**Divergent patterns in institutional entrepreneurship of MNCs
in emerging economies**

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# Abstract

Purpose – Starting from a critical review of the International Business (IB) literature on institutional voids, we develop a theoretical framework that addresses the question of how and why MNCs from developed economies engage in divergent patterns of institutional entrepreneurship in emerging markets.

Design/methodology/approach – We combine IB’s concept of institutional voids with Comparative Capitalism’s insights into the institutional embeddedness of firm capabilities and institutional entrepreneurship. This theoretical cross-fertilisation is instrumental in developing a refined understanding of institutional voids and how MNCs proactively engage with them.

Findings – We emphasise the notion of institutional voids as a relative concept and, thereby, move away from an ethnocentric view of emerging markets as ‘empty spaces’ that are void of institutions. Our framework proposes that MNCs from liberal and coordinated market economies experience institutional voids differently and engage in different patterns of institutional entrepreneurship.

Research limitations/implications – The main limitation of our work is that we restrict our propositions to the country-of-origin effect and that we draw on anecdotal evidence only. Based on these limitations we call for a more comprehensive research agenda in our conclusion.

Social implications: The paper sensitises policymakers in emerging markets for the potentially different patterns of involvement of MNCs in their institutional environments. Specifically, we argue that MNCs may have a strong inclination to rebuild critical elements of their home country institutional setting in emerging markets. This touches upon questions of national sovereignty and highlights the need for emerging market policymakers to decide which kinds of institutional settings they would like or not like to see imported.

Originality/value: The paper provides a new and critical perspective of the mainstream International Business concept of institutional voids. Our key contribution is to highlight that the home country institutional context may substantially matter in how MNCs perceive and respond to institutional voids in emerging markets.

Keywords: Multinationals, emerging markets, institutional voids, institutional entrepreneurship, comparative capitalism

**Introduction**

This article aims to explore the divergent patterns in the institutional entrepreneurship of MNCs in emerging markets. Emerging market economies offer great business opportunities for multinational companies (MNCs) from developed market economies. The flip side of these opportunities are tremendous challenges with regard to reproducing firm capabilities and competencies as local institutional contexts may not provide institutional arrangements and the complementarities in which these advantages are embedded. Drawing on Comparative Capitalism (CC), we argue that MNCs do not passively adapt to such institutional environments but are oftentimes powerful actors who seek to change and create institutional environments in emerging markets through institutional entrepreneurship (IE). Moreover, we argue that patterns of IE will systematically diverge, depending on the home country institutional contexts of MNCs. This assumption builds on CC’s insight that firms from different market economies command different capabilities and competencies which are embedded in different kinds of relationships, forms of economic coordination and institutional arrangements. Thus, as firms from different types of market economies venture into the vastly different institutional environments of emerging markets, they will not only perceive different kinds of weak or absent institutional complementarities, but will also address them differently. Drawing on Hall and Soskice’s (2001) ideal types of liberal and coordinated market economies, we exemplarily theorise how and why MNC patterns of institutional entrepreneurship might diverge, depending on their home institutional context. We argue that MNCs from LMEs and CMEs differ in the ways they experience and engage with institutional voids. These propositions are also illustrated and supported by publicly available data and two interviews conducted at the German-Arab Chamber of Commerce and the German Embassy in Cairo[[1]](#footnote-1).

Our paper makes a contribution to both International Business (IB) and Comparative Capitalism (CC) research: Our first and main contribution relates to IB research. Most IB literature has focused on the passive organisational adaptation of MNCs when they face institutional misfit and distance in foreign business environments (Jackson and Deeg, 2008). By borrowing the concept of institutional entrepreneurship from CC literature, we contribute to an emergent body of literature on IB that has started asking how MNCs proactively respond to situations of institutional contradiction, distance or void (e.g. Cantwell, Dunning, and Lundan, 2010; Kostova, Roth, and Dacin, 2008; Kwok and Tadesse, 2006; Murray and Fu, 2016). Importantly, while a modest body of IB literature has started to explore how MNCs proactively respond to business environments in emerging markets – mainly understood through the concept of institutional void (e.g. Khanna and Palepu, 2010b) – this literature provides little systematic understanding of how and why MNCs experience of and response to institutional voids might differ. Our paper seeks to address this caveat by combining IB’s concept of institutional voids with CC’s insights into the institutional embeddedness of firm capabilities and its understanding of institutional entrepreneurship. In doing so, we contribute to IB’s understanding of how and why MNC perceptions and responses to institutional environments in emerging markets might differ.

At the same time, our paper also contributes to CC literature that has started asking how MNCs influence institutional change in host economies in general and in emerging market economies, in particular. CC literature has contributed to our understanding of how home and host institutional environments influence the behaviour of MNCs (e.g. Whitley, 2001b). CC literature also recognises that MNCs have considerable potential for impacting or changing the institutional environments of emerging markets (Morgan, 2009; Whitley, 2001a). So far, however, there is little systematic exploration of how and why MNCs might impact institutional change in emerging markets differently (Morgan, 2011). By theorising the effect of home institutional context on divergent patterns in institutional entrepreneurship of MNCs in emerging markets, we contribute to developing such an understanding.

The paper is structured as follows: Following the introduction, we review the literature on institutional voids, as this stream in IB literature has been most explicitly concerned with emerging market contexts and MNC responses to them. Building on CC, in the third section we develop propositions which relate divergent patterns of institutional entrepreneurship of MNCs to their home institutional context. We conclude the paper in the last section with a call for a new research agenda and discuss the critical nature of our research.

# Literature review: Voids and entrepreneurship

For more than a decade, IB research has recognised the importance of institutions for the behaviour of MNCs. It is probably accurate to state that the concept of institutional distance, mainly going back to the work of Kostova (1999) and Kostova and Roth (2002), has been one of the most prominent institutional theory-based concepts accounting for the behaviour of MNCs. While this stream has taught us a lot about how ‘institutional distance’ impacts, for example, practice transfers and their adoption and integration, this literature has shown only little interest in the specific institutional conditions of developing countries or emerging economies and how MNCs deal with these kinds of environments. Starting from this observation, we review the literature on institutional voids, which has been most explicitly concerned with emerging market contexts and MNC-responses to these contexts.

*Institutional voids and MNCs in emerging markets*

Literature on institutional voids has its roots in the research on the rise and success of business groups and family firms in emerging markets. The idea is that firms in emerging markets face particularly challenging business environments. Specifically, operating in emerging markets poses particular challenges to firm formation and growth as these business environments tend to be characterised by weak institutional settings and markets (Khanna and Palepu, 2000a, b, 2006; Khanna and Yafeh, 2007; Khanna, 2015). While *definitions* of institutional voids vary, they are generally understood as the “absence of specialised intermediaries, regulatory systems, and contract-enforcing mechanisms” (Khanna and Palepu, 2006: 62) giving rise to market failure and agency problems (Khanna and Palepu, 2010a, b). Market failures, in turn, can involve a wide range of markets, including markets for labour and capital (markets for inputs) as well as products and services (markets for outputs) (Dhanaraj and Khanna, 2011).

Regarding the question of how institutional voids impact *organizational responses*, the main focus is on how institutional voids impact theformation, evolution, governance and performance of firms in emerging markets. Mainly embedded in Transaction Cost Theory, the core *theoretical rationale* is that absent or weak institutions either forestall market transactions altogether or increase the cost of external market transactions to such an extent that internalisation becomes the transaction mode of choice. While early contributions in this stream focused on business groups in emerging markets (e.g. Castelacci, 2015; Khanna and Palepu, 2000a), more recent contributions have started to also look at MNCs (e.g. Alimadi and Pahlberg 2014; Khanna and Palepu, 2010b; Luiz and Ruplal, 2013; Parmigiani and Rivera-Santos, 2015). Probing deeper into MNCs’ organisational responses to institutional voids shows that different approaches are available. Khanna and Palepu (2010a, b) suggest a range of strategic responses that involve either an organisational adaptation to the emerging market context or an adaptation of the emerging market context to the organisation. Specifically, MNCs in emerging markets can: 1) ‘replicate or adapt’ home-market business models, 2) ‘compete alone or collaborate’ with competitors and other stakeholders, 3) ‘accept or change market context’, that is, by either substituting voids through internalisation (e.g. in-house training) or by stimulating market development (e.g. induce development of market intermediaries), and 4) ‘enter, wait or exit’ (Khanna and Palepu, 2010b: 87-91). Alimadi and Pahlberg (2014) emphasise the importance of establishing local networks and forging links not only with political actors, but also with local business elites, state-owned and private firms, as well as industrial and civil society organisations. In a similar vein, Luiz and Ruplal’s (2013) study demonstrates the need to build relationships and trust with host country governments, for example by engaging in social projects. Parmigiani and Rivera-Santos (2015) show that MNCs also establish collaborations with aid agencies and foundations to deal with institutional voids.

While the concept of institutional voids has increasingly been referred to in the field of IB, it has not been without criticism. Mair, Marti and Ventresca (2012) challenged, for instance, Khanna and Palepu’s notion of institutional voids as the absence of particular institutions. They argue that while formal (or regulatory) market institutions such as property rights or the judicial system may indeed be absent or weak in emerging market contexts, they tend to host a wide array of informal institutions (e.g. religious beliefs, trust, social norms, and patriarchal systems in local communities) that play a compensatory role for market creation, market functioning and business development. Hence, they argue that institutional voids are not institutionally ‘empty’ spaces, but only perceived as such by actors from developed markets.

*In sum*, the institutional voids literature provides a concept for capturing the institutional conditions in emerging markets. Recent contributions have analysed the different responses of MNCs to institutional voids in emerging markets, and started to explore how organisations in emerging markets, including MNCs, proactively engage with their institutional environment. However, the notion of institutional voids is discussed controversially. While Khanna and Palepu (e.g., 2010b) understand institutional voids as an absence of institutions, Mair, Marti and Ventresca (2012) argue that emerging markets are characterised by a dense web of informal institutions that might compensate for absent or weak formal institutions. Lastly, although there is recognition that MNCs have the potential to proactively engage with host context environments, little systematic attention is given to the question of how and why MNCs may differ in the way they do it.

# Drawing on Comparative Capitalism: Towards a framework

## *The institutional embeddedness of a firm’s competitive advantage*

One of Comparative Capitalism’s (CC) central building blocks is seeing a firm’s competitive advantage, that is, their capabilities and competencies as embedded in specific social relations and institutional settings. The most widely cited contribution in this regard is probably the ‘Varieties of Capitalism’ approach by Hall and Soskice’s (2001). Hall and Soskice (2001) distinguish two ideal types of market economies, that is, *coordinated market economies* (CME) and *liberal market economies* (LME). The vantage point for this distinction is conceptualising firms as the key actors in capitalist economies. Taking a relational view, capitalist firms are vested with capabilities or competencies which are constituted by certain types of internal and external relationships. These relationships pose coordination problems across different institutional domains including industrial relations, vocational training and education, corporate governance, interfirm- and employee-relations. These coordination problems can be resolved in alternative ways, that is, either through markets and hierarchies or through non-market and collaborative *forms of coordination*. Significantly, the different forms of coordination rely on different kinds of supportive organisations and institutional arrangements which are seen as complementary and path dependent in nature (Hall and Soskice, 2001). The gist of the approach is that different types of economic coordination and relations prevalent in the respective market economies are supported by corresponding kinds of institutional arrangements (Hotho, 2014). In short, firms operating in different types of market economies are embedded in different kinds of institutional complementarities that structure their organisational capabilities and competencies (see table 1).

|  |  |  |
| --- | --- | --- |
|  | **LME (e.g. UK, USA)** | **CME (e.g. Germany, Japan)** |
| Dominant form of coordination in firm relationships | Hierarchies and competitive market arrangementsArm’s length exchange in context of competition and formal contracting(Market competition) | Non-market and collaborative relationships Long-term exchange based on extensive relational or incomplete contracting, network monitoring(Strategic interaction) |
| Supporting institutions and organisations | Market coordination rests primarily on institutions that support high market competition and arm’s length relations through formal and complete contracting E.g. Markets and legal system, antitrust regulations  | Strategic interaction rests primarily on institutions that encourage (deliberative institutions) and support collaboration relations among actors by providing exchange of information among actors, monitoring of behaviour, and sanctioning defective behaviour E.g. Business or employer associations, trade unions, business networks, legal or regulatory systems  |
| Competitive advantage and competencies of firms | Easily transferable and switchable assets (i.e. assets whose value can be realised if diverted to other purposes) | Non-transferable or co-specific assets (i.e. assets that cannot be readily used for another purpose and assets whose returns depend heavily on the active cooperation of others) |

Table 1: Comparison of liberal and coordinated market economies

*Institutional entrepreneurship and its antecedents*

Notwithstanding the substantial variety in CC approaches, early contributions tended to emphasise the stability and homogeneity of institutional settings in national environments. In this view, firms were seen to be tied into coherent, complementary and stable institutional arrangements whose opportunities and constraints gave rise to similar organisational responses. In a similar vein, the firms’ relationships with their environment was seen as a rather passive and homogeneous response. Contrasting with early contributions, recent work has increasingly focused on the change of institutional environments (e.g. Campbell, 2004; Crouch, 2005; Hall and Thelen, 2009; Streeck and Thelen, 2005). This shift involves seeing firms as proactive agents in both maintaining and changing institutional environments (Hall and Thelen, 2009). With the increasing attention to institutional change, CC literature also adopted the notion of institutional entrepreneurship (Campbell, 2004; Crouch, 2005). In this body of work, IE is generally understood as the efforts of powerful actors to change institutions in their interest (Campbell, 2004; Crouch, 2005; Deeg and Jackson, 2007; Hall and Thelen 2009; Streeck and Thelen, 2005).

While CC perspectives recognise both exogenous and endogenous sources of institutional change and entrepreneurship, their main focus is on endogenous institutional change (e.g. Hall and Thelen, 2009; Streeck and Thelen, 2005). The main antecedents of endogenous institutional change, and consequently of IE, are associated with the characteristics of national institutional contexts and the characteristics of actors.

With regard to *contextual characteristics,* the focus is on the presence of institutional heterogeneity and complexity or contradiction and contestation in national institutional environments (Campbell, 2010; Crouch, 2005; Hall and Thelen, 2009). One of the central insights into the antecedents of institutional change and entrepreneurship in CC relates to the concept of complementarity, that is, the ‘institutional interconnectedness’ and the benefits that are associated with these relations (Campbell, 2010). Drawing on Deeg and Jackson (2007), Campbell (2010) argues that actors in certain institutions have come to rely on related institutions which provide certain benefits. As related institutions change and the more tightly coupled these related institutions are, the more actors will have an interest in engaging in institutional entrepreneurship (Campbell, 2010).

CC contributions also emphasise that certain actor types will be more able and motivated to engage in IE than others. Crouch (2005) argues that actors who can draw on different repertoires are more likely to adapt or create new institutions. Typically these are actors who can draw on hidden or dormant institutional repertoires from past experience, different repertoires based on their experience of operating in different action spaces or different repertoires based on their embeddedness in networks and structured relationships that provide them with access to the experience of other actors operating in other action spaces.

Lastly, CC pays attention to institutional change and entrepreneurship as a political process. Hall and Thelen (2009) see much of institutional entrepreneurship rooted in the failure of institutions to serve the interest of powerful actors in capitalist economies. In a similar vein, Campbell (2004) sees institutional change and entrepreneurship as rooted in conflicts over the control of valued resources, market dominance and power. Overall, CC scholars see IE as a political process, which tends to be triggered by conflict and struggle and is underwritten by power-relations and coalition-building among actors. While actors can use extant institutions creatively as resources to further their interest, their choices are not arbitrary but conditioned by extant institutional arrangements and the political coalitions that sustain them.

*MNCs, national institutional context and patterns of institutional entrepreneurship*

CC inspired studies have produced a substantial body of work that deals with the question of how the institutional home background of MNCs impacts their pattern of internationalisation and organisational constitution. At the same time, this work has also started to explore how emerging markets differ and how MNCs might influence institutional change in emerging markets. We discuss these two streams respectively.

*National institutional contexts and firm internationalisation:* CC scholars who have looked at the constitution of MNCs, particularly their subsidiaries abroad, have been focussing on the question of to what extent different aspects of organisation (structure, coordination and control, work systems, and production model) reflect home institutional environments (e.g. Ferner and Quintanilla, 1998; Ferner, Quintanilla, and Varul, 2001; Geppert, Williams, and Matten, 2003). While there is continuing evidence that the home country effect plays a crucial role in understanding the behaviour of MNCs in foreign markets (e.g. Geppert et al., 2003; Harzing and Sorge, 2003; Whitley, 2001b), there is equal evidence that the home country effect is moderated by a range of factors. These include, on the one hand, the question of to what extent an MNC or its subsidiaries are actually embedded in the home country context (e.g. Tüselmann, Heise, McDonald, and Allen, 2010), the institutional heterogeneity of practices of different firms in the home country (e.g. Morgan, 2009; Dörrenbächer, 2003) and the degree to which home country practices and their institutional complementarities are perceived as core capabilities or as a constraining competitive advantage (e.g. Dörrenbächer, 2003; Whitley, Morgan, Kelly, and Sharpe, 2003). Moderating factors include, on the other hand, a host of context related questions, that is, how strong, cohesive and diverse institutions are in the host context, and in particular, how permissive the host context is with regard to the import of foreign models, practices and related institutions (e.g. Whitley, 1998, Morgan, 2009). A crucial question is, for instance, whether specific transferred practices and models find complementary institutions in the host context or whether they are at least not in opposition to or incompatible with host institutional conditions (e.g. Geppert et al., 2003; Jackson and Deeg, 2008).

*MNCs and institutional entrepreneurship in host economies:* Finally, we would like to note that there is a small body of CC contributions that explores how international influences, including the activity of MNCs, impact and change the institutional environment in both developed and developing economies (e.g. King and Szelenyi, 2005; Morgan, 2011; Whitley, 1998; 2001a; Schaumburg-Müller, 2001). In this work, there is not only recognition that MNCs may have the ability and willingness to influence institutional environments in emerging markets but there are also suggestions under which conditions this is most likely to happen. Whitley (2001b) and Morgan (2009, 2011) relate this mostly to two conditions, the nature of FDI and the nature of the host economy itself. The *nature of FDI* includes the size of FDI flowing into a host economy, particularly in relation to total investment. It also includes the concentration of FDI in certain sectors, the kind of FDI undertaken and its diversity with regard to country of origin. The *nature of the host context* relates mainly to the openness of a host economy to FDI as well as the strength and cohesion of host institutions in an emerging economy (Whitley, 2001a, b; Morgan, 2009, 2011).

*In sum*, CC literature provides us with crucial building blocks to understand how and why MNCs might differ in their patterns of institutional entrepreneurship in host countries. It does so by emphasising the national institutional embeddedness of firm capabilities and competencies, by introducing the concept of institutional entrepreneurship and by stressing the importance of home country institutions in understanding the internationalisation behaviour of MNCs. In the following section we seek to integrate these elements into a coherent framework towards understanding divergent patterns of institutional entrepreneurship of MNCs.

## Research framework and propositions

IB literature, particularly the concept of institutional voids, has provided us with important insight into the nature of business environments in emerging markets and how firms, including MNCs, cope with them. At the same time, scant systematic attention has been paid to the question of *how and why MNCs* responses to these institutional voids may differ. In the following framework, we will first outline our understanding of institutional voids. Then, we will draw on CC to theorise as to how and why MNCs perceive and respond to institutional voids in different ways. We argue that CC literature provides us with a refined understanding why such patterns may differ, depending on the home institutional context.

*Institutional voids and MNCs*

The concept of institutional voids has recently gained currency in capturing institutional environments in emerging markets. At the same time, the concept has received criticism from institutionalist scholars (e.g. Mair et al., 2012). We share the criticism that there are no ‘institutional empty’ spaces in emerging markets. However, the concept of institutional voids is useful as a relative concept. Rather than arguing that institutional voids exist per se, we argue that voids become meaningful when seen in relation to a reference context. Hence, we define institutional voids as an MNC’s perception of absent or weak institutions in a host context based on their taken for granted home context. Drawing on insights from CC, we suggest that MNCs experience and perceive institutional voids when internal and external relationships that constitute their firm capabilities and competencies cannot be realised because of weak or absent institutions in the host context. In other words, emerging markets are by no means void of institutions. Instead, institutions such as the state, the military, the family and different kinds of communities based on kinship, ethnicity, religion and corresponding social norms, play a crucial role in constituting and coordinating economic relationships. However, institutional settings in emerging economies may indeed be experienced as void by foreign firms as specific economic relationships and forms of coordinating are difficult to realise in the absence of complementary institutions such as strong markets, market intermediaries, legal or regulatory systems and business associations or networks.

*Antecedents of MNC Institutional Entrepreneurship*

Following recent advancements in CC we define institutional entrepreneurship (IE) as the purposeful efforts of powerful actors to change institutions in their interest (e.g. Campbell, 2004; Crouch, 2005; Deeg and Jackson, 2007). Drawing on CC insights (Campbell, 2004; Crouch, 2005; Streeck and Thelen, 2005) into the crucial role of actor- and institutional context characteristics for IE, we expect MNCs to be likely candidates to engage in IE. Firms that internationalise with the intention of reproducing their home-grown competencies and capabilities may find that the institutional setting in the host context contradicts or does not provide the complementary institutions required for their reproduction. Exposed to such contradictions or institutional voids, MNCs may opt to engage in institutional entrepreneurship. In other words, MNCs may come under pressure to engage in IE, if a particular emerging market is perceived as economically attractive but not does not provide the complementary social relations and institutions required for the reproduction of home-grown competencies and capabilities. Hence, we argue:

*Proposition 1: MNCs engage in IE when they perceive an emerging market as attractive but experience its institutional context as an obstacle to reproducing their core capabilities.*

We acknowledge that MNCs may not always be motivated and able to engage in IE. As discussed above, this may be connected to the nature of the MNC, the kind of FDI it undertakes, as well as the nature of the host context. MNCs might, for instance, have limited resources, they may suffer from a liability of foreignness or from a lack of experience in entering foreign, especially emerging markets. In addition, MNCs might not intend to reproduce competences and capabilities (Dörrenbächer, 2003). At the same time, the host contexts might vary in their openness with regard to MNC political involvement in or their interference with domestic institutions (Morgan, 2011).

*Home country of MNCs and divergent patterns of institutional entrepreneurship*

Despite increasing recognition that market economies rarely, if ever, are constituted through a singular mode of coordinating economic activities (e.g. Deeg and Jackson, 2007), there is also continuing evidence that developed market economies differ substantially with regard to their dominant modes of economic coordination (e.g. Hotho, 2014; Schneider and Paunescu, 2011), and, importantly, that this difference matters with regard to the behaviour of MNCs (e.g. Djelic and Ainamo, 1999; Geppert et al., 2003; Harzing and Sorge, 2003). Detomasi (2015) argues, for instance, “that firms emanating from particular institutional environments would, at the very least, feel more comfortable when encountering similar institutional structures abroad, and would likely want to replicate those structures if and when they could” (Detomasi 2015: 691).

Based on these insights, we assume that the home institutional context is likely to have a particularly strong influence on IE when the success of foreign investments depends on reproducing home-grown capabilities and competencies. To capture divergent patterns of IE we focus on 1) institutional voids experienced and targeted, 2) actor diversity, collectiveness and coordination in IE, 3) dependence on other MNCs. We restrict our analysis to those three dimensions because they appear to relate most clearly to differences in market economies, that is, differences in firm capabilities and related forms of coordination and supporting institutional arrangements. In the following paragraph, we propose that CME and LME MNCs will differ in their patterns of IE in emerging markets. We expect these differences based on the assumption that LME and CME firms typically hold different types of capabilities and competencies. These different capabilities and competencies are crucial because they are not only the *source* of experiencing voids differently but they also provide divergent *means* for engaging with them.

*Institutional voids experienced and targeted:* Firm capabilities and competencies are a key source of IE because they are embedded in particular kinds of internal and external relations which are supported by specific types of institutions. Since the capabilities of CME firms, on the one hand, and LME firms, on the other, rely on different types of institutions, we assume that they experience institutional voids differently, even if they have entered the same emerging economy. Differences might surface in at least two ways. The first possibility is that CME (or LME) firms perceive an institutional void, which is not perceived as such by LME (or CME) firms, because the absent institution is not part of the home institutional context of the latter firms and is not relevant for the reproduction of their core capabilities. The second possibility is that an institutional void perceived by LME (or CME) firms is also perceived by CME (or LME) firms – but in a less intense way, because the CME (or LMEs) firms’ capabilities rely less on this absent institution. The resources that MNCs have at their disposal are usually considerable, but nevertheless limited. Hence, we expect that MNCs will devote most resources to the institutional voids that are considered critical for reproducing the core competencies of the particular MNC. Apart from that, we would like to emphasise that MNCs cannot be expected to “automatically” reproduce their home country institutional context. This is not only for the obvious reason that such an endeavour would be unrealistic, even for resource-rich MNCs, but also for the reason that their home market institutional context is an outcome of political processes between actors with potentially conflicting interests (Campbell, 2004; Hall and Thelen 2009). The implication of the political nature of institutions is that MNCs do not necessarily consider all their home institutions as conducive to the generation of their capabilities (e.g., strong trade unions) (Dörrenbächer, 2003). The lack of a particular institution will be only perceived as an institutional void when management of MNCs considers it essential for the generation of their core capabilities. In the following, we illustrate our argument that the different capabilities of CME and LME firms lead to correlating differences in the institutional voids experienced and targeted. We refer to German firms as exemplary cases for CME firms and US-American firms as exemplary cases for LME firms (Schneider & Paunescu, 2012).

A typical capability of many CME firms is to possess firm or co-specific assets which allow them to incrementally innovate in mature technology sector niches, which is also termed “diversified quality production” (Streeck, 1997). Such a production strategy relies on collaborative relationships between management and employees (internally) as well as between companies competing in the same industry (externally). This, in turn, is supported by several non-market institutions such as education and training systems, inter-firm relations or industrial relations. According to a report of the Federal Ministry of Education and Research (BMBF, 2013), for German firms the most important obstacle to overcome when they enter emerging markets via foreign direct investment is the insufficient development of vocational training and education. Without their home-country dual system of vocational training and development – which combines education at special vocational schools with on-the-job training and is supported by employers, unions and the state – the reproduction of the firms’ capabilities, employees with the task and industry-specific skills in this case, is hardly possible. As a result, it is this institutional void that has received considerable attention from German firms who are internationalising into emerging markets such as KHS and its partners as seen in the example below.

*‘The steel monster, Werner Gessner, has installed in Vietnam rattles relentlessly. A filling plant for canned beer, which operates almost 24/7 and produces 33,000 beer cans per hour. This is the ninth facility of its kind that Gessner’s employer KHS has sold to the Sabeco brewery in Ho Chi Minh City; the plant and machinery installer from Dortmund realises in Vietnam an annual turnover of up to 50 million Euro. Although the Vietnamese population’s thirst for beer remains unabated, local growth has reached its limits due to a lack of qualified personnel (…) ‘Many workers do not have the necessary qualifications for operating these highly complex facilities”, says Gessner, responsible for KHS in Asia. His customers expect the high-priced plant and machinery installer to provide also well-trained employees – and the Dortmund-based company has difficulties in training sufficient numbers. “Many of our customers therefore complain about considerable losses in efficiency.” (…) Gessner’s solution: in order to increase the vocational training standards, he and partners on site implement vocational education and training following the German model.’* (Imove, 2013)

In the same report by the Federal Ministry of Education and Research, there are also several examples of firms that exported the German model of vocational training to other emerging economies such as Brazil, Russia, India and China in order to develop a local workforce to reproduce their capabilities (BMBF, 2013). Similarly, Volkswagen China proudly reports on its website that it has, in cooperation with governments and educational institutions, set up centres in which employees are trained in accordance with the dual system used in Germany (Volkswagen, 2014).

Conversely, the capabilities which LME firms possess are rather switchable assets (e.g. general skills) that can be easily diverted to other purposes and which enable them to quickly seize opportunities in new growth areas or to quickly react to changing market conditions, often requiring the implementation of completely new business strategies. These capabilities are mainly embedded in hierarchies (i.e. within the firm) and arms-length relationships, which are supported by strong market institutions. The evidence shows that LME firms, such as from the US, operating in emerging markets, have experienced different institutional voids (Khanna & Palepu, 2006). The general picture seems to be that the institutional voids receiving most attention by US firms were the lack of market intermediaries and the insufficient protection of intellectual property rights, or to put it more generally, the lack of strong market institutions. With regard to market intermediaries, General Motors, after their entry into China, suffered from a lack of automotive finance providers, consumer and market research as well as logistics providers. Similarly, Monsanto in Brazil experienced a void in the form of a lack of finance providers for its customers and McDonald’s in Russia experienced a void in the form of insufficiently developed logistics providers. With regard to intellectual property rights, General Electric and Microsoft as well as Monsanto experienced and targeted the void of intellectual property rights that were not well-protected. Other voids perceived by General Motors and McDonald’s were the lack of capable suppliers and skilled employees that made the traditional arm’s length relations of LME firms with suppliers as well as with technical training institutions, difficult to sustain.

*To sum up*, the evidence indicates that CME firms, on the one hand, and LME firms, on the other, experience and target institutional voids differently. The dual system of vocational training and education, an institutional feature of several CMEs (especially of Germany), is a non-market institution (requiring long-term and strategic interactions between different kind of actors) which CME firms heavily rely on in order to reproduce their capabilities in emerging markets. We would like to stress that our argument is not that CME firms do not also rely on market institutions. Clearly, a weak intellectual property rights regime will also be perceived by CME firms as an institutional void that calls for attention. In comparison to LME firms, however, CME firms experience a lack of institutions which support long-standing and strategic non-market interactions between different actors as more threatening to their capabilities. Conversely, LME firms seem to devote more attention towards institutional voids which constrain strong market relations. The lack of non-market institutions such as the dual system of vocational education and training is not experienced by LME firms as an institutional void, because those firms do not rely on this institution for reproducing their capabilities and in addition, it is not part of their home-country institutional context. This is also reflected in a study by Fortwengel and Jackson (2016) on the transfer of apprentice-based training from a CME to an LME context. In the study the German president of a US subsidiary is quoted as saying:

*“If you talk about apprenticeships in Germany, everyone knows what you are talking about. Here in the US no one knows what you are talking about, nothing, this is basically non-existent. It is like a cell phone that has not been invented yet. And now I have to go and tell them what a cell phone is and what it can do. Well, and then they say, I do have a landline already”* (Fortwengel and Jackson, 2016).

Based on these considerations, we argue:

*Proposition 2: Compared to LME MNCs, CME MNCs will experience and target more those institutional voids that constrain the establishment of non-market and collaborative internal and external relationships.*

*Proposition 3: Compared to CME MNCs, LME MNCs, will experience and target more those institutional voids that constrain high market competition and arm’s length relations.*

*Actor diversity, collectiveness and coordination in IE*: Different firm capabilities and competencies are based on different kinds of relations and supporting institutions. CME firms rely to a large extent on non-market strategic interaction as coordination mechanisms for generating and sustaining their capabilities. When CME firms engage in IE, they often target voids that constrain the establishment of non-market strategic interaction, which are based on collaborative and long-term relations.

We expect these non-market strategic interactions to be constituted by a high degree of collectiveness, actor diversity and coordination. The IE of CME firms will involve several actors because building non-market relations and supporting institutions involves substantial investment in a collective good. Such an investment is difficult unless cost and risks are shared among a greater number of actors. What is more, to reproduce and sustain collaborative non-market strategic interactions, firms need to monitor behavior and sanction defective behavior, which is only possible if several actors are involved in the close collaboration. The IE of CME firms will involve a diversity of actors because setting up non-market relations is not only based on a close collaboration among a larger number of firms, but also on the interaction with non-market actors such as government agencies or business or employer associations. CME firm’s IE will often take a strongly coordinated form. In this regard, business associations or government agencies often play a facilitating role in initiating, coordinating and monitoring strategic interaction among the collaborating actors. In short, we expect the IE of CME firms to take the form of rather coordinated collective action involving diverse sets of actors. LME firms, in contrast, rely strongly on competitive market arrangements and hierarchies as coordination mechanisms for generating and sustaining their capabilities. Since they rarely target voids that constrain non-market strategic interaction, they can be expected to be less dependent on the availability of collaboration partners. If LME firms experience voids in the form of absent or weakly developed market intermediaries, they can also internalise these functions and, thereby, rely on hierarchies as a coordination mechanism.

Based on the different competencies and capabilities of LME and CME firms and the different institutional embeddedness of these competencies and capabilities, we do not only expect CME and LME firms to experience institutional voids differently, but also to differ in the ways how they fill the voids. To a large extent, the evidence gathered on the institutional entrepreneurship of CME and LME firms in emerging markets, and also developed markets, points in this direction.

For instance, in a recent study, Fortwengel and Jackson (2016) demonstrate the importance of inter-organizational networks for institutional entrepreneurship. More specifically, eight MNCs, mostly originating from CMEs, formed a network and transferred this organisational practice to a region in the US by collaborating with several local actors such as schools, colleges, and the State Department of Labor. The network acted as a governance mechanism to limit opportunistic practices, such as to poach skilled employees, and helped to pool resources to make this institutional project financially viable. The authors also point out that they did not expect that the same collaborative efforts were used by LME firms.

Another example is the institutional entrepreneurship of German firms in Africa. The initiative “AFRIKA KOMMT” (Africa is coming), was launched in 2008 with the goal of improving the technical and management skills of African employees and to provide the firms with better access to knowledge of African economies (AFRIKA KOMMT, 2014). The future managers are sent to Germany for one year, where they receive on-site training. Nineteen German partners companies are participating in this initiative. These companies also include competitors: for instance Bayer AG, Boehringer Ingelheim GmbH and Merck KGaA (pharmaceuticals), Daimler AG and Volkswagen AG (automobiles), ZF Friedrichshafen AG, Continental AG and Robert Bosch GmbH (automotive manufacturing). ‘AFRIKA KOMMT’ is not only supported by companies, but also by other actors such as the GIZ (Deutsche Gesellschaft fuer Internationale Zusammenarbeit / German Society for International Collaboration), a federal enterprise, which runs the programme on behalf of the initiative, the Federal Foreign Office as well as two independent charities, the Robert-Bosch-Stiftung GmbH and the Zeit-Stiftung SbR. This case of institutional entrepreneurship displays strong features of long-term strategic interaction as well as a high degree of collectiveness and actor diversity.

The way how LME firms in emerging economies engage in institutional entrepreneurship differs markedly from CME firms and the example outlined above. According to Hall and Soskice (2001), LME firms mainly rely on their coordination on market relations and hierarchies. However, reliance on classical market relationships is often difficult in emerging markets. This is, for instance, due to the lack of developed suppliers, distributors or highly-qualified employees. The evidence on US firms in emerging markets seems to indicate that they fill institutional voids in two ways. One way is to integrate activities such as McDonald’s in Russia or General Motors (GM) in China. McDonald’s outsources most of its supply chain activities. When entering the Russian market, however, McDonald’s realised that in many cases this was not possible. Because of the scarcity of capable suppliers they set up a plant, the so-called McComplex, to produce many food products (e.g., ketchup). They also established their own truck fleet due to the undeveloped logistics infrastructure. As a result, McDonald’s operations in Russia show a high degree of vertical integration, which is in sharp contrast to the company’s approach in the US. Similarly, GM integrated many supply chain activities in China: they built a plant with all-inclusive production and developed China’s first automotive finance provider (Khanna and Palepu, 2010b). This is consistent with the notion of Hall and Soskice (2001) that LME firms rely more than CME firms on hierarchy as a coordination mode. A second way to deal with institutional voids is collaboration, although on a limited scale. LME firms such as McDonald’s and GM operating in emerging markets also collaborate with local suppliers to increase their expertise (partly because their home-market suppliers are reluctant to enter these markets), or with universities to improve the training of local employees (Khanna and Palepu, 2006). This deviation from home-country practices is required to compensate for the institutional voids in emerging markets and it is likely that these are close and long-standing collaborations. This being said, the collaborations are usually only bilateral (with suppliers, joint venture partners, or training and education institutions) and do not show the high degree of collectiveness that characterises institutional entrepreneurship initiatives of CME firms in emerging economies. Collaborations between competitors, for instance are, unlike in the case of CME firms, hardly existent.

*To sum up*, we see marked differences in the way how CME firms, on the one hand, and LME firms, on the other, fill institutional voids in emerging markets. While there are indications that the way in which LME firms address institutional voids in emerging markets deviates from the coordination mode in their home-market context, they still differ significantly from CME firms. Specifically, when compared to CME firms, the IE initiatives of LME firms are characterised by a lower degree of collectiveness and actor diversity and a higher degree of internalisation. Similarly, their reliance on strategic interaction as a coordination mode in emerging markets is also less pronounced than in the case of CME firms. We therefore assume that:

*Proposition 4: Compared to LME MNCs, CME MNCs will have a higher propensity to engage in IE that involves high levels of actor diversity, collectiveness and coordination.*

*Proposition 5: Compared to CME MNCs, LME MNCs will have a lower propensity to engage in IE that involves high levels of actor diversity, collectiveness and coordination.*

*Dependence on other MNCs:* In earlier work, CC scholars already suggested that the size of FDI flowing into a host economy in relation to total investment, its sectoral concentration and the home context diversity of MNCs investing in a country have a potential impact on the ability of MNCs to engage in institutional change in the host context (Whitely 2001b; Morgan 2009, 2011; Geppert and Hollingshead, 2014). We would like to specify this argument further by pointing to the potentially different dependence of MNCs on other MNCs from the same market economy. As outlined above, CME MNCs require long-standing collaborative relationships and institutions to support them, in reproducing their core capabilities. Following from proposition 4, CME MNCs need the support and collaboration of several partners to fill such voids effectively. It implies that unless CME MNCs find a critical mass of potential collaboration partners with a similar voids perception in a given emerging market, they will not be able to engage in collective and coordinated IE. This contrasts with LME MNCs who rely less on collaboration partners for their IE. Specifically, addressing the absence of market intermediaries, which LME MNCs usually perceive as a particularly critical void, requires less collaboration.

Evidence gathered on the attempts of German firms to fill the institutional void of vocational training in Egypt supports this line of reasoning. The evidence is based on an interview conducted with the Executive Director of the German-Arab Chamber of Industry and Commerce in Cairo in 2014. In the interview he stated that the limited number of German companies in Egypt has serious implications for their capability in dealing with institutional deficiencies. A central void in the Egyptian economy from the perspective of German firms is the lack of skilled employees. To a large extent, they fill this void by offering an internal training programme to employees or, to put it differently, by internalisation. When asked whether there is no interest among German firms in setting up a collaborative initiative to address this institutional void, the chamber’s chairman responded:

*‘Yes, the interest is there. We have also already considered establishing a technical vocational education centre linked to the chamber, but the funding of such an initiative is currently infeasible due to the lack of firms that are able to finance this.’*

This shows that the approach best suited for filling this void – a collaborative approach of companies to set up an industry-wide training and education programme emulating the German dual system – is not considered feasible due to the relatively small pool of CME firms in this emerging market. This does not mean that they do not fill this void; but the filling of the void is suboptimal in the sense that it does not allow firms to provide their employees with a comprehensive training and education, modelled on the dual system of their home country, which encompasses both firm- and industry-specific as well as practical and theoretical knowledge. Such a context makes it quite difficult for CME firms to adequately reproduce their core capability of diversified quality production. Hence, we assume:

*Proposition 6: To fill institutional voids perceived as critically important for the reproduction of core capabilities, CME MNCs are more dependent on the availability of other MNCs from the same type of market economy to collaborate with than LME MNCs.*

*Proposition 7: To fill institutional voids perceived as critically important for the reproduction of core capabilities, LME MNCs are less dependent on the availability of other MNCs from the same type of market economy to collaborate with than CME MNCs.*

# Conclusion

Reviewing the literature on institutional voids in the field of International Business, we showed that so far no systematic effort has been made to understand how and why MNCs experience and respond to institutional voids differently. Drawing on Comparative Capitalism, we presented an analytical framework proposing that MNC patterns of institutional entrepreneurship may differ systematically based on the firm’s home institutional context. More specifically, we argued that CME MNCs will perceive and respond to institutional voids in emerging markets differently to LME MNCs. Given that emerging markets are increasingly important for MNCs from developed economies and that the experience of institutional voids in those markets represent important obstacles to growth for these firms, this insight is a significant contribution to International Business research.

Our framework also has important implications for critical International Business research for at least two reasons. Firstly, we share the view with institutional scholars such as Mair, Marti and Ventresca (2012) that emerging markets might have an abundance of institutions that potentially support market transactions. Hence, to see emerging markets as ‘empty spaces’ with regard to institutions appears to us as an ethnocentric view. Instead, we understand institutional voids as a relative concept, which is meaningful when seen in relation to a reference context. When entering emerging markets, MNCs from developed markets perceive institutional voids because the *specific* institutions they rely on in their home countries, and often in many other developed economies, are weak or absent. Such a notion of institutional voids does not rule out that some emerging markets are characterised by institutional settings that are significantly different from developed economies but are nevertheless conducive to market transactions and, thereby, not on a lower level of institutional development than developed economies. Second, our research holds implications for policy makers in emerging markets. The framework we presented suggests that MNCs seeking to reproduce home-grown capabilities and competencies may have a high propensity to reproduce critical elements of their home country’s institutional system when entering emerging markets. While this is not necessarily detrimental to the development of a particular emerging market, policymakers should bear in mind that MNCs engage in IE to advance their own interests. Policymakers, therefore, need to consider whether the ‘export’ of such institutional elements is in their country’s best interest. As CMEs and LMEs have different implications for various stakeholders – for instance, that employee representatives are usually in a stronger position in CMEs and investors in a stronger position in LMEs – this is worthy of consideration. This last point harks back to understanding IE as a political process in which MNCs as powerful actors use and seek resources to further their interests. These MNC interests are not necessarily aligned with those of the host context.

Finally, we are just at the outset of developing a better understanding of how and why MNCs diverge in their patterns of IE in emerging economies and how this will impact emerging economies differently. Future research clearly needs to move beyond anecdotal evidence. It could involve both in-depth and comparative case studies to generate more informed propositions as well as testing propositions in a quantitative survey.

Furthermore, the question of how and why MNC engage in different types of IE calls for a broader research agenda exploring a wider range of potentially relevant factors. While we think that home country context has a strong impact on how and why MNCs engage in divergent patterns of IE, we are equally aware that there is a range of other factors that systematically play into such divergence. CC literature suggests, for instance, that home context is not constituted by singular logics of economic relationships and coordination. This perspective suggests a focus on the effects of specific sectors and industries within and across countries. Similarly, firm variation such as different MNCs strategies, MNC experience, subsidiary roles, modes of control and integration, modes of entry and size of foreign investment will equally influence the ability and willingness of MNCs to engage in IE. Lastly, there is a range of host context-related factors that play into the ability and willingness of firms to engage in IE. Emerging markets differ in the scale and scope of FDI which they receive and in their dependence on it. Emerging market contexts also vary with regard to the strength and cohesion of their institutions which equally translates into varying openness to institutional entrepreneurship by foreign firms (e.g. Morgan, 2011; Zang and Whitley, 2013). Zang and Whitley (2013) argue, for instance, that emerging economies in Asia varied substantially with regard to state direction of the economy and degree of business coordination of economic activities. It is not hard to imagine that different forms of capitalism in emerging markets go along with a different openness for the IE of foreign firms. It can also be surmised that some patterns of IE by foreign firms are more compatible or complementary with pre-existing relations and institutions in the host environment than others. In summary, understanding divergent patterns of IE in emerging markets calls for a comprehensive research agenda that systematically explores the interplay of firm, industry and country variance.

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1. Both interviews were held on 25.08.2014 and lasted for about an hour. The interview at the German-Arab Chamber of Commerce was held with the Chamber’s Executive Director. The interview at the German Embassy was held with the Head of the German Embassy Economic Department in Cairo. [↑](#footnote-ref-1)