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Comparing capitalisms: understanding institutional diversity and its implications for international business

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Abstract

This paper examines the role of institutional analysis within the field of international business (IB) studies. Within IB, institutions matter, but the view of institutions tends to be "thin", utilizing summary indicators rather than detailed description, and thus approaches institutions as unidimensional "variables" that impact on particular facets of business activity. This paper argues that IB research would be usefully advanced by greater attention to *comparing* the topography of institutional landscapes and understanding their diversity. A number of alternative case-based approaches are outlined that draw on a growing "comparative capitalisms" literature in sociology and political science. The paper develops a number of empirical examples to show the utility and limits of these approaches for IB scholars.
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INTRODUCTION

Scholars of international business (IB) know that "institutions matter", but how they matter remains a hotly contested question. Multinational enterprises (MNEs) operate in different business environments and face challenges in strategically locating themselves and adapting to the diversity of institutions across countries and regions. MNEs bring different home country endowments in the way of routines, standard practices, and capabilities, but operate in diverse host country environments where very different sets of institutional constraints and opportunities may exist. MNEs' experience in emerging markets, including central and eastern Europe, has highlighted the importance of institutions for understanding business strategy and performance across national borders.

The theoretical and methodological approaches to studying institutions remain diverse, and draw variably from different fields of social science, such as economics (Aoki, 2001; North, 1990), sociology (Powell & DiMaggio, 1991; Streeck & Thelen, 2005), and political science (Immergut, 1998; Thelen, 1999). Indeed, the very meaning of institutions remains contested, and despite much interdisciplinary cross-fertilization, institutional theory remains characterized by an eclectic set of approaches.

Institutions may be defined as the "rules of the game" (North, 1990) or more broadly as regulative, normative, or cognitive parameters (Scott, 1995) that influence organizations in various ways. IB scholars have studied institutions in terms of how diverse regulatory rules and legal norms impact on transaction costs for MNEs (Brouthers, 2002) or expose firms to politically related hazards (Delios & Henisz, 2000). Institutions offer different degrees of support for market exchange (e.g., between advanced capitalist economies and transitional or emerging economies) by securing property rights or protecting investors (Djankov, Glaeser, La Porta, Lopez-de-Silanes, & Shleifer, 2003). Institutions also create uncertainty for MNEs owing to the "distance" between home and host country institutions (Kostova, 1999) or between cultures (Hofstede, 1980). IB scholars have thus stressed how institutions create incentives and constraints on strategic choice (Ingram & Clay, 2000), and link MNEs' success with the adaptation of their strategy or structure to the institutional environments in diverse host countries (e.g., Wan, 2005). While institutions matter, the view of institutions in IB tends to be "thin" in utilizing summary indicators rather than detailed description, and thus approaches institutions as unidimensional "variables" that influence particular facets of business activity.

Despite a renewed focus on institutions, IB research has devoted surprisingly little attention to *comparing* the topography of institutional landscapes and understanding their diversity. Comparative approaches to studying business exist in fields such as industrial sociology (Dore, 1973; Sorge & Warner, 1986), political economy (Katzenstein, 1985; Shonfield, 1965), economics (Aoki, 1988, Greif, 2005), and even business studies itself (Chandler, 1990; Porter, 1990). More recently, a new body of literature, which we define as *comparative capitalisms* (CC), has gone beyond these approaches to examine how institutions across several economic domains interact to form distinct national constellations or "varieties" of capitalism (Amable, 2003; Crouch & Streeck, 1997; Hall & Soskice, 2001; Whitley, 1999). Institutions exist in distinct *national configurations* or types that generate a particular systemic logic[1] of economic action and competitive advantages related to complementarities among those institutions. The emphasis is on *how* and *why* institutions differ across countries, often starting from a "thick" description of institutions (see Redding, 2005) and holistic analysis of institutions within a specific national "case".

A key contribution of the CC approach is the analysis of *non-market forms of coordination*. Rather than treating institutional diversity in terms of its "distance" from the norms of an MNE's home country or ideal-typical liberal markets, the CC approach has developed a theory of comparative institutional advantage in which different institutional arrangements have distinct strengths and weaknesses for different kinds of economic activity. By stressing the social embeddedness of firms or other economic actors (Granovetter, 1985), institutions are seen not only as constraints but also as resources for solving key problems of economic coordination through non-economic, value-rational sets of commitments. The CC approach may be seen as an institutional theory of the *supply side* of the economy that examines how institutions shape the supply of inputs (e.g., skills, capital) collectively available to firms and the legitimate forms of coordination or governance that determine their usage. This approach has been well suited to explain the distinct comparative advantages of countries such as Japan, based on incremental innovation and flatter organizations, or the United States, based on more radical innovation and network forms of organization, such as in Silicon Valley (Aoki, 2001).

The IB and CC approaches to institutions thus have very different theoretical assumptions, methodological predilections, and analytical foci. However, we argue that a strong potential for cross-fertilization exists. While IB has contributed much to understanding how firms deal strategically with institutions, this perspective misses important ways in which institutions impact on MNEs, and particularly how strategy is shaped by institutionally available resource capabilities and governance structures. Whereas IB sees institutions as producing generic sets of constraints related to broad constructs such as "distance", in fact MNE strategies are shaped by the nature and interactions between *particular* home and host country institutions studied in the CC approach (Sorge, 2005). Conversely, the CC approach may benefit by drawing on IB to better understand how MNEs engage in institutional arbitrage and diffusion, strategically manage their global value chains, and thereby create regime competition that may trigger institutional change. A more firm-centered perspective will help move beyond debates about convergence or persistent divergence of national institutional systems and enable an approach to institutional change that is more dynamic by taking account of the tensions between global and local forms of organization, as well as their incremental adjustment and potential hybridization.

In this paper, we examine how institutions have been studied in the IB and CC literatures respectively along four key dimensions:

- how firms are embedded in institutions;
- institutional configurations at the national level;
- the approach to competitive advantage; and
- understanding of institutional change.

In the next section, we show how the IB literature has approached institutions as a constraint on MNE activity through transaction costs, differing resource environments or institutional distance. The focus is on how MNEs can best "fit" or adapt their strategies to diverse institutional settings, which are taken largely as given. The third section examines how institutions are studied within the CC literature along the same four dimensions, stressing how institutions are studied within the context of distinct "types" of capitalism that reflect diverse forms of coordination, patterns of authority, or governance. The fourth section contrasts and seeks to reconcile these two approaches. One essential methodological difference is that the IB literature has approached institutions largely as "variables" or single parameters that *constrain* business decisions. Meanwhile, the CC literature has emphasized how institutions must be analyzed in the context of a particular "case" as part of wider, non-random configurations of institutions that directly influence or *constitute* the capabilities of businesses themselves within different national forms of capitalism.

We argue further that IB and CC may usefully inform one another. CC may contribute to the study of MNE strategies by stressing the country-specific nature of how MNEs export, adapt, or arbitrate between diverse sets of institutions. This suggests placing more focus on national economies as a unit of analysis, and asking how distinct "cases" of institutional diversity shape both market and non-market forms of business coordination. Likewise, IB may also contribute to studies of institutional change in the CC literature in ways that generate a more dynamic theory of institutional change. Here IB has much to say about issues of strategic choice and organizational adaptation of firms, such as through learning, decoupling, symbolic management and the like. We also suggest that many recent contributions of the CC literature are consistent with this approach.

INTERNATIONAL BUSINESS: VARIABLE-BASED APPROACHES TO INSTITUTIONAL ANALYSIS

In this section we examine how IB scholars have applied institutional theory, and highlight some common features of this approach. Table 1 compares different strands of this literature along four dimensions: how firms are embedded in institutions; the major institutional differences posited across countries; the approach to competitive advantage; and understanding of institutional change. Notably, IB scholars have taken MNE strategy as the basic unit of analysis and sought to understand institutions as "variables" or particular dimensions that constrain or impact on the cost of IB activity.

An important focus of the IB literature is on how host country institutions shape the mode of entry of foreign businesses by creating *restrictions*, *costs* or *hazards* for MNEs (Brouthers, 2002; Meyer, 2001).[2] Institutions, such as legal restrictions on foreign equity ownership, may affect timing, location, or entry mode decisions in different ways. For example, MNEs are likely to choose a wholly owned subsidiary as contractual hazards increase (i.e., the incentives for opportunistic behavior by counterparties) or joint ventures as political hazards increase (Henisz, 2000). Peng (2003) also argues that, where formal institutions supporting markets are "underdeveloped", MNEs will rely more on joint ventures than on wholly owned subsidiaries as a way of dealing with informal institutional constraints. More generally, firms may adopt informal network-based organization either as a response to less advanced or incomplete institutional infrastructure (Peng & Heath, 1996) or as an adaptation to persistent cultural patterns such as particularistic social ties used in the absence of universalistic, impersonally ordered institutional ties (Pearce, Branyiczki, & Bigley, 2000). Institutions, such as the legal system, thus vitally impact on the costs of using markets, such as the stock market (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998) or different forms of labor (Djankov, La Porta, Lopez-de-Silanes, & Shleifer, 2002). In sum, this approach draws usefully on transaction costs economics in understanding how institutions impact on market behavior (see also Henisz & Williamson, 1999).

Table 1 Institutional approaches within the IB literature

View of institutions	*Country patterns/institutional configurations*	*Comparative advantage*	*Institutional change*
Costs Constraint on strategy	None. Degree of market development (e.g., developed *vs* emerging economies)	Fit of strategy or structure to context of transaction costs	Institutions taken as given
Resources Constraint on strategy	None. Degree of resources (e.g., developed *vs* emerging economies, institution *vs* factor-led developing economies)	Fit of strategy to exploit or complement context of resources	Institutions taken as given
Distance Constraint on strategy	None. Degree of pair-wise difference matters	Fit of strategy to minimize or compensate for high distance; conversely, low distance enhances transferability and lower costs	Institutions taken as given

Institutions may also be seen as *resources* that influence the strategic development of firm-specific resources and the likelihood of success of different corporate strategies (Wan, 2005). Resources may be more ''plentiful'' or ''deficient'' in different country environments, and create opportunities for firms to utilize different types of firm-specific capabilities, such as competitive market-based resources or non-market-based resources that strengthen the internal or political capacity for control. Resource environments of countries are differentiated according to the level of institutional infrastructure, such as between developed and emerging economies, as well as between institution-driven and factor-driven emerging economies. In short, firm-specific resources should ''fit'' the particular resource environments of a host country. This perspective draws closely on the resource-based view (RBV) of the firm (Barney, 1991), and links RBV with institutional theory (Wright, Filatotchev, Hoskisson, & Peng, 2005).

A final IB approach sees institutions in terms of the *institutional distance* between home country and host country business practices. Much work on cross-national differences has been influenced by cultural value theory, which drew heavily on the work of Hofstede and cross-cultural psychology (Hofstede, 1980; Schwartz, 1994). This work stresses underlying differences in values that affect behavior in business across a wide range of areas. Researchers have attempted to identify a small number of universal dimensions to culture.[3] These cultural dimensions are often linked with different business outcomes. For example, Chui, Lloyd, and Kwok (2002) argue that high levels of corporate debt are negatively related to a country's level of Schwartz's conservatism and mastery values. Others argue that the ''distance'' or difference between home and host country cultures is important for MNEs' entry mode choice, international diversification strategies, and performance (see Tihanyi, Griffith, & Russell, 2005). Here cultural difference increases the cost of entry, decreases the efficiency of operations, and hampers the ability of firms to transfer core competencies or home country practices (Barkema & Vermeulen, 1997; Brouthers & Brouthers, 2001).

While the cultural literature is less concerned with concrete differences in how business is organized, the concept of ''distance'' has also been developed in institutional theory to study issues of cross-national diffusion and transplantation of practices. Institutional distance has been measured in terms of broad country-level institutional profiles that capture the relative distance between countries, and apply this to study issues such as cross-national transfer (Kostova, 1999; Kostova & Roth, 2002). Notably, this literature goes beyond the emphasis on regulative aspects of institutions that affect transaction costs or resources, and integrates normative and cognitive aspects of institutions. For example, Gaur, Delios, and Singh (2007) use the *World Competitiveness Yearbook* to obtain seven indicators of regulative aspects (political transparency, anti-trust regulation, intellectual property protection, judicial system efficiency, fiscal policy, inflation, and market dominance in key industries) and seven indicators of normative aspects (responsiveness of the political system to economic challenges, bureaucratic corruption, government's attitude towards economic realities, transparency towards citizens, political risk, bureaucratic hindrance to economic development, and the independence of local authorities). This approach has thus greatly broadened the range of dimensions and measures used to conceptualize institutions, and integrated these into composite notions of institutional distance or measured degree of similarity across a wide array of scored indices of institutional development (Delios & Beamish, 1999; Gaur & Lu, 2007; Wan & Hoskisson, 2003). Institutional distance is hypothesized to increase transaction costs, making it harder for MNEs to obtain reliable information, and discouraging investment into institutionally distant countries. Conversely, governments may treat MNEs differently if they are more "foreign". Other work has stressed that the impact of institutional distance may vary according to different aspects or dimensions of institutional distance, and that investors or firms may mediate the impact of distance through the accumulation of experience (Ionascu, Meyer, & Estrin, 2004). To this end, Ghemawat (2001) proposes an integrative perspective on difference that includes cultural distance, administrative or political distance, geographic distance, and economic distance.

Drawing on Table 1, we propose some common characteristics in how the IB literature has used institutional theory. First, the IB literature stresses how regulative, normative or cognitive institutions constrain the strategic choices of MNEs. In particular, institutions influence the transaction costs involved in using markets in different countries (Henisz & Williamson, 1999) and the different risks associated with diverse country environments (Brouthers, 2002). Likewise, high degrees of institutional "distance" are associated with additional costs for coordinating IB activity. MNEs or informal institutions may serve as functional substitutes for "incomplete" development of formal institutions or "institutional voids" characterized by "the absence of specialist intermediaries, regulatory systems, and contract-enforcing mechanisms" (Khanna & Palepu, 2006: 62). This choice-within-constraints approach to understanding institutions has been discussed widely elsewhere (Ingram & Clay, 2000).

Second, institutions are studied largely as single "variables" that impact on firms rather than in relation to specific national "cases" (Ragin & Zaret, 1983). In terms of methods, institutions influence MNEs along single dimensions, such as costs, resources, or distance, that vary from high to low. Institutional diversity is measured in terms of conventional continuous variables that can be applied within conventional statistical techniques. For example, regulative institutions are often measured in terms of the severity of legal restrictions on business activity in different countries, either as perceived by business (Brouthers, 2002) or ranked based on objective criteria (Djankov et al., 2002). Measures of institutional distance go beyond single measures to encompass a wide range of regulative, normative or cognitive institutions, but aggregate these institutional indices into single measures of distance between home and host country scores. However, the use of highly aggregated measures and linear-based statistical techniques elides the possible importance of *particular combinations* of institutions, as opposed to the simple linear degree or "distance" as a total sum of vectors. Consequently, IB has discussed cross-national diversity in terms of "levels" of development (e.g., between advanced and emerging economies) or the relative "distance" between pairs of countries, rather than institutions as particular configurations or "types" of cases at the country level.

Third, institutions impact on the competitive advantage of firms through their "fit" or adaptation to different institutional environments. Firms are argued to be more successful if they adapt to or develop capabilities that complement the risk, cost or resource environments of different countries. For example, MNEs may substitute hierarchy for markets in distant or underdeveloped institutional environments, or develop capabilities that complement those different resource environments (Wan, 2005). Firm-specific factors, such as organizational capacities, experience and learning, influence the success of firms in adapting to different institutional environments (Delios & Henisz, 2000). However, the IB literature is less clear about how institutional diversity impacts on the capabilities of firms to pursue different types of strategy or forms of innovation. Non-market forms of coordination, such as through ownership control or networks, are treated largely as a substitute for "deficient" market-oriented institutions.

Finally, in stressing firms' strategic responses to institutions (see more generally Oliver, 1991), the IB literature has paid relatively little explicit attention to how institutions change and evolve. Where change is acknowledged, it is seen as driven by competition based on the relative efficiency of alternative institutions. Alternatively, institutions are taken as given through exogenous political and cultural factors that tend to be viewed as stable. For example, politics may entrench vested interests for particular groups and hence lead to high levels of stability or path dependence (Bebchuk & Roe, 1999).

In sum, the IB literature has demonstrated the importance of institutions, such as host country context, for the strategy and performance of MNEs. A major contribution of IB is to see how MNEs deal strategically with institutions by adapting their strategy and structure in the face of "deficient" or distant institutions. However, a number of critical observations can be made. First, the view of institutions in IB remains rather "thin" in stressing how institutions constrain strategic choice. Firms remain largely unitary, rational, and self-interested actors with stable preferences, although constrained by institutional rules and norms. Less attention is given to conceptualizing how institutions socialize the diverse sets of actors related to the firm (managers, employees, owners, partner firms), or shape the interests and the interactions among those stakeholders, and hence the capabilities of firms to pursue different strategies. Second, the variable-based approach views institutional diversity as variation along discrete parameters at a high level of aggregation. This approach neglects the potential for interactions among these different institutional dimensions that give rise not just to differences *of degree*, but to fundamental differences *in kind*, where the impact of one institution may depend very much on the presence or absence of particular other institutions. Institutional effects are themselves unlikely to be universal. Third, IB has consequently conceived of comparative advantage in a somewhat narrow sense of "fit" between firm strategies and institutional environments. However, this literature says surprisingly little about the advantages of the institutional arrangements themselves (Porter, 1990), apart from the degree to which they support market activity. Despite the aforementioned work linking institutions to resources and the RBV of the firm, IB has no explicit theory linking institutions to the coordination problems facing firms across a variety of functional domains, such as finance, human resources, or managerial capabilities. Finally, given the emphasis on the effects of institutions, the IB literature has little explicit theory about the origin or change of diverse institutions. In the next section, we argue that recent comparative institutional analysis has developed a substantially different, "case"-based approach that goes a long way to redress these gaps and thereby offers a substantial contribution to the IB literature.

COMPARATIVE CAPITALISM: CASE-BASED COMPARISONS OF INSTITUTIONS-AS-CONFIGURATIONS

Comparative studies of business have a long tradition in sociology and political science, and contributed a substantial body of knowledge about the diversity of employment (Streeck, 1992), financial systems (Zysman, 1983), and corporate governance (Aguilera & Jackson, 2003) across countries. The CC literature represents an attempt to synthesize such comparisons of particular institutions as "building blocks" into a broader theoretical approach to understanding national systems. Institutions are viewed as being systemically interdependent configurations, rather than in isolation (Aoki, 1994). That is, the ways in which firms solve coordination problems in different domains (e.g., finance, labor, management, inter-firm relations) are seen as functionally interdependent in fundamental ways that may create strategic complementarities among different sets of institutions (Milgrom & Roberts, 1990, 1994). The resulting internal cohesion among institutions leads to non-random "types" or patterns of institutions at a national level and particular endemic strategies at the firm level. However, since Albert's (1993) popular characterization of Rhineland *vs* Anglo-Saxon capitalism, the question of how to categorize and compare different "types" of capitalism remains hotly debated.

In this section, we examine how the CC literature has approached the study of institutions in order to identify the common features within this literature and its respective differences from the IB literature. We focus on three representative approaches: the varieties of capitalism approach; the national business systems approach; and the governance approach. Table 2 summarizes these approaches along the same four dimensions discussed in the previous section. We argue that these literatures have several common elements that distinguish the CC approach: studying institutions as resources for non-market forms of coordination; comparison of institutional configurations that stresses their integrity as national cases; a theory of comparative institutional advantage for different types of

Table 2 Institutional approaches within the CC literature

View of institutions	*Country patterns/institutional configurations*	*Comparative advantage*	*Institutional change*
Coordination Resource for strategy	Liberal *vs* coordinated market economies	Resources for radical *vs* incremental innovation Specific *vs* general asset-based strategies	Path dependence due to complementarities
Coordination and coherence Legitimate authority	Six types: • fragmented • coordinated • industrial district • compartmentalized • state-organized • highly coordinated	Firm-level based on coordinating, learning, and reconfigurational capabilities consistent with institutional context	Path dependence due to complementarities and traditions of state authority
Governance Power relations with external enforcement	Infinite types	Resources for different sectoral advantages or product niches diverging in quality, price and standardization. Also different macroeconomic levels of inequality	Path dependence, but change through incremental adjustment and recombination of institutions is possible

economic activity; and a broad notion of institutional path dependence.

The CC literature often sees institutions in terms of resources for *strategic coordination* across different institutional domains. Firms seek to develop core competencies and dynamic capabilities, but the pursuit of these competencies and capabilities requires firms to develop and manage successful relationships with other micro-agents, as in transaction cost (Milgrom & Roberts, 1990; Williamson, 1975) or principal–agent approaches. But whereas new institutional economics conventionally sees institutional structure as following firm strategy (e.g., firms create structures that are efficient for them), strategy is seen as being constrained by institutional structures and thereby leads to different firm behavior across institutional settings (Hall & Soskice, 2001: 14–15). On this basis, Hall and Soskice (2001) distinguish two basic types of production regime (capitalisms): *liberal market economies* (LMEs) and *coordinated market economies* (CMEs). This ''varieties of capitalism'' typology is based on the relative extent of market coordination through investment in transferable assets *vs* strategic coordination through investment in specific assets.

Hall and Soskice link their analysis closely to the economic functions of institutions for firms in ways that articulate a very parsimonious theory of comparative institutional advantage, wherein ''the institutional structure of the political economy provides firms with advantages for engaging in specific kinds of activities'' (Hall & Soskice, 2001: 32). In liberal economies such as the US, UK, or Canada the market plays the dominant role in coordinating economic behavior, and the state remains an arm's length enforcer of contracts. LMEs share the following characteristics across the four key institutional domains: short-term orientated company finance; deregulated labor markets; general education; and strong inter-company competition. Here firms are most successful when they pursue production and market strategies that seek to exploit easily transferred assets. This, in turn, imparts these national systems with an institutional advantage in radical forms of innovation. In coordinated economies such as Germany, Sweden, or Austria firm behavior is strategically coordinated to a larger extent through non-market mechanisms. CMEs utilize long-term industrial finance, cooperative industrial relations, high levels of vocational and firm-specific training, and cooperation in technology and standard-setting across companies. This institutional context gives firms incentives and capabilities to pursue production and market strategies that seek to exploit the advantages of non-transferable or specific assets. CME institutions provide competitive advantage for incremental forms of innovation.

A central theoretical claim is that models of capitalism display strong complementarities between the four institutional domains (Soskice, 1999: 110). Institutions facilitating strategic (or market) coordination in one domain also support similar forms of coordination in other domains. For example, short-term finance requires quick entry and exit from business activities, and the value of this type of finance is mutually enhanced by industrial relations systems that allow inexpensive hiring and firing of labor. Intrinsic complementarities across different institutional domains suggest that institutions should not be distributed randomly, but cluster into two cohesive types.[4] In fact, additive measures of strategic coordination have been used in ways similar to the variable-based approaches in IB, though with an emphasis on interaction effects (Hall & Gingerich, 2004). Intermediate or "mixed" cases are predicted to underperform "pure" LME or CME types (Hall & Soskice, 2001; Kenworthy, 2006). This suggests a U-shaped relationship, where countries that cluster near either of the bipolar institutional types of pure coordination will have better economic performance than intermediate cases. Moreover, the institutional complementarities within LMEs or CMEs are argued to be a source of path dependence and a high degree of institutional stability. These claims have led to several criticisms regarding the two-dimensional CME *vs* LME typology, including its neglect of the state (Ebbinghaus, 1999; Schmidt, 2002) and the problems of reconciling the theory of complementarities with the empirical observations of mixed cases or change in capitalist systems (Allen, 2004; Blyth, 2003).

A second CC approach conceptualizes institutions in a more Weberian fashion as patterns of *legitimate authority* that give rise to different forms of coordination within and across business firms. Comparisons of East Asia emphasized differences in how business groups in Japan, South Korea and Taiwan evolved in relation to state and its efforts to establish or maintain legitimate political rule (Biggart, 1991). Some authors differentiated coordination along horizontal and vertical dimensions in order to identify at least three types of capitalism: alliance capitalism, dirigiste capitalism, and familial capitalism (Orru, Biggart, & Hamilton, 1997).[5] Richard Whitley incorporated these forms of authority into a systematic approach to comparing "national business systems" as "distinctive patterns of economic organization that vary in their degree and mode of authoritative coordination of economic activities, and in the organization of, and interconnections between, owners, managers, experts, and other employees" (Whitley, 1999: 33). While similar to Hall and Soskice in its emphasis on the importance of institutional configurations and complementarities, this approach includes more sociological variables, and discusses the internal make-up of firms (see also Redding, 2005), such as ownership control and sectoral *vs* intersectoral coordination. This allows a more fine-grained distinction among different forms of non-market coordination and even different sorts of hierarchy within firms. This framework utilizes eight comparative dimensions:

- the means of owner control (direct, alliance, or market);
- the extent of integration of production chains by ownership (low, medium, high);
- the extent of integration of industrial sectors through ownership;
- the extent of alliance coordination of production chains;
- the extent of collaboration between competitors;
- the extent of alliance coordination of sectors;
- the extent of employer–employee interdependence; and
- the extent of delegation to and trust of employees.

In moving beyond dichotomous classification, the business systems approach identifies six ideal types. Two types are broadly market-oriented: *fragmented systems* are dominated by small firms, and *compartmentalized systems* such as the US have large and integrated firms competing with each other in arm's length markets. Four other types cover a variety of non-market forms of coordination, in terms of *industrial districts* (e.g., the "Third Italy"), *highly coordinated systems* (e.g., coordination via ownership and horizontal alliances, such as Japanese keiretsu), *collaborative systems* (e.g., Germany based on sectoral associations), or *state organized systems* (e.g., France) with strong ownership control among large firms, but supported through state subsidies for credit. These are linked to a more varied notion of competitive advantage based on the degree of innovation, as well as the capacity for flexible adaptation.

National business systems are argued to have path-dependent features rooted in their institutional coherence and strategic complementarities for firms. However, Whitley is careful to distinguish the institutional environment (e.g., states, financial systems, skill development, and trust and authority) from the internal aspects of firm organization. Thus Whitley (2005) points to varying degrees of diversity in internal firm organization within national business systems, arguing that the character of the state determines the degree of institutional coherence and homogeneity in firm behavior across the national economy. Liberal states act as market regulators with minimal intervention, allowing firms to be more diverse in their strategies. Thus Silicon Valley firms, deeply enmeshed in various forms of network coordination (Saxenian, 1994), coexist with vertically integrated manufacturers in Detroit producing within a nexus of arm's length market relationships. Meanwhile, promotional states tend to homogenize firm strategy because they direct economic activity and organize interest groups in order to achieve either developmental goals (developmental state) or social harmony (business corporatist state). Consequently, the emphasis on path dependence is counterbalanced to some extent by seeing the degree of institutional constraint as variable cross-nationally and over time. So change is possible, but within some broader boundaries – which resonate with recent notions of institutional meta-traditions (Sorge, 2005).

A final CC approach sees institutions in terms of mechanisms or processes of *governance* (Crouch & Streeck, 1997; Hollingsworth & Boyer, 1997; Hollingsworth, Schmitter, & Streeck, 1994). Institutions are compared in terms of how they embody different generic coordination mechanisms, such as *markets* and *hierarchies* (Williamson, 1975). This approach addresses additional coordination mechanisms, which are either ignored or conceived differently in the IB literature, such as *social networks* (Powell, 1991), *community norms* (Aoki, 2001), *associations* (Streeck & Schmitter, 1985), and *state intervention* (Shonfield, 1965). These six basic governance mechanisms describe the degree to which power is distributed horizontally or exercised vertically (as in Whitley) and the degree to which self-interest *vs* social obligations (each reflects a different "logic of appropriateness") governs economic actors.[6]

Unlike other CC approaches, the governance approach has increasingly moved away from utilizing broad national-level typologies. Early studies compared industrial sectors rather than nations (Hollingsworth et al., 1994), and often found substantial variation across sectors within single countries. Yet Hollingsworth & Streeck (1994: 272) conclude that

> just as sectoral differences in technology and market conditions give rise to differences in industrial order within countries, national differences produce different governance regimes within sectors. Differences in governance within sectors are often recognizable as national differences in that they follow a similar logic across sectors.

Later comparisons used the collection of governance mechanisms to identify the distinctiveness or even uniqueness of different national models (Crouch & Streeck, 1997). When national typologies are employed, these tend to be derived from empirical and inductive methods for grouping countries, rather than economic theory or ideal types. For example, Amable (2003) undertook a cluster analysis of institutional indicators related to product market competition, labor market institutions, finance/corporate governance, social protection/welfare state, and the education/training system. This yielded five types or clusters of capitalism: market-based, social-democratic, continental European, Mediterranean, and an Asian model.[7] Unlike the traditional variable-based approaches of IB, cluster analysis has an inductive emphasis on how variables combine at the level of national cases, and links these cases with different performance outcomes empirically. Here CC has moved beyond the comparison of firm strategies in two or more countries toward statistical or set-theoretical analyses that directly link institutions-as-configurations to diverse economic outcomes (see Boyer, 2004; Kogut & Ragin, 2006).

The concept of institutional complementarity has remained important within the governance approach, but applied in a less rigid way and linked to a wider notion of comparative institutional advantage. Comparative institutional advantage was initially studied in terms of the production strategies of firms, such as differences between Fordist mass production and alternative patterns of flexible specialization or diversified quality production. Later, Boyer (2004) utilized set theoretical analysis based on qualitative comparative analysis to demonstrate a link between successful "technology-led growth regimes" in ICT sectors and at least three distinct clusters or institutional configurations, including a Scandinavian cluster. Cross-country differences are again reflected in sectoral performance profiles, but produce some different substantive results in terms of country patterns and the particular sets of complementarities argued to drive performance. The governance approach further stresses the distributional consequences of capitalist diversity. For example, national corporate governance models have different normative conceptions of who should control the corporation, different distributions of value-added among the corporate stakeholders (De Jong, 1996; Dore, 2000), and broader differences in the levels of inequality (Rueda & Pontusson, 2000). Countries such as Sweden, Germany, and Japan were able to achieve excellent economic performance and maintain much more egalitarian patterns of income distribution than Anglo-Saxon models of capitalism. Thus different systems of capitalism may produce different levels or patterns of social exclusion.

In sum, the CC literature encompasses diverse approaches to institutions, the dimensions of comparison, and the resulting comparative typologies, which range from dichotomous ideal types to seeing each national case as a unique configuration. More recent literature has also continued to identify additional dimensions and typologies when looking at transitional economies (Holscher, Tomann, Lane, & Myant, 2007). Other influential theorists prefer to approach comparative institutional analysis without aiming at broad national typologies, but developing middle-range theoretical models that map diversity within domains and a limited number of bilateral linkages between them (Aoki, 2001). While not trivializing these differences (see Jackson & Deeg, 2006), we argue that several common features of the CC approach can be identified.

First, institutions influence the identity and interests of economic actors, and hence the development of firm resources and capabilities. Unlike the emphasis on institutions as constraints as in IB, this literature links a supply-side theory of institutions to resource-based theories of the firm (Barney, 1991) or economic theories of the firm that stress tacit skills based in informal organization, routines, etc. (Nelson & Winter, 1982; Penrose, 1959). Starting with the embeddedness of actors in a particular social context (Granovetter, 1985), CC scholars pay close attention to how private economic actors (e.g., firms, networks, associations) are socially organized and interact within one another – a "thick" view of institutions that takes account of the diverse identities and interests of actors across countries, including investors, employees, unions, managers, firms, and business groups (Redding, 2005). Firms are seen not as unitary actors, but as coalitions among different types of investors, employee and manager, whose interactions are shaped by various institutions outside the firm (Aguilera & Jackson, 2003). In turn, firms may develop different internal capabilities and foundations for competitive advantage across countries. For example, strong insider control and blockholding owners may facilitate strategies based on investment in specific types of human assets because these owners may better protect the unique contributions (firm-specific skills, dedicated capital, etc.) that each type of actor must make (Gourevitch & Shinn, 2005).

Second, the CC literature conceptualizes various institutions within an economy as being interdependent and often complementary. This approach is fundamentally different from IB approaches based on institutions as single variables, because it shows how different domains of the economy are functionally interrelated within one another, and give rise to specific, non-random configurations of capitalism. Complementarity may be defined as situations where the difference in utility between two alternative institutions $U(x')$ $U(x'')$ increases for all actors in the domain X, when z' rather than z'' prevails in domain Z, and vice versa. If these conditions, known as "super-modularity", exist, then x' and z' (as well as x'' and z'') complement each other and constitute alternative equilibrium combinations (Aoki, 2001; Milgrom & Roberts, 1990). Complementarities do not imply economic efficiency in any absolute sense, but a process of interaction and mutual reinforcement. In terms of research methodology, CC studies often rely on comparisons of how firms perform or adjust to similar pressures in two or more national "cases". For example, different forms of employee voice may impact on firm-level innovation patterns (Wever, 1995) or strategies of outsourcing to overseas production plants (Berger and The MIT Performance Center). Likewise, institutional interactions have been studied using methods of set theoretical methods or cluster analysis to examine outcomes in relation to different empirical *combinations* of institutions (Boyer, 2004).

Third, the CC literature treats institutional diversity as having *comparative institutional advantage* in supporting different sorts of economic activity. Rather than focusing on the degree of fit or adaptation of firms to any given institutional environment, CC analyses the concrete institutions themselves in describing the affinities between different institutions and patterns of strategy and performance. Competitive advantage is described in relation to business strategies and production niches described by variations in price, quantity and quality, for example, mass *vs* customized product market strategies (Herrigel & Wittke, 2005; Sorge, 1991).[8] Others frame competitive institutional advantage in terms of differences between incremental innovation and radical innovation strategies (Lehrer, 2000; O'Sullivan, 2000; Vitols, 2002). Despite some criticism of this dichotomous approach to patterns of innovation (Taylor, 2004), other related typologies and methods have produced encouraging empirical results (Boyer, 2004). The CC literature has also extended beyond the firm to address questions of macroeconomic performance, growth, unemployment, inequality, and the welfare state (Hall & Gingerich, 2004; Rueda & Pontusson, 2000).

Fourth, the CC approach sees institutional change as being a *path-dependent* process (Arthur, 1989). Contrary to notions of convergence on a single model of best practice, the CC literature stresses how common competitive pressures are refracted through different sets of institutions. Institutional change is therefore slow and incremental, based on the existing institutional endowments. In the CC approach, path dependence relates to complementarity-generated advantages of existing institutions, and the high costs to change these even when adapting to new challenges. Of course, path dependence may have other roots in culture or political institutions (Pierson, 2000), but complementarity adds a further dimension to this story since institutional change will alter the functional interdependence of institutions in different domains, either making change more difficult or leading to knock-on effects from initial changes.

RECONCILING INSTITUTIONAL DIVERSITY AND IB

The preceding sections have demonstrated that the IB and CC literatures have divergent and even seemingly opposite approaches to studying institutions. Table 3 summarizes and contrasts these main features.

IB sees institutions from a firm-centered perspective that emphasizes how institutions constrain MNE strategies by creating costs for market-oriented exchange or the transfer of home country practices. Where institutions are too "distant" or "underdeveloped", MNEs must substitute their own resources and power for control in order to adapt and actively manage the institutional environment. CC scholars view institutional effects more broadly as influencing actors' identities, interests, and capacities for action. Institutions shape the supply of inputs, such as different sorts of finance or human capital, collectively available to firms. Institutions also shape the internal governance of firms by shaping the power of different stakeholders and capacity for market and non-market forms of coordination across different functional domains. Consequently, institutions endow firms with different capabilities and a fundamental diversity.

These different theoretical perspectives on institutions have strong methodological implications related to studying cross-country differences. IB studies institutions as variables that impact on firms, and measures institutions in terms of broad differences of degree. For example, IB studies often focus on MNEs, usually from a single home country, and how these adapt to a wide range of host country environments, which are measured along a particular dimension. CC scholars approach institutions in the context of national or subnational "cases" where institutions form an interdependent whole. This literature stresses differences in kind, and the units of analysis are typically *firms within two or more particular contexts*,

Table 3 Two views of institutions compared

Literature	*View of institutions*	*Country patterns/institutional configurations*	*Comparative advantage*	*Institutional change*
IB	Constraints on rational action	Variables that impact on individual firms Countries as differences of degree (e.g., developed *vs* emerging, distance)	Fit of strategy to cost context Firm performance	Path dependence due to vested interests or cultural inertia
CC	Influencing actors' identities and interests	Cases of national economies that impact the dominant characteristics of firms within a population Countries as distinct "varieties" of advanced capitalist economies	Different sources of comparative advantage Firm and national economic performance	Path dependence due to complementarities

such as the Japanese and German economies or other broad "types" of economy. CC scholars compare how firms in different countries adjust to similar pressures in order to explore to what extent institutional differences impact on strategy. For example, Goyer (2006) compares how large firms in Germany and France responded to various pressures for corporate governance reform, including demands of foreign investors. Owing to differences in the forms of worker power and their relationship to management, German firms responded to these pressures mostly by increasing corporate transparency to external investors, whereas French firms responded with more radical corporate reorganizations that enhanced profitability. Conversely, the choices of foreign investors were also conditioned by these national institutions. Whereas foreign hedge and mutual funds preferred investment in French firms because higher managerial autonomy led to more rapid improvements in share performance, pension funds showed no such preference because their long-term investment strategies are more compatible with German institutions.

Further differences concern issues of competitive advantage and institutional change. IB sees competitive advantage as a firm-level phenomenon that results from a "fit" of strategy to an institutional context, resulting in higher performance. Firms undergo isomorphic adaptation to institutions or compensate for institutional deficiencies. Institutions are largely taken as given, determined by exogenous political or cultural forces. Hence the IB literature has tended not to focus on questions of institutional change. The CC literature sees competitive advantage in terms of resources and capabilities, as in the resource-based view (RBV) of the firm. However, CC stresses that resources are not only firm-specific and idiosyncratic as in RBV, but institutionally shaped capabilities for different sorts of strategy and forms of coordination. Institutions shape capabilities across several interrelated functional domains, such as finance, corporate governance, industrial relations, skill formation, innovation, and so on. This theory suggests many pathways to high performance based on alternative constellations of institutions, given that different market and non-market forms of coordination will lead firms to have different competitive strengths and weaknesses in pursuing different sorts of production strategy or patterns of innovation. For example, Lehrer (2000) studied three European airlines and found two divergent but equally successful paths to developing new firm capabilities (in his case, revenue management systems). One path was the *evolutionary capability regime* (Lufthansa), where firms acquire new capabilities incrementally within the bounds of long-term employment and existing skills; the other is a *revolutionary capability regime* (British Airways), where firms acquire capabilities in a discontinuous manner that involves high employee turnover and reorganization imposed by managers. Since both regimes rely on complementarities among several institutions for success, the mixed strategy of Air France led to an inferior outcome.

In the remainder of this section, we argue that these fundamental differences between the IB and CC approaches to institutions also suggest several opportunities for cross-fertilization in addressing several major substantive debates relevant to both literatures. Both fields of study face a similar dual task of understanding how MNEs strategically engage in economic, financial, and organizational linkages across countries, as well as how they adapt to the diversity of institutions across those countries and regions. Here the CC approach has much to offer IB in terms of understanding institutional diversity, but equally the internationalization of firms and markets is actively transforming the nature and profile of institutional diversity described in the CC literature. Consequently, the CC approach needs to develop a more dynamic view of institutions and firms that is better equipped to understand the evolving interdependencies between them in an international context (Sorge, 2005). Here we take two sets of examples in order to develop this point further: MNE strategies and institutional change.

MNE Strategies

MNEs seek competitive advantage through at least three distinct types of strategy:

(1) aggregation of activities based in a home country or the export of home country practices abroad to achieve standardization and economies of scale and scope;
(2) adaptation to diverse host country environments; or
(3) arbitrage through selective specialization of activities in different locations (Ghemawat, 2007).

As discussed in the second section, IB scholars have shown that the success of different strategies depends on the specific types of national institution, such as the degree of development (Lee & Beamish, 1995) or "distance" from the host country (Ghemawat, 2001). While IB explores single institutional effects *ceteris paribus* and achieves a high level of theoretical generalization, the CC approach stresses that MNEs are affected by the whole institutional configuration of host countries and consequently that the results of such generalizations may be quite misleading owing to the interactions with other complementary institutions.

We argue here that a greater focus is needed on country-specific aspects of MNE strategies, for example by comparing specific countries such as China or South Korea or different types of country based on their clusters of institutional characteristics as identified in the various CC approaches. Along these lines, we argue that the particular types and interactions of home and host country institutions influence the form and effectiveness of MNE strategies mentioned above: agglomeration or export of practices, adaptation, and arbitrage.

First, the CC literature suggests that MNEs cannot easily export "best practices" to the degree that they conflict with, or lack complementary inputs from, the institutional environment of a host country (Streeck, 1996).[9] Rather than seeing diffusion in relation to generic degrees of difference, as in IB, the CC literature stresses the particular constellations of differences. For example, Geppert, Williams, & Matten (2003) show that German firms face greater barriers than UK firms in exporting a global MNC strategy based on standardized products and processes. German firms' home country strategies are based strongly on collective inputs, such as strong apprenticeship-based skill formation, which are typically absent in host countries. Meanwhile, UK firms base their strategies on a strong use of markets for external resources or high internalization of firm-specific resources. Extending this argument, firms from CMEs may be less able to export their home country practices than firms from LMEs. Equally, however, the same logic of complementarities may even apply within the category of LME countries. For example, efforts by US MNEs to transfer their workplace diversity policies (race and gender) to UK subsidiaries resulted in formal adoption but little real change in outcomes owing to the conjoined effects of various UK institutions surrounding human resource management, including divergent norms embedded in legislative and regulatory institutions (Ferner, Almond, & Colling, 2004). Thus despite the US and UK being quite similar countries in cultural and institutional terms, the success of diffusion depends upon particular functional linkages with other institutions.

Second, institutional diversity impacts on the ability of MNEs to adapt their strategy to host country institutions or the expectations of international investors. Home country institutions constrain adaptation owing to the influence of regulations and norms, as well as the distribution of power among different stakeholders. For example, as stakeholder-oriented firms from Germany undergo internationalization, they tend to adapt to Anglo-American shareholder-oriented institutions through legitimacy-seeking symbolic management and decoupling of shareholder-value practices from other "core" stakeholder-oriented practices, such as those related to human resource management (Fiss & Zajac, 2004). Meanwhile, the strong institutionalization of shareholder-value in US MNEs leads these firms to cope with German stakeholder-oriented institutions largely through institutional avoidance and imposition of home country practices outside the boundaries of home country institutions (Edwards & Ferner, 2002). Thus, despite the same degree of "distance", the particular types of home country institution lead to very different strategic adaptations on the part of MNEs.

This perspective suggests that institutions shape the divergent interests and power relationships among the different units within an MNC. An intensive study of one MNE by Kristensen and Zeitlin (2005) showed that local actors (production units) sought to exploit the comparative institutional advantages residing in their different home locations, such as those related to factor cost, transaction costs or innovation capacity as identified in the CC literature. Successful use of local institutions enabled these units to compete more effectively within the firm for assignments and with outside competitors, that is, they were a source of competitive advantage. Managers in the home country, meanwhile, were rooted in a different institutional context that led them to pursue different strategies for the firm, rather than adapt to these local settings. The resulting clashes created endemic potential for strategic conflict, and inhibited organizational integration. In this scenario the firm becomes a series of multiple but linked strategic games between local units or subsidiaries and home country headquarters. This outcome also suggests the impact of institutions on *particular modes of entry into foreign markets*, in this case through mergers and acquisitions. Since M&A has become an increasingly common mode of entry, such "clashes" between different strategic logics rooted in different national institutional settings are likely to increase within MNEs.

Third, institutional diversity shapes the potential for MNE strategies based on arbitrage between different institutional systems. In pursuing arbitrage, an MNE may locate different functional activities in different locations in order to exploit the competitive advantages of those institutions. The embeddedness of MNEs in their home country institutions has a critical influence on the development of distinctive competences and capabilities (Guillén, 2005; Morgan & Whitley, 2003). MNEs may therefore focus certain activities in their home country in order to utilize certain institutional resources. For example, firms in countries with a strong capacity for incremental innovation and diversified quality production, such as Germany or Japan, may be more likely to retain manufacturing in their home country than firms in more LMEs, because the innovation advantages of the former grow directly out of control over the manufacturing process. Conversely, MNEs may locate other activities in host countries with stronger institutional supports for those activities. In this way, arbitrage strategies may lead to new and broader sets of institutional complementarities by drawing strategically on elements of geographically separated institutional systems. This argument contrasts with much of the IB literature, which implies that MNEs should focus on reducing the transaction costs that arise from institutional distance or selecting countries that are "most similar". Rather, MNEs may gain advantage by explicitly seeking out "distant" institutional contexts that favor different sets of activities or firm capacities (Whitley, Morgan, Kelly, & Sharpe, 2003). For example, despite their very different institutional environments, German pharmaceuticals firms have located substantial R&D activities in more LMEs, such as the US, in order to take advantage of comparative institutional advantages in science-based radical innovation and thereby compensate for some weaknesses of German institutions (Lane & Probert, 2006).

The consequences of institutional arbitrage remain an under-researched topic. Some arbitrage strategies may *defend* comparative institutional advantages by preserving the core competences centered on home country institutions. For example, German firms have sought greater access to international capital markets through symbolic management and communication with investors, but have been much more reluctant to adopt change in their fundamental product strategies driven by high quality, product diversity, and incremental innovation (Börsch, 2007). This line of argument suggests that internationalization may reinforce existing national institutional arrangements and even intensify concentration on specific industries or market segments. Other arbitrage strategies may *compensate* for weaknesses in existing national institutions, either by exit or by the creation of new strengths. For example, drawing on Hall and Soskice, Witt and Lewin (2007) argue that the slower pace of institutional change among CMEs may be associated with higher rates of outward foreign direct investment as firms seek to "escape" institutional constraints of the home country. Notably, the effects of such compensating strategy may be ambiguous and either stabilize or undermine existing national institutions depending on whether new complementarities arise based on new bundling of institutional practices that span across national boundaries (Crouch, 2005).

Applying the CC approach to issues of MNE strategy thus underlines the importance of issues of institutional complementarities – that is, the functional interactions between institutions in a particular case, rather than single institutional variables or global measures of institutional development or distance. The same institution may have very different or even opposite effects when interacting with different configurations of institutions. For example, strong employment protection law may raise costs for businesses on average, but will have different impacts on human resource strategies depending upon other complementary institutions. Export-oriented German machine tool firms, for example, meet cost pressures by using other institutions to support incremental innovation based on highly skilled labor, and by substituting capital for labor. Conversely, workers will invest in such industry-specific skills only if they have a high level of job security (Culpepper, 2005; Hall & Soskice, 2001; Iversen & Soskice, 2006; Thelen, 2004). Yet in other contexts lacking complementary institutions, employment protection laws may be associated with declining competitiveness or different sorts of effect. For example, high employment protection in Spain is associated with high use of labor market segmentation by MNEs and strong use of a contingent labor force (Aguilera, 2005; Guillén, 2005). In sum, understanding institutional complementarities has far-ranging consequences for a number of empirical issues of interest to IB scholars, such as the impact of the rule of law

(Pistor, 2005), work practices (Streeck, 1996), or corporate finance (Zysman, 1994).

One criticism of the CC approach is a tendency to see firm strategy as being too strongly determined by institutional structures such that strategies within a national system tend to become very homogeneous (Crouch, 2005). The CC focus on national-level institutions has led to a neglect of meso-level mechanisms within organizational fields that link institutions and organizations, and actually create isomorphic pressures.[10] Here IB scholars have important contributions to make to debates with CC, since MNEs do not slavishly follow institutional constraints and opportunities. Rather, firms respond strategically towards institutions in a number of ways (Oliver, 1991). For example, MNEs may actively seek to compensate for institutional deficits by developing their own firm-specific internal capacities (Khanna & Palepu, 2006). Likewise, as noted in the case of arbitrage above, MNEs may strategically locate different parts of their value chain in different countries in order to create firm-specific combinations of inputs from different national business systems, such as science-led R&D from the US and incrementally oriented product development and production from Germany (Vitols, 2002).

Institutional Change

As noted above, both the IB and CC literatures have stressed the view that institutions exhibit path dependence, and national systems tend to be stable or slow to change. In rebutting theses of cross-national convergence, the CC literature sought to explain aspects of continuity with arguments ranging from the imperfect nature of market competition (Boyer, 2004) to the observation that institutions adopted from abroad are always "translated" into the local context (Campbell, 2004; Sorge, 2005). However, this emphasis resulted in a major criticism of the CC literature for its failure to develop a more dynamic view of how institutions originate and evolve (Deeg & Jackson, 2007). In other words, a new agenda is emerging to understand the dynamic relationship between the reproduction and change of national institutions, on the one hand, and processes of international competition and international institution building, on the other.

How has the CC literature responded to the challenge of institutional change? We can divide this response into two segments. First, efforts are being made to introduce more agency into the creation and change of institutions. It is here in particular that the resource-based view of the firm found in some of the IB literature, with its emphasis on managerial (firm) autonomy and capacity for creative use of institutions, can be joined with recent trends in the CC literature to construct an institutional approach that incorporates insights into the constraining effects of institutions with insights into how actors can circumvent or recast those institutions toward new ends. Second, a growing literature has begun to rethink the theoretical role of institutional complementarity and the nature of institutional linkages.

Given its stress on institutional continuity, the CC literature has viewed individual actors, especially at the firm level, as institutional "takers". In the last few years this bias has been challenged from within the CC literature (Campbell, 2004; Crouch, 2005; Hancké & Goyer, 2005; Morgan, Whitley, & Moen, 2005; Streeck & Thelen, 2005; Vogel, 2006). Rather than see institutions as equilibria for firms within a matrix of incentives and constraints, firms can employ institutions as "resources" to solve coordination problems or develop specific capacities. In this perspective economic actors are more or less continuously experimenting with novel uses and combinations of institutions. When existing institutions become too constraining, actors will seek to exit or change them. These processes are captured well in a recent study of the internationalization strategies of UK and German corporate law firms (Morgan & Quack, 2005). In both countries firms had to reinterpret and redefine the institutional context (e.g., professional standards) in which they were embedded in order to overcome constraints to cross-border expansion and mergers with foreign law firms. In the 1990s, firms in both countries pursed a strategy of gradual or organic internationalization. This later gave way to numerous mergers between large German and UK law firms, creating new global law firms with distinct capacities to operate within each national institutional context while creating new capabilities in international legal services. Casper and Kettler (2001) find similar processes of firm-led institutional change in a comparison of the UK and German biotech sectors.

The CC literature has also sought to identify specific patterns of change. At least three routes of change might be followed: actors might *defect* from behaviors prescribed by institutions (i.e., ignore them); they can *reinterpret* existing institutions, leading to new practices associated with the institution while leaving it formally intact; and actors can change institutions through a formal process of *reform* (Hall & Thelen, 2005). Others have identified specific mechanisms of incremental institutional change, such as "layering", in which change is accomplished not by eliminating existing institutions but by creating new, alternative ones that enable actors to pursue different strategies (Streeck & Thelen, 2005). For example, in several European nations laws were enacted in the 1990s giving firms the choice of using US-GAAP or the IAS accounting standards in order to facilitate listing on foreign exchanges. As this gained acceptance, the EU was later able to mandate the use of international accounting standards (IAS) for all listed firms in the EU (Posner, 2005).

This emerging view of institutions does not dismiss the constraints placed on action by them. Rather, it is recognized that institutions do not fully determine or circumscribe action. Similar points have been emphasized in some IB literature. For example, MNEs engage in direct political pressure to change institutions and suggest diverse patterns of change based on the interactions of MNEs with diverse political systems (Henisz & Zelner, 2005). Likewise, MNEs may learn about institutions (Delios & Henisz, 2003), and sometimes combine practices from different institutional settings by transplantation or reverse diffusion (Edwards, Almond, Clark, Colling, & Ferner, 2005). In a similar way, CC scholars have begun to stress how the "gap" between institutionalized rules and situational demands is the space in which actors' choices may lead to innovative changes or institutional entrepreneurship (Crouch, 2005). Competitive challenges to MNEs induce regular experimentation with the institutions that govern them, leading to marginal adjustments that strengthen the underlying institution and restore competitiveness, or alter, marginalize, or eliminate existing institutions.

As a result, CC studies now seek to conceptualize national models as having different degrees of heterogeneity among firms – even in countries such as Japan that were known for their very uniform and homogeneous sets of business practices (Aoki, Jackson, & Miyajima, 2007; Jacoby, 2004). For example, a growing trend has been the bifurcation in national patterns of corporate finance between large internationally oriented and small firms or different industrial sectors (Deeg, 2005; Schmidt, Hackethal, & Tyrell, 2002; Vitols, 2005). This perspective harks back to past studies of subnational institutions. For example, the success of clusters within LMEs such as the US derives in part from modes of local coordination in places like Silicon Valley that are difficult – but not impossible – to construct within this national institutional context (Casper & Kettler, 2001). Clusters may also develop in even less favorable institutional contexts in more CMEs (e.g., software and telecoms around Stockholm or biotech firms around Munich) through institutional building at the local level, and strategic deviation from predominant patterns of organization (Casper & Whitley, 2004). These new economies succeeded, in part, because they utilized inputs from incumbent sectors that were more compatible with the national institutional context, utilizing these for new and creative purposes. While firm heterogeneity was always, to one degree or another, a feature of national models, the growth of MNEs does imply that the formal mechanisms of institutionalization at the national level may become more fragmented, and lead to an overall increase of diversity, particularly as more coordinated systems liberalize (Sako, 2005).

The possibilities for diversity and recombination of institutional elements within and between national systems have also led to re-examination of the concept of institutional complementarities. Institutional complementary was often interpreted as implying that change will be incremental and path dependent, because complementarities generate increasing returns for firms. Hence piecemeal borrowing of institutions may fail to generate the same sorts of efficiency associated with the initial model (Streeck, 1996). However, if a new practice or institution becomes established, complementarities may generate a compounding effect on the surrounding institutions, leading to a rapid collapse or erosion of other, linked institutions (Lane, 2003).

While national capitalisms certainly follow distinctive "paths" in a general sense of historical legacies or meta-traditions (Sorge, 2005), placing too much emphasis on the coherence and complementarities among institutions may lead to overestimating the degree of stability (Crouch, Streeck, Boyer, Amable, Hall, & Jackson, 2005). More historically oriented CC work has suggested that broad types of capitalism are far more dynamic than previously assumed. In particular, different capitalisms were not created as coherent wholes, but were the result of political contention (Vogel, 2006) or unintended results of piecemeal development over long periods of time (Aoki, 2001; Streeck & Yamamura, 2001). The various institutions within a national system are ever only partially reconciled with one another. Likewise, recent studies of contemporary transformations of national capitalisms suggest a scope for "hybridization" – a dynamic mixing and matching of institutional elements that changes the characteristic linkages and nature of complementarities between institutional elements (Aoki et al., 2007; Djelic, 1998; Zeitlin, 2000).

This work resonates with some recent IB scholarship on international diffusion. For example, studies on the adoption of shareholder value practices by German firms suggest that different sorts of firm are more or less likely to adopt them, and will often adapt them to the German context (Buck & Shahrim, 2005). If institutions are seen as resources that circumscribe but do not determine firm strategy, then complementarity must also be analyzed at the level of firm-specific bundles of practices (Fiss, 2007) with regard to the range of diversity among firms within a national setting and the possibilities for institutional arbitrage created by MNEs (Kristensen & Zeitlin, 2005). Thus the CC literature is coming to recognize that the nature of linkages among institutions is far more variable than long assumed. One implication is that better middle-range theories are needed, linking particular pairs or sets of institutions (Aoki & Jackson, 2008), in order to deconstruct the broader complementarities hypothesized in some national typologies, such as those based on CME and LME economies.

CONCLUSION

This paper has contrasted two approaches to understanding the impact of institutional diversity on business, based on the IB and CC literatures. These differences reflect different understanding of institutional embeddedness, differences between variable or case-based methodologies, distinct views of competitive advantage rooted in "organizational fit" or "comparative institutional advantages", and different emphasis on institutional change. We have stressed some specific contributions of the CC literature regarding how institutions influence the capabilities of firms, and a case-based approach to comparison that takes account of interdependencies and complementarities between different institutions. CC thus has much to offer in terms of understanding how institutions impact on a wide range of issues that are central to IB scholars, such as MNE strategy, governance, innovation and the cross-national diffusion of business practices.

The CC approach suggests that IB could draw upon a much richer understanding of institutions and their effects, thereby strengthening its links with other fields of scholarship. A central message here is the importance of looking at institutions within particular combinations or configurations, and exploring the nature of institutional complementarity and conflicts within those contexts. The methodological consequences of this move would be considerable. It suggests that IB must take stronger account of the country-specific configurations, rather than resorting to broad generalizations about home country and host country effects without regard to the specific countries. In looking at particular cases or sets of cases in more detail, new methods are needed to better conceptualize and measure the combinations and interactions of institutions in different contexts – rather than using linear combinations of indices or traditional factor analysis. Here we have suggested the potential importance of set-theoretical approaches that see organizations and institutions in terms of various "bundles" of traits, which would be consistent with the notion of "types" of capitalism or theories of institutional complementarity (Fiss, 2007; Kogut, MacDuffie, & Ragin, 2004; Kogut & Ragin, 2006).

Despite the important contributions that CC approaches have to make for IB scholars, we caution equally a growing challenge in understanding not only how institutional diversity impacts on firms, but also how IB activity influences patterns of institutional change. In particular, internationalization has changed the characteristics, boundaries and internal coherence of national "types" or models of capitalism. The response of CC scholars has been to develop a less rigid view of how institutions influence firm strategies and a more empirical approach to understanding complementarities in light of possible new hybrid forms of organization. This literature has some important commonalities with themes of the IB literature, which has emphasized the range of strategic responses of MNEs to institutions. Now empirical research must substantiate this emerging agenda of dynamic institutional analysis that brings together a stronger focus on firm-level IB strategy with a case-based analysis of institutions in the tradition of the CC literature. This approach will be particularly important in understanding the emergence of new "types" of capitalist economy in the transition economies of central and eastern Europe, as well as China, whose very institutional development has been strongly shaped by the activities of MNEs (Holscher et al., 2007; Stark & Bruszt, 1998).

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NOTES

[1]"Logic" means the typical strategies, routine approaches to problems and shared decision rules that produce predictable patterns of behavior by actors within the system.

[2]While MNEs prefer institutions that are largely stable and pose few hazards for their business activities (Brouthers & Barmossy, 1997), firms may also engage in negotiations between investors and state authorities to change institutions (Henisz, 2000).

[3]For example, Hofstede has stressed five areas: power distance, individualism, masculinity, uncertainty avoidance, and recently long-term orientation. More recently, Schwartz has identified six areas: conservatism, affective and intellectual autonomy, hierarchy, mastery, egalitarian commitment, and harmony.

[4]The authors differentiate only briefly between two subtypes of CME: in *industry-coordinated* economies, such as Germany, coordination takes place within the industrial sector or branch, whereas in *group-coordinated* economies, such as Japan or South Korea, coordination takes place across groups of companies. These subgroups mirror a distinction between associations versus networks found in the "governance approach" described below.

[5]Alliance capitalism, such as in Germany and Japan, involves elaborate horizontal linkages between institutional domains, and cooperation across the boundaries of firms. Dirigiste capitalism, as in France and South Korea, has institutional domains connected by the subordination of the private economy to centralized political influence. Finally, family capitalism, such as in Italy or Taiwan, is typified by smaller firms that are strongly segmented across the lines of personalistic family networks.

[6]Some authors in this approach take an even more explicitly constructivist approach to institutional choice and change (Campbell, 2004; Herrigel, 1996; Sabel, 1994).

[7]However, Boyer (1997: 75) argues that "the process of institutionalization reflects the social and political conflict particular to each country" and thereby identifies four major variants of capitalism: market-oriented (Anglo-Saxon countries), Rhineland (Germany, Japan), statist (France, Italy), and social democratic (Sweden, Austria).

[8]For example, German firms tend to specialize in high-quality markets, producing lower volumes of specialized products that are relatively insensitive to small differences in price. This "high-road" niche not only accommodates the constraint of high and uniform wages in Germany, but also makes use of collective inputs such as the broad occupational training of blue-collar workers and cooperative institutions of co-determination (Streeck, 1992).

[9]Institutional diversity has similar impacts on the potential for reverse diffusion, whereby host country practices are imported to the home country by an MNE, often undergoing subsequent adaptation or ineffective implementation owing to lack of institutional support (Edwards & Ferner, 2004).

[10]Schneiberg and Clemens (2006) outline a number of such linkages in organizational sociology, including ties to regulating bodies, certification or legitimation by institutional authorities, conduits for institutional models (e.g., inter-organizational networks), and proximity to institutional pressure (e.g., visibility or resource dependence).

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