Unbalanced Institutions in Market Transition: How Do They Matter for Firm Strategic Choices and Performance in Emerging Economies?

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Abstract
The legal and economic institutions in emerging economies normally undergo major changes during the transition to a market economy. The development of legal and economic institutions in such economies is discussed, and two different development paths are analyzed. One relates to economies with relatively better-developed economic institutions, and the other to those with relatively better-developed legal institutions. A series of propositions are developed to explain how different imbalances in institutional development might influence market competition, firms' strategic choices, and firm performance. A three-stage model of economic development is proposed which attempts to account for the two different situations.

Keywords Unbalanced institutions · Market transition · Strategic choice · Competitive advantage

1 Introduction
Institutions are the humanly devised rules and constraints that structure human interactions (North 1990), and they include both formal rules and informal constraints. Institutions, including the economic and legal dimensions, establish norms, rules, and procedures for economic and social activities, and constitute a society’s basis for production, exchange, and distribution (North 1990). Following prior literature, we define economic institutions as the structural arrangements through which a society

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produces, distributes, and consumes goods and services (Khanna and Palepu 2000). Economic institutions generally involve market intermediaries (Khanna and Palepu 1997; North 1990) and supporting infrastructures (Porter 1990). They provide needed infrastructure and systems to allow for business activity and exchange, and influence production and transactions by shaping resource availability and access to opportunities within a region (Khanna and Palepu 1997, 2000; North 1990). We define legal institutions as the existence of laws, regulations, and written rules that define the ‘rules of the game’ of market competition (Acemoglu and Johnson 2005; Acemoglu et al. 2005). They constitute and define an established order within which businesses operate (North 1990) and set constraints on practices that considered unfair or socially harmful.

The institutional transition process under way in many emerging economies has attracted the attention of scholars in a wide range of disciplines, including economics, sociology, international business, and business strategy (Boisot and Child 1996; Hoskisson et al. 2013; Li 2013; Nee 1992; Wright et al. 2005). Emerging economies are defined here as those undergoing institutional transition towards a market-based system, a process which normally involves building various market-supporting institutions (Hoskisson et al. 2000). The institutional transition normally involves “fundamental and comprehensive changes introduced to the formal and informal rules of the game that affect organizations as players” (Peng 2003, p. 275). Business scholars have developed an institution-based view of firm strategy which emphasizes the dynamic interaction between institutions and firms, and considers strategic choices as a reflection of the prevailing economic, legal, and political systems (Peng 2003). According to the institution-based view, emerging economies often lack the stable institutional structure which facilitates economic exchange, and thus tend to suffer from high costs. Organizations pursue strategies that take advantage of opportunities while accommodating the constraints imposed by the underdeveloped institutions.

Such an institution-based perspective has been widely adopted by scholars in strategic management. Most of them adopt a simple dichotomy that divides the world into emerging and developed economies, and emphasize the underdeveloped nature of institutions in emerging economies, such as deficient capital market structures, poor legal infrastructure, weak property rights protection, or high institutional uncertainty. More recently, Hoskisson et al. (2013) go beyond the simple dichotomy to consider firms in mid-range economies, i.e., economies that are positioned between traditional emerging economies and those considered fully-developed. These economies have more developed market infrastructures, but their development is often unbalanced.

Institutional transition is a dynamic process in which different institutions develop in different ways at different speeds. As a result, institutional transitions in different economies may manifest diverse patterns which may have different impacts on firms (Jackson and Deeg 2008; Lundan and Li 2019). When the multiple dimensions of institutions transit simultaneously, they could interweave, support, and reinforce each other. Better synchrony promotes their reaching some sort of equilibrium, which in turn facilitates development (Hall and Soskice 2001) and economic performance (Yang et al. 2015). When the development of institutions is unbalanced, however, the misfit can lead to conflicts and frictions, which trigger uncertainties in, for example, transferring critical
information, accessing opportunities and resources, or safeguarding intellectual property. In leveraging institutions to their competitive advantage, firms need to adjust and coordinate their business activities, which may lead to inefficiencies and high transaction cost, hampering market transactions.

China and India, for example, are two economies which are reforming their market infrastructures (Hitt and He 2008; Kapur and Ramamurti 2001; Pathanandla 2002). In both, the development of legal institutions has so far failed to keep pace with that of economic institutions. The law has lagged behind, the enforceability of contracts is weak, and competition has been relatively slow to develop (Rawski 1994; Yang 2002). Some other countries such as Poland have been able to foster better legal institutions after the breakup of the Soviet bloc (Hoskisson et al. 2013). The Polish government has revised the laws that regulate economic activity, reaffirming private ownership and enhancing the efficiency of the law enforcement. In Poland, however, economic institutions have not changed commensurately. Some of the central planning infrastructure remains despite being outdated. Figure 1 shows data on the development of economic and legal institutions in several emerging and developed economies (published in the IMD World Competitiveness Report) for selected recent years.

The figure shows that in China, India and Russia, the development of institutions is unbalanced: somewhat developed in terms of economic institutions but less developed in terms of legal institutions. Other economies, like Hungary and Poland, are unbalanced in a different way: with relatively developed legal institutions but underdeveloped economic institutions.

The unbalanced development of institutions prevails in many economies, but has so far received inadequate scholarly attention. The literature on institutional transition in emerging economies has mainly treated it as a two-stage model and emphasized the underdeveloped nature of institutions in the transition process while predicting an eventual evolution to a full development (Peng 2003). But the transition process could be more complex than such models imply. In particular, the unbalanced development of institutions and its impact on firm strategies have been largely overlooked (Hoskisson et al. 2000, 2013).

This study built upon an institution-based view of firm strategy and investigated how imbalances in the development of institutions can influence market competition, firms’ strategic choices and firm performance. With a major foundation in the new institutional economics, this approach emphasizes the actual functions that the different dimensions of institutions perform in the effective functioning of markets. Institutions work as both constraints and facilitators under this perspective. Specifically, this research focused on the development of economic and legal institutions, holding the development of other dimensions constant (Hitt et al. 2006; Khanna and Palepu 1997; North 1990). The aim was to investigate how imbalances in the development of economic and legal institutions in an emerging economy can influence its markets, firm strategies and firm performance. Figure 2 illustrates two unbalanced development paths (Path 1 and Path 2) at an intermediate stage (Stage II) in the market transition process.
Fig. 1 The development of economic and legal institutions in 2005, 2011, 2016 (Economic and legal institutions are calculated based on the data disclosed in the IMD World Competitiveness Yearbook (2005, 2011, 2016). All scores related to economic and legal institutions are normalized within the range of 0 to 1, and a principal component factor analysis with varimax rotation is performed. Two dimensions/factors with eigenvalue greater than 1 are extracted: one with basic infrastructures, labor market efficiency, finance efficiency, business policy, and finance & banking policy (the economic dimensions), the other one with rule of law, IPR protection, and legal and regulatory framework (the legal institutions).)

2 Theoretical Framework

2.1 The Institution-Based View of Economic Development

The traditional institutional perspective emphasizes the embeddedness of organizations in the institutional environment, and has its roots in both sociology (Scott 1995) and economics (North 1990). The sociological approach of institutional analysis emphasizes the legitimacy-defining roles of institutions, which are
**Fig. 2** Institutional development during economic transition (a), and the two unbalanced development paths (b: Path 1, c: Path 2)
composed of cultural-cognitive, normative, and regulative elements (Scott 1995). These institutions, as widely shared beliefs, shape the way people in a society think and behave, and exert significant pressure on firms (Scott 1995).

Alternatively, the institutional economics view, as represented by North (1990), focuses on the actual functions that institutions perform for the effective working of markets. It considers institutions—as reflected in laws, regulations, or capital markets—to be both constraints and facilitators, and contends that, institutions determine transaction and production costs, define the incentives of individuals and organizations, and thus influence firm activities and performance (North 1990). This perspective places little emphasis on the legitimation processes and the process of institutionalization in explaining firm actions (Zucker 1987). But there is also an emergence of explanations based on institutions ‘behaving’ as actors in their own right (Zucker 1987).

With a main foundation in institutional economics, an institution-based view of firm strategy has been developed that accounts for the impact of institutions on firm strategy and on organizational and economic outcomes. This view emphasizes the dynamic interaction between institutions and firms, and considers strategic choices as the outcome of such interactions (Peng 2003). As Ingram and Silverman (2002, p. 20) point out, “institutions directly determine what arrows a firm has in its quiver as it struggles to formulate and implement strategy, and to create competitive advantage”.

In the past few years, the institution-based view has been a leading perspective in strategic management (Wright et al. 2005), especially in research on emerging economies (Hoskisson et al. 2000; Xie and Li 2018). This discussion will be based on the institution-based view, especially the institutional economics perspective (North 1990). It will emphasize the distinct roles of institutions in two dimensions, i.e., the economic and legal dimensions, and look at how the imbalances in development influences market competition, firm strategies, and performance.

We specifically focus on these two dimensions because, first, they are the most fundamental components of the formal institutional infrastructure (North 1990), providing institutions necessary to conduct business operations, and they are known to affect firm behavior and outcomes. Compared with the informal institutions that emerge spontaneously (Williamson 2000), the developments of economic and legal institutions are more malleable and more likely to be unbalanced, as they are often a product of human agency (DiMaggio 1988). Moreover, they have been used in prior research as essential dimensions in clustering and comparing emerging economies at different stages of transition (e.g., Hoskisson et al. 2013; Wan 2005).

### 2.2 Institutional Transition in Emerging Economies

Emerging economies are undergoing institutional transition to market-based systems that favor liberalization and privatization (Hoskisson et al. 2000). Through changes in institutions, the reforms are enacted to improve the functioning of the market and promote economic growth. Such transitions typically involve developing the market intermediaries and infrastructure needed to better support market-based
transactions (Khanna and Palepu 2000; North 1990; Porter 1990). Intermediaries such as auditors, brokers, analysts, investment bankers, and traders bridge between parties with complementary interests. They increase the availability of and access to complementary resources and supporting services, and reduce search costs and uncertainty in the markets (Khanna and Palepu 1997; Nachum 2000). Supporting infrastructure such as means of transportation and distribution channels provides fundamental facilities and systems necessary for transactions to take place smoothly. They improve operational productivity and efficiency, knowledge acquisition, and technological development (Chan et al. 2008; Li and Xie 2011). When such intermediaries and infrastructure are well established, firms face less uncertainty in transactions (North 1990), and can communicate better with transaction partners and resolve information problems (Khanna and Palepu 2000). The smooth functioning of the economic institutions, and thus firms’ access to factors in the capital, labor, and product markets, is an important condition promoting firm growth and economic development (Acemoglu and Johnson 2005; Acemoglu et al. 2005; Levine and Zervos 1998; Williamson 2000).

Economic institutions are not by themselves sufficient to ensure smooth market functioning. They must be monitored and controlled through laws and regulations (Coase 1992). Legal institutions such as contract law, bankruptcy law, and laws protecting property rights, set and enforce the basis of transactions. They help ensure order and affect the incentives and costs of transactions and production (Claessens and Laeven 2003; La Porta et al. 1998).

Taken together, a society’s economic institutions provide the basic conditions for production and exchange, and its legal institutions maintain discipline in firms’ market operations. Both are essential for sound economic development and are the capstone of economic transition (Hoskisson et al. 2000), as has been widely recognized. For example, studies of the automobile industry in India have shown that India’s poor transportation infrastructure, an important economic institution, has hindered the development of its automobile industry (Hoskisson et al. 2013). Companies doing business in the Indian market need to overcome the challenges of poor roads and underdeveloped seaports, which can make it difficult to transport goods and to work with suppliers (Luthra et al. 2005). Studies of firms in China demonstrate that the absence of effective legal institutions in enforcing contracts has led to dysfunctional competitive practices, including food safety problems (Khanna et al. 2005), copyright piracy, and counterfeiting (Li and Atuahene-Gima 2001).

However, institutional transition is largely an incremental, path-dependent process (North 1990), requiring the gradual development of institutions along multiple dimensions. Due to the influence of the initial quality of institutions, different cultural traditions, political interests and government capability, institutional reform is usually non-linear, displaying a mixture of progress and regress (Nee 1992). Since different dimensions of institutions may develop at a different pace (North 1990), institutional development tends to be unbalanced, with some dimensions inevitably lagging behind others.

In general, exogenous cultural, political, and economic forces influence the development of institutions in different dimensions (North 1990). First, historical factors, cultural norms and social values may inhibit a country from adopting institutional
solutions which conventional economic theory would regard as optimal (North 1990). In a comparative study of the effectiveness of national legal systems, for example, La Porta et al. (1998) find that the prior existence of a common law versus a civil law tradition is significantly related to the effectiveness of rules (La Porta et al. 1998). Second, governments and interest groups often play a significant role in designing and building institutions (Ring et al. 2005), which may influence the progress of institutional transition. For example, governments in many emerging economies are reluctant to provide strong intellectual property rights (IPRs) protection so that local firms are free to imitate the technologies of multinational firms during the early stage of opening up the economy to international trade (Kim 1997; Mahmood and Rufin 2005). Third, inward foreign direct investment (FDI) may influence the development of institutions in a host country. The governments of emerging economies often give foreign investment a high priority on their developmental agenda. They offer inward investment a wide array of incentives and institutional support (Meyer and Sinani 2009; Wang et al. 2013) seeking the transfer of advanced technology, management know-how, and human capital (Meyer 2004). That may influence the design and operation of the economy’s institutions. Foreign investors who commit resources in a developing country try to take steps to protect their long-term financial interests from policy instability and institutional uncertainty (Kim and Li 2014), which may also influence the development of local institutions.

History shows that the institution building process has varied significantly among emerging economies (please refer to Fig. 1 for an overview of the development of institutions in different economies). Economies like Hong Kong and Singapore have graduated from the ‘emerging’ stage to a more developed stage, with more balanced development of their economic and legal institutions. Hong Kong and Singapore share a number of similarities in their development trajectories. Both until recent decades suffered severely from widespread and institutionalized corruption (ICAC 1999; Quah 1999), but they have now set independent government agencies which have been very successful in fighting corruption. The strict anti-corruption ethos throughout the public services and the transparent and rules-based approach to policymaking has made the institutional systems in Hong Kong and Singapore more efficient and effective over the past several decades. In terms of economic institutions, both Hong Kong and Singapore today are known for their professional intermediaries, market-supporting infrastructure, and specialized knowledge and skills. Despite small land area and high labor cost, they have developed their competitive advantages in trade and financial services, and both have established themselves as international financial centers.

Some other economies are characterized by unbalanced development of institutions. In China and the economies of the former Soviet Union, the most challenging and time-consuming transition has been the building of legal institutions. Those economies have a short history of using IPR laws to protect innovation, and the concept of private property is still fragile due to the influence of communism. China, for example, has implemented focused reforms of some of its economic institutions, including the labor and capital markets, transport links, and reliable power generation, so as to provide a favorable environment for firms and enhance economic development. Indeed, better infrastructure (e.g., electricity and transportation) has helped
China receive more FDI than other developing countries (Bai and Qian 2010). But the development of legal institutions has been poor, characterized by inadequate regulatory regimes, weak contract enforcement and extensive state intervention (Boisot and Child 1996). The law in China remains largely "a tool of state administration" (Lubman 1995, p. 2) and its implementation remains a major source of uncertainty for firms (Jia 2016).

Others like Hungary, Poland, or the Czech Republic have good legal traditions (Ireland et al. 2008) but the challenge has been to develop effective economic institutions (Hitt et al. 2000). Poland, for example, has been able to foster better institutional development after the breakup of the Soviet bloc (Hoskisson et al. 2013). The establishment of the first non-communist government in Poland and the rapid approach to liberalization after 1989 created a more welcoming environment for a capitalist, private ownership-based market economy (Winiecki 1997). The new government changed the laws regulating economic activity so as to affirm the legitimacy of private ownership and enhance the efficiency of law enforcement. However, compared with those legal system developments, Poland's economic institutions have not changed very much. Some of the infrastructure is left over from central planning and is now out of date. It sometimes fails to provide necessary resources. The development of Poland's legal institutions has outpaced that of its economic institutions (Hoskisson et al. 2013).

The dissonance between the development of economic and legal institutions portrayed in Fig. 1 is often seen in emerging economies (c.f. Havrylyshyn and van Roojen 2003). A 2 by 2 typology of emerging economies (Fig. 3) can be developed when considering the development of economic and legal institutions at different levels. We specifically focus on the unbalanced development of institutions (Quadrant I, Quadrant IV) and consider both within- and between-group differences among them.

### 2.3 Institutions and Development: Within Group Comparison

We first consider within group comparison under two possible situations: one with better-developed economic institutions but less-developed legal institutions (Path 1 in Fig. 2a), the other with better developed legal institutions but less-developed economic institutions (Path 2 in Fig. 2a). The impact of unbalanced institutions on markets, organizations, and performance will be explored.

**Path 1:** Relatively well-developed economic institutions with less-developed legal institutions (see Fig. 2b)

Emerging economies such as China are characterized by relatively well-developed economic institutions but underdeveloped legal institutions. After several decades of reform, China has introduced market-supporting institutions and significantly improved its economic infrastructures (Hitt and He 2008). To ensure firms' access to factors of production at reasonable cost and to facilitate market operations, the Chinese government has made efforts to liberalize trade and finance, adopt effective macroeconomic policies, and enhance the development of factor markets.
However, China’s legal system has not been able to keep up with, with inefficient regulations, capricious enforcement, and ill-defined and poorly-protected property rights (World Trade Organization 2006; Yang 2002). In particular, in the quest for advanced technology and rapid economic growth, the protection of intellectual property rights has been weak and the regulation of market competition has been inadequate (Javorcik 2004).

Despite its continuing reform of the rules and legal institutions, evidence suggests that the laws in China are still uncertain in their implementation and enforcement is subject to political considerations (Child and Tse 2001). Weaknesses in the economy’s legal institutions remain major obstacles to business operations. In fact, the Chinese economy has been cited as a particularly serious case of the rule of law having done little to stimulate economic growth (Dowdle 1999; Li 1996; Posner 1998; Wang 2000).

Market competition Institutions and markets inevitably intersect. Institutional arrangements in the economic, political, and legal spheres provide the framework within which a market system develops (North 1990). Studies in strategic management usually focus on economies with well-developed institutions and assume the existence of a functional competitive environment where market rules are valued, property rights are protected, product innovations are rewarded, capable firms grow and prosper, and customers buy ever-improving products. In such a setting, institutions regulate market transactions, correct for market imperfections and help establish a vigorous, fair, and functional competitive environment (North 1990). However, when the institutions are not well developed, it inevitably influences the

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1 Some mechanisms, including ownership concentration, private contracts, and reputation-based mechanisms have been found to work as substitutes for private property rights in support of private sector activities (La Porta et al. 1998).
functioning of the market. In China, for example, relatively developed economic institutions facilitate firms’ access to production factors, promoting market entry and competition. This reduces firms’ traditional dependence on relationships, encouraging them to rely instead on market-based strategies. In the initial stage of such a market transition, there is limited competition, but by the second stage competitive pressure tends to be more intense (Child and Tse 2001). Still, the underdeveloped legal institutions indicated weak governance and both may distort market competition. Weak enforcement of intellectual property rights, for example, can deprive firms of the means to protect their technology, their brands and other original creations, making innovation risky and less profitable. Firms are tempted to engage in opportunistic or even unlawful practices (Boisot and Child 1996; Li and Atuahene-Gima 2001; Xin and Pearce 1996). We follow the lead of Li and Atuahene-Gima in defining dysfunctional competition as “the extent to which the competitive behavior of firms in a market is opportunistic, unfair, or even unlawful” (Li and Atuahene-Gima 2001, p. 1125). We propose that dysfunctional market competition will become prevalent when the development of an economy’s legal institutions falls short of the development of its economic institutions.\(^2\)

Proposition 1: Emerging economy countries with relatively developed economic institutions but less developed legal institutions (A1, A2 in Fig. 2b) will have a higher level of dysfunctional competition than economies with a more balanced development path (A0 in Fig. 2b).

Firms’ strategic choices Institutions influence firm strategies through creating incentives and allocating resources (Peng and Heath 1996). Such influence is particularly significant in emerging economies, where firms need to develop strategies to cope with institutional voids (Khanna and Palepu 1997, 2000). For example, when factor markets are not well developed, firms develop relationships with others to get access to resources. In fact, relationship-based strategies often dominate in the early stage of market transition (Peng 2003).

Moving beyond the early stage, many emerging economies such as China’s have actively developed their economic institutions. Funds, materials and labor are usually available through market channels, which minimize a firm’s dependence on powerful individuals or government agencies. As the market grows, the number of potential trading partners increases and transactions become increasingly impersonal, weakening the effectiveness of relationship-based strategies. Firms increasingly see the need to evolve toward market-based operations (Peng 2003).

If, however, such economies suffer from underdeveloped legal institutions, there is a greater risk of unenforceable contracts and insecure property rights. Transaction costs increase because firms need to protect their assets from expropriation. Poor IPR protection, for example, increases the risk and uncertainty of innovation and

\(^2\) Dysfunctional competition is less likely to become prevalent when the development of economic and legal institutions is in balance, since even if the legal institutions are poorly developed, the similarly under-developed economic institutions constrain market entry and thus the level of dysfunctional competition.
erodes a firm’s ownership advantages, so firms are less likely to invest in innovation (Hoekman and Kostecki 2001). The legal risk of counterfeiting is low, so firms find it more effective to produce and sell explicitly copied or slightly modified products, and to rely on imitation-based development (Child and Tse 2001; Li and Atuahene-Gima 2001). Such strategies enable firms to capture market share and earn returns quickly, and are attractive in the short run. At the same time, the relatively developed economic institutions provide ready access to the labor and capital needed for such imitation activities. Firms’ weak technological capabilities and increasing market competition tend to drive local rivalry with a quantity focus. Firms are forced to imitate others’ products and compete on volume and price. The larger the gap between the development of economic and legal institutions, the more likely that firms will adopt volume/price-based strategies. Take China and India as an example. Both have relatively well-developed economic institutions and less developed legal institutions. But compared with India, China has relatively better-developed economic institutions but less-developed legal institutions, and this relatively large institutional gap may help explain why Chinese firms rely more on volume/price-based strategies than Indian firms.

Proposition 2: Firms operating in countries with relatively developed economic institutions but less developed legal institutions (A1, A2 in Fig. 2b) are more likely to pursue volume/price-based strategies than firms operating in economies with a more balanced development of institutions (A3 in Fig. 2b).

Performance impact Firms operating in markets with relatively better-developed economic institutions but less-developed legal institutions are likely to pursue short-term growth, because the effective economic institutions facilitate their access to resources while the weak legal institutions encourage opportunistic behavior and increase uncertainty. That encourages firms to concentrate on projects with low sunk costs and short payback periods. This is shown by the many Chinese firms which have taken advantage of the institutional weaknesses in China by focusing on strategies generating quick returns. Geely Automobile Company of China, for example, is a motorcycle manufacturer with limited knowledge of car production prior to its entry into that sector, but it quickly gained market success through imitating, reverse engineering, and mixing-and-matching of car components produced by others (Wang 2008). India also has more developed economic institutions but less developed legal institutions. But compared with China, India’s economic institutions are less developed than China, which amount to a smaller institutional development gap, and this may to some extent prevent firms from gaining market share quickly. This is an example of how a larger gap between the development of economic and legal institutions promotes short-term growth.

However, firms may find it difficult to achieve sustainable competitive advantage when operating in such institutional environments. According to the resource-based view of the firm, when a firm exploits complex resources or capabilities, or sophisticated knowledge that other firms don’t have and can’t easily obtain, that firm’s advantages are more likely to be sustainable (Barney 1991). When, by contrast, a firm relies on simple capabilities or resources that can be easily duplicated, its advantages are less likely to endure. It follows that for firms

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operating in an environment with relatively well-developed economic institutions but less-developed legal institutions, their competitive advantages tend to be less sustainable. The underdeveloped legal institutions discourage them from investing in new technology or new capabilities while the relatively well-developed economic infrastructure facilitates the entry of new competitors. Any competitive advantage a firm gains through imitation and price competition may be easily eroded by other imitators who provide similar products at lower prices (Jain 1996; Teece 1986).

Proposition 3: Firms operating in countries with relatively well-developed economic institutions but less-developed legal institutions ($A_1, A_2$ in Fig. 2b) are more likely to show short-term growth than firms operating in economies with more balanced development ($A_0$ in Fig. 2b).

Proposition 4: Firms operating in countries with relatively well-developed economic institutions but less-developed legal institutions ($A_1, A_2$ in Fig. 2b) are less likely to show sustainable development than firms operating in economies with more balanced development ($A_0$ in Fig. 2b).

Path 2: Relatively well-developed legal institutions with less-developed economic institutions (see Fig. 2c)

Some economies, those of Hungary and Poland for example, are characterized by relatively well-developed legal institutions but underdeveloped economic institutions (Spicer et al. 2000). In such a situation firms may find it difficult to rely on networking, co-opting government bureaucrats or bribing key stakeholders (e.g. banks), since the regulatory regime has specified well the firms’ and the government’s rights and responsibilities. Traditional relationship-based strategies are less effective. The inefficient economic infrastructures and therefore the relatively high costs of factors of production may compel firms to move away from cost-driven strategies (Brouthers et al. 2000).

Market competition Legal institutions structure competitive environments by defining the ground rules of economic life, the legal form of corporations, and the rules governing competition (North 1990). Relatively well-developed legal institutions ensure lawful market activities and trading practices, and deter especially the illegal applications of patented technology and copyrights. But if economic institutions are underdeveloped, new market entry and thus competition tend to be constrained (Acemoglu et al. 2005). Ineffective economic institutions influence resource availability and reduce entrepreneurial activity, constraining firms from pursuing opportunities and engaging in productive activities (Bartholomew 1997). Such a market environment could be characterized as having weak market competition.

Proposition 5: Emerging economy countries with relatively well-developed legal institutions but less-developed economic institutions ($A_1, A_2$ in...
Fig. 2c) will have weaker market competition than economies with a more balanced development path (A₀ in Fig. 2c).

Firms' strategic choices Institutions influence firms' strategic choices by shaping their risk perceptions and their access to resources. The legal framework deals with issues of opportunism and uncertainty and provides legal protection for innovation and other long-term investments. In particular, strong IPR protection increases the chances of earnings returns to innovation and thus encourages it (Claessens and Laeven 2003). However, when economic institutions are underdeveloped, firms may suffer from a lack of credit and other critical resources. Poor economic infrastructure and insufficient factors of production thus make it difficult for firms to innovate, which often requires significant amount of investment in R&D. Studies have shown that when firms have limited access to resources they will tend to concentrate on a few target markets and pursue niche/quality-based strategies (Carter et al. 1997). That approach emphasizes knowledge of the market and of customers' needs (Porter 1980). Firms adopting such strategies develop specialist products for niche markets. By focusing on one or two market segments and tailoring the marketing mix to those specialized markets, firms can make the best use of their scarce resources by offering quality products which meet the segment's needs. Where economic institutions are better-developed, firms have more freedom to pursue innovation and other capability-based strategies.

Proposition 6: Firms operating in countries with relatively well-developed legal institutions but less-developed economic institutions (A₁, A₂ in Fig. 2c) are more likely to pursue niche/quality-based strategies than firms operating in economies with more balanced development (A₀ in Fig. 2c).

Performance impact The growth of firms operating in economies with relatively developed legal institutions but underdeveloped economic institutions may be hampered by, for example, a shallow talent pool, inefficient financial institutions, or an unreliable distribution system. Any of these could lead to less productive investments and lower growth rates. In other words, without enough factors to grease the wheels of production and exchange, a firm's activities begin to stall like an engine without enough oil (Fu 2006).

Proposition 7: Firms operating in countries with relatively well-developed legal institutions but less-developed economic institutions (A₁, A₂ in Fig. 2c) are less likely to show short-term growth than firms operating in economies with more balanced development (A₀ in Fig. 2c).

2.4 Institutions and Development: Between Group Comparison

We next consider between-group comparison of the two different development paths: one with better-developed economic institutions (Quadrant I in Fig. 3), and the other one with better-developed legal institutions (Quadrant IV in Fig. 3).
We argue that when the development of legal institutions lags behind the development of economic institutions, resource availability and abundant opportunities makes market entry easier and increase the intensity of market competition. But as the legal institutions cannot constrain and punish unlawful or unethical competitive activities, the competition tends to be dysfunctional. To reduce transaction costs and avoid the influence of opportunistic behavior, firms are more likely to invest in low-cost and labor-intensive activities. For example, China is well known for its manufacturing industries. The reason could be the unbalanced reforms in multiple dimensions; in particular, the more developed economic institutions associated with the less developed legal institutions encourage market entry but drive firms to invest more in cost-driven activities rather than technology-driven activities.

But when the development of economic institutions lags behind the development of legal institutions, firms face barriers in conducting basic business activities, which directly reduce market entry and mute market competition. For those firms which have entered the market, the underdeveloped economic institutions constrain their investment in labor-intensive or cost-driven operations while the relatively well-developed legal institutions define the functional nature of market competition.

Proposition 8: Emerging economy countries with relatively well-developed economic institutions but less-developed legal institutions (Quadrant IV in Fig. 3) will tend to have more dysfunctional competition than economies with better-developed legal institutions but less-developed economic institutions (Quadrant I in Fig. 3).

Proposition 9: Firms operating in countries with relatively well-developed economic institutions but less developed legal institutions (Quadrant IV in Fig. 3) are more likely to pursue volume/price-based strategies than firms operating in economies with better-developed legal institutions but less-developed economic institutions (Quadrant I in Fig. 3).

Proposition 10: Firms operating in countries with relatively well-developed economic institutions but less developed legal institutions (Quadrant IV in Fig. 3) are more likely to show short-term growth than firms operating in economies with better-developed legal institutions but less-developed economic institutions (Quadrant I in Fig. 3).

2.5 The Evolutionary Process of Institutions, Markets, and Organizations

Institutions are not static, nor are organizations and their strategies (Peng 2003). The rapidly changing landscape of many emerging economies suggests that an evolutionary perspective is needed when investigating the transition process. Peng (2003) has proposed a two-state model describing the transition of institutions from poorly-developed to well-developed and, accordingly, firm strategies transiting from network-building in a relationship-based market to capability-based strategies in a rule-based market.
Peng’s model has, however, been criticized for oversimplifying the transition process (Carmen 2004; Yang and Li 2008). Many emerging economies have developed both their economic and legal institutions (albeit to differing extents) and can be considered ‘mid-range emerging economies’ between (newly) developed economies and traditional emerging economies, though some significant differences among them remain (Hoskisson et al. 2013). The foregoing discussion of institutions, markets, and organizations instead suggests a three-stage model which may offer a more refined understanding of the transition process. Such a model is presented schematically in Fig. 4.

Stage I
- Early stage
- Institutions:
  - Economic
    - Poorly developed
  - Legal
    - Limited competition
  - Market competition:
    - Relationship/network-based

Stage II
- Intermediate stage
  - Path I:
    - Relatively developed
    - Less developed
  - Path II:
    - High, dysfunctional
    - Low, functional
    - Volume/price-based
    - Niche/quality-based

Stage III
- Fully developed stage
  - Developed
  - High, functional
  - Capability-based

![A three-stage model of market transition](image)

**Fig. 4** A three-stage model of market transition

**Early stage** In the early stage of market transition (stage I in Fig. 4), institutions are underdeveloped. The development of factor markets constrains firms’ access to critical production factors. The government controls scarce resources and is overwhelmingly dominant in economic activities (Xin and Pearce 1996). The legal system is also poorly-developed. Official discretion rather than the rule of law regulates market operations (Peng and Heath 1996). The underdeveloped factor markets and institutions create high entry barriers, stifle market competition, and damage the functioning of the market (Boisot and Child 1996). To reduce institutional uncertainty, gain legitimacy, and get access to factor markets, firms have to build relationships with power brokers, often government officials (Peng and Luo 2000). Such relationships are valuable and rare resources that are difficult to imitate in such situations, making them the basis of competitive advantage in the early stage of market transition.

**Intermediate stage** In the intermediate stage (stage II in Fig. 4), a rule-based structure begins to emerge but has not yet begun to dominate the market logic, while relationship-based transactions begin to decline. Some economies have developed their institutions in a relatively balanced manner: they have developed their banking systems, public equity markets, and venture capital industries in tandem, which provide a good foundation for market-based operations. They have also developed their legal systems and enforcement mechanisms, which facilitate new business creation and growth, and protect investors (Path 3 in Fig. 2a).

Many others, however, are characterized by an unbalanced development of institutions, with some dimensions more- or less- developed than others. India and China have
relatively well-developed economic institutions but underdeveloped legal institutions (Path 1 in Fig. 2a), as has been discussed. Market competition tends to be unhealthy, unfair, or even unlawful (Li and Atuahene-Gima 2001). Firms prefer imitation-based development and compete on volume and price (Child and Tse 2001; Li and Atuahene-Gima 2001), making it hard for them to develop long-term competitive advantages. Some other economies like those of Hungary and Poland are characterized by relatively well-developed legal institutions but underdeveloped economic institutions (Path 2 in Fig. 2a). The relatively developed legal system ensures functional market competition, but the underdeveloped economic institutions constrain firms’ access to factors of production. Firms are pushed to adopt niche/quality-based strategies. The underdeveloped economic institutions, and therefore firms’ constrained access to resources, inhibits rapid growth.

Fully developed stage As the market evolves, it matures to a situation in which a rule-based transaction mode dominates (stage III in Fig. 4) (Peng 2003). By that stage both economic and legal institutions are well-developed. Legal institutions help regulate market activity while economic institutions encourage more firms to enter the market. The market environment becomes more competitive and uncertain. The increasingly competitive market, working together with the development of new technology and sophisticated customer needs, encourages firms to focus on capability-based strategies such as innovation (Hoskisson et al. 2000; Oliver 1997) and develop more sustainable competitive advantages.

The following propositions describe the three-stage model.

Proposition 11: During the transition toward a market-based system, an economy’s institutions will evolve from being poorly developed (Stage I) to an intermediate stage (Stage II, via Path 1, Path 2, or the balanced Path 3), before reaching a full development (Stage III).

Proposition 12: During that transition, the market environment will evolve from a less competitive market (Stage I) to either a competitive but dysfunctional market (Path 1), or a functional but less competitive market (Path 2), or along a balanced path (Path 3) (Stage II), before becoming fully competitive and functional (Stage III).

Proposition 13: During the transition, firms will evolve from relying on a relationship/network-based strategy (Stage I) to a volume/price-based strategy (Path 1) or a niche/quality-based strategy (Path 2) (Stage II), before evolving to an innovation/capability-based strategy (Stage III).

3 Discussion

Legal and economic institutions are essential elements of an institutional transition in an emerging economy. Although an institutional transition calls for simultaneous development of both the economic and legal institutions in a society, they may evolve inconsistently. In fact, unbalanced institutional development has been widely observed in emerging economies but the imbalances are often overlooked.
Sometimes the economic institutions are better developed, while in other situations the legal institutions lead the way. This discussion has argued that this can be described in terms of two trajectories for the maturation of emerging economies. In particular, the analysis may help advance studies of emerging economies by introducing the following factors as of particular importance.

The unbalanced development of institutions Prior studies on emerging economies have analyzed institutional differences across countries. They used to emphasize the underdeveloped nature of their institutions in general or the different dimensions of institutions separately. However, the unbalanced development of institutions, as a key feature of emerging economies in their market transition process has been largely overlooked. This discussion has proposed considering institutions as multi-dimensional, with different dimensions developing at different speeds. Doing so can suggest fresh insights and contributes to a more fine-grained description of the institutional environments.

The nature of markets The existence of a competitive environment with well-developed institutions has usually been a basic assumption in discussions of business strategy. However, market competition in many emerging economies tends to be dysfunctional, with features which would be unlawful in a better-developed environment. Considering the inconsistent development of economic and legal institutions helps extend the traditional Western assumptions about the market environment and provides a more complete picture of market dynamics (Hoskisson et al. 2000).

Firm strategic choice Prior studies emphasize a predominant adoption of low cost/price leadership strategies by emerging economy firms due to their low factor costs, weak demand conditions, high price sensitivity or low purchasing power (Porter 1980, 1985). Our analysis, however, suggests the prevalence of two different strategies in emerging economies: volume/price-based strategy and niche/quality-based strategy. The analysis shows that the unbalanced development of institutions may favor either volume/price-based strategies or niche/quality-based strategies depending on the nature of the imbalance.

Short-term growth vs. long-term sustainability Business scholars emphasize the importance of developing sustainable competitive advantage (Barney 1991; Porter 1985), but competitive advantage may be particularly hard to sustain in an emerging economy (Chacar and Vissa 2005; Glenn et al. 2001). This analysis has illustrated why firms in some countries can achieve rapid growth in a short time but then find it difficult to sustain it in the long run, while firms in some other countries find short-term growth difficult. The differences may be a result of patterns of institutional weakness inherent in the transition process, and firms must understand the process to achieve long-term development. Our finding of a decline in sustainability of competitive advantage supports observations in the literature on the need for greater attention to strategies in emerging economy countries.

The three-stage model The three stages of institutional transition proposed here reflect the typical evolutionary path of institutions better than the traditional two-stage model. The three-stage model underscores the co-evolution of institutions, markets and organizations, and the inclusion of an intermediate stage offers a more
complete picture of the transition process. Delineating the different paths of institutional transition offers a systematic approach to capturing the similarities and differences in institutional development across emerging economies. The two different paths could be a reliable way to cluster diverse economies, and such clustering may in turn generate patterns in market competition and firms’ strategic choices, contributing to a better understanding of institutions, markets, and organizations in large-scale institutional transitions.

4 Contributions and Implications

By focusing on imbalances in the development of institutions, this discussion extends our understanding of the new emerging mid-range economies and of the convergence and divergence of firm strategies in economies at different stages of development. The three-stage model enriches the institution-based view of business strategy and may serve as a foundation for future research into capitalism in emerging economies. Specifically, the paper contributes to the literature in the following ways.

First, this research contributes to our understanding of emerging economies by highlighting the emergence of mid-range economies with unbalanced institutional development as a key feature of the development process. In the last decade, emerging markets have assumed a prominent position in the global economy. As locations of future growth, countries such as China and India have experienced rapid growth and have attracted increasing attention from scholars and managers. Yet our understanding of such economies has not kept pace (Davis and Marquis 2005). Hoskisson et al. (2013) has previously identified the emergence of ‘mid-range economies’ based on the stage of development of their infrastructure and factor markets and general institution development (Hoskisson et al. 2013). But their study didn’t explore how imbalances influence firms and markets. This discussion has extended Hoskisson’s treatment of the intermediate stage of market transition and of the emergence of mid-range economies by explaining how the imbalances influence market competition, firms’ competitive strategies and performance. As emerging markets continue their remarkable growth trajectory, discussion of such mid-range economies becomes important both for theory and in practice.

Second, clustering emerging economies based on the development of economic and legal institutions and the identification of common institutional characteristics can help explain the convergence and divergence of firm strategies in different economies. Emerging economies share a number of similarities which distinguish them

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3 There are different ways to define institutions and its multifaceted dimensions. Hoskisson et al., adopt North (1990)’s definition of institution, i.e., focuses more on the formal rules and regulations that influence market transactions, but does not explicitly take into account infrastructures, intermediaries and factor markets as institutions. In contrast, Khanna and his colleagues see such constituents, especially, market intermediaries and infrastructures as critical factors that differentiate institutional environments of advanced economies from those of emerging economies. We follow Khanna and his colleagues to adopt a more broad definition.
from their more developed counterparts, but they are not a homogenous group. It is important to identify the similarities and differences among them and to understand how the development of institutions channels organizational attention and strategic decisions.

Third, the three-stage model developed here offers a clearer understanding of the co-evolution of institutions, markets, and organizations in institutional transition, enriching our understanding of emerging economies. Understanding the market transition process will be critical not only for the long-term development of individual firms, but also for the development of the entire economy.

Fourth, this paper enriches the institution-based view of business strategy (Meyer and Peng 2005; Wright et al. 2005) by emphasizing the diverse functional roles of institutions and illustrates how their unbalanced development can influence competition, firm strategy and performance. Under the traditional institution-based view, institutions matter, but the view of institutions tends to be ‘thin’ (Jackson and Deeg 2008) in the sense of focusing on the development of institutions as a whole or of specific institutional dimensions. The degree to which different institutions in an economy are transitioning synchronously has been less investigated. An economy hosts a wide range of economic, legal, and political institutions, and their separate roles in influencing business operations and market exchange should not be assumed to be equally influential. They develop distinct means of reducing the costs of market transactions and transformations, and influence firms differently. This discussion has treated institutions as multi-dimensional and investigated how imbalances in their development might influence firms and markets according to their different functional roles. Such treatment enriches our understanding of institutional diversity and contributes to a more fine-grained delineation of the institutional context.

Last but not least, this analysis may also serve as a foundation for future research into capitalism in emerging economies. The varieties of capitalism (VoC) framework emphasize the distinctiveness of national institutional contexts and ask how distinct configurations of institutions might generate systematic differences in corporate strategy across countries (Hall and Soskice 2001). Such research has previously focused primarily on mature capitalist economies (Boyer 2005), and little attention has been paid to economies still emerging. The broad dichotomization of institutional contexts in previous studies into liberal market economies (the US, UK, and Australia, for example) and coordinating market economies (Germany and Japan, for example) has been criticized as overly simplistic (Herrigel and Zeitlin 2010). The transitional nature of the economy as well as the poorly-developed institutions has forced emerging economy countries to identify patterns of economic growth of their own. Like Hall and Soskice (2001), this study has linked its analysis closely to the functional roles of institutions and has been able to show how imbalances in the development of economic and legal institutions can lead to differences in corporate strategy across nations. It contributes to the literature by moving away from the all-encompassing label of ‘emerging economies’ (Hoskisson et al. 2013) to look at the distinct paths of market transition. It also offers an analytical framework which can help to explain patterns of economic growth in emerging economies, and serves as a foundation for future studies to explore capitalism in emerging economies.
The study’s propositions also have practical implications for policy-makers and practitioners in emerging economies.

First, this research has practical implications for policy makers in emerging economies. In implementing market-based reforms, policy makers must address a range of institutional policies. They should attempt to synchronize the development of different dimensions of the institutional environment so as to remove constraints and create a supportive institutional and market environment.

Since government channels the transition process by defining the rules of market operation, weak innovation and unsustainable competitive advantage should be a concern for emerging economy governments. Development-minded governments have for many years viewed weak protection of intellectual property rights as a tool for technological and economic development (Jain 1996). But the propositions presented here indicate that when underdeveloped legal institutions are associated with more developed economic institutions, dysfunctional competition is encouraged and firms are tempted to adopt price/volume-based strategies. That undermines the sustainability of any competitive advantage they obtain. In fact, this analysis suggests that China, even more than smaller transition economies, risks economic slowdown if it fails to improve its legal institutions. A comprehensive legal framework conducive to innovation and sustainable development needs to be established before the returns to factor inputs begin to decline. For economies with well-developed legal systems but underdeveloped economic infrastructure, the analysis suggests that only when the economic institutions keep pace with the development of legal institutions can they expect to sustain rapid development.

Second, it provides suggestions for policy makers in emerging economies on how to manage the process of FDI inflow. To enhance FDI and maximize FDI spillovers, one policy option that local governments could adopt would be to deepen market-oriented reforms and improve institutions by strengthening the enforcement of IPR. The belief that FDI brings in advanced technology and generates positive spillovers to local firms has led governments in many emerging markets to devote resources and offer policy incentives to attract FDI. But the regulatory institutions in some emerging economies may favor the interests of local firms over those of foreign firms (Boddewyn 1988). That creates an environment discouraging foreign investment. Potential technology imitation and unfair competition will of course encourage foreign firms to take steps to protect their knowledge from imitation by local firms (Feinberg and Gupta 2009; Zhao 2006), which will tend to limit the opportunities for positive spillovers and learning (Feinberg and Majumdar 2001). In attracting FDI, governments in emerging economies with underdeveloped legal institutions need to choose between developing economic institutions and policies needed to attract FDI or weak IPR protection which will discourage local R&D and knowledge spillovers. They must also balance local firms’ intentions of catching up through knowledge spillovers against the reluctance of foreign firms to share their knowledge with local firms.

Of course, foreign firms will not automatically move their activities off-shore when simply offered a better legal environment. Economic considerations are also essential in attracting FDI. For economies with underdeveloped economic institutions, their institutional environment will significantly influence foreign firms’
location preferences and constrain FDI almost regardless of how well a location's legal institutions provide protection for investment in high-risk research and development activities. Indeed, better infrastructure has helped economies such as China receive more FDI than other countries (Bai and Qian 2010).

Third, the analysis has implications for firms in emerging economies, which are not only affected by institutions, they also have scope for managing them (DiMaggio 1988; Lounsbury and Crumley 2007). Exploiting institutional idiosyncrasies has been an effective strategy for generating rents in institutionally underdeveloped countries (Henisz 2003). To overcome the obstacles posed by the unbalanced institutions, firms may make active strategic responses instead of adapting passively. For example, firms may set up advocacy groups to participate actively in institution building. Firms operating in environments with poorly-developed legal institutions need to protect themselves from dysfunctional competition. Certain strategies such as 'low-cost innovation' (Zeng and Williamson 2007) may be appropriate. Rather than simple price leadership, firms may seek to exploit sources of cost advantage in radically new ways and offer products with better value as well as a lower price (Zeng and Williamson 2007). Maintaining low costs can help firms deter imitation and offset the deleterious pressures from dysfunctional competition, while innovation can help them develop new capabilities and attain a desirable market position proactively. Such a strategy also helps firms expand to areas with different developmental trajectories, i.e., areas with developed legal institutions but relatively undeveloped economic institutions, or areas where both economic and legal institutions are relatively more developed.

Emerging economy countries have occasionally witnessed the success of this approach. For example, Goodbaby is a well-recognized Chinese company specializing in the design, manufacturing and distribution of children’s products. It offers customers innovative products at mass-market prices, challenging the idea that if customers want variety and customization they have to pay a price premium. By exploiting cost advantages over their competitors and imitators, and by satisfying customer needs, such firms are able to capitalize on market opportunities and innovate profitably, even in the face of dysfunctional competition. Low costs and innovation need not be mutually exclusive. Firms can balance them through managing a portfolio of products. They can focus on low cost and low price for most of their products to achieve economies of scale, while simultaneously investing in innovation with respect to one or a few related products. Such strategies help a firm escape intense price competition and offer long-run payoffs. In addition, firms can invest in specialized and complementary knowledge and resources (Teece 1986), such as manufacturing and marketing capabilities, to impede imitation and sustain the uniqueness and value of their advantages.

Firms operating in environments with relatively well-developed legal institutions but less-developed economic institutions may instead attempt to overcome external market failures through internal economies (Wan 2005). Substituting for the dysfunctional external labor market that often characterizes such economies, a firm may, for example, try to create an internal labor market by training and promoting talented employees internally (Khanna and Palepu 1997). Studies have shown that successful firms often emphasize training programs and advisory services in
their business models as a way of building capacity. Some large firms may choose
to access global markets for finance, technology, and talent (Khanna and Palepu
2006). Thanks to globalization, emerging market firms are increasingly able to
access advanced markets’ institutions to offset some of the institutional weaknesses
they face at home. Or alternatively, firms can overcome external market failures by
internalizing transactions through, for example, diversification or vertical integration
(e.g., Hill and Hoskisson 1987).

Marquis and Raynard (2015) have reviewed the non-market strategies that firms
use in navigating and managing the institutionally-diverse settings in emerging
economies. This discussion may advance such enquiry by integrating it specifically
with the unbalanced nature of institutional development. It might ask, for example,
whether firms rely more on infrastructure-building in countries with underdeveloped
economic institutions but better-developed legal institutions, and on political strategies
in countries with underdeveloped legal institutions but more developed economic
institutions. We may further think about the different types of challenges that
firms will face when expanding and adapting to the different types of transitions.
In other words, what are the unique challenges for a firm that has to adapt from a
situation of undeveloped market institutions to a situation with developed economic
institutions but relatively undeveloped legal institutions? And perhaps more interestingly,
how can firms follow the transition from a situation with underdeveloped economic
institutions but developed legal institutions to one where both are developed?
Answering these questions is important given the transitional nature of the economy
and that different developmental trajectories require different adaptive capabilities/
strategies. It offers an important direction for future research that may follow from
our model.

Finally, the analysis informs foreign firms operating in emerging economics,
particularly in economies with underdeveloped legal institutions. Firms need to think
about how to protect their brand names and trademarks from counterfeiting, and
how to compete with local firms who produce similar products but at much lower
prices. Forming alliances with local firms may enhance their understanding of the
local customers, competitors, regulations, and idiosyncratic local government poli-
cies, and enable them to make better use of any local partners’ resources and net-
works to deal with the host environment (Hitt et al. 2000).

This analysis promises to be useful, but applying it merits a few qualifications.
First, instead of a full analysis of all dimensions of institutions, this discussion has
focused specifically on the economic and legal dimensions of institutional develop-
ment. The development of social-political institutions was taken as a constant. That
is clearly unrealistic, but their impacts on business operations and market exchanges
may not be as pervasive and direct as those of the economic and legal environment
(Acemoglu et al. 2005; Przeworski et al. 2000). For instance, one glaring difference
between India and China is that India is a democracy. But up to now scholars seem
to have been reluctant to investigate whether democracy facilitates or impedes eco-
nomic growth in those two economies. Moreover, it should be acknowledged that in
spite of the deficiencies in political institutions, firms can still develop and prosper
as long as there is a relatively stable environment. Brazil, Russia, India, and China

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have all demonstrated economic progress in recent years despite limited improvements in their institutional contexts (Blackburn and Forgues-Puccio 2009).

Given the very rich dimensions of institutions, we acknowledge that the unbalanced development of institutions between other dimensions, for example, the formal and informal dimensions, may also influence firm activities and performance. Compared with formal institutions that are often prescribed by government (DiMaggio 1988), informal institutions are often embedded in a country’s long cultural traditions and ideological paradigms. They change only incrementally in the market transition process, and it is therefore more difficult to identify changes in their development in the different stages of market transition. But it should be noted that when a society’s formal institutions are underdeveloped, firms can sometimes rely more on informal ones to fill in the voids (North 1990; Peng and Heath 1996; Xin and Pearce 1996). For example, many transition economies fail to develop or enforce laws to support the fulfillment of contracts, so entrepreneurs must often pursue less formal mechanisms based on relationships and trust (Peng and Heath 1996). There should be a unique balance between the society’s formal and informal institutions that better fits its circumstances (Puffer et al. 2010). This analysis could therefore usefully be extended beyond its emphasis on formal institutional dimensions to investigate how imbalances between a society’s formal and informal institutions might influence firm operations and performance. Indeed, some recent studies (e.g., Yang et al. 2015) have begun to investigate such dynamics considering both formal and informal institutional dimensions.

It should be acknowledged too that the relationships treated here may be more complex than has been assumed (North 1990; Scott 1995). Future studies are thus needed to examine the multifaceted interrelationships among institutions simultaneously and to investigate how their asynchronous development influences firm strategies.

In terms of institutional development, this discussion has assumed that all emerging economies will transit toward full development. But it doesn’t mean that there is only one end of ‘liberal market economy’. Even among developed economies, there are different patterns of coordination and institutional configurations, leading to significant differences in how competition is organized (Hall and Soskice 2001; Lewin and Kim 2004; Ring et al. 2005). Their effects on firm strategies and performance will become more salient when the necessary institutional frameworks are fully developed to support business operation and ensure market order. These differences have been heavily simplified here for the purposes of discussion. The characteristics assumed for institutions and markets represent a simplification of the complex reality. Price leadership and niche strategies are often the most prevalent, but that does not exclude the successful use of others. Moreover, the exact timing of the three stages of market transition is more difficult to define than has been recognized, if it is possible at all. The development of institutions was used to mark the three stages. That captures the essential features and facilitates meaningful analysis, but other treatments are possible.
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