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PERSPECTIVE

# Informal institutions and the international strategy of MNEs: Effects of institutional effectiveness, convergence, and distance

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**Abstract**
Informal institutions influence all aspects of international business (IB), but they have received limited attention in the literature relative to formal institutions. This article extends prior IB work by examining the relationships between several key formal and informal institutional factors and the international strategy of MNEs. First, it examines the direct effects of formal and informal institutional effectiveness, convergence, and distance on MNE local adaptation, developing arguments and propositions for each relationship. Second, it focuses on the interactions of formal and informal institutional effectiveness and convergence to develop an eight-fold typology of market institutional configurations. This typology depicts the role that informal institutions take in a market depending on the interaction of these three institutional factors. Third, it builds on these interactions and the concept of institutional distance to develop a conceptual framework of market and MNE institutional diversity and dynamism. This framework captures the formal and informal institutional relationships *within* a home market, host market, parent firm, and foreign subsidiary, as well as the formal and informal institutional relationships *across* each of these entities over time. In so doing, this article helps advance research on informal institutions and IB, which can lead to considerable future work on the topic.
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## INTRODUCTION

Research in international business (IB) has devoted considerable attention to the institutional environment, understanding how critical it is for business across markets (e.g., Chacar, Newburry, & Vissa, 2010; Danis, Chiaburu, & Lyles, 2010; Dau, Moore, & Kostova, 2020; Eden, 2010; Kostova, 1997; Kostova, Roth, & Dacin, 2008; Verbeke, Tulder van, Rose, & Wei, 2021; Xie & Li, 2018). Institutions are the socially constructed rules that enable and constrain human interaction (Clemens & Cook, 1999; North, 1990, 2005). They are made up of written or formal institutions, such as laws and regulations. Also present are unwritten or informal institutions, such as norms of behavior, customs, and traditions (North, 1990, 1991, 2005; Pejovich, 1999; Sartor & Beamish, 2014; Sauerwald & Peng, 2013). More specifically, informal institutions are unwritten rules that serve to provide collective societal expectations for social interactions and behavior (Helmke & Levitsky, 2004, 2006).

The literature has devoted considerably less attention to informal institutions than to formal institutions (Estrin & Prevezer, 2011; Martin, 2014; North, 1990, 1991, 2005; Pejovich, 1999; Sartor & Beamish, 2014; Sauerwald & Peng, 2013). Even a basic search in Google Scholar for articles published in *JIBS* with the word "institution(s)" appearing in the title provides 50 results, whereas the same search for the term "informal institution(s)" provides 1 result (Cao, Li, Jayaram, Liu, & Lumineau, 2018), not including articles appearing in this special issue (SI). This in itself shows a clear gap in the literature, as there is a disproportionate amount of work in IB on formal institutions, when compared to the sparing work on informal institutions. A more thorough review does yield a few more articles on the topic, but this basic search helps to illustrate the relative paucity of work on the topic in our field.[1] This is regrettable, as informal institutions can be as meaningful as formal institutions for IB (Chacar, Celo, & Hesterly, 2018; Kuilman & Li, 2009; Li, Yang, & Yue, 2007), and in some markets, such as those in the developing world, can be much more so (Estrin & Prevezer, 2011; Khanna & Palepu, 1997, 2000; Li & Fleury, 2020; Verbeke & Kano, 2013). This dearth of work on the topic is likely due to the challenges that researchers have faced in terms of conceptualization and measurement of informal institutions. At the same time, we were unable to find much work across journals on informal institutions and IB prior to 2003, suggesting that the topic is relatively new to the IB literature, spanning less than two decades.

Furthermore, of the limited IB literature on informal institutions, one of the concepts that has received the most attention is that of informal institutional distance (e.g., Aguilera-Caracuel, Hurtado-Torres, Aragón-Correa, & Rugman, 2013; Estrin et al., 2007; Kostova, Beugelsdijk, Scott, Kunst, Chua, & Essen van, 2020; Sartor & Beamish, 2014; Schwens, Eiche, & Kabst, 2011). In terms of formal institutions, two of the concepts that have received the most attention are formal institutional effectiveness/voids (e.g., Doh, Rodrigues, Saka-Helmhout, & Makhija, 2017; Khanna & Palepu, 1997; Palepu & Khanna, 1998) and formal institutional distance (e.g., Abdi & Aulakh, 2012; Dikova, Sahib, & Witteloostuijn Van, 2010; Kostova et al., 2020). We incorporate each of these concepts in our study. However, we go beyond these concepts in our article by examining other largely neglected aspects of informal institutions, as well as the relationship between formal and informal institutions, and how they impact international strategy.

In addressing these gaps in the extant literature, this article makes several contributions. First, it extends Helmke and Levitsky's (2004) seminal work by considering variation in the degree to which informal institutions are meaningful and important in a given market. This leads directly to the development of the concept of informal institutional effectiveness, to complement the concepts of formal institutional effectiveness, and formal–informal institutional convergence. Second, it connects this to the IB literature by developing theoretical arguments for the effects of several key formal and informal institutional concepts on international strategy. Third, it further extends Helmke and Levitsky's (2004) work by proposing a three-way typology of informal institutions. Fourth, it proposes a conceptual framework capturing the institutional dynamics of markets and multinational enterprises (MNEs). In short, the article contributes to the literature by consolidating, synthesizing, and extending prior work.

The remainder of this article is organized as follows. Section two provides definitions, examples, and a discussion of the main concepts of the study. Section three develops theoretical arguments and propositions for the direct effects of formal and informal institutional effectiveness, convergence, and distance on MNE local adaptation. Section four puts forth a typology of market institutional configurations, based on the interactions of formal and informal institutional effectiveness and convergence. It then incorporates the concept of institutional distance to develop a framework of the IB institutional landscape. The final section provides the conclusion, describing the contributions and implications of the study, as well as areas for future research.

## INSTITUTIONAL CONCEPTS AND MNE LOCAL ADAPTATION

### Institutions: Formal Versus Informal

Institutions are commonly defined as the "rules of the game in a society" (North, 1990: 3), or the shared "humanly devised constraints that structure political, economic and social interaction" (North, 1991: 97).[2] A key distinction that is stressed in the literature is between informal institutions and formal institutions (North, 1990, 1991, 2005; Rutherford, 1996). Formal institutions are the written rules (e.g., laws and regulations), whereas informal institutions are the unwritten rules that create expectations of appropriate and inappropriate social behavior (Helmke & Levitsky, 2004, 2006; North, 1990, 2005; Pejovich, 1999; Sartor & Beamish, 2014).[3] An example of an informal institution is the norm of reciprocity, which is based on the expectation of repaying what someone has done for you in kind (MacLean, 2010). Other examples include norms based on respect, loyalty, honor, patrimonialism, clan politics, clientelism (Helmke & Levitsky, 2004), social trust (see Brockman et al. and Gaur et al. in this SI), corruption (Godinez & Liu, 2015), and superstition (see Andrews et al. in this SI).

In the following sub-sections, we discuss four characteristics of institutions: formal institutional effectiveness, informal institutional effectiveness, formal–informal institutional convergence, and formal and informal institutional distance. We then discuss the outcome variable of the study: MNE local adaptation. Table 1 provides a summary of the concepts and definitions used in this study.

### Formal and Informal Institutional Effectiveness, Convergence, and Distance

In their seminal article, Helmke and Levitsky (2004) focus on two key institutional dimensions or concepts: formal institutional effectiveness and formal–informal institutional convergence. The first of these, formal institutional effectiveness, is defined as "the extent to which rules and procedures that exist on paper are enforced and complied with in practice" (Helmke & Levitsky, 2004: 728). It captures the degree to which formal institutions are well established and effective, and thus necessary and important for the functioning of a given market. Effective formal institutions encourage a high degree of compliance through clear articulation and strong enforcement mechanisms (Helmke & Levitsky, 2004, 2006; Li & Yue, 2008).[4] An example of how the degree of formal institutional effectiveness can vary dramatically across markets is property rights protection, which tends to be much stronger in developed than in developing markets (Brandl, Darendeli, & Mudambi, 2019; Contractor, 2019).

The second dimension is formal–informal institutional convergence, which is defined as "the degree to which formal and informal institutional outcomes converge" (Helmke & Levitsky, 2004: 728). It captures the extent to which formal and informal institutions are aligned with each other and reinforce each other's influence. When formal and informal institutions have high levels of convergence, that means that unwritten rules or expectations of behavior encourage adherence to formal rules or expectations and vice-versa (Helmke & Levitsky, 2004, 2006; see also Andrews et al. in this SI).[5] For instance, most nations have laws against murder, and most nations also have informal norms that suggest murder is unacceptable. When formal and informal institutions are divergent, on the other hand, formal rules may be in place, but commonly shared unwritten norms run counter to them, leading to conflicting expectations and motivations. For example, there may be clear formal rules in terms of driving speed limits, while unwritten expectations suggest that such limits are too low. This can lead to driving somewhat faster than the speed limit, but not fast enough to get pulled over by the police. Another example is bribery, which is usually against the law, but informally considered acceptable in many countries as a cost of doing business. Institutional divergence in markets can lead companies to seek loopholes to reduce their tax burden or to get around the terms of a contract, so they can have a meaningful effect on IB. Of course, a market may have some convergent and some divergent formal and informal rules, but this construct captures the degree to which they are aligned or divergent on aggregate, relative to other markets. That is, the term captures how the formal set of rules in their totality and the informal set of rules in their totality are aligned or divergent in an aggregate and systemic manner.

However, Helmke and Levitsky's (2004) work does not consider the extent to which informal institutions are effective versus ineffective or strong versus weak toward the functioning of a given market, relative to the levels in other markets. In their conceptualization, the role and level of

**Table 1** Concepts and definitions

| Concept | Definition |
|---|---|
| Institutions (formal and informal) | The shared and established "rules of the game in a society" (North, 1990: 3). "...the humanly devised constraints that structure political, economic and social interaction" (Ibid: 97). "...they consist of formal written rules as well as typically unwritten codes of conduct" (ibid: 4) |
| Formal institutional effectiveness | "the extent to which rules and procedures that exist on paper are enforced and complied with in practice" (Helmke & Levitsky, 2004: 728) |
| Informal institutional effectiveness | The extent to which unwritten rules are prominent, important, and necessary for the functioning of a given market |
| Formal–informal institutional convergence | "the degree to which formal and informal institutional outcomes converge" (Helmke & Levitsky, 2004: 728) or are aligned with each other and reinforce each other |
| Institutional distance (formal and informal) | "the difference/similarity between two or more institutional environments" (Kostova, 1996: 30) ... "the extent of similarity or dissimilarity between the formal… and the informal… aspects of institutions of any two countries" (Gaur & Lu, 2007: 87–88). Can also be conceptualized as Home-/Host-Market Institutional Convergence/Divergence |
| MNE local adaptation | "the degree to which a multinational corporation… should adapt home country practices to meet local needs" (Lau & Ngo, 2001: 95) |
| Market–firm institutional convergence | The degree of alignment/misalignment between the formal and informal institutions in place in a market and those in place in a firm operating within that market |
| Market institutional configuration | The particular arrangement of institutions in a given *market*, capturing the overall formal institutional effectiveness, informal institutional effectiveness, and the formal/informal institutional convergence between the two. For MNEs, it can be used to examine either their home or their host market(s), as well as the institutional relationships between them |
| Firm institutional configuration | The particular arrangement of institutions in a given *firm*, capturing the overall formal institutional effectiveness, informal institutional effectiveness, and the formal/informal institutional convergence between the two. For MNEs, it can be used to examine either their parent firm or their foreign subsidiary(ies), as well as the institutional relationships between them |
| IB institutional landscape | Framework capturing the market institutional configurations of the MNE's home and host market(s), the firm institutional configurations of the MNE parent firm and foreign subsidiary(ies), and the formal–informal institutional convergence among them over time |

importance of informal institutions for the functioning of a given market depends only on the degree of formal institutional effectiveness and formal–informal institutional convergence. However, markets "with [weak or] strong formal institutions can… either have weak or strong informal institutions" (Duran, Essen Van, Heugens, Kostova, & Peng, 2019: 246; see also Williamson, 2009). The authors do acknowledge that "formal institutional weakness does not necessarily imply the presence of informal institutions. It may be that no stable or binding rules – formal or informal – exist" in a given market (Helmke & Levitsky's, 2004: 727). However, their actual conceptualization and theorization does not incorporate this possibility, nor does it explicitly consider whether informal institutions are effective/ineffective and that this can vary across markets.[6] We thus extend their work by acknowledging that formal institutional effectiveness and informal institutional effectiveness are separate concepts and not opposites of each other, and that they are both variable. This leads directly to the development of the concept of informal institutional effectiveness[7] as a third dimension to complement the two discussed above.

We define informal institutional effectiveness as the extent to which unwritten rules are prominent, important, and necessary for the functioning of a given market. Markets typically have informal institutions in place or unwritten norms that create expectations of behavior (Helmke & Levitsky, 2004, 2006). However, these are much more effective and meaningful in some markets than in others. In some markets, the use of informal institutional structures, such as relational contracting based on favors, trust, reciprocity, interdependency, family ties, social capital networks, mutually beneficial relationships, interpersonal connections, and business group networks (Vissa, Greve, & Chen, 2010), is much more critical than in others. For instance, informal institutional structures play a decisive role in the proper functioning of various markets, including informal structures such as Guanxi/Guanxiwang in China (Estrin & Prevezer, 2011; see also Li et al. in this SI), Jeito/Jeitinho in Brazil (Puffer, McCarthy, Jaeger, & Dunlap, 2013), Wasta in the Arab nations (Smith, Torres, Leong, Budhwar, Achoui, & Lebedeva, 2012), Svyazy in Russia (Batjargal, 2007), Kankei in Japan (Nobeoka, Dyer, & Madhok, 2002), Yongo in Korea (Horak & Taube, 2016), and 'pulling strings' in many parts of the world (Smith et al., 2012). In other markets, such as the US, Canada, and much of Western Europe, informal institutions based on aspects such as relationships and favors are meaningful, but to a relatively lesser extent than in other parts of the world.

In addition to the three institutional concepts above, we also examine formal and informal institutional distance. Institutional distance is defined as "the difference/similarity between two or more institutional environments" (Kostova, 1996: 30). It is "the extent of similarity or dissimilarity between the formal… and the informal… aspects of institutions of any two countries" (Gaur & Lu, 2007: 87–88). The opposite of institutional distance is institutional proximity, which captures how similar the institutional systems are in those markets (Castellani, Jimenez, & Zanfei, 2013; Mingo, Morales, & Dau, 2018). Informal and formal institutional distance capture the dissimilarity between two countries in their unwritten and written rules, respectively (Aguilera-Caracuel et al., 2013; Estrin et al., 2007; Schwens et al., 2011). As stated above, the IB literature has devoted considerable attention to the formal and informal institutional distances between the home and host market of MNEs (Busenitz, Gomez, & Spencer, 2000; Kostova, 1996, 1997; Kostova et al., 2020; Xu & Shenkar, 2002). We incorporate them in this study to better connect it with the extant literature.[8]

Note that we conceptualize each of the dimensions or concepts described above as continuous, ranging from low to high, and not as categorical. For instance, a market may have higher or lower levels of formal or informal institutional effectiveness. It may also have greater or lower levels of formal–informal convergence. The formal and informal institutional distance between home and host markets also ranges from low to high. Furthermore, as alluded to above, the dimensions capture the relative level to that of other markets. For instance, saying a market has high formal or informal institutional effectiveness means that it does so on the aggregate and relative to the average levels of other markets. These distinctions become especially important in section four, so we return to them there.

## MNE Local Adaptation

One of the most important international strategic decisions that MNEs need to make is their degree of local adaptation in a host market (Bartlett & Ghoshal, 1989; Kostova & Roth, 2002). MNE local adaptation or local responsiveness is defined as "the degree to which a multinational corporation… should adapt home country practices to meet local needs" (Lau & Ngo, 2001: 95). Local adaptation can increase the ability to overcome the liability of foreignness or outsidership and increase the chance of survival (Johanson & Vahlne, 2009; Zaheer, 1995). It may also increase the stickiness of a firm's knowledge (Jensen & Szulanski, 2004). In addition, some practices may be context-dependent and hence need adapting (Kostova, 1999). However, adaptation comes at a cost, and may lead to a loss of the firm's distinctive strategy. As such, MNEs tend to prefer to maintain a greater degree of standardized practices between their home and host markets to the extent possible (Bartlett & Ghoshal, 1989).

When determining whether to enter a potential host market and how to operate once there, MNEs need to balance the potential benefits and costs in deciding the extent of local adaptation. IB research suggests that firms try to adapt their practices in various areas and to different extents (Beechler & Yang, 1994; Westney, 1987). For example, many MNEs seem to adopt to a great extent local human resource practices (Rosenzweig & Nohria, 1994). Adaptation may also be done indirectly by hiring local (e.g., Newman & Nollen, 1996; Schuler & Rogovsky, 1998). These costs of local adaptation include the inefficiencies involved in having to adapt to a greater or lesser extent to the host market. Therefore, understanding the antecedents of local adaptation is valuable not only for international business researchers but also for practitioners.

An example of local adaptation comes from an interview with an MNE executive conducted by one of this article's authors. As the executive explained, MNEs from developed countries typically avoid discriminating among their employees on the basis of religion and/or are formally forbidden to do so. They often adopt religion-neutral practices. They must, however, decide the level of local adaptation when they move into predominantly Muslim countries. In a number of these countries, companies offer prized 'Pilgrimage Benefits' to a select few. Most Muslims are obligated by religious law to partake in a Hajj, a particular and long pilgrimage to Mecca in Saudi Arabia, which can only be done during certain restricted times of the year. With demand very high, Saudi Arabia offers a limited number of Hajj visa slots each year to Muslim countries. Local companies jockey in turn for some of these slots and award them using different rules to a select few of their employees. When foreign MNEs establish a presence in these countries, they must make decisions as to whether or not they will offer Hajj benefits, which typically include a guaranteed visa to Hajj, time off, and trip costs, which can be significant. Canadian-born Kinross Gold, the fifth largest gold mining company in the world, readily offered Hajj benefits to 10 of its employees in Mauritania per year (Kinross, 2014). It also built a 21,500 square foot mosque to accommodate up to 3000 people for prayers, with its two imams hired by the company (Kinross, 2021). The company also provides an additional hour break on Fridays to allow employees to attend Friday prayers (Kinross, 2014). On the other hand, automaker Renault, which has a large plant in Tangier in Morocco, resisted doing the same. In 2015, however, following labor unrest, the company agreed with the union to provide Hajj benefits to four employees (Bassine, 2015).

Although there are other international strategy decisions, we examine local adaptation because it is important for companies in determining whether to enter a market, how to operate once there, and the costs involved in doing so. We discuss other international strategy decisions that could be examined to extend this project at the end of the article, under areas for future research.

In the following section, we examine the consequences of the formal and informal institutional aspects identified above on MNEs' degree of local adaptation in a host market.

## THE EFFCT OF FORMAL AND INFORMAL INSTITUTIONAL EFFECTIVENESS, CONVERGENCE, AND DISTANCE ON MNE LOCAL ADAPTATION

Prior work suggests that the mechanisms of the different institutional theoretical traditions need to be considered to better understand the strategic decisions and actions of firms (Campbell, 2004). In particular, rational choice institutionalism focuses on a logic of instrumentality (instrumental rationality), organizational institutionalism on a logic of appropriateness (legitimacy), and historical institutionalism on both sets of logics (Campbell, 2004).[9] Here, we embrace the notion that both of these logics need to be considered (Campbell, 2004).

Organizations such as MNEs seek to act instrumentally, based on the notion of rational self-interested behavior, and to maximize profitability. However, due to bounded rationality and imperfect information (Cyert & March, 1963; March & Simon, 1958), the best course of action to achieve this is not always clear (Arthur, 1994; Brinton & Nee, 1975; Coleman, 1990; Knight & Sened, 1998; Langlois, 1986; Rutherford, 1996; Scharpf, 1997). MNEs thus often seek heuristics and imitation of the actions of other players in that market as a means to address those gaps in information and their knowledge or understanding. The term used in the literature to capture this form of imitation is isomorphism (DiMaggio & Powell, 1983; Powell & DiMaggio, 1991, 2012; Scott, 1995, 2013). As part of this, they seek to act appropriately through legitimacy maximization vis-à-vis relevant players in that market, such as policymakers, customers, partners, headquarters in their home market, and other stakeholders. In the presence of imperfect information, legitimacy maximization through local isomorphism provides a path for managers to justify their actions, while using this form of imitation as an indirect means to seek greater efficiency and profitability. Of course, the goal may not always be achieved (e.g., Beechler & Yang, 1994; Bourmault & Siegel, 2021), but understanding how both logics of instrumentality and appropriateness operate jointly helps explain the behavior of MNEs.

We argue that the greater the presence of institutional complexity and dissimilarity between the home and host market, the greater will tend to be their degree of local adaptation to that market. We capture complexity with the degree of informal institutional effectiveness, the degree of formal institutional ineffectiveness, and the degree of divergence between the formal and informal institutional frameworks in place in a given host market. We capture dissimilarity with the distance or degree of divergence between the home and host markets' informal institutional frameworks and formal institutional frameworks.

We develop the arguments and propositions below.

### Formal and Informal Institutional Effectiveness and MNE Local Adaptation

We propose that the degree of formal institutional effectiveness in a particular host market reduces the need for MNE local adaptation in that market. When formal rules such as laws and regulations are strong, clear, and well enforced, the institutional environment will be characterized by less complexity, more transparency, and greater levels of compliance (Helmke & Levitsky, 2004, 2006; Li & Yue, 2008). MNEs will have a clearer roadmap to follow in their operations in that market. This will allow them to minimize local adaptation to the extent possible, in order to simplify their operational financial services, reduce their costs, and maximize their profitability in that market. Conversely, when there are ineffective formal institutions, the MNEs will have to acquire more tacit institutional knowledge to operate in that market (Dau, 2010). MNEs will thus not be able to rely on formal institutions as readily for their operations.

On the other hand, we propose that informal institutional effectiveness in a particular host market increases the degree of local adaptation for MNEs establishing foreign subsidiaries in that market. That is, when informal institutions are relatively more necessary or essential for the proper functioning of the market, MNEs are more likely to adapt to local conditions. For example, in the case of Asian societies where relationships (e.g., guanxi) are essential, MNEs from the West need to adapt their product and market strategies to a greater extent to the local market (Lovett, Simmons, & Kali, 1999; Zhao, Park, & Zhou, 2014). This occurs because of the tacit nature of informal institutional knowledge and the greater presence of imperfect information in such environments (Shenkar & Li, 1999; see also Sofka et al. in this SI). *Tacit knowledge* refers to knowledge that is intangible and implicit, and thus needs to be acquired through direct experience and interaction (Polanyi, 1966). This is in contrast with *explicit knowledge*, which is written down or codified, and thus more readily transferable via oral or written language (Polanyi, 1966). That is, explicit knowledge is "knowledge that is easy to articulate, write down, and share" (Alexander, 2018). Considering the tacitness of knowledge is critical to understand organizational geographic or location decisions (Gertler, 2003; Howells, 2002; Shenkar & Li, 1999).

Prior research has examined the importance of institutional knowledge for firms (Eriksson, Johanson, Majkgard, & Sharma, 1997; Li & Fleury, 2020; Xie & Li, 2018). Institutional knowledge is made up of formal institutional knowledge and informal institutional knowledge (Dau, 2015). Informal institutional knowledge is much more tacit than formal institutional knowledge which is more explicit, by virtue of the former being based on unwritten expectations that are not always evident, while the latter are codified rules that are easier to learn and share. That is, acquiring informal institutional knowledge often requires a greater degree of interaction with and exposure to local players and their environments (Dau, 2016).

Furthermore, in environments with high informal institutional effectiveness, imperfect information is amplified for foreign MNEs, leading them to act to a greater degree based on a logic of appropriateness vis-à-vis local players (Ge, Qian, & Li, 2019). That is, in the absence of a clear understanding of the local market and how best to operate there to maximize efficiency and profitability, MNEs will seek to emulate local players through isomorphism as a means of increasing their legitimacy. This dynamic will thus lead to a greater degree of local adaptation.

An example of informal institutional effectiveness increasing the need for local adaptation is Google's first internationalization effort into China (Quelch & Jocz, 2010). The host government pressured the company to adapt to local expectations to self-censure its content and search results to continue to operate in that market. Some of this pressure was based on formal laws, but the majority was based on informal norms and expectations on the part of the host government. Google found this to be counter to the openness and transparency of information they were accustomed to, which led them to exit the market. The local competitor Baidu grew rapidly as a result and took over a commanding lead of the Chinese market (Quelch & Jocz, 2010).

In sum, we propose that, all else equal, markets characterized by high levels of formal institutional effectiveness require lower degrees of MNE local adaptation. On the other hand, markets depicted by high levels of informal institutional effectiveness require greater degrees of local adaptation. We develop this based both on logics of instrumentality and appropriateness.

These arguments are summarized in the following two-part proposition.

**Proposition 1:** (a) Formal institutional effectiveness decreases and (b) informal institutional effectiveness increases the pressure on MNE local adaptation in a host market, ceteris paribus.

### Formal–Informal Institutional Convergence and MNE Local Adaptation

Furthermore, when formal and informal institutions are convergent, and thus not in conflict with each other, MNEs will find it is easier to understand and learn the local institutional functioning. In such a situation, the tacitness of informal institutional knowledge (Dau, 2010) becomes less relevant, as acquiring explicit formal institutional knowledge and following the formal rules will be sufficient to a greater extent to operate effectively in that market. MNEs in such cases will therefore have less of a need for local adaptation. That is to say, the need for local adaptation (Bartlett & Ghoshal, 1989; Kostova & Roth, 2002; Lau & Ngo, 2001) will still exist due to the effectiveness of informal institutions, but this will be lessened, as MNEs can rely more on the explicit formal institutional framework and less on the tacit informal institutional framework.

The opposite situation would be when formal and informal institutions are divergent. For instance, this would occur when laws are on the books, but they are not followed because of shared unwritten rules or norms that contradict those laws (Lauth, 2000). In this case, the divergence would decrease information transparency and increase confusion, making it more difficult for MNEs to acquire the necessary knowledge to operate effectively in that market. As an example, clear business tax laws may be in place in a market, while unwritten norms suggest that the state cannot be trusted with those funds, leading to rampant tax evasion. Divergence increases imperfect information and complicates learning and understanding the system for foreign players, increasing isomorphism with local players and thus the degree of local adaptation.

An example of how formal–informal institutional divergence increases the need for local adaptation comes from one of the SI articles, which studies superstition in Myanmar (see Andrews et al. in this SI). The study examines how superstition is illegal in Myanmar, but is very much informally present in the norms and practices of the population. The article suggests that the practices of MNEs from western countries were affected by this formal–informal institutional divergence or misalignment, increasing their need for local adaptation.

These arguments lead to the following proposition.

**Proposition 2:** Formal–informal institutional convergence in a host market decreases the pressure on MNE local adaptation, ceteris paribus.

### Formal and Informal Institutional Distance and MNE Local Adaptation

Finally, the formal and informal institutional distances between the home and host country (Busenitz et al., 2000; Kostova, 1996, 1997; Li & Wan, 2016; Li, Tian, & Wan, 2015; Xu & Shenkar, 2002) are also important considerations. In particular, the greater the informal and formal institutional distances between the home and host country, the more challenging it will be to learn and understand the local institutional environment of the host market, thus increasing the likelihood that MNEs will have to adapt to local conditions. More specifically, if the home and host markets have informal institutional systems that are closely aligned or very similar to each other (i.e., low informal institutional distance), then MNEs will already possess much of that informal knowledge. Therefore, having greater overlap in the informal institutional frameworks of the home and host markets will reduce the need to learn from local players in the host market, reduce the need for isomorphism, and thus reduce the need for local adaptation. Similarly, when the formal institutional frameworks of the home and host markets are closely aligned or very similar (i.e., low formal institutional distance), MNEs will have less formal knowledge to acquire to operate in the host market and will thus more readily be able to rely on its extant knowledge base.

Of the two, informal institutional distance will likely have a more pronounced effect on local adaptation, given the greater difficulty in bridging an informal than a formal knowledge gap. However, low formal institutional distance will also reduce some of the learning required to operate in that market, thus also allowing the company to rely less on host-market local knowledge to operate in that market.

An example of how institutional distance increases the need for local adaptation is the US MNE Walmart's failed internationalization efforts in Germany (Neissa & Trumbull, 2004). The expectation from the company was that it would need to adapt little to the formal and informal institutional distances with the host country. The company largely used expatriates from the US, many of whom were not experts in the institutional landscape of Germany. For instance, a difference it encountered was a stronger unionization tradition in Germany than Walmart was used to, leading to frequent clashes for the company. The company would also require employees to smile at customers, which locals in Germany often perceived as flirtatious. Similarly, the company would offer a bagging service, but locals often saw this as strangers touching their groceries. Ultimately, Walmart left Germany after having massive losses (Neissa & Trumbull, 2004). The pressures for local responsiveness due to the institutional distance were clear, but the company did not respond quickly enough.

Another example is Disneyland's internationalization to France (Brannen, 2004). Once again, the company failed to appreciate many of the formal and informal institutional differences it would encounter. For instance, local workers were expected to smile at visitors, to wear certain clothes, and to act in certain ways. The workers saw this as an affront to their freedoms of expression and dress, which were not well received. The company entered the market with limited local adaptation, which proved to be very costly, and required adaptation over time (Brannen, 2004).

These arguments lead to the following two-part proposition.

**Proposition 3:** (a) Formal and (b) informal institutional distance between the home and host market increase the pressure on MNE local adaptation, ceteris paribus.

## INTERACTIONS BETWEEN INSTITUTIONAL CONCEPTS AND APPLICATION TO MNES

In this section, we further extend Helmke and Levitsky's (2004) work by examining how the interactions between the different institutional concepts identified above can lead to distinct market institutional configurations, how these can vary across home and host markets, and how different forms of institutional convergence come into play.

### Institutional Configurations and Roles of Informal Institutions

In particular, Helmke and Levitsky's (2004: 727) use the dimensions of formal institutional effectiveness and institutional convergence to develop a 2 × 2 typology of informal institutions, which has been applied in prior IB work (e.g., Estrin & Prevezer, 2011). Combining these two dimensions leads to a typology of four possible roles of informal institutions in a given market: complementary, accommodating, substitutive, and competing. *Complementary informal institutions* refer to those that exist in relative harmony and alignment with effective formal institutions, providing clear expectations of compliance with written rules. They are called complementary in that they support and strengthen the extant formal institutions (Lauth, 2000). *Substitutive informal institutions* refer to unwritten rules that are convergent with ineffective formal rules. As the formal rules are ineffective and not properly enforced, the informal rules take their place and provide the necessary structure for social interactions (Lauth, 2000). *Accommodating informal institutions* refer to unwritten rules that are divergent with effective formal rules. In this case, the written rules are effective and properly enforced, while economic actors disagree with them and will thus seek to undermine them in subtle ways where possible, leading to some degree of inefficiency (Helmke & Levitsky, 2004, 2006). Finally, *competing informal institutions* refer to unwritten rules that are divergent with ineffective formal rules. As the formal rules are not properly enforced and the informal rules are at odds with them, actors often see them as impositions and are less likely to follow them, often leading to great degrees of inefficiency (Helmke & Levitsky, 2004, 2006). We reproduce this typology in Table 2.

Furthermore, we extend this typology by incorporating the concept of informal institutional effectiveness, as discussed in Sect. 2. In particular, Table 3 adds the dimension of informal institutional effectiveness to the two dimensions covered in Table 2: formal institutional effectiveness and formal–informal institutional convergence. This leads to a 2 × 2 × 2 typology with eight possible roles for informal institutions.

We also provide Figure 1, which depicts the information in Table 3 in diagram format, to facilitate clarity for the reader. It shows how the combination of the three institutional dimensions leads to the eight possible roles for informal institutions. The term institutional configurations refers to the possible combinations of the three dimensions in a given social environment.

We extend Helmke and Levitsky's (2004) typology by examining eight possible types, instead of just four. We begin with the terms they use for their four types: *substitutive, competing, complementary,*

**Table 2** Helmke and Levitsky's typology of informal institutions

| | **Formal institutional effectiveness** | |
|---|---|---|
| | Effective | Ineffective |
| **Formal–informal institutional convergence** | | |
| Convergent | *Complementary* | *Substitutive* |
| Divergent | *Accommodating* | *Competing* |

Adapted from Helmke and Levitsky (2004: 728). This provides a 2 × 2 typology with 4 possible roles for informal institutions.

**Table 3** Extended typology of informal institutions

| | **Degree of formal institutional effectiveness** | | | |
|---|---|---|---|---|
| | Effective | | Ineffective | |
| **Degree of informal institutional effectiveness** | | | | |
| Effective | Convergent | *Synergistic* | Convergent | *Substitutive* |
| | Divergent | *Opposing* | Divergent | *Competing* |
| Ineffective | Convergent | *Complementary* | Convergent | *Fragile* |
| | Divergent | *Accommodating* | Divergent | *Discordant* |

This table adds the dimension of informal institutional effectiveness to the two dimensions covered in Table 2: formal institutional effectiveness and formal–informal institutional convergence. This leads to a 2 × 2 × 2 typology with 8 possible roles for informal institutions. Note also that we conceptualize the three dimensions as continuums ranging in degree from low to high. The table captures the generalized or extreme case for each of them for the sake of simplification.

and *accommodating*. As our typology is different in that it considers a third dimension, their four types do not fit perfectly into any of ours. Instead, we incorporate the terms where we see them as being most intuitive. We used these terms for two reasons: because they are the most accurate ones we could identify to capture each category, and because this allows us to better connect with Helmke and Levitsky's classification. As Table 3 shows, we place two of these in the top right and the other two in the bottom left. We use the terms *substitutive* and *competing* when informal institutions are effective and the terms *complementary* and *accommodating* when informal institutions are ineffective, based on selecting the most intuitive terms for each classification in the typology. We refer to the remaining four types as *synergistic, opposing, fragile, and discordant*, again with the intention of using intuitive terms.

As mentioned in Sect. 2 above, we conceptualize the three dimensions as continuous, ranging from low to high, and not as categorical. That is, both Helmke and Levitsky (2004)'s typology, as well as our own, provide the generalized or extreme case for each of the dimensions, leading to 4 or 8 types, respectively. For instance, if a market on the aggregate (relative to other markets and at a given point in time), has effective formal institutions, effective informal institutions, and convergence between the two, it would fall into the *synergistic* category. That does not mean that market is a monolith and that the three dimensions fall precisely into those specific categories, as the variables are continuous. That is to say, the market may have on the aggregate effective formal or informal institutions, but that does not mean it does not have some ineffective formal or informal institutions in the mix. Similarly, the market may have formal–informal institutional convergence, but that does not mean that there are not some aspects of institutional divergence. To know precisely where in the typology a market would fall at a given point in time, one would need to consider the totality of its formal and informal institutions, and the convergence between them, and categorize them based on their aggregate level. This would mean that any general examples of markets we provide for the 8 types below would always have counter-examples. For instance, we say Japan at present tends to have relatively effective formal and informal institutions and convergence between the two, leading to a synergistic classification. This does

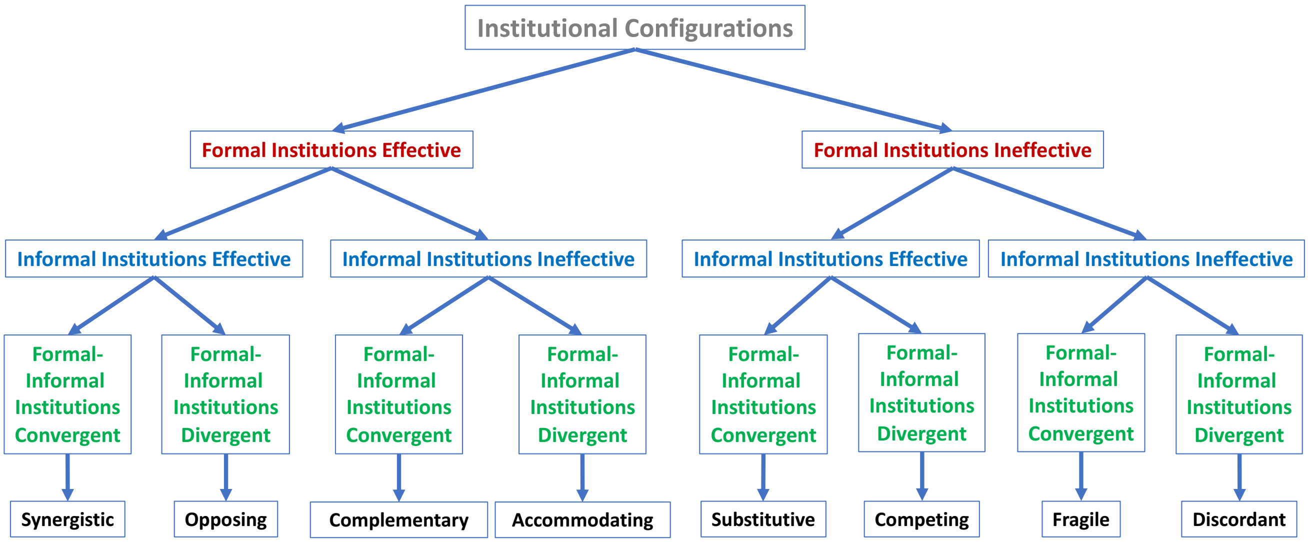


**Figure 1** Institutional configurations and roles of informal institutions. This figure depicts the information in Table 3 in diagram format, to facilitate clarity for the reader. It shows how the combination of the three institutional dimensions leads to 8 possible roles for informal institutions. The term institutional configurations refers to the possible combinations of the three dimensions in a given market or other social grouping.

not mean that market does not have some ineffective or divergent formal and informal institutions. It means, on the aggregate at a specific point in time, that market is closest to that classification relative to the average of other markets.[10] We therefore follow Helmke and Levitsky's (2004) lead in providing examples below of markets in particular situations or moments in time.

Below, we describe each of the eight ensuing market institutional configurations.

### *Synergistic*

When both formal and informal institutions are effective in a market, and formal and informal institutions are convergent, informal institutions provide a synergistic role in strengthening and enhancing formal institutions.

An example of this type of market would be the current Japanese market, where formal rules are well developed and respected. At the same time, informal institutional frameworks – such as the concept of "wa" – which refers to the emphasis "on group loyalty and consensus… [and] the search for or the existence of mutual cooperation so a group's members can devote their total energies to attaining group goals" (Alston, 1989: 26) – are also necessary and important for the functioning of markets (Parry, 2006). The formal rules and "wa" are generally congruent in encouraging the proper functioning of the market. More generally, communities of practice around the globe are often synergistic with existing formal institutions in facilitating learning and knowledge development and ultimately market functioning (Tallman & Chacar, 2011a, b).

### *Opposing*

When formal and informal institutions are effective in a market and the two are divergent, informal institutions provide an opposing or antagonistic role vis-à-vis formal institutions. In such cases, written rules, such as laws and regulations, and unwritten expectations of behavior are both strong but at odds with each other, which can complicate market functioning.

An example comes from Morocco, which can be classified as Competing during most of the year (see below), but Opposing during Ramadan. The country has a clear formal institution stating that Muslims cannot drink alcohol. However, this is rarely enforced, leading to the formal institution regulating alcohol drinking being relatively ineffective. In fact, the market has a strong and effective informal norm, where many see drinking as something that only non-cosmopolitan people avoid. As a case in point, the King and Religious Leader of Morocco, Mohamed VI, and the Royal family are a majority shareholder in the Société Nationale d'Investissement (SNI), which in turn owns a stake in Brasseries du Maroc, the largest alcoholic beverages manufacturer and distributor of brands such as Heineken in the country (Sqalli, 2006). As such, these formal and informal rules are highly divergent throughout much of the year. During the holy month of Ramadan, however, there is more social pressure not to drink alcohol. The informal institution in support of drinking has supposedly weakened with the rise of Saudi Arabia and stricter enforcement of Islamic rules. So local companies must decide whether to allow drinking or to offer alcohol during office lunches or business lunches, and after sunset during Ramadan (Sqalli, 2006).

A more general example would be the Brazilian market. The market is characterized by its well-developed legal and regulatory systems in place, but also by a highly normative environment where relationships and connections often trump formal rules. Such divergent or conflicting formal and informal institutions can lead to rampant market inefficiency. This may help explain why some markets find themselves stuck in what is known as a middle-income trap (Gill & Kharas, 2015).

### *Complementary*

When formal institutions are much more effective than informal institutions in a market, and the two are convergent, then informal institutions provide a complementary role to formal institutions (c.f., Helmke & Levitsky's, 2004). That is, the formal institutional framework dominates in such markets, while informal institutions primarily serve to facilitate market transactions.

An example comes from France and its formal and informal institutions surrounding civil unions (Nahmani, 2022). In France, a formal law on civil unions was passed in 1999 called 'PACS' with the aim of providing similar benefits to same-sex couples as were already in place for married couples. By law, married people benefitted from certain holidays, such as a right to a four-day holiday when getting married. These rights were nevertheless not given to those 'PACSes' or entering a civil union. However, there were two informal institutional rules that were largely shared by the population. The first was the norm of nondiscrimination based on sexuality. The second was that civil union was equivalent to marriage. These informal rules were weak and largely ineffective, but since they were convergent with the aims of the formal institutions, they provided a complementary role to those formal institutions. This left companies in a dilemma. By law, they were not required to provide paid leave for a civil union (whether the partners were of the same or of the opposite sex). However, if a civil union is tantamount to a marriage then not providing a leave for a civil union felt discriminatory, albeit not required by law. So a few MNEs, such as Sanofi and L'Oreal, voluntarily offered benefits to partners in civil unions similar to those offered to those entering into a marriage (RSE, 2011). Eventually, in 2014, French law caught up with this and updated the benefits of those entering into civil unions to be more closely aligned to those entering marriages (Nahmani, 2022).

### *Accommodating*

When formal institutions are more effective than informal institutions, but the two are divergent, then informal institutions provide an accommodating role to that of formal institutions (c.f., Helmke & Levitsky, 2004). This occurs because the role of informal institutions in such cases is not as meaningful, and, as they are divergent with formal institutions, they play much less of a role and mostly have to accommodate and be overshadowed by formal institutions.

An example comes from the US. The market would largely fall into the Complementary category, as the legal and regulatory systems are generally adhered to with minimal internal institutional conflict. That is, the market is typically characterized by relatively effective formal institutions and relatively ineffective informal institutions, while the two are in alignment. However, in recent years, due in part to massive political and media misinformation campaigns (Hsu, 2022), a significant percentage of the population has developed informal norms that are counter to (or divergent from) the formal norms. This includes extremist views, such as QAnon conspiracy theorists, with roughly 41 million followers or 16% of the population (Hsu, 2022). For instance, during the pandemic, the government introduced formal rules and guidelines for vaccination and masking, while a large share of the population held antivaccination and antimasking informal norms (MacFarquhar, 2021). This created some degree of uncertainty for companies, since the formal rules were opposed by some of their employees. Given the relative effectiveness and strength of formal institutions in the country, and the relative ineffectiveness and weakness of the informal institutions, companies were more readily able to follow the formal rules. For instance, companies like Apple, Amazon, AT&T, and many others were able to enforce masking requirements, even with the opposition of some employees (Reuters, 2021).

### Substitutive

On the other hand, when informal institutions are highly effective and formal institutions are much less so, while the two are convergent, informal institutions have a substitutive role over formal institutions. That is, informal institutions prevail in such markets and take the role of providing the necessary frameworks for market functioning, while formal institutions provide a complementary role. "Substitutive institutions tend to emerge where state structures are weak or lack authority" (Helmke & Levitsky, 2004: 729).

This can occur in markets where formal legal business supports exist, but are not fully in place or properly enforced, and where informal systems based on connections or relationships arise to take their place to facilitate market functioning. The formal and informal systems are largely convergent because both seek to facilitate business activities and strengthen the market, but the informal rules will play a more meaningful role. For example, in China, the concept of guanxi captures a complex informal network based on mutually beneficial relationships that can facilitate business dealings (Zhao & Castka, 2021). This system can provide trust in business relationships that can help facilitate business transactions when formal institutions are not sufficiently strong (Luo, Huang, & Wang, 2012; Puffer, Mccarthy, & Boisot, 2010; Su, Yang, Zhuang, Zhou, & Dou, 2009). This does not necessarily apply equally to all businesses in China. Indeed, research has suggested that "an underdeveloped legal framework makes private-company executives more dependent on guanxi than executives in state-owned or collective-hybrid companies" (Xin & Pearce, 1996: 1641). As we discussed earlier, many other markets have developed relational network systems to strengthen the functioning of the market in the presence of weak or ineffective formal institutions, such as Svyazy in Russia (Batjargal, 2007) and Jeitinho in Brazil (Puffer et al., 2013). In China, although there have been efforts on the part of the state to weaken informal institutional structures, informal institutional legacies have endured and remain strong (see Zhang et al. in this SI).

### Competing

Furthermore, when informal institutional effectiveness is high, while formal institutional effectiveness is low, and the two are divergent, informal institutions will tend to compete for primacy over formal institutions (c.f. Helmke & Levitsky, 2004). As informal institutions are stronger, they would dominate in such markets, while having formal institutions being divergent leads them to be largely ignored or even penalized in market practices.

This occurs for instance in locations where bribing officials is commonplace. For example, in several Latin American countries, there is an informal expectation that, if you are driving and a traffic police officer pulls you over, you will need to give them a bribe or 'mordidita' (Fried, Lagunes, & Venkataramani, 2010). To ensure you comply, they may use scare tactics or even threats: such as removing the license plate from your car or keeping your driver's license, with the excuse that doing so will ensure you will show up to pay the ticket. Similarly, entrepreneurs in Indonesia often find they need to bribe government officials to obtain a business permit (Kuncoro, 2004). Refusing to provide such 'grease payments' can lead to permits not getting approved, while paying them can provide benefits to businesses such as allowing them to pay less in taxes. As these examples show, following informal norms becomes expected, while following formal laws is not only discouraged but can even be detrimental in some situations.

Another useful example comes from Helmke and Levitsky (2004: 729): "Competing informal institutions are often found in postcolonial contexts in which formal institutions were imposed on indigenous rules and authority structures. In postcolonial Ghana, civil servants were officially instructed to follow the rules of the public bureaucracy, but as Robert Price found, most believed they would pay a significant social cost (such as a loss of standing in the community) if they ignored kinship group norms that obliged them to provide jobs and other favors to their families and villages." Although Helmke and Levitsky (2004) do not consider the possible variability of informal institutional effectiveness in their conceptualization, this example also works well in our typology.

### Fragile

When both formal and informal institutional effectiveness is low, even if the two are convergent, the market will be largely dysfunctional and fragile. In such cases, informal institutional structures are not well enough established to create confidence in market operations, making aspects such as formal contracts or informal agreements based on handshakes difficult to enforce or trust (see Brockman et al. in this SI). However, although both formal and informal rules are weak in such an environment, having convergence between the two can at least facilitate some market transactions to a greater extent than when they are divergent. Small informal economic activity is likely to predominate in such markets.

Examples include a number of the least developed countries in Africa and parts of Asia that have established institutional structures that are not yet solid enough to sustain a strong market economy. Informal institutions are present in such markets, but they are not strong or effective enough to support significant market development. When both formal and informal institutional structures are ineffective or weak, even if the two are relatively convergent, a market lacks sufficient institutional supports to allow for consistent economic growth. This type of situation may lead to what is often referred to as a low-income trap, where markets have difficulty breaking out of their low level of development (Morck & Yeung, 2004).

### *Discordant*

Finally, the most challenging situation occurs in markets where both formal and informal effectiveness is low and the two are divergent, leading to a discordant institutional landscape.

In such a situation, the rule of law is weak and the social norms are weak. In this case, they are at odds with each other, creating an unreliable institutional environment where it can be difficult for markets to grow and thrive.

This scenario can occur when new states are being formed, such as in the Wild West of the early history of the United States. In such an institutional environment, formal institutions such as laws and regulations were being implemented but were not solidly established or enforced to the necessary extent, making them weak or ineffective. At the same time, informal norms were still being shaped, but a consensus of shared expectations of acceptable behavior was far from settled, nor were they solid enough to facilitate trust in market transactions. Moreover, the two were divergent because much of the formal institutional structure was being imposed from the top down, including from the federal and state governments, without attempting to harmonize them with informal institutional structures.

Other more recent examples include war-torn states, such as South Sudan during its civil war in 2013 (De Waal, 2014). As a conflict of that nature rages on, formal laws are no longer closely observed or respected, while at the same time, informal norms become much less reliable as aspects such as social trust, honor, and loyalty deteriorate, and survival of self and loved ones at all costs takes precedence. Both formal and informal rules will continue to exist and have some effect, but both will be relatively weak and ineffective. Reliance on both formal institutions and informal institutions will be largely weakened or broken, where individuals can only trust perhaps their closest family or friends, while there are no market-level or society-level binding or effective institutions in place. Local businesses will struggle to survive in such environments (BBC, 2015), but there will still be a need for them to provide social necessities (WEF, 2016). Even MNEs will often operate in such markets, in part as a means to access oil and other natural resources, potentially even exacerbating the detrimental institutional situation for private gain (Patey, 2006).

A discordant institutional landscape typically evolves over time into one of the other types, as the state and legal framework become stronger and/or the social fabric of society becomes stronger. As we discuss below, we can examine historically how such situations change over time, often leading to greater convergence and stronger formal and/or informal institutional frameworks.

## The IB Institutional Landscape

Based on the discussion above, we conceptualize the institutional configuration of a given social environment[11] by its formal institutional effectiveness, informal institutional effectiveness, and convergence between formal and informal institutions. This is displayed in Figure 2. This figure provides a simplified version of the information provided in Table 3 and Figure 1, as it includes the three key constructs of interest, but not the eight ensuing institutional configurations. We provide this figure here as a 'stepping stone' to show how we develop the figure that follows it.

### *Market institutional configuration*

Moreover, the institutional environment displayed in Figure 2 applies both to MNEs' home and host markets. Therefore, one can examine the formal and informal institutional convergence or distance between the home and host market. Figure 3 displays, in the top two rectangles, the home and host market institutional frameworks, as well as the formal and informal institutional distance or convergence between them.

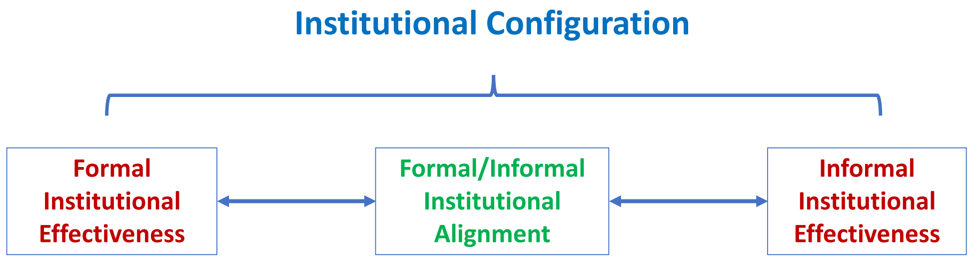


**Figure 2** Market-level or firm-level institutional configuration.

### *Firm institutional configuration*

Institutions can be conceptualized at different levels of analysis beyond the market level, including at the firm level (see the Editorial introduction to this SI). As such, ne can conceptualize both the MNE's parent firm located in the home market, as well as a focal international subsidiary located in a given host market, using the same institutional environment diagram in Figure 2. Figure 3 displays these two firm-level institutional environments with the two bottom rectangles. The arrows connecting them capture the degree of formal and informal institutional distance or convergence between the parent and subsidiary in terms of their formal and informal institutional frameworks. The arrows connecting the home/host market with the parent/subsidiary show their degree of formal and informal institutional convergence, respectively. We describe the relationships between each of the four ensuing market-level and firm-level institutional environments below.

### *Institutional distance: between MNE home and host markets*

As Figure 3 displays with the arrows connecting the top two boxes, one can examine the institutional distance between the home and host markets. As stated above, the IB literature has devoted considerable attention to the formal and informal institutional distances between the home and host markets of MNEs. The word 'influence' is also included in the diagram connecting the two markets, to capture how their formal and informal institutional frameworks can impact each other.

### *Institutional distance: between MNE parent firm and foreign subsidiary*

As the arrows connecting the two bottom boxes of Figure 3 show, one can also examine the institutional distance and influence between the MNE's parent firm and a given foreign subsidiary. The solid line suggests the parent typically has a greater influence, while the dotted line suggests the subsidiary can also influence the parent. Such dynamics vary significantly across firms, depending on how open parent firms are to learning from subsidiaries. For example, the global cement company CEMEX has been widely recognized as seeking to learn from its foreign operations and acquisitions to increase its efficiency and improve its overall operations (Özcan, Mondragon, & Harindranath, 2018).

Here, the word 'influence' appears with a solid line from the parent to the subsidiary and a dotted line in the opposite direction, as the parent firm will most likely have a greater degree of influence on the institutional environment of its subsidiary than the other way around, but the influence can exist in both directions.

### *Institutional convergence/divergence: between the home market and MNE parent firm*

Figure 3 also displays with the arrows connecting the two boxes on the left the convergence or divergence between the home market and the MNE's parent firm, located in that market. The solid arrow from the market to the firm shows the greater influence of formal and informal institutions in place in that market on firms that operate there. The dotted line from the firm to the market shows how firms can also influence market-level institutions, such as through *nonmarket strategy* (Baron, 1995; Doh, Lawton, & Rajwani, 2012, 2015; Lux, Crook, & Woehr, 2011; Mellahi, Frynas, Sun, & Siegel, 2016), but that this influence is typically weaker than the top–down influence.

### *Institutional convergence/divergence: between the host market and the foreign subsidiary*

Similarly, the arrows connecting the two rightmost boxes in Figure 3 show that host-market formal and informal institutions typically have a greater influence on foreign subsidiaries, but that foreign subsidiaries can also influence the host-

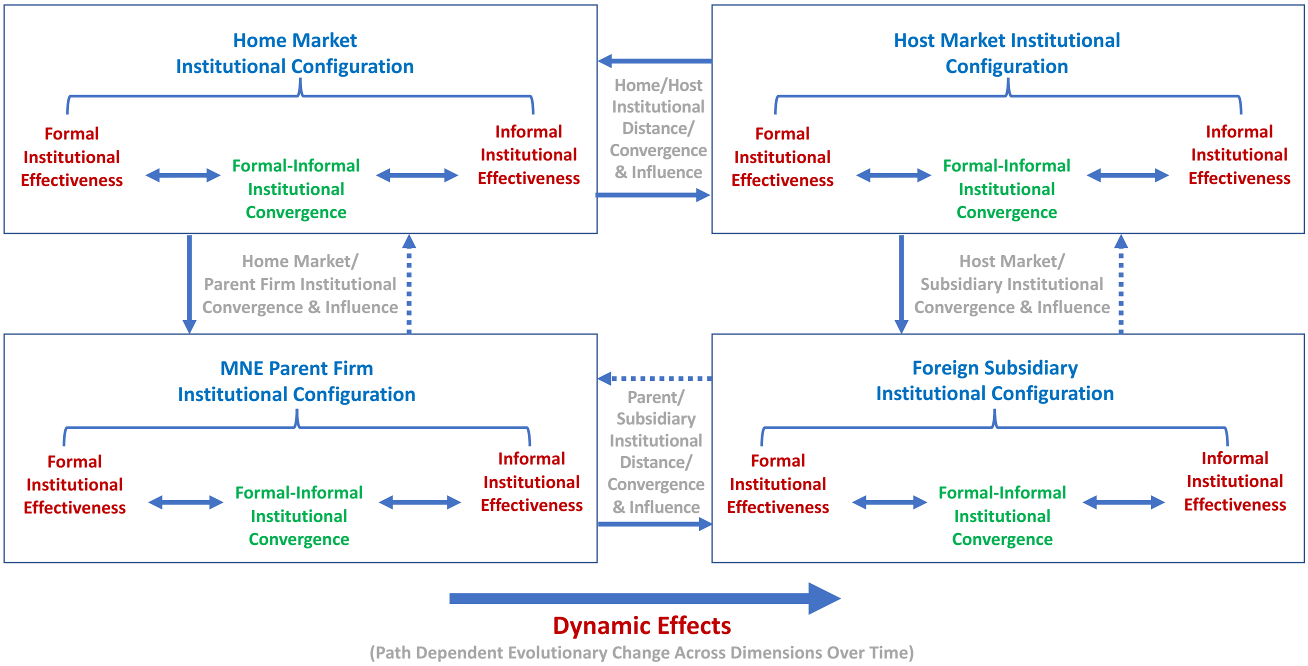


**Figure 3** The IB institutional landscape. This figure extends Figure 2 by examining the institutional configuration (i.e., combination of formal institutional effectiveness, informal institutional effectiveness, and formal–informal institutional convergence) of the MNE's home market and host market, captured by the *two top boxes*. At the same time, as institutions can be conceptualized at different levels, it shows the institutional configuration of the parent firm within the home market and the foreign subsidiary within the host market, captured by the *two bottom boxes*. The *arrows* connecting the two top boxes display the formal and informal institutional distance (or convergence) and influence between the home and host market. The *arrows connecting the two bottom boxes* display the formal and informal institutional distance (or convergence) and influence between the parent firm and its foreign subsidiary. The *arrows connecting the two boxes on the left* display the formal and informal institutional convergence and influence between the home market and the parent firm. The *arrows connecting the two boxes on the right* display the formal and informal institutional convergence and influence between the host market and the foreign subsidiary. The *arrow at the bottom* indicates all of these relationships are dynamic, based on a path dependent evolutionary institutional change across dimensions over time. This conceptual framework provides the simplified case of MNEs with a single foreign subsidiary. It could be complicated by examining a larger network of host markets and foreign subsidiaries, as well as the relationships across them.

market institutional system. The influence of subsidiaries can be great in some cases, such as when a large MNE operates in a relatively small country, such as the oft-cited example of Intel in Costa Rica (Rodríguez-Clare, 2001). Intel has over 2000 employees in this country of 5 million people, accounts for roughly 60% of the nation's R&D exports, and provides a boon for STEM training and education (Intel, 2022). This gives Intel a greater leverage and bargaining advantage over Costa Rica than it would otherwise have, as it represents such a large part of the economy.

### *Dynamic effects*

As the arrow at the bottom of Figure 3 displays, each of the institutional relationships illustrated in the figure is expected to evolve in a path-dependent manner over time. For instance, the example of the US's Wild West above allows us to see how historically formal and informal institutions in such a market can become increasingly convergent, and how formal and informal institutional structures over time can become increasingly solid, leading to a better functioning market. As another example, within the host market institutional environment captured in the top right of Figure 3, one would expect formal and informal institutional structures to slowly become increasingly convergent over time, unless a significant disruption takes place, such as a political coup or revolution. Such a disruption could lead to a new government imposing new formal institutions that are divergent with the informal institutions in place. Describing all of the possible institutional changes is beyond the scope of the article, so here we provide only a few examples, but examining how each of the informal and formal institutional dimensions and relationships in the diagram evolves over time would provide significant room for future work.

### *Additional considerations*

In addition, one could complicate Figure 3 further by including multiple foreign subsidiaries across different host markets, including the institutional relationships across each of them and across levels, so our diagram provides the simplest case that can be extended in future work. For instance, one could complicate the diagram in Figure 3 even further by adding other levels of analysis beyond the country and firm, such as levels within MNEs (e.g., department level, workgroup level, etc.). Our purpose here is to show a simplified case of how this can be done, but future work could further tease out how the degree of convergence/divergence across different units and levels of analysis relate to each other, as well as to their antecedents and consequences for IB.

As this section has shown, this type of work on informal institutions and their relationship to formal institutions can lead to extensive progress for the study of institutions and IB. Indeed, Figure 3 shows why IB is an ideal field to help further work not only on informal institutions but on institutions in general. IB allows one to examine highly complex institutional structures in context, which can help advance institutional work and influence other fields.

## CONCLUSIONS

This article concludes the SI by exploring the consequences of formal and informal institutional effectiveness, convergence, and distance for international strategy. First, it examines the effects of these constructs on MNE local adaptation. This section develops propositions that can be developed into hypotheses and tested in future work. Second, it develops an eight-way typology of market institutional configurations, based on the interaction between formal and informal institutional effectiveness and convergence. Third, it further extends this conceptualization by examining the degree of convergence or distance between the institutional configuration of the home market, the host market, the parent firm, and the foreign subsidiary, as well as the dynamic effects of these relationships.

This article provides several contributions to the literature that help integrate, synthesize, and expand extant work. First, it extends Helmke and Levitsky's (2004) article by considering variation in the degree to which informal institutions are meaningful and important in a given market, leading to the development of the concept of informal institutional effectiveness. Second, it develops theoretical arguments and propositions for the effects of formal and informal institutional effectiveness, convergence, and distance on MNE local adaptation to a host market. Third, it proposes a typology of informal institutions that further extends the work of Helmke and Levitsky (2004) and related work in IB (e.g., Estrin & Prevezer, 2011). This typology identifies eight different formal and informal institutional configurations that markets can have, which can be especially useful for IB research on the topic that seeks to understand the effects of contextual factors on MNEs. Fourth, it develops a conceptual framework displaying the relationships between market and MNE institutional dynamics, showing the complexities involved when accounting for different institutional and organizational aspects, the convergence or distance between these aspects, and their change over time. Fifth, it examines how institutions can be conceptualized at different levels of analysis. We examine the market and MNE levels, but this can be extended to include other levels. Finally, and encompassing all of the above, the article moves the IB literature from primarily examining formal institutions to also examining several key aspects of informal institutions.

The article also provides meaningful implications for practice. MNEs entering foreign markets will be well served, providing greater attention not only to the formal institutional environment but also to the informal institutional environment. They can do so for instance by providing training on local norms from host-market experts, hiring a combination of home- and host-market managers, and pursuing joint ventures or other forms of strategic alliances that allow them to tap into local knowledge. Similarly, policymakers seeking to encourage foreign MNEs to enter their markets can provide them with informal institutional training and other similar efforts to help facilitate the process. Practitioners can also make use of a number of extant measures that capture different aspects of the informal institutional landscape of a market, such as social trust (Haerpfer et al., 2020) and corruption (TI, 2021). This can help them better understand the complexities of operating in a given host market.

We identify areas for future research on informal institutions and IB. First, we examine the direct effects of formal and informal institutions on international strategy. A next step that could be explored in future work would be to examine possible moderating or mediating relationships of these institutional constructs as they relate to IB outcomes. In addition, future work can develop measures of the concepts studied in this article, especially of informal institutional effectiveness and formal–informal institutional convergence. As an example of how researchers can develop measures of informal institutional concepts, the article by Berrone et al. in this SI develops a "family business legitimacy index". Once these measures are developed, future work can test the proposed relationships we study empirically.

Also, we examine the consequences of informal institutions on MNE degree of local adaptation, but other dependent variables could be examined in future work. These include the likelihood of different modes of entry, such as joint ventures and strategic alliances or greenfields and acquisitions, the likelihood of entry into a market, the degree of internationalization of a firm, subsidiary performance, the likelihood of subsidiary survival or its longevity, learning/knowledge sharing across MNEs international units and with their headquarters, and other aspects of internationalization strategy.

Moreover, we discuss dynamic effects but do not incorporate them in our theoretical development and propositions to avoid lengthening the article excessively. Future work can extend the proposed relationships with dynamic effects. For instance, over time, as MNEs operate in a market and learn the informal institutional ecosystem better, the relationships we examine would likely become weaker, as MNEs have less of a need for local adaptation. After that, we develop an eight-fold typology of informal institutions and a conceptual framework of the IB institutional landscape. A next step would be to develop theoretical arguments and propositions for how each of the ensuing elements relates to international strategy. We do not do so here to avoid over-complicating and over-lengthening the article, but we believe this can be a rich area for future work.

In line with prior work, such as Helmke and Levitsky (2004, 2006), we examine informal institutions and formal institutions in their totality and study the degree of convergence between the two. Future work can further tease out each of the two and look at other institutional aspects such as heterogeneity (or diversity, multiplicity, dimensionality). For instance, just as there can be convergence/divergence between the systems of formal and informal institutions in their totality, one could also examine the degree of convergence/divergence (or internal consistency) within the system of informal institutions in a given market. This is beyond the scope of the current study, but we would encourage this as an additional step in this line of research.

Future work can examine the antecedents of the institutional aspects we tease out in this article, such as informal institutional effectiveness and informal–formal institutional convergence. This could include research on nonmarket strategy of how MNEs can seek to impact informal institutional factors (Mellahi et al., 2016, see also Brandl et al. and Li et al. in this SI). In section three, we focus primarily on the host-market institutional environment. Future work could also focus on the home-market institutional environment. The home-market environment provides an imprinting effect for MNEs that may also affect their degree of local adaptation in a host market.

Another area for future work can be to examine other characteristics of informal institutions beyond those we examine here. For instance, in place of looking at informal institutional effectiveness capturing the full informal institutional environment of a market, future work can examine the effectiveness of one particular informal institution or norm in a given market and its consequences. Further, examining specific informal institutions or sets of institutions such as those covered in this SI – aspects like social trust (see Brockman et al. and Gaur et al. in this SI), public sentiment (see Yiu et al. in this SI), and superstition (see Andrews et al. in this SI) – and their relationships to MNE international strategy would also be useful to advance the literature. Moreover, other aspects explored in the SI articles – such as historical institutional legacies (see Zhang et al. in this SI), absorptive capacity (see Yao et al. in this SI), political ties or participation (see Li et al. and Sofka et al. in this SI), and family business legitimacy (see Berrone et al. in this SI) – can also be extended in future work by examining how they relate to the conceptualizations developed in this article.

In conclusion, given the importance of informal institutions for the field of IB and the relatively limited work that has been conducted on the topic when compared to work on formal institutions, we believe this article can meaningfully help stimulate and advance work on the topic going forward.

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## NOTES

[1]For a brief review of the IB literature on informal institutions, see the Editorial introduction to this SI. Note also that a number of articles on informal institutions were developed in response to the SI Call for Papers, several of which were not selected and were submitted elsewhere. So we are starting to see a growing number of publications on the topic in other journals as a positive externality or spillover from the Call for Papers, not to mention additional work that is now being developed on the topic.

[2]We adopt the definitions of institutions, formal institutions, and informal institutions used in this SI – including in the Call for Papers and in the introductory Editorial article – for the sake of internal consistency of the SI. Furthermore, as described in the Editorial, these definitions are the most commonly employed across different streams of institutional work. The Editorial also discusses other major definitions used in institutional work, such as Scott's (1995), which break down institutions into regulative, normative, and cognitive. This article does not examine this distinction, to avoid distracting the reader as the focus is on formal and informal institutions, but this can be studied in future work.

[3]In line with prior work, such as Helmke and Levitsky (2004, 2006), we examine informal institutions and formal institutions in their totality and study the degree of convergence between the two. As we discuss in the conclusion, future work can further tease out each of the two and look at other institutional aspects such as heterogeneity (or diversity, multiplicity, dimensionality).

[4]Other terms related to formal institutional effectiveness that are commonly used in the IB literature include: *formal institutional strength or weakness* which captures whether the formal rules in place function property to allow for and encourage market efficiency (Coeurderoy & Verbeke, 2016; Feinberg & Gupta, 2009). Similarly, *formal institutional quality* refers to how well developed and established are the formal rules and enforcement mechanisms in place in a market (Liu, Feils, & Scholnick, 2011; Mickiewicz, Stephan, & Shami, 2021; Miletkov, Poulsen, & Wintoki, 2017). *Formal institutional voids* (typically referred to simply as institutional voids) refer to missing, weak, or ineffective formal rules, such as weak legal and regulatory systems in place in a given market, as well as missing intermediaries that are required for the proper functioning of the market (Doh et al., 2017; Khanna & Palepu, 1997). We examine formal institutional effectiveness, since we are building on Helmke and Levitsky (2004) to be consistent with their terminology.

[5]Other terms related to institutional convergence that are used in the literature are *institutional alignment* (see Yao et al. in this SI) and *institutional congruence* (Fredström, Peltonen, & Wincent, 2021). Furthermore, the rich *institutional polycentrism* literature is also closely related to this concept, as it refers to *close coupling* and *decoupling* of formal and informal institutions (Ostrom, 1990, 2005, 2008, 2010). There is also an emerging, but thus far limited, literature on the role of polycentric institutions in management (Batjargal, 2010; Batjargal, Hitt, Tsui, Arregle, Webb, & Miller, 2013; Xu & Hitt, 2012).

[6]This is not to criticize their valuable work, but simply to build on it. We discuss the implications of their conceptualization in more detail in section four.

[7]We considered several terms to capture informal institutional effectiveness, including informal institutional prominence, salience, pressure, and

strength. These may be more intuitive to capture the extent to which informal institutions are meaningful and important in a given market. However, we used informal institutional effectiveness to be consistent with the terminology used by Helmke and Levitsky (2004) of formal institutional effectiveness, and to show more readily how this article connects to and builds on their work.

[8]The terms institutional distance/proximity are analogous to institutional divergence/convergence. We describe the institutional convergence between the formal and informal institutional structures in place in a market. Institutional distance/proximity on the other hand captures the degree of convergence between the home- and host-country institutional frameworks. As such, the term convergence serves as a way to generalize several institutional relationships, including that of institutional distance. However, we use the term institutional distance in the article, to be consistent with the more common nomenclature used in the IB field. We consider this at greater length in the discussion section of the article.

[9]The institutional literature is made up of three major institutional traditions: rational choice institutionalism (a.k.a., institutional economics, new institutional economics: Acemoglu, Johnson, & Robinson, 2001, 2003; Djankov et al., 2003; North, 1990, 2005; Shleifer & Vishny, 1998; Williamson, 1985, 2000), organizational institutionalism (a.k.a. neo-institutional theory: Meyer & Rowan, 1977; DiMaggio & Powell, 1983, 1991; Powell & DiMaggio, 1991, 2012; Scott, 1987, 1995, 2013; Selznick, 1957), and historical institutionalism (a.k.a., comparative institutionalism, with comparative capitalism as an important strand: Block, 1994; Fukuyama, 2004; Granovetter, 1985, 1992, 2017; Hall & Soskice, 2001; LaPorta, Lopez-de-Silanes, Shleifer, & Vishny, 1998; Polanyi, 1957; Stark, 1996), each arising from different academic fields (Campbell, 2004; Campbell & Pedersen, 2001; Hall & Taylor, 1996; Hotho & Pedersen, 2012). For a detailed treatment of the three as they relate to informal institutions and IB, see the introductory Editorial to this SI.

[10]Future empirical work can pin down more precisely where each market falls in the typology, by developing or using extant measures of each of the three dimensions. As with all measures, these will of course have some limitations and may not capture the totality and may miss some important aspects of formal and/or informal institutional effectiveness and/or convergence. However, this would allow researchers to develop a classification of markets into the eight categories of the typology.

[11]As we explain below, this can be conceptualized at different levels of analysis where formal and informal institutions exist, including at the market level and at the firm level.

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