

THE UNIVERSITY OF TEXAS AT SAN ANTONIO, COLLEGE OF BUSINESS

Working Paper SERIES

Date June 14, 2012

WP # 0032MGMT-551-2012

Institutional Misalignment as a Cost of Doing Business Abroad: Varieties of Capitalism Approach

Kim Clark and Indu Ramachandran
Department of Management
University of Texas at San Antonio

Copyright © 2012, by the author(s). Please do not quote, cite, or reproduce without permission from the author(s).

Institutional Misalignment as a Cost of Doing Business Abroad:
Varieties of Capitalism Approach

Kim Clark and Indu Ramachandran
Department of Management
University of Texas at San Antonio

We are grateful for support of the College of Business - University of Texas at San Antonio.

Institutional Misalignment Hazard as a Cost of Doing Business Abroad: Varieties of Capitalism
Approach

ABSTRACT

Cost of Doing Business Abroad (CDBA) is an important construct in International Business. The variety of causes leading to the CDBA has been the subject of and many scholars' examinations. Extending CDBA to an institutional level, we develop a new perspective on the CDBA by incorporating *institutional misalignment* between the home and the host country as a cause of CDBA. We propose that institutional misalignment should be considered as a component of the CDBA. Using the theoretical lens of Varieties of Capitalism (VoC), we explain why and how institutional misalignment can create additional cost for MNEs operating in foreign countries. Specifically, we discuss how the differences between institutional configurations of the home and the host country create institutional misalignment. Furthermore, we explain why institutional misalignment is inevitable as MNEs cross national borders and how it incurs economic as well as social cost that MNEs may not be aware of. By doing so, we extend the CDBA research to a national level of analysis and showed that a set of firms from a nation can lose its national comparative institutional advantage as they cross national borders. Finally, we assert that the larger the institutional distance between the two countries, the greater the institutional misalignment is.

Key Words: Cost of Doing Business Abroad, Institutional Misalignment, Varieties of Capitalism, Institutional Distance

INTRODUCTION

International business literature has emphasized the need to understand the cost of doing business abroad (CDBA). Many international business scholars have elaborated upon Hymer's (1960) seminal work on CDBA that foreign subsidiaries of multinational corporations (MNEs) have to face comparative disadvantages relative to the local firms. Such additional costs can cause multinational enterprises (MNEs) to bear higher failure rates or lower profits in foreign markets (Delios & Beamish 2001; Mezas 2002; Miller & Parkhe 2002; Zaheer, 1995) and therefore, IB researchers have focused on means to reduce CDBA.

However, before determining ways to reduce the CDBA, an important first step is to learn the causes of the CDBA. Hymer (1960) underscored the additional costs incurred by foreign subsidiaries relative to local firms, due to unfamiliarity with local markets and discrimination by host country government and buyers, and difficulties caused by home government. Zaheer (1995) extended the notion of CDBA by introducing the construct of a liability of foreignness where she identified sources of LOF including costs due to spatial distance, firm-specific costs (unfamiliarity; lack of roots in local environment), host country environment costs, and home country environment costs.

Among the causes that have been examined, researchers of this topic (e.g., Calhoun, 2002; Miller & Richards, 2002; Yu & Eden, 2002) have focused on the unfavorable treatment (e.g., economic nationalism) of host country environment towards MNEs, and difficulties (e.g., regulatory restrictions) caused by the home country. Although these discriminations from the host country and restrictive regulations from the home country environment cause CDBA for MNEs, these approaches examine the two environments separately and have overlooked what happens when these two environments with unique institutional environments interact with each other.

Thus, the purpose of this paper is to propose that CDBA can also occur at an institutional level. Furthermore, we develop a new perspective on the CDBA by incorporating *institutional*

misalignment between the home and the host country as a cause of CDBA. Institutional misalignment refers to the extent to which institutions within a business system are incongruent with one another and prevent the institutional configuration from generating complementary effects. We argue that there are risks associated with the institutional misalignment, causing economic as well as social costs for MNEs¹ operating in foreign countries. Based on the assumption of institutional embeddedness of firms, we argue that institutional misalignment occurs as MNEs cross national borders. Each country has a unique configuration of institutions, generating economic logic upon which firms in the country operate. Similarly, MNEs' economic activities are embedded in unique institutional configurations of their home countries. In view of that, it is unlikely that the institutions that MNEs bring from the home country to the institutional environment of the host country will align to the full extent of complementarity that it had at home. Hence, MNEs are to face hazards associated with the institutional misalignment, resulting in economic as well as social costs.

Drawing upon institutional theory and the Varieties of Capitalism (Hall & Soskice, 2001), we extend this assertion and propose that institutional misalignment is one of the components of CDBA. We further explain how an institutional misalignment between the home and the host country presents economic as well as social cost for MNEs. We propose that institutional misalignment is inevitable as MNEs interact with other countries, and that it incurs cost that MNEs need to aware of. Furthermore, we extend the CDBA research to a national level of analysis. Finally, we assert that institutional misalignment increases with increasing institutional distance between two countries.

By proposing institutional misalignment as a component of CDBA, we attempt to make contributions to institutional theory and international business. First, we delineate a central

¹ CDBA associated with institutional misalignment will incur across different level of an MNE. It influences the parent company as well as the foreign subsidiary in a specific institutional setting. It is beyond the scope of this paper to delineate specific costs at different levels of the MNE. For simplicity reason, MNE is used throughout the paper.

concept in IB literature, CDBA, and propose “institutional misalignment” as another component of CDBA, and explain how institutional misalignment can incur economic as well as social CDBA. Extant IB research on CDBA has focused on how the institutional environment of the host country leads to MNE subsidiaries incurring additional costs, but has overlooked how the interaction between home and the host country’s institutional environments creates disadvantages for the MNE subsidiaries. Second, we contribute to institutional theory by extending the notion of CDBA to an institutional level. By proposing institutional misalignment as a cause of CDBA, we provide detailed explanation of how institutional environment of MNEs can incur economic as well as social cost for them. Lastly, we provide an explanation on how to evaluate the extent of institutional misalignment that a firm might face as they prepare to enter a new country. By examining the institutional distance of the coordination mechanism of institutions, we propose that MNEs can approximate the extent of the institutional misalignment.

The paper is organized as follows. We begin with an overview of the literature to provide a theoretical background for the construct. Next, we discuss comparative capitalism and its link to institutional misalignment. We examine the definition of institutional misalignment and discuss how it incurs economic as well as social cost for MNEs. We then discuss the institutional misalignment and its relations to institutional distance. Finally, we conclude with suggestions for future research.

CONCEPTUAL BACKGROUND

Cost of Doing Business Abroad

Hymer (1960) underscored the additional costs incurred by foreign subsidiaries relative to local firms, due to unfamiliarity with local markets and discrimination from the host government incurring the cost of doing business abroad (CDBA). Specifically, Hymer (1976) stated that MNEs face additional costs due to (1) lack of information of foreign markets; (2) unfavorable treatment by host government and buyers; (3) difficulties caused by the home government; and

(4) foreign exchange risks. Zaheer (1995) extended the notion of CDBA by introducing the construct of a liability of foreignness (LOF). Zaheer defined LOF as “the costs of doing business abroad that results in a competitive disadvantage for an MNE subunit ...broadly defined as all additional costs a firm operating in a market overseas incurs that a local firm would not incur” (1995: 342-3). She identified the four main sources of LOF as: (1) costs due to spatial distance (travel, transportation; coordination over distance/time zones); (2) firm-specific costs (unfamiliarity; lack of roots in local environment); (3) host country environment costs (lack of legitimacy, economic nationalism); (4) home country environment costs (regulatory restrictions on high-technology sales to certain countries). Zaheer (1995) explained why foreign firms needed to have a firm-specific advantage to offset this liability. Researchers (e.g., Zaheer & Mosakowski, 1997; Mezias, 2002) further developed the notion of LOF by suggesting that MNEs face LOF because they were not embedded in the host-country’s information networks and they lacked isomorphism with the host-country’s environment, which made it vulnerable to powerful institutional pressures.

Since the introduction of the LOF concept, the two terms (LOF and CDBA) have been used interchangeably, creating confusion among international business scholars (Luo & Mezias, 2002; Eden & Miller, 2004). However, there has recently been a steady effort to delineate and differentiate these two concepts. For example, Zaheer (2002) clarified that CDBA is an economic concept consisting primarily of market-driven costs related to geographic distance, while LOF is a sociological concept consisting primarily of structural/relational and legitimacy costs. Furthermore, researchers (e.g., Eden & Miller, 2004; Sethi & Guisinger, 2002) suggested that LOF maybe a subset of CDBA. Eden and Miller (2004) deconstructed the CDBA and suggested that LOF serves as a key component of CDBA. They argued that CDBA is a broader concept that includes both economic cost and social cost. Specifically, the authors argued that the CDBA is concerned with economic market-based activity costs, including transportation, communication, trade barriers, and costs associated with foreign exchange transactions. In comparison to

economic cost associated geographical distance, the social cost of LOF arises from unfamiliarity and is driven by institutional distance, persisting over time. Furthermore, Eden and Miller (2004) delineated LOF into unfamiliarity hazards, discrimination hazards and relational hazards that places the foreign firm at a disadvantageous position compared to local firms.

Johanson and Vahlne suggested that lack of business market knowledge (a firm’s business environment including firms with which the focal firms is doing or attempting to do business with, or the relationship between firms in the environment) constitutes the “liability of outsidership” (2009: 1416). The authors argued that being an outsider to the relevant network is the root of uncertainty, creating a disadvantage for the foreign firms. If a firm attempts to enter a foreign market where it has no relevant network position, it will suffer from the liability of outsidership.

CDBA can be specific to an MNE or a set of foreign firms based on an industry or on national origin. Disadvantages can be firm-specific when only the focal firm (a subsidiary in this case) experiences them. Eden and Miller (2006) describe these disadvantages as unfamiliarity hazards caused by lack of knowledge or experience in the host country. In addition, a subsidiary can experience relational hazard, which includes additional costs to manage internal relationships with local employees and external networks with suppliers, distributors, and competitors. Furthermore, there may be additional administrative costs in managing the relationship between the parent MNE and the subsidiaries due to geographical distance as well as cultural distance (Buckley & Casson, 1998).CDBA could be common to a set of firms that belong to the same industry or nation. This group of firms can experience discrimination hazards due to differential treatment by the home or host governments, consumers or the general public in the host country (Eden & Miller, 2004). CDBA based on the specificity and the hazard type has been summarized in the Table 1.

Insert Table 1 About Here

IB researchers have sought to identify the key components of the CODBA caused by geographical as well as institutional distance, incurring economic as well as social cost for MNEs. However, most extant research have examined these two environments (home vs. host country) separately and have overlooked what happens when these two environments interact with each other, in other words, the additional costs that foreign firms incur when these two distinct institutional environments of home and the host country interact.

Institutional Studies in IB Literature

As discussed earlier, extant research has identified economic costs incurred mainly due to geographical distance and social costs associated with institutional distance. While MNCs can definitely anticipate and quantify costs associated with geographical distance, the costs associated with institutional distance cannot be easily anticipated or quantified. Institutional distance has been defined as the degree of similarity or dissimilarity between the institutional environments of two countries (Kostova 1999). Institutional distance has been an important topic in the IB research, as it has been regarded as a major constraint on MNE activities (Jackson & Deeg, 2008). Institutional distance makes it harder for MNEs to obtain reliable information resulting in higher transaction costs (Zaheer, 1995).

The institutional distance concept adopted in IB literature typically encompasses three pillars; regulative, normative or cognitive institutions (Kostova, 1997). Scott defined institutions as “cognitive, normative, and regulative elements that, together with associated activities and resources, provide stability and meaning to social behavior” (1995: 48). Institutional environment of MNEs has been a particularly important research topic in the IB research field because of dual institutional constraints that MNEs face which create tremendous uncertainties in their strategic choices (Kostova, 1999). Institutional theorists (DiMaggio & Powell, 1983; Scott, 1995; etc.) have viewed institutions as exogenous to the firms operating within them and that it is important

that firms have to adapt their behavior to achieve a fit with them. Similarly, IB research has contended that MNEs are under pressure to adapt to and be consistent with the local institutions to gain legitimacy, thereby ensuring organizational survival (Kostova, 2002; Zaheer, 1995). Accordingly, IB literature has emphasized how MNEs should adapt their strategy and structure to the idiosyncratic institutional environment of the host countries (e.g., Meyer, 2001; Wan, 2005). Furthermore, IB scholars have studied institutions in terms of how different regulatory rules and legal norms impact transaction costs for MNEs (Brouthers, 2002); cause political hazards for MNEs (Delios & Henisz, 2000), and facilitate or hinder market transactions by securing property rights or protecting investors (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998).

In regards to the institutional research, Jackson and Deeg (2008) argued that IB literature has viewed the institutions as “unidimensional variables” that affect business activities, instead of specifying the full depiction of the institutions. Specifically, IB research has examined institutions as “variables”, or particular dimensions (e.g., normative, regulatory, or cognitive) that constrain or affect MNE activity (Jackson & Deeg, 2008). Specifically Jackson and Deeg (2008) suggested that it is important to look at institutions in terms of their particular configurations, and to explore how institutions interact, complement, or conflict with each other within that context. Similarly, Henisz and Swaminathan suggested that future IB research should focus on the institutional environment as “not a parameter but a rich constellation of interdependent structures and systems within a country, across dyadic pairs of countries and at the level of the international state system” (2008: 539).

Accordingly, some IB researchers (e.g., Jackson & Deeg, 2008; Schneider, Schulze-Bentrop, & Paunescu, 2010) have suggested that the “comparative capitalisms” literature in sociology and political science can fill this gap and enrich our understanding of how institutions impact key IB topics such as MNE strategy, governance, innovation and the cross-national diffusion of business practices. Comparative capitalisms (CC) in the discipline of political economics examine how institutions across several economic domains interact to form distinct

national configurations, or “varieties” of capitalism (Crouch & Streeck, 1997; Hall & Soskice, 2001). CC views the institutional configuration of a nation as containing distinct characteristics that generate a particular systemic logic of economic action, and the extent to which these institutions complement each other contributes to the competitive advantages of a nation. CC explains how these unique institutional configurations create a distinct institutional landscape, explaining why institutions differ across countries, and why certain countries with a specific institutional configuration have comparative advantage over another. Thus, CC views the institutions from rational choice perspective and assumes that members (e.g., individuals, firms, governments, etc.) of institutions behave in response to the economic logics of institutional configuration, seeking to advance their interests in a rational way by strategically interacting with others (Hall & Soskice, 2001).

Varieties of Capitalism

Built upon a relational view of the firm, the VoC assumes that firms are the central actors in the economy, in which multiple actors (e.g., individuals, firms, governments, etc.) seek to advance their interests in a rational way through strategic interactions with each other (Scharpf, 1997). That is, the VoC suggests that firms engage with others in multiple institutional domains of the political economy to develop their core competences and dynamic capabilities. These interrelationships between the firms and other actors are organized and structured within a framework of incentives and constraints to resolve coordination problems. In this framework, firms are embedded in a context with five institutions: a) industrial relations to regulate wages and working conditions, b) vocational training and education to ensure that workers have the requisite skills, c) corporate governance to access finances, d) inter-firm relations to secure inputs and technology, and e) relations with employees (information-sharing, work effort incentives). In the VoC framework, these five institutions comprise a ‘business system’ in which a nation

governs the economic activity of firms and employees (Redding, 2005; Whitley, 1999; Witt & Lewin, 2007).

Hall and Soskice (2001) note that this institutional framework is determined by coordination mechanisms such as markets and hierarchies (Williamson, 1975), or other non-market mechanisms, such as social networks (Powell, 1991), associations (Streeck & Schmitter, 1985), and government intervention. Hall and Soskice suggest that a complementarity exists when “the presence (or efficiency) of one institution increases the return from (or efficiency of) the other” (2001: 17). For example, Aoki (1994) suggested that long-term employment is complemented by the financial system, and provides capital on terms that are not sensitive to current profitability, while fluid labor markets are more effective in financial markets where share prices and profitability are critical in gaining access to financial resources and avoiding hostile takeovers. When there is congruence among these institutions, VoC argues that it can lead to institutional complementarities across them. Accordingly, firms will often adapt their strategies to take advantage of these complementarities that, in turn, lead to particular practices, which then become institutionalized (Hall & Soskice, 2001).

Coordinated Market Economies (CMEs) vs. Liberal Market Economies (LMEs): The VoC approach draws distinctions from two major modes of coordination along a continuum. On one end of the continuum, called “*liberal market economies (LMEs)*”, firms coordinate with others through competitive market relationships with arm’s-length exchanges of goods, services and formal contracting. The actors adjust their behavior based on the supply and demand of neoclassical economics. On the other end, termed “*coordinated market economies (CMEs)*”, firms coordinate strategically with others through the processes of non-market relationships entailing incomplete contracting, network-monitoring based on the exchange of private information, and more reliance on collaborative relationships to build the competencies of firms. Hall and Soskice suggest that “the institutional framework of the political economy provides

firms with advantages for engaging in specific kinds of activities” (2001: 32), implying that firms in different market economies (LMEs vs. CMEs) will behave differently.

Hall and Gingerich (2004) establish *coordination* as a crucial dimension reflecting variation along a spectrum: from market coordination (LME) to strategic coordination (CME). Using the empirical measurement of the extent of coordination for 20 OECD countries, Hall and Gingerich (2004) have developed an index. The index is standardized to vary between 0 for the country with little reliance on strategic coordination, and 1 for the country with relatively high reliance. The countries with a coordination index value of less than 0.5 are referred to as LMEs, while countries with a value higher than 0.5 are referred to as CMEs.

The coordination index reveals that the United States is a typical LME that is coordinated by market mechanisms. According to the VoC perspective, firms in the United States face large equity markets characterized by high levels of transparency and dispersed shareholdings, whereas firms’ access to external finances depends on publicly accessible criteria such as market valuation. Due to relatively weak trade unions and low employment protection, labor markets are fluid, and wage-setting is generally done through contracts between workers and individual employers. The deregulated labor markets allow the firms to hire and fire employees at low cost, set flexible reward systems, and have no co-determination rights. Furthermore, weak industry-related associations suppress the collaborative training programs that foster industry-specific skills (Hall & Soskice, 2001). Other examples of LMEs are Australia, the United Kingdom, Canada, and Ireland.

On the other hand, Germany is an example of CMEs. In Germany, firms are connected by dense networks of cross-shareholding and influential employers associations. This network of inter-company relations allows cooperation, standard setting, and technology transfer among firms, through which firms develop reputations. Accordingly, firms can rely on their reputation to gain access to capital rather than their share values. Because the corporate governance system is allowed to use reputation-based monitoring systems, firms’ access to capital is relatively

independent of fluctuations in their profitability, which allows long-term financing as well as long-term job security to their employees. Labor markets in CMEs are less fluid, causing firms to rely on industry-level collaboration for knowledge transfer. Other examples of CMEs are Austria, Italy, and Belgium. These institutional variations across different coordination mechanisms are summarized and compared in Table 2.

Insert Table 2 About Here

Hall and Soskice (2001) note that neither of these differently arranged institutions are inherently superior at generating good macroeconomic outcomes. Instead, superior macroeconomic performance is an outcome of institutional coherence. That is, countries with more coherent sets of institutions (i.e. with consistently non-market-oriented or consistently market-oriented institutions) will lead to superior performance (regardless of whether they are CMEs or LMEs).

Although institutional research in IB has made significant contributions in our understanding of how institutions matter in the IB setting, probing beyond the normative, regulatory and cognitive dimension of institutions will increase our understanding on this. The following section of the paper attempts to do just that by examining what type of additional costs MNEs have to bear when two unique institutional configurations interact.

THEORY DEVELOPMENT

Cost of Doing Business Abroad (CDBA) can occur at multiple levels. In this paper, we propose CDBA can also occur at an institutional level. Furthermore, we examine institutional misalignment as a cause of CDBA at an institutional level. Institutional misalignment represents the extent to which institutions within an institutional configuration are incongruent with one

another and prevent generation of complementary effects. Institutional misalignment hazard refers to the disadvantages that MNEs have to bear because of institutional misalignment. Our approach to the construct of ‘institutional misalignment’ is built on Varieties of Capitalism (VoC), a stream of research in ‘comparative capitalism’. The VoC approach provides a rich framework in understanding institutions because it views institutions within particular configurations and explores how institutions interact, complement, or conflict with each other within the context.

. CBDA at Institutional Level

CBDA can incur at a multi-level of MNE operation. However, IB research on CBDA has been mostly analyzed at the level of MNE subsidiaries (Cuervo-Cazurra et al., 2007; Chen, 2008). In particular, Zaheer & Mosakowski (1997) indicated that LOF is likely to be borne primarily by the foreign facility of an MNE, although some of the costs might be shared between the parent and the foreign facility. Consequently, CBDA research has treated LOF as disadvantages arising from the foreign subsidiary and focused on determinants and strategies to reduce the LOF (Sethi & Juedge, 2009). For example, Petersen and Pedersen (2002) showed that subsidiary’s managerial discretion can reduce the unfamiliarity hazards of LOF. Furthermore, Eden and Miller (2001) argued that mode of entry can reduce LOF. For example, selecting the right local joint venture partner would reduce unfamiliarity costs and discriminatory treatment by the local government.

Recently, researchers (e.g., Chen, 2008; Sethi & Judge, 2008) have begun to examine the additional costs incurred by the MNE subsidiaries in interacting with entities outside the host-country’s context. For instance, Chen (2008) examined the cost associated between the parent company and its subsidiaries and found that leveraging the parent company’s capabilities increased activity-based CBDA of the subsidiaries. Furthermore, Sethi and Judge (2008) proposed the “liability of multinationality”, conceptualizing additional cost not incurred by the

host country's environment, rather by multi-national-subsiary's interaction outside the host country with the parent MNE's global network. The additional costs include complexities associated with a global supply chain, monitoring trade policies of NGOs, and subsidiary's strategy being constrained by the parent MNE's global strategy.

Moving beyond the subsidiary and its relationship with the host and MNE environment, some researchers have begun to examine the CDBA at the level of industry. Cuervo-Cazurra et al. (2007) suggested that loss of advantages can occur to a set of firms in an industry by not obtaining value from a transferred resource. This incurred loss could be viewed as a source of disadvantage in existing operations because their new products are not useful in the host country. In addition, the authors argued that a set of firms from same industry can experience government-based and/or consumer-based disadvantages in the host country because of their country -of- origin. The existence and persistence of CDBA have been reported in various industrial and geographical contexts such as the currency trading industry (Zaheer, 1995; Zaheer & Mosakowski, 1997), the global banking industry (Miller & Parkhe, 2002), and the international venture capital industry (Lu & Hwang, 2010).

This study contends that CDBA can also occur at an institutional level to a set of firms from a certain nation by not obtaining value from an institutional complementarity that has been a source of advantage in its political economy. Institutions matter and are the underlying determinants of the long-run performance of economies (North, 1990). Moreover, how these institutions interact with each other dictate the behaviors of firms (Hall & Soskice, 2001). When the interaction among the institutions is complementary and results in a synergistic effect, it provides firms with advantages because they can produce more effectively with the institutional support they receive (Hall & Soskice, 2001). Hall and Soskice argue that certain institutional features of a nation might confer "comparative institutional advantage" by providing a coordination mechanism to arrange institutions to support firms seeking certain competences and dynamic capabilities (2001: 37). Specifically, the institutional configuration of a particular

political economy provides firms with advantages for engaging in specific types of activities. The authors suggest that the comparative advantage may explain why particular nations tend to specialize in a specific type of production and products.

MNEs from a nation with certain comparative advantage may not create value from the advantage when they operate in the foreign countries. For example, many firms from Germany, a typical CME, tend to employ production strategies that rely on highly skilled labor forces with industry-specific and firm-specific skills. This kind of production strategy is possible with the support of varieties of institutions such as industrial relations, education and training systems, and the financial system. In order to secure the skilled labor forces, German industrial relations provide long-term job security for the labor forces to invest in skills that are not easily transferable. At the same time, the education and training system provides programs for apprenticeship and training programs to develop industry-specific skills. German firms have more access to bank-oriented patient capital which makes it possible for firms to retain skilled workers because it is less sensitive to profitability. This kind of institutional coordination grants a comparative advantage to German firms. However, when the German firms decide to enter a country that does not have similar institutional arrangement, they will lose the advantage that German firms can benefit from at home. For instance, when a German firm enters the U.S., an LME will not be able to implement a production strategy based on highly skilled workers. The U.S. does not have industrial relations providing long-term employment. In addition, training and education institution in U.S. focuses on general knowledge that is easily transferred to other industries. Finally, U.S. firms generally rely on the equity market for their finances, which is attentive to short-term profitability. Thus, German firms deriving a competitive advantage from their home country's institutional arrangement may lose that advantage as they enter a country with different institutional arrangement.

Proposition 1. There will be additional cost common to a set of firms from the same institutional configuration. The additional cost incurs by losing the advantage conferred by comparative institutional advantage.

Institutional Misalignment

Institutional misalignment refers to the extent to which institutions within an institutional configuration are incongruent with one another and prevent them from generating complementary effects. An institutional configuration is complementary when each institution raises the returns available from the other. This implies that changes in one of the institutions may yield negative economic results if unaccompanied by parallel changes in others (Hall & Gingrich, 2004).

Causes of misalignment. Then, how does institutional misalignment happen? Witt and Lewin (2007) discuss the notion of institutional misalignment that is caused by slowly changing institutions within a business system. Specifically, when changes in one institution do not coincide with changes in others, not only are there institutional congruencies, but also the complementarities give way, creating a misalignment. In other words, the institutional misalignment arises because the institutional arrangement cannot change fast enough for firms that are responding to the environmental changes (Witt & Lewin, 2007). This is an intra-institutional misalignment where institutions in a business system do not align with each other and is similar to Seo and Creed's (2002) nonadaptability contradiction—the inability of a prevailing institutional logic to change.

Similarly, MNEs operating across national borders will experience inevitable misalignment because the institutional configuration of the host country may not be congruent or complementary to that of the home country. This assertion is grounded in the institutional embeddedness of firms that the national institutional system has a strong influence on shaping the firms' strategy (Beck, Kabst & Walgenbach, 2009; Tregaskis & Brewster, 2006; Hall & Soskice, 2001). Accordingly, MNEs' core competences and capabilities will be shaped by, and are

embedded in the institutional arrangement of the home country, and consequently, MNEs' strategies, structure, and routines reflect the unique institutional arrangement of the home country. This country-of-origin effect will be also evident in the MNEs' subsidiaries, as they will reflect institutional heritage from the home country (Ferner, 1997; Ferner et al., 2001; Tregaskis & Brewster, 2006). Hence, it is likely that strategies and practices that subsidiaries employ will misalign with the institutional arrangement of the host country.

This inter-institutional misalignment is equivalent to what Seo and Creed describe as "intra-institutional conformity that creates inter-institutional incompatibilities" (2002; 228). For example, U.S. firms tend to have employment practices that facilitate the fluid movement of employees, which is complementary to the profit sensitive governance system based on the equity market. These MNEs may have to adopt employment practices that are based on long-term commitment and regulatory constraints of a host country such as Japan or Germany. This labor movement that the MNEs have to adopt will misalign with the rest of the business institutions that the MNEs are embedded in.

The differences in the institutional configurations across countries are driven by the mechanisms (e.g. markets, hierarchies) employed to coordinate the economic actors' (e.g., firms, labor unions, etc.) behavior. For example, in LME countries, the market plays the dominant role in coordinating economic behavior, and the state remains an arm's length enforcer of contracts (Hall & Soskice, 2001). In contrast, in CME countries, firm behavior is strategically coordinated to a larger extent through non-market mechanisms such as trust, cooperation, and relationships (Hall & Soskice, 2001). The shaping of the institutional framework for economic order in a society must be affected by multitudes of factors (e.g., culture, history, etc.). In regards to determinants in shaping institutions, Witt and Redding (2009) examined the process of thought patterns of the perceived ends and preferred means for economic behavior in specific societies such as Japan and Germany and found that institutional variations across nations are related to differences in rationale, i.e., an underlying thought pattern held by economic actors.

In VoC, firms are regarded to be key actors pursuing core competences and dynamic capabilities, and therefore engage in strategic interaction with other economic actors (Hall & Soskice, 2001). In managing a strategic relationship, the firms encounter typical coordination problems such as moral hazards, shirking, opportunism, etc. in relationships with other economic actors. The respective coordination mechanisms are sustained through formal institutions (e.g., laws, regulations, etc.) and informal institutions (culture, informal rules, history, etc.). These mechanisms are also supported by the self-interested members within the institutional configuration (North, 1990; Hall & Soskice, 2001). These institutions play the roles of the exchanges of information among the actors, the monitoring of behavior, and the sanctioning of illegal or inappropriate behaviors. The notion of institutional misalignment is illustrated in Figure 1.

Insert Figure 1 About Here

Conversely, institutional misalignment between the home and the host country is more likely to result in hazard, or disadvantages for MNE subsidiaries. Institutional misalignment hazards are suggested to differ from LOF for a couple of reasons. First, LOF focuses on the difficulties caused by home country institutions (e.g., restrictive regulations) and/or differential treatment from the host country government or consumers, creating a discrimination hazard for MNE subsidiaries (Eden & Miller, 2006). However, institutional misalignment hazard does not involve the host government's intentional discrimination or the home country's restrictive regulations against the focal firm. Rather, it concerns the unintentional disadvantage that foreign firms have to bear because of two distinctly different institutional configurations being forced to merge, creating a misalignment. Second, LOF suggests that lack of information or experience about the host country's environment creates an unfamiliarity hazard, which diminishes over time.

Institutional misalignment hazard, however, is not caused by unfamiliarity. Even if the firm is familiar with the host country's institutional configuration, the extent that the MNE (a foreign subsidiary in this case) can control the hazard may be limited because it is unlikely that a firm can change the complementary effect of an entire institutional configuration.

Proposition 2: A firm entering a country in search of new markets is more likely to face additional cost of doing business abroad when home country's institutional arrangement misalign with that of host country.

Institutional misalignment and institutional distance. We contend that the extent of institutional misalignment is determined by institutional distance. Institutional distance refers to the degree of similarity or dissimilarity between the institutional environments of two countries (Kostova 1999). VoC measures the extent to which the institutions are coordinated through strategic non-market relationships that entail incomplete contracting, network-monitoring based on the exchange of private information, and more reliance on collaborative relationships to build the competencies of firms. Thus, we suggest that the greater the differences in the coordination mechanisms (i.e., arms-length market coordination vs. strategic non-market coordination), the larger the institutional distance.

Moreover, we suggest that the larger the institutional distance between the MNE's home and the host country, the greater will be the institutional misalignment. Specifically, an MNE from a market-coordinated country (i.e., LME) will have competitive advantage derived from highly liberal institutions. When this MNE enters a country coordinated through non-market relationships (i.e., CME), it will experience a higher level of misalignment, and vice versa. MNEs from nations where neither type of coordination is well-developed, or market and strategic coordination is combined, entering similar institutional arrangement will face the least possible amount of institutional misalignment. For example, German MNEs (high CME) entering the U.S.

(high LME) will experience greater institutional misalignment than the ones entering Austria (high CME). Thus, we suggest following proposition.

Proposition 3a: The greater the difference in the institutional coordination mechanisms (market coordination vs. strategic non-market coordination) between the home and host country, the larger the institutional distance.

Proposition 3b: The larger the institutional distance, the greater the institutional misalignment.

Institutional Misalignment Hazard: Economic Costs. This misalignment of institutions is economically costly (Witt & Lewin, 2007). Economic cost of CDBA refers to activity-based costs (e.g. production, marketing and distribution) (Eden & Miller, 2004), or market-driven costs incurred by spatial distance (e.g. travel, transportation) (Zaheer, 1995). The economic costs are also concerned with transferring and teaching parent companies' capabilities to foreign subunits (Teece 1977; Kogut & Zander, 1993); coordination and management control costs within multinational corporations (Buckley & Casson, 1981); international production, distribution, and trade barrier costs (Buckley & Casson, 1998), government tariffs (Yip, 1992); international capability transfer (Teece 1977; Kogut & Zander, 1993); cross-border communication, and monitoring costs (Buckley & Casson 1976; Zaheer 1995).

We argue that institutional misalignment hazard includes economic costs because the MNE subsidiaries have to operate at suboptimal levels of institutional complementarity. Institutional complementarity implies that the presence of one institution increases the return of the other, resulting in macroeconomic performance (Hall & Soskice, 2001). This assertion is supported by empirical evidence. For example, Campbell and Pedersen (2007) suggested that Denmark's success is based in a large part on its institutional competitiveness – its capacity to achieve socioeconomic success as a result of the competitive advantages that firms derive from operating

within a particular set of institutions. Similarly, MNEs that have to operate in an institutional arrangement that is misaligned will experience a decrease in the advantages of the home countries' institutional complementarities, which will, in turn, incur economic costs. This is similar to Cuervo-Cazurra, Maloney, & Manahan's "loss of an advantage" in internationalization process in which a firm's resources lose their advantageous nature when transferred to a new country (2007: 711). Consequently, MNE subsidiaries may not fully realize the competitive advantages that they derive from the institutional complementarities of the home country.

VoC contends that each institution of an institutional configuration complement each other, thus creating a synergy effect. For example, research (Aoki, 1994; Caballero & Hamour, 1998) has shown that long-term employment mode is facilitated by a bank-oriented financial system because it is less sensitive to profitability, while the fluid labor market is more effective in the equity-based financial market. At the same time CME countries tend to have a bank-oriented financial system, which allows firms to make the long-term employment security. This long-term employment facilitates hiring and retaining highly skilled laborers who are willing to invest in industry or firm specific human capital, which is essential for high quality production strategy, which is typically pursued in CME economies.

As MNEs operate in a different institutional arrangement, the institutional complementarities that MNEs have at home will become suboptimal as the firms intricately coordinate with other economic actors to achieve their core competences. For example, an equity financing system at home emphasizing short-term profitability of LME subsidiaries will misalign with local labor institutions of long-term employment in a CME host country. Specifically, LME subsidiaries in CME countries will not be able to respond to equity market demand by reducing the number of labor forces because of high level of employment protection rules. In contrast, CME subsidiaries in LME countries will have difficulty in securing the labor forces willing to invest in human capital that are not easily transferrable to other industries or firms. In particular, labor forces are not likely to do so in the LME labor market environment where long-term employment is not

supported systematically through strong industrial relations, government regulations, and the financial system. This misalignment of institutions will result in sub-optimal performance, creating economic costs.

Furthermore, we argue that the larger the institutional misalignment, the greater the economic cost. The extent to which a nation achieves its institutional complementarities is contingent upon how well the institutions are coordinated based on their economic logic (Hall & Soskice, 2001). Supporting this view, Hall and Gingerich (2006) found that the rates of economic growth is higher in nations where levels of market, or strategic coordination are high across institutions of the political economy, but lower in nations where neither type of coordination is well-developed or market and strategic coordination are combined, indicating a U-shaped relationship between coordination and economic growth. That is, congruence in the institutional coordination is positively associated with economic outcome. Thus, subsidiaries facing larger institutional misalignment are more likely to experience greater incongruence of institutions, indicating more economic loss. Thus, we propose the following:

Proposition 4a: A firm entering a country in search of new markets is more likely to face economic CDBA because of institution misalignment.

Proposition 4b: The larger the institutional misalignment, the greater the economic cost.

Costs of misalignment: Social Costs. This study suggests that institutional misalignment hazard bears a social cost. Eden and Miller (2004) indicate that social cost is mainly incurred by LOF, resulting from three hazards of doing business abroad: (1) unfamiliarity hazard, which refers to the lack of knowledge of a host country, (2) discrimination hazard or discriminatory treatments against a foreign firm in both the host and home countries, and (3) relational hazard, which includes intra-firm transactions costs, external market transaction costs, managing intra-firm relations, external market transactions, incurring higher administrative costs and managing

relationships with suppliers, distributors, customers, etc. Johanson and Vahlne (2009) further emphasize the relational hazard, introducing the 'liability of outsidership' that arises from being an outsider of extensive networks. The foreign MNEs will bear an induced cost because they are outsiders to both the structural (impersonal configuration of linkages between people and units) and relational network (personal relationship through interaction) (Granovetter, 1992).

Social cost associated with institutional misalignment differs from LOF, as it involves relational hazard and not discrimination and unfamiliarity hazards. However, the relational hazard that MNE subsidiaries bear goes beyond the boundary of relational hazard or liability of outsidership (Johanson & Vahlne, 2009). It extends to the institutional level because certain institutional arrangements require cohesive coordination among the members. For example, governance in CME countries usually relies on extensive systems of reputational monitoring in which information about the reputation and operation of a firm is available to investors through business network. Specifically, information about a firm can be secured through a relational and extensive network or cross-shareholding that firms have with other firms, suppliers, and customers. In addition, firms rely on structural network, such as membership in industry associations which typically coordinate through an industry-standard setting, technology transfer, and the vocational training of workers (Hall & Soskice, 2001). Consequently, firms from different economies (e.g., LME) will face difficulty building a positive reputation or strong sense of trust, especially at an early stage of entry, since trust is built through a network of strong personal relationships, and develops over time (Nahapiet & Ghoshal, 1998; Coleman, 1988). In particular, LME firms with governance systems mainly rely on the market valuation of a firm, and the dispersed shareholder acquires firm-specific information through publicly accessible information (Hall & Soskice, 2001). LME firms do not have to rely on networks, either formal or informational to gather information. Consequently, MNEs operating in a different business system will incur cost

Proposition 5a: A firm entering a country in search of new markets is more likely to face social CDBA because of institution misalignment.

Proposition 5b. The larger the institutional misalignment, the greater the social cost.

CONCLUSIONS

In this paper, we proposed that CDBA can also occur at an institutional level. Furthermore, we develop a new perspective on the CDBA by incorporating *institutional misalignment* between the home and the host country as a cause of CDBA. We proposed that institutional misalignment should be considered as a component of the cost of doing business abroad (CDBA). Using the theoretical lens of Varieties of Capitalism (VoC), we explained why and how institutional misalignment can create additional cost for MNEs operating in foreign countries. Specifically, we discussed how the differences between institutional configurations of the home and the host country create institutional misalignment. Furthermore, we explained why institutional misalignment is inevitable as MNEs cross national borders and how it incurs economic as well as social cost that MNEs may not be aware of. By doing so, we extended the CDBA research to a national level of analysis and showed that a set of firms from a nation can lose its national comparative institutional advantage as they cross national borders. Finally, we asserted that the larger the institutional distance between the two countries, the greater the institutional misalignment is.

By addressing institutional misalignment as a dimension of CDBA, we make theoretical contributions to the international business and institutional theory. First, by developing a new perspective on CDBA research, this paper extends the IB theory on CDBA to the institutional level, which has been underexplored. Extant IB research on CDBA has focused on how institutional environment of the host country discriminate MNE subsidiaries, thus incurring additional cost. It has, however, overlooked how the home and the host country's institutional

environments interact with each other and create disadvantages for the MNE subsidiaries. Second, we delineated a central concept to the IB literature “cost of doing business abroad ” and proposed another component, “institutional misalignment.” We further explained how institutional misalignment can incur economic as well as social CDBA. Third, we provide an explanation on how to evaluate the extent of institutional misalignment that a firm might face as they prepare to do business with a new country. By examining the institutional distance of coordination mechanisms of the market economies, MNEs can approximate the extent of the institutional misalignment. Fourth, we have incorporated VoC in analysis of CDBA. VoC examines the institutions in a more dynamic way by looking at them as particular combinations or configurations, and exploring how institutions interact, complement, or conflict with each other within those context. We believe this approach adds richness to the analysis of CDBA.

This paper also has important practical implications. First, it is essential for firms to understand what internationalization entails. Comprehensive understanding of the cost associated with internationalization, firms contemplating an overseas venture will be able to estimate the risk associated with the internationalization. Second, by understanding the cost associated with the institutional misalignment, firms will be able to make a better decision on destination of their internationalization. By entering a country with institutional configuration that resembles with their home country, the firms are more likely to reduce the disadvantages that they will face. Third, understanding the interaction between the home and host country’s institutions will allow MNE subsidiaries to implement strategies in terms of destination, entry mode, partner selection, and subsidiary management.

We hope future research can refine and extend the additional cost associated with the institutional misalignment hazard. Among various international business topics that the institutional misalignment hazard can be applied, the internationalization process may be of particular interest. Johansson and Vahlne (1977 and 1990) argue that MNEs expand first in a geographically proximate location, and then venture out to more distant markets as their

experiential learning increases. In a similar note, Rugman and Verbeke (2005) propose the theory of regional MNEs based on the empirical evidence that a majority of large MNEs' sales concentrated within their home region, while global sales is profound lacking. The authors argue that large MNEs adopt regional, rather than global strategies in their internationalization. According to VoC, similarities in institutional arrangement tend to exist in geographical as well as cultural proximities. For instance, most of the CME countries are in Western Europe, while LME countries are in North America and England. Consequently, in regards to which country to enter, MNEs will consider how well their institutions would align with that of the host country, instinctively or consciously. Hence, MNEs may choose a destination with institutional arrangement that is most similar to that of their own so that they can reduce any additional cost.

Second, future research may examine how institutional misalignment hazard could affect practice transfer across national borders. Extant research on how MNEs respond to the institutional misalignment existing between the home and the host country in terms of organizational structures, practices, and processes differ significantly (Morgan et al., 2001). For instance, Whitley (2001) suggested MNEs will take practices, routines of control and coordination with them by finding locations that fit the best with the institutional configuration of the home country. That is, MNEs may seek out a host country with similarly coordinated institutional configuration. This perspective may provide a support for Rugman and Verbeke (2004)'s argument that MNEs are regional rather than truly global because the patterns of MNE internationalization show a clustering around a particular region. On the other hand, Kristensen & Zeitlin (2005) suggested that subsidiaries will build practices based on the host country institutional foundation. Considering MNEs as a unique "transnational social space," (Morgan & Kristensen, 2006: 1471), some researchers have argued that subsidiaries are not driven into either conformity or resistance but 'appear to demonstrate considerable space, within structural constraints, for managerial "strategic choice"' (Ferner et al., 2005b: 317). This approach recognizes that firms are not static recipients of institutional contexts, but are rather involved in a

complex and dynamic interaction with institutions at the national and international level (Morgan & Kristensen, 2006: 1471). Thus, it will be a worthwhile research effort to examine how MNEs negotiate the institutional misalignment.

Viewing the MNEs as transnational social space, our primary contention in this paper is that the institutional misalignment hazard should be considered as part of the CDBA. With this acknowledgement, MNEs will have a more in-depth understanding of cost involving internationalization. Specifically, with deeper understanding of CDBA, MNEs can make better decisions on timing, destination, ownership strategy, partner selection, and organizational practices transfer.

REFERENCE

- Albert, M. 1993. Capitalism vs. capitalism: How America's obsession with individual achievement and short-term profit has led it to the brink of collapse (P. Haviland, Trans.). New York: Four Wall Eight Windows
- Aoki, M. 1994. The contingent governance of teams: Analysis of institutional complementarity. *International Economic Review*, 35(3): 657-676
- Brouthers, K. D. 2002. Institutional, cultural and transaction cost influences on entry mode choice and performance. *Journal of International Business Studies*, 33(2): 203-221.
- Buckley, P. J. & Casson, M. 1981. The optimal timing of a foreign direct investment. *The Economic Journal*, 91(361): 75-87.
- Buckley, P. J. & Casson, M. C. 1998. Models of the multinational enterprise. *Journal of International Business Studies*, 29(1): 21-44.
- Caballero, R. J. & Hammour, M. L. 1998. Jobless growth: Appropriability, factor substitution, and unemployment. *Carnegie-Rochester Conference Series on Public Policy*, 48(0): 51-94.
- Calhoun, M. A. 2002. Unpacking liability of foreignness: Identifying culturally driven external and internal sources of liability for the foreign subsidiary. *Journal of International Management*, 8(3): 301-321.
- Campbell, J. L. & Pedersen, O. K. 2007. Institutional competitiveness in the global economy: Denmark, the united states, and the varieties of capitalism. *Regulation & Governance*, 1(3): 230-246.
- Chen, R. 2008. The cost of doing business abroad in emerging markets and the role of MNC parent companies. *Multinational Business Review (St. Louis University)*, 16(3): 23-39.
- Coleman, J. S. 1988. Social capital in the creation of human capital. *American Journal of Sociology*, 94, Supplement S95-S120: S95-S120
- Crouch, C. & Streeck, W. 1997. *Political economy of modern capitalism: Mapping convergence and diversity*. Cambridge: Cambridge University Press.
- Cuervo-Cazurra, A., Maloney, M. M., & Manrakhan, S. 2007. Causes of the difficulties in internationalization. *Journal of International Business Studies*, 38(5): 709-725.
- Delios, A. & Henisz, W. J. 2003. Political hazards, experience, and sequential entry strategies: The international expansion of Japanese firms, 1980-1998. *Strategic Management Journal*, 24(11): 1153-1164.
- Delios, A. & Beamish, P. W. 2001. Survival and profitability: The roles of experience and intangible assets in foreign subsidiary performance. 44: 1028-1038.

- DiMaggio, P. & Powell, W. 1983. The iron cage revisited: Institutional isomorphism and collective rationality in organizational fields. *American Sociological Review*, 48(2): 147-160.
- DiMaggio, P. & Powell, W. 1991. *Introduction to the new international on organization studies*: University of Chicago Press.
- Eden, L., & S.R. Miller. 2001. Opening the black box: The multinational enterprise and the costs of doing business abroad. Best Paper Proceedings, Academy of Management.
- Eden, L., & Miller, S. R. 2004. Distance matters: Liability of foreignness, institutional distance and ownership strategy. In M. Hitt & J. Cheng (Eds.), *Advances in international management*, vol. 16: 187–221. New York: Elsevier.
- Ferner, A. 1997. Country of origin effects and HRM in multinational companies. *Human Resource Management Journal*, 7(1): 19-37.
- Ferner, A., Quintanilla, J., & Varul, M. Z. 2001. Country-of-origin effects, host-country effects, and the management of hr in multinationals: German companies in Britain and Spain. *Journal of World Business*, 36(2): 107-127.
- Granovetter, M. 1992. Economic institutions as social constructions: A framework for analysis. *Acta Sociologica*, 35: 3-11.
- Greenwood, R. & Suddaby, R. 2006. Institutional entrepreneurship in mature fields: The big five accounting firms. *Academy of Management Journal*, 49(1): 27-48.
- Gulati, R. 1995. Does familiarity breed trust? The implications of repeated ties for contractual choice in alliances. *The Academy of Management Journal*, 38(1): 85-112.
- Hall, P. A. & Soskice, D. W. 2001. *Varieties of capitalism : The institutional foundations of comparative advantage*. Oxford [England]; New York: Oxford University Press.
- Hall, P. A. & Gingerich, D. W. 2004. Varieties of capitalism and institutional complementarities in the macroeconomy: An empirical analysis, *Mpifg discussion paper 04/5*. Cologne: Max-Planck-Institut fur Gesellschaftsforschung.
- Henisz, W. & Swaminathan, A. 2008. Institutions and international business. *Journal of International Business Studies*, 39(4): 537-539.
- Hitt, M. A., Hoskisson, R. E., & Kim, H. 1997. International diversification: Effects on innovation and firm performance in product-diversified firms. *Academy of Management Journal*, 40(4): 767-798.
- Hymer, S. 1976. *The international operations of national firms*. Cambridge, MA: MIT Press.
- Jackson, G. & Deeg, R. 2008. Comparing capitalisms: Understanding institutional diversity and Its implications for international business. *Journal of International Business Studies*, 39: 540-561.

- Johanson, J. & Vahlne, J.-E. 2009. The Uppsala internationalization process model revisited: From liability of foreignness to liability of outsidership. *Journal of International Business Studies*, 40(9): 1411-1431.
- Kenworthy, L. 2006. Institutional coherence and macroeconomic performance. *Socio-Economic Review*, 4(1): 69-91.
- Kogut, B. & Zander, U. 1993. Knowledge of the firm and the evolutionary theory of the multinational corporation. *Journal of International Business Studies*, 24(4): 625-645.
- Kostova, T. 1997. Country institutional profiles: Concept and measurement. *Academy of Management Proceedings*: 180-184.
- Kostova, T. 1999. Transnational transfer of strategic organizational practices: A conceptual perspective. *Academy of Management Review*, 24(2): 308-324.
- Kostova, T. & Zaheer, S. 1999. Organizational legitimacy under condition of complexity: The case of the multinational enterprise. *Academy of Management Review*, 24(1): 64-81.
- Kristensen, P.H. & Zeitlin, J. 2005. Local players in global games. The strategic constitution of a multinational corporation. Oxford: Oxford University Press.
- La Porta, R., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R. 1998. Law and "finance. *Journal of Political Economy*, 106: 1113-1155.
- Lu, Q. & Hwang, P. 2010. The impact of liability of foreignness on international venture capital firms in Singapore. *Asia Pacific Journal of Management*, 27: 81-97.
- Madhok, A. 1995. Revisiting multinational firms/' tolerance for joint ventures: A trust-based approach. 26: 345-369.
- Meyer, K. E. 2001. Institutions, transaction costs, and entry mode choice in eastern Europe. *Journal of International Business Studies*, 32(2): 357-367.
- Meyer, J. W. & Rowan, B. 1977. Institutionalized organizations: Formal structure as myth and ceremony. *American Journal of Sociology*, 83(2): 340-363.
- Mezias, J. M. 2002. Identifying liabilities of foreignness and strategies to minimize their effects: The case of labor lawsuit judgments in the united states. *Strategic Management Journal*, 23(3): 229-244.
- Miller, S. R. & Parkhe, A. 2002. Is there a liability of foreignness in global banking? An empirical test of banks' x-efficiency. *Strategic Management Journal*, 23(1): 55-75.
- Miller, S. & Richards, M. 2002. Liability or foreignness and membership in a regional economic group: Analysis of the European union. *Journal of International Management*, 8: 232-337.
- Morgan, G. & Kristensen, P. H. 2006. The contested space of multinationals: Varieties of institutionalism, varieties of capitalism. *Human Relations*, 59(11): 1467-1490.

- Nahapiet, J. & Ghoshal, S. 1998. Social capital, intellectual capital and the organizational advantage. *Academy of Management Review*, 23(2): 242-266.
- North, D. C. 1995. The Adam Smith address: Economic theory in a dynamic economic world. *Business Economics*, 30(1): 7-12.
- Petersen, B. & Pedersen, T. 2002. Coping with liability of foreignness: Different learning engagements of entrant firms. *Journal of International Management*, 8: 339-350.
- Powell, W. W. 1991. Expanding the scope of institutional analysis. In W. W. Powell & P. J. DiMaggio (Eds.), *The new institutionalism in organizational analysis*: 183-203. Chicago and London.
- Putnam, R. D. 1993. The prosperous community: Social capital and public life. *American Prospect*, 13: 35-42.
- Redding, G. 2005. The thick description and comparison of societal systems of capitalism. 36(2): 123-155.
- Scharpf, F. W. 1997a. *Games real actors play. Actor-centered institutionalism in policy research*. Boulder: Westview.
- Schneider, M. R., Schulze-Bentrop, C. & Paunescu, M. 2009. Mapping the institutional capital of high-tech firms: A fuzzy-set analysis of capitalist variety and export performance. *Journal of International Business Studies*, 41: 246-266.
- Scott, W. R. 1995. *International and organizations*. Thousand Oaks, CA: Sage.
- Seo, M.-G. & Creed, W. E. D. 2002. Institutional contradictions, praxis, and institutional change: A dialectical perspective. *The Academy of Management Review*, 27(2): 222-247.
- Sethi, D. & Judge, W. 2009. Reappraising liabilities of foreignness within an integrated perspective of the costs and benefits of doing business abroad. *International Business Review*, 18(4): 404-416.
- Sethi, D. & Guisinger, S. 2002. Liability of foreignness to competitive advantage: How multinational enterprises cope with the international business environment. *Journal of International Management*, 8(3): 223-240.
- Streeck, W. & Schmitter, P. C. 1985. Community, market, state-and associations? The prospective contribution of interest governance to social order. *European Sociological Review*, 1(2): 119-138.
- Teece, D. J. 1977. Technology transfer by multinational firms: The resource cost of transferring technological know-how. *The Economic Journal*, 87(346): 242-261.
- Tregaskis, O. & Brewster, C. 2006. Converging or diverging? A comparative analysis of trends in contingent employment practice in Europe over a decade. *Journal of International Business Studies*, 37: 111-126.
- Wan, W. P. 2005. Country resource environments, firm capabilities, and corporate

diversification strategies. *Journal of Management Studies*, 42(1): 161-182

Whitley, R. 1999. *Divergent capitalisms: The social structuring and change of business systems*. Oxford: Oxford University Press.

Whitley, R. 2000. The institutional structuring of innovation strategies: Business systems, firm types and patterns of technical change in different market economies. *Organization Studies*, 21(5): 855-886.

Williamson, O. E. 1975. *Markets and hierarchies: Analysis and antitrust implications*. New York: Free Press.

Witt, M. A. & Lewin, A. Y. 2007. Outward foreign direct investment as escape response to home country institutional constraints. *Journal of International Business Studies*, 38(4): 579-594.

Witt, L. A. & Redding, G. 2009. Culture, meaning, and institutions: Executive rationale in Germany and Japan. *Journal of International Business Studies*, 40: 859-895.

Yip, G. S. 1992. *Total global strategy*. Englewood Cliffs, NJ: Prentice-Hall, Inc.

Yu, T. & Eden, L. 2001. *Safe in my backyard: Strategic trade policy and multinational rivalry*. Paper presented at the Academy of Management Proceedings & Membership Directory.

Zaheer, S. 1995. Overcoming the liability of foreignness. *Academy of Management Journal*, 38(2): 341-363.

Zaheer, S. 2002. The liability of foreignness, redux: A commentary. *Journal of International Management*, 8(3): 351-358.

Zaheer, S. & Mosakowski, E. 1997. The dynamics of the liability of foreignness: A global study of survival in financial services. *Strategic Management Journal*, 18(6): 439-463.

Table 1: CDBA by Specificity and Hazard Type

Specificity	Firm specific		Non-Firm Specific
Level of Analysis	Subsidiary	Inter/Intra firm	Industry/Nation
Hazard Type	unfamiliarity hazard	relational hazard	discrimination hazard
Causes	<ul style="list-style-type: none"> •lack of information •unfamiliarity •lack of legitimacy •lack of experience 	<ul style="list-style-type: none"> •Higher transaction cost •Higher administrative cost •Subsidiary strategy being constrained by parent MNE's global strategy 	<ul style="list-style-type: none"> •Difficulties caused by home government •Unfavorable treatment by host government & buyers •Economic nationalism

Table 2. Comparison between CMEs and LMEs

	CME	LME
Coordination Mechanism	Strategic non-market	Market
Education and training system	Firm or industry specific skills are trained	General skills are trained
Corporate governance	Monitoring based on relations and reputation	Monitoring based on publicly assessable information
Industrial relationship	Employee cooperation in companies and wage moderation; co-determination rights	Deregulated labor markets, low cost hiring and firing, no co-determination rights, flexible reward-setting
Intercompany relations	Cooperation, standard setting and technology transfer	Strong competition policy, market competition, technology transfer via market
Example country	Germany	United States

Complementarities of Institutions

Figure 1
Institutional Misalignment

