentage of high-income consumers in emerging economies) (Bartlett & Ghoshal, 1989; Yip, 1992). A focus on emerging economies calls for more strategic attention and new business models built on how to profit from the bottom of the global economic pyramid, that is, the four billion people each making less than $2000 a year (London & Hart, 2004; Prahalad & Hammond, 2002). In other words, simple adaptation and extension of the traditional "global strategy" may not be sufficient (Schlie & Yip, 2000; Tallman & Yip, 2001). Overall, emerging economies present a powerful challenge to the traditional "global strategy" (Peng, 2006). While there is some convergence between developed and emerging economies (such as cell phone usage), if Western MNEs only look at these aspects of convergence, they may be "trapped by their devices in gilded cages, serving the affluent few but ignoring the potential of the billions of new customers that attracted them in the first place" (Dawar & Chattopadhyay, 2002: 457). Despite significant regional and country differences, emerging economies may have enough common underlying logic to justify developing an alternative business model based on price–value trade-offs that are different from those in developed economies. It seems impossible to do that in emerging economies without an understanding of how formal and informal institutions affect firms – as well as managers, consumers, and policymakers – in these countries (Burgess, 2003; Doh et al., 2004; Meyer, 2004; Teegen et al., 2004). As a result, the new institution-based view of IB strategy will help promote and advocate such research.

A benefit from focusing on the strategies of domestic firms in emerging economies is that some of them may embark upon their own internationalization in the near future, thus becoming a new breed of MNE (Mathews, 2006; Peng & Delios, 2006; Ramamurti, 2004). How they internationalize, in addition to being influenced by industry- and resource-based considerations, is inherently shaped by the domestic and international institutional frameworks governing these endeavors. Given IB's traditional focus on MNEs from developed economies, we currently know very little about how firms from emerging economies internationalize (such as how they overcome antidumping regimes erected as entry barriers) (Khanna & Palepu, 2006; Wright et al., 2005). If the field aspires to remain globally relevant, it seems imperative that more research be devoted to these crucial strategic issues (Brouthers et al., 2005; Dunning, 2006; Mathews, 2006; Narula, 2006).

Practical Implications

In terms of practical benefits, an institution-based view can help firms in emerging economies enhance their competitiveness, especially when venturing abroad. They need to know more about the rules of the game abroad that may be different from the familiar rules at home. In China, at present executives at competing firms can legally sit down, discuss pricing, and carve up markets – a practice that has been labeled by US antitrust laws as "collusion" and outlawed for over 100 years. Imagine the shock these Chinese executives may generate when they venture abroad and approach competitors in the United States to discuss pricing.[11] They would be prosecuted by US antitrust authorities if they did that. Another example lies in the area of antidumping. Many Chinese firms are surprised that their low-cost strategies, following the playbook often from translated Western textbooks stemming from industry- and resource-based views (such as Porter, 1980), are labeled "illegal" and "unfair" dumping in the very countries whose scholars have preached about the virtues of "free market" competition. In reality, even in developed economies, "free markets" are a myth – markets are not necessarily "free". Executives from firms in emerging economies that venture aboard will ignore the institutional intricacies governing competition in developed economies at their own peril.

For foreign entrants in emerging economies, there are at least two benefits. First, given that the economic growth of most developed economies is stagnant, focusing on fast-growing emerging economies may generate significant growth potential for the entire MNE on a worldwide basis – not just emerging economies. For instance, approximately one-third of Volkswagen's and one-fourth of General Motors' worldwide profits now come from China alone (Tao, 2006).[12] A second practical benefit is that MNEs' new learning on how to tackle emerging economies may provide a strong growth engine not only for emerging economies but also for developed economies. For example, automakers such as GM and Honda are racing to develop $5000 entry-level car models for China. Given their inability to produce such models profitably in the United States and Japan, imagine the profit potential these developed-in-China models may have back home, where entry-level cars now sell for $10,000.

CONCLUSION

Overall, a growing number of scholars have come to realize that institutions matter, and that IB strategy research, especially in emerging economies (but also in developed economies), cannot just focus on industry conditions and firm capabilities (see Mahoney, 2005: 223). An institution-based view, in combination with the industry- and resource-based views, thus puts the strategy tripod on firmer ground. For scholars, taking institutions seriously is only a first step, working out the analytical logic is the second, and explicating the underlying mechanisms comes next (Williamson, 2000). We have just embarked on this journey, and a lot will come in future research on *how* institutions matter. In conclusion, an institution-based view of IB strategy, in combination with industry- and resource-based views, will not only help sustain a strategy tripod, but also shed significant new light on the most fundamental questions confronting IB, such as (1) What drives firm strategy in IB? and (2) What determines the international success and failure of firms?

In closing, we quote an influential recent paper by a leading IB scholar, John Dunning, who is not known as an "institutional theorist" (Dunning, 2004):

> I believe that current events are forcing IB scholars to pay more heed to Douglass North's concept of institutions (p. 19) … there can be little doubt that institution-related assets have become more important (p. 19) … I would hope that the fraternity of IB scholars will place these issues at the top of their research agenda over the next decade or so. If we do not do so, I believe that we will be failing both our students and the international community that we seek to serve (p. 24).

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NOTES

[1]For example, we recognize that political scientists have studied the organization of government for decades (March & Olsen, 1989). Indeed, there is a neoinstitutional school of political science that shares many concerns of an institution-based view of IB strategy. Nonetheless, there are far too few exchanges between management scholars (who are located primarily in business schools) and organizational theorists in political science departments and policy schools. Management scholars would do well to build bridges with researchers who have made government organization a major focus of their research (Ring et al., 2005).

[2]McMillan (2007) suggests that "the notion that institutions matter is as old as the study of economics," dating back to Adam Smith, who recognized that the state must define property rights and enforce contracts.

[3]The term "an institution-based view of business strategy" was first proposed by Peng (2002) and popularized by Peng (2006). Additional elaboration can be found in Lee et al. (2007), Meyer and Peng (2005), Peng (2003), Peng and Delios (2006), Peng et al. (2005), and Wright et al. (2005).

[4]This chosen focus on emerging economies does *not* imply that the institution-based view is not relevant for developed economies. See Ingram and Silverman (2002), Lewin and Kim (2004), Oliver (1997), and Ring et al. (2005) for examples of recent work on the application of the institution-based view in developed economies.

[5]While we acknowledge that many would argue that it is culture rather than institutions that need to be the focus of future research in IB (as noted by Reviewer 1), it is not our intention to engage in this debate in this paper.

[6]One example of an interesting substantive area is the recent World Bank studies on the time and monetary costs of setting up businesses around the world (Djankov, La Porta, Lopez-de-Silanes, & Shleifer, 2002). In general, governments in developed economies impose fewer procedures and a lower total cost. On the other hand, entrepreneurs confront harsher regulatory burdens in poorer countries. As expected, the more entrepreneur-friendly these formal institutional requirements are, the more entrepreneurship flourishes, and the more developed these economies will become – and vice versa (Le, Venkatesh, & Nguyen, 2006; Lee et al., 2007). Another example is research on business groups and conglomerates (Chang, 2006; Chung, 2006; Dieleman & Sachs, 2006; Guillen, 2000; Khanna & Palepu, 2000; Li, Ramaswamy, & Petitt, 2006a; Lu & Yao, 2006; Ma et al., 2006; Peng & Delios, 2006; Ramaswamy et al., 2004; Yiu et al., 2005).

[7]Another geographic region that has attracted significant research attention is Central and Eastern Europe. See Puffer and McCarthy (2003), Rona-Tas (1994), Sedaitis (1998), Spicer et al. (2000), Stark (1996), and Uhlenbruck and De Castro (2000) for some examples. This literature has been comprehensively reviewed elsewhere by Meyer and Peng (2005).

[8]During the discussion after an early draft of this article was presented at the Second Annual AIB/*JIBS* Conference on Emerging Research Frontiers in IB in September 2004, Alan Rugman commented that such a lack of published articles in *JIBS* concerning antidumping is a "systematic failure" of the *JIBS* review process. Drawing on his own experience of submitting four papers on antidumping during 1988–91 drawing on Canadian data in the 1980s, which were rejected, he suggested that the prevailing industry- and resource-based paradigms, which are dominant at *JIBS* (and presumably at AIB), have ignored and marginalized important institutional issues such as antidumping. The papers rejected by *JIBS* were subsequently published in international law journals (e.g., Rugman & Verbeke, 1990).

[9]We thank Arie Lewin, Editor-in-Chief, for suggesting this point.

[10]This does not mean that China does not have a lot of laws and regulations. It does. For example, in the first mandatory trade policy review (often known as a "peer review") by the World Trade Organization (WTO) for China in 2006, fellow WTO members commended China's comprehensive efforts to revise over 2000 laws and regulations to comply with its WTO commitments. However, many members expressed concern that despite China's efforts, *enforcement* remained problematic (WTO, 2006).

[11]When the first author taught in a leading EMBA program in China and introduced antitrust laws in the United States, virtually all Chinese EMBAs were surprised and were not aware of such US laws. The first author was equally surprised when told by EMBA students that such laws did not exist in China.

[12]These pieces of anecdotal evidence from Volkswagen and GM may not be generalizable to the entire population of MNEs based in developed economies. Rugman and Verbeke (2004) find that 320 of the 380 MNEs with data had an average of 80% of their sales in the home region (in developed economies). This implies that 20% of profits would come from all non-home regions, including China, on average. We thank Reviewer 2 for raising this issue. However, there are data documenting that an *increasing* percentage of sales and profits of these multinationals now comes from emerging economies (see Peng, 2006).

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