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The Influence of Institutional Complexity on the Internationalization Plans of Corporations from Emerging Markets

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Abstract

The internationalization practices of corporations in emerging economies challenge traditional perspectives, prompting a steady refinement of institutional complexity theory in recent years to elucidate the export-oriented internationalization behavior of these enterprises. Institutional complexity occurs when many institutional logics conflict inside the institutional context, prompting enterprises to exhibit diverse behaviors in the face of institutional limitations. The absorption effect and the statute effect show that institutional complexity and firms' desire to export are linked in a way that looks like an upside-down U. As the institutional complexity of the home environment diminishes, firms adopting avoidance-oriented export strategies are more likely to pursue expansion in international markets rather than compete domestically.

Keywords

Institutional Complexity; Institutional Restrictions; Firms in Emerging Economies; Exports.

1. Introduction

Over the past fifty years, extensive theoretical analysis and empirical investigation have enabled Western enterprise management research, particularly by North American researchers, to establish a more coherent framework of management theory. International mainstream management theory is categorized into four components: (1) the exchange theory, (2) the environmental correspondence theory, (3) the boundary crossing theory, and (4) the enterprise growth theory. The environmental correspondence theory encompasses the institutional perspective, strategic perspective, co-evolutionary perspective, and ecological perspective. Raymond Vernon previously noted that the trend towards transnationalization is generally perceived as analogous regardless of the parent company's nationality; however, some research suggests that the formal institutions of the home country influence both the motivation of firms to internationalize and the internationalization process itself. Research on this issue is primarily categorized into two domains: firstly, it is contended that governments in emerging markets devise economic policies to encourage outward foreign direct investment (OFDI) and, at the institutional level, serve to mitigate the competitive disadvantages faced by emerging market firms in global competition. Conversely, it has been posited that institutional limitations in the home nation induce "institutional flight," a mechanism for evading these constraints. The notion of system flight was initially introduced by Oliver (1991), who noted that organizations select suitable corporate strategies based on their internal resources and external institutional context, which encompasses avoidance techniques. Within the framework of globalization, outward foreign direct investment (OFDI) serves as the primary mechanism for enterprises to implement their avoidance tactics; hence, an increasing number of firms may contemplate exiting the domestic market and pursuing international investments when the home country's system is ineffective.

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As multinational corporations in emerging economies persist in their internationalization efforts, the innovative management methods and business models developed throughout this process present a significant challenge to conventional Western views. The growth of institutions in emerging markets encompasses various levels of institutional features that can either promote or obstruct market-based changes. When the components of the system progress at disparate rates, intrinsic frictions and conflicts emerge among the different dimensions. Lu Yadong (2015) posits that current institutional theories inadequately account for the institutional complexity arising in emerging markets, exemplified by China, which undergoes institutional reform and development.

This paper aims to examine the influence of institutional complexity on the internationalization strategies of firms at the macro level, considering their unique characteristics and resource endowments, as it is challenging to elucidate why various international firms in the same emerging market adopt divergent internationalization strategies at the micro level due to macro-level institutional complexities affecting their strategies at the intercontinental or national level. This paper seeks to examine how firms' unique characteristics and resource endowment influence their perceptions of institutional complexity, thereby impacting their internationalization strategy choices based on their internal views of institutional heterogeneity. The institutional complexity in emerging markets encompasses four dimensions: multidirectionality, heterogeneity, variability, and ambiguity. This research aims to examine the internationalization process of enterprises through the lens of institutional complexity as a whole. This article examines the influence of institutional complexity on the internationalization strategies of Chinese firms, focusing on exporting as a significant avenue for internationalization and globalization in emerging market enterprises.

2. Theoretical Framework

2.1. Institutional Complexity

Institutional complexity arises when an organization encounters numerous, conflicting institutional logics. Institutional logic is the comprehensive framework of concepts that delineates the interpretation of organizational operations, defines appropriate organizational behavior, and outlines pathways to success. Organizations frequently encounter multiple logics that are not recognized as compatible, resulting in significant incompatibilities in their prescriptions and prohibitions, thereby generating challenges and conflicts for the businesses involved. The pattern of institutional complexity encountered by organizations is not static; rather, its nature is shaped by processes inside the organizational area. Institutional complexity evolves throughout time, and the kind and severity of the institutional complexity encountered by organizations vary as their position within the field shifts.

Organizations encounter differing levels of institutional complexity, and their coping mechanisms can substantially influence society, thus influencing their access to essential resources. Weilei Shi (2017) introduces the notion of institutional vulnerability, akin to the idea of institutional complexity. He contends that when various features of institutions do not progress at an equivalent pace, intrinsic friction and conflict may emerge during institutional development. This institutional fragility may compel a corporation to abandon its native nation as a strategic reaction. By analyzing Chinese firms, he discovers that provincial institutional vulnerability correlates with an uptick in OFDI decisions, a relationship that diminishes when firms exhibit greater productivity, are state-controlled with elevated shareholding, or possess extensive export networks. This article examines how corporations react to challenging conditions, emphasizing the importance of understanding their views of institutional complexity to inform their internationalization behavior.

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2.2. Institutional Limitations

The institutional base approach typically regards institutions as the regulations that enterprises must adhere to in their production processes, the expectations and demands of their geographical context, and the institutional pressures compelling firms to conform to local rules, conventions, and perceptions. This institutional pressure encompasses both the formal institutional level (such as regulations, laws, and market systems) and the informal institutional level (including traditional practices, ideologies, and ethical norms). The primary rationale for institutional flight is that several enterprises from emerging markets pursue outward foreign direct investment (OFDI) to evade the institutional limitations of their home nations. In response to institutional complexity, corporations lacking institutional advantages in their home nations opt to invest internationally; nevertheless, the decision to invest in higher or lower-tier markets is contingent upon additional factors, including the firm's competitive and innovative capabilities.

Research on the influence of formal institutions on the internationalization behavior of firms in China has concentrated on the fragmentation of the market system and the legal framework. The evolution of enterprises has resulted in increased institutional complexity due to the market and legal systems, particularly evident as dysfunction in China, which obstructs enterprise growth and encourages institutional flight behavior. Zhang Jie (2015) asserts that in provinces or regions characterized by significant market segmentation in China, enterprises possessing robust creative capabilities and elevated productivity are compelled to opt for exporting to overseas markets. China's inadequately developed legal system is marked by considerable regional disparities in the quality of the institutional framework that facilitates wealth accumulation, since the degree of protection afforded by magistrates and the efficacy of enforcement differ across locations. Domestic non-state enterprises in China, having limited influence over legal institutions and greater benefits from an advanced legal system, will perceive institutional complexity in a manner that affects their internationalization behavior, prompting them to relocate activities to countries with more developed systems to mitigate transaction and risk costs.

At the level of informal institutions, social networks and trust, as two significant manifestations of informal social capital, have emerged as crucial complements to formal institutions in emerging countries. Relationship networks are increasingly recognized as standard norms and rules of conduct in Chinese enterprises, significantly constraining their output and business operations. Social relationships, primarily sustained through banquets and gifts, often foster corruption and intensify competition, along with various rent-seeking behaviors outside the realm of business, thereby increasing the non-operational costs of the enterprise to the detriment of its long-term growth.

Per the rationale of institutional flight, when the formal and informal systems in a home country conflict with the developmental needs of enterprises, these enterprises will opt to relocate to foreign markets with more robust institutional frameworks. Additionally, the motivation for enterprises in countries or regions exhibiting greater resistance to institutional flight is correspondingly intensified.

3. The Influence of Institutional Complexity on the Internationalization Behavior of Organizations

3.1. The Influence of Institutional Complexity on Enterprises' Export Behavior

Organizations are seen as examples of adaptive systems, necessitating that these systems align with the complexity of their environment in a distinctive manner. Organizations employ two potentially conflicting techniques to navigate institutional complexity: complexity absorption

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and complexity reductio ad absurdum, both of which interact with businesses' exporting behavior.

The initial principle is the absorption impact, utilized to elucidate why companies augment exports in a context of elevated institutional complexity. Traditional research typically posits that exporting organizations pursue an expansion-oriented strategy, suggesting that only those with superior productivity, competitiveness, and innovation capacity can engage in internationalization. These organizations possess the capability to navigate the complexities and risks of foreign markets, manage foreign obligations, and excel in international markets. Nevertheless, the conduct of exporters adopting an avoidance-oriented strategy is often overlooked, as these firms navigate institutional complexity by perpetually establishing networks of external risk mitigation opportunities, primarily motivated by a desire to evade irregular and underdeveloped institutional settings. Consequently, certain enterprises in emerging markets, confronted with the dangers and uncertainties inherent in high complexity, opt to pursue overseas markets for risk mitigation. These export-oriented behaviors can be perceived as an escape-driven export strategy to mitigate the challenges posed by the institutional environment. The export strategies of emerging market firms are significantly influenced by the institutional environment. Given that institutional complexity is widespread and alterations in this environment manifest across various dimensions and indicators—encompassing both elements that enhance and those that hinder improvement—the uncertainty stemming from this complexity leads firms to favor an export strategy for international market expansion.

The second rationale is the reversionary impact, which elucidates how institutional complexity hinders enterprises from accessing overseas markets. Companies in developing markets must not only undertake the external obligations of the host nation but also navigate the limits imposed by both official and informal institutional frameworks stemming from the institutional intricacies of their home country. As institutional complexity in the home country escalates, the costs for firms to navigate the domestic political landscape increase, thereby complicating export activities and diminishing competitiveness abroad, which subsequently hampers their capacity to penetrate international markets.

Certain researchers have integrated the two differences and identified an inverted U-shaped correlation between institutional complexity and enterprises' inclination to export, as illustrated in Figure 1.

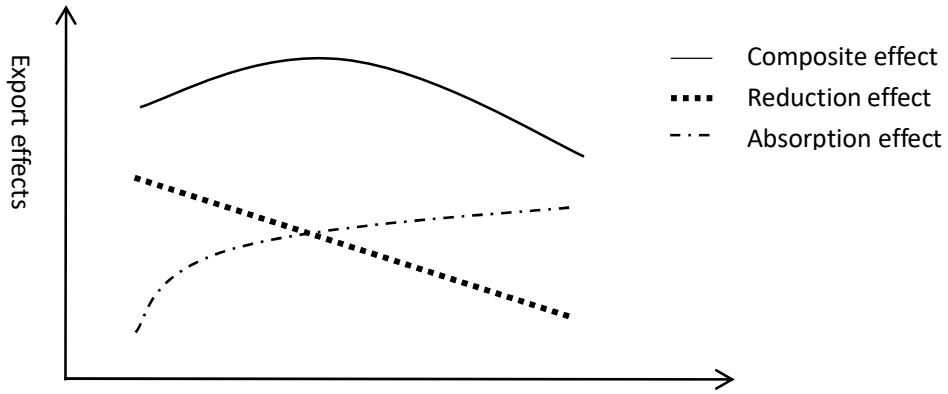


Figure 1. Political intricacy in the export effect curve

3.2. Influence of Institutional Complexity on Export Intensity

Export intensity (EI), a frequently utilized metric for export performance, is the proportion of a firm's export sales to its overall sales revenue. A reduction in the institutional complexity of

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the home country diminishes incompatible logics within the institutional framework, decreases trade frictions and governmental restrictions, and enhances factor markets, commodity markets, and the legal environment, thereby lowering costs for firms. This encourages greater market entry, culminating in increased competition. Expansion-oriented enterprises find the domestic market increasingly appealing; however, organizations employing an escape strategy are more likely to depend on international markets rather than engage in the domestic market amidst fierce competition. The optimization of institutional complexity can result in more advantageous export policies, reducing enterprises' export expenses. Consequently, it may be anticipated that in an environment characterized by diminished institutional complexity, expansion-oriented firms will exhibit less sensitivity to augmenting their export intensity compared to avoidance-oriented enterprises.

Due to the correlation between domestic sales and exports, an increase in the complexity of the home country's system may lead some non-exporting firms in emerging markets to eschew strategies aimed at international market participation, in accordance with the complexity of the absorption effect. The level of product uniformity among developing market firms within the same industry is significant, hence exacerbating competitiveness among existing export enterprises.

3.3. The Moderating Role of Business Ownership

The ownership structure directly reflects the institutional context and features of each country or region, with both public and private ownership models being popular in rising countries. In emerging economies, private enterprises frequently encounter challenges and impediments associated with the institutional framework, stemming from deficient market institutions, inadequate legal security mechanisms, and insufficient political transparency. They possess diminished influence over governmental institutions and are less capable of capitalizing on the political landscape, which further incentivizes enterprises to adopt evasion-oriented export strategies. The diminutive scale of private enterprises and their adaptable production structures facilitate their responsiveness to international markets.

In contrast to private enterprises, state-owned enterprises (SOEs) are substantial, possess preferential access to resource allocation, exhibit greater competitiveness in the domestic market, and are more prone to receiving extensive institutional backing owing to their crucial function in sustaining a nation's economic stability, enhancing employment, and augmenting social welfare, thereby diminishing the motivation for SOEs to engage in export activities.

4. Conclusion

This research examines how institutional complexity influences the nationalization strategies of developing market corporations from a theoretical standpoint. From the standpoint of the institutional environment in conventional international management theory, it is observed that the various institutional characteristics inherent in the development of emerging market institutions may either promote or obstruct market-oriented reforms. Institutional complexity occurs when various elements of the system change at differing rates, and this research examines the influence of institutional complexity on the export strategies of enterprises from the perspective of micro-firms. This research presents two logics of political complexity influencing exports and elucidates the effect of institutional complexity on enterprises' export intensity. Simultaneously, as corporate ownership directly mirrors the institutional environment to some degree, it offers more insights into how ownership influences the export behavior of enterprises in emerging regions.

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