UNIVERSITY OF
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Judge Business School

Working Paper Series

1/2012

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Cambridge Judge Business School Working Papers

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Operationalising the Adaptation of Strategies to the Institutional Contexts of Emerging Markets

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Acknowledgements: Thanks for their input to Mark de Rond and Jochen Runde.

Abstract

It is widely recognised both in the IB literature and among practitioners that institutional contexts in emerging markets differ markedly from advanced economies, and that effective strategies must be adapted accordingly. In practice, however, it is less clear how strategies can actually be adapted to reflect differences in institutional context. This paper develops a framework for operationalising institutional context in the formulation of emerging market strategy. Using data on the response to a technical change in the banking industry, in this case the Basel II Capital Accord, we show how a typology of institutional contexts can be derived and deployed for improving the adaptation of strategies to local variations in institutional context.

Keywords: localisation; strategic adaptation; global strategy; institutional context; emerging markets strategy; Basel II Capital Accord; action research.

INTRODUCTION

This paper focuses on the question of how strategies can be better adapted to the institutional contexts of emerging markets. Literature on the adaptation of strategies to local market conditions has long recognized the need to adjust to a variety of factors ranging from differences in climate and tastes, through to spending power and availability of local infrastructure (Prahalad and Doz, 1987; Bartlett and Ghoshal, 1989). A growing body of scholarship has argued that strategies should be increasingly responsive to variations across emerging markets (Hoskisson et al., 2000) by paying attention to ‘deep context’ (Tsui, 2007). The dangers of adopting ‘one-size-fits-all strategies’ in the face of institutional voids (Khanna et al., 2005) and the benefits of unique approaches (Peng, 2003) that are sufficiently idiosyncratic (Kostova et al., 2008) have been highlighted. More recently, the ability of a company to adapt its strategy to the institutional environment of a country has been identified as being central to global strategy (Tallman and Pedersen, 2011) and decisive in determining the success of foreign market entry (Meyer et al., 2009).

Existing studies, however, have provided little practical guidance on how to systematically operationalise the adaptation of strategy to the wide variations in institutional context either between advanced economies and emerging markets or across emerging markets. The complex interplay of institutional forces may lead to differences in institutional context that, while marked, are difficult to classify and quantify (Westney, 1993; Kostova and Roth, 2002; London and Hart, 2004). Thus, traditional approaches used by multinational enterprises (MNEs) to adapt to more easily measured economic variations, such as variations in per capita income, may prove ineffective. At the same time, ‘trial and error approaches’ requiring MNEs to delay local adaptation of organization practices until after the practice has been fully transferred and implemented (Jensen and Szulanski, 2004), are likely to be inadequate in fast-moving, emerging markets where competition from local players unencumbered by the ‘liability of foreignness’ (Zaheer, 1995) is increasingly intense (Williamson and Zeng, 2004).

This paper seeks to address the gap between the scholarship on the need to adapt strategies and the practical difficulties of doing so in emerging market contexts. A methodology is presented that can help characterise differences in institutional context with practical implications for adapting strategies to variations in context.

CHARACTERISING INSTITUTIONAL CONTEXT

Institutional context is defined as 'the environment around concrete social forms of the economy and political system, created and refined by the actors who use them, carried forward by the shared meaning embodied' (Alvi, 2012; based on Turner, 2006; Fligstein, 2001; and Dobbin, 2005). This definition combines macro-level forces of diffusion (concrete social forms of the economy and political system) with micro-level forces of culture and behaviour (social forms being 'created and refined by the actors who use them') which then in a bridging of macro and micro level forces allows for the 'concrete social form' to be modified and 'carried forward by the shared meaning embodied'.

The definition focuses attention on the way institutional contexts of emerging markets vary on a number of dimensions, such as the social, political, economic, cultural and historical. The dimensions vary based on, for example: the size of the economy; economic growth rate and stage of development; local culture, different political, regulatory and legal regimes; the role of government in managing the economy, the extent of economic reforms and their impacts on industry structure and the other aspects of the environment (Luo, 2002). Adapting strategy to emerging markets necessitates engaging with the complex dynamics of a local environment and responding to the business implications of the unique historical, social and economic circumstances (Luo and Peng, 1999). Thus, adaptation is generally achieved by making adjustments to the strategy, structure, processes, capabilities and organisational culture of the local subsidiary, which may also necessitate changes in the way the unit interacts with headquarters and its sister subsidiaries.

Previous adaptation research has offered guidance on a broad array of issues including, among others, how to adapt to particular dimensions of the institutional environment such as culture and cultural distance (Hofstede, 1980; Erramilli, 1991),

uncertainty and risks in emerging markets (Root, 1988), and specific business practices that require localised learning (Tallman, 1991). Many of the prevailing approaches, however, provide only partial solutions. In trying to achieve a more effective and complete adaptation to institutional environment, the challenge is how to characterise in a tractable way the multidimensional, inter-related and dynamic variations in institutional environments. Managers are challenged to grasp context meaningfully when deciding what aspects of the firm's activities and organisation to adapt and how to vary strategy, structure, processes, capabilities and culture to achieve a better fit with the local requirements for success.

The challenge in adapting to institutional context arises for at least two reasons. First, unlike economic variables such as per capita income, many of the dimensions of institutional context are difficult or impossible to quantify or measure on a consistent scale. Second, the inherently systemic nature of institutional context means that it is usually unrealistic to identify simple, one-to-one rules that link the variation in a particular aspect of the institutional environment to a particular adaptive response. For example, we cannot usually say that the existence of a particular type of government regime implies the need for a particular type of adaptation, because the right course of action may also depend on other aspects of the institutional environment such as the legal infrastructure, sub-national variations, or business sector peculiarities.

In deciding how best to adapt to variations in institutional environment, firms need some means to characterise systemic differences on a few, meta-level dimensions. The meta considerations can point the firm to what strategic adaptations would improve the chances of success in the local market. In moving towards this ideal, we propose a four-step approach:

Step 1: Collect data on various dimensions of the behavioural responses of the actors in a set of markets with different institutional environments to an identical, exogenous stimulus such as a technical or regulatory change or the emergence of a new, strategic opportunity.

Step 2: Divide the actors into clusters, based on similarities and differences in the various dimensions of their behavioural responses.

Step 3: Deploy these clusters to impute a typology of different institutional environments.

Step 4: Utilise this typology, a proxy for different institutional environments, as a tool for formulating alternative adaptation strategies.

We believe that these four steps offer an alternative approach to characterising differences in institutional context that is more tractable than attempting to measure institutional context directly. It also enables different institutional environments to be classified according to systemic differences that are more relevant for guiding strategies. Variations in single measures of institutional context can ignore the importance of interactions between individual variables considered in isolation.

The empirical application of the four-step approach is illustrated below using data for the response of banks in a cross-section of emerging markets to the technical change and strategic challenge of the Basel II Capital Accord (Basel II). We then discuss the strengths and limitations of the empirical application in assisting firms to successfully adapt to differences in institutional context.

EMPIRICAL APPLICATION

Coined by the IFC (International Finance Corporation) in 1981, the term 'emerging markets' initially described stock markets in developing countries that are either located in a low- to middle-income country as defined by the World Bank, or have low investable market capitalization relative to GDP (IFC, 1999). Today, emerging markets have come to represent entire countries rather than just stock markets, in particular those countries that hold the promise of high rates of economic growth. The precise roster of markets qualifying as emerging varies widely, though some attempts at standardization have been made. Of growing influence is a list of 64 countries described as emerging markets (Hoskisson et al., 2000).

Emerging markets share a common goal of developing rapidly so as to 'catch up' with advanced economies as opposed to economies that 'fall behind' (Buckley and Ghauri, 2004:84). Despite the common goal, emerging markets vary greatly in their institutional contexts. Differences in institutional context have received comment in the literature (Narayanan and Fahey, 2005; Farjoun, 2002; Peng et al., 2005; Ramamurti, 2004), but have proved much more difficult to incorporate into analysis and decision making than more measurable variation, such as differences in income or savings rates. Thus, there have been calls for better ways of characterising and adapting to institutional differences (Khanna et al., 2005; Peng, 2003; Tsui, 2007). Emerging markets, therefore, provide fertile ground for empirical implementation of our suggested approach.

The response to Basel II, meanwhile, provides an opportunity to compare an array of organizational responses to an identical and significant transnational stimulus (Djelic and Sahlin-Andersson, 2006) across a set of emerging markets. Basel II builds on the Basel Capital Accord of 1988 (Basel I). Basel I set minimum capital requirements of 8% in order to create a buffer against which bad loans or similar write-offs resulting in a capital loss could be absorbed. Basel I was designed to promote banking sector stability, and since its promulgation in 1988 for the G13 countries of the Basel Committee, spread to become the *de facto* global standard. Basel II goes substantially beyond Basel I in a number of respects, including the imposition of incremental capital buffers to cover operational risks in addition to credit risks. Unlike the relatively straightforward technical calculations of Basel I, however, the higher standards of Basel II require assessment of business culture and practices within the organization that impact operational risks. The cultural aspects (organizational level) of Basel II as opposed to technical aspects (meta level) of Basel I therefore present challenges when applied to the widely divergent institutional contexts of emerging markets.

There are various degrees of Basel II implementation, from simplified to advanced approaches. The rewards for pursuing advanced approaches are significant as measured ultimately through optimized capital allocation, which is why Basel II is sometimes perceived as favouring larger, wealthier banks from more advanced markets. Additionally, most

emerging market banks believe that they have received insufficient guidance from their regulators on Basel II (Hansen, 2005). The advent of Basel II thus presents a growing divergence between some knowledgeable banks moving at a faster speed than their regulators, and many other banks confounded by bureaucratic uncertainty on Basel II adoption.

For most global organizations, Basel II is viewed as inevitable, and uncertainties where they exist focus on the speed of implementation. That banking markets operate globally as commodity businesses with thin margins and efficient capital utilization is understood by its participants as a given, but there is a special resonance for emerging markets. As the economic development agenda in emerging economies progresses, there is greater need to access capital markets, and for an emerging market to develop its capital markets, moves consistent with the Basel II evolution are essential (Thomas, 2005).

Step 1: Data Collection

An action research dataset (Lewin, 1946; Robson, 2002) on the diffusion of Basel II in emerging markets was collected and analysed. The action research consisted of interviews at 50 organizations, principally government bureaucracies or state-owned banks, in 19 emerging markets over a 16-month period. The data collection was possible as part of a Basel II advisory project conducted by one of the authors for a leading European bank (EB) from March 2004 to June 2005. The project consisted of offering EB's Basel II expertise as an advisory service to clients in the emerging markets seeking to adopt advanced banking techniques. We used an interactive approach that entailed observing the response of subjects (banks) to a stimulus (offering EB's service), adapting the stimulus to better achieve EB's goal, and learning and theorizing throughout the process.

The dataset consists of three components, summarized in Table 1. The first two components are action research data, procured by the author in the course of executing his project with EB: (1) written accounts of interviews carried out by the author and his project team with prospective emerging market clients; and (2) weekly summaries tracking client responses to EB and Basel II over time. Raw data from 91 organizations in 28 countries was

reduced to a more manageable dataset consisting of 109 interviews with 50 organizations in 19 emerging markets (92 interviews were conducted with emerging market organizations, and 17 interviews were part of the follow-up at EB – see Table 2). Interviews were conducted with senior bureaucrats and senior management of state-owned banks who were often proxies for the government agenda due to entrenched practices of government directed lending.

In the third component of the dataset, 17 follow-up interviews were conducted at EB in May and June 2007. The follow-up interviews assessed the results of the initial project of 2004-2005 by drawing on field experiences of EB professionals who executed the Basel II advisory for emerging market clients. Interview responses provided a basis for gauging institutional capabilities in emerging markets for addressing the diffusion of Basel II, going beyond the initial responses captured in the action research. The details of the data analysis are set out in the Appendix.

Insert Tables 1 & 2 about here

Organisational responses to the Basel II stimulus varied. The field data shows some organisations as proactively engaged with reform efforts and promoting Basel II improvements, others as more reticent. Similarly, some banks were moving forward substantively with Basel II reforms, with or without the support of their regulators, and others were not. In part, a bank's response depended on whether it viewed Basel II as an onerous regulatory burden, or as an opportunity to move in step with sophisticated international banks, where short-term implementation costs would pay for themselves in the longer term.

There were 608 firm level observations for the 50 organisations interviewed, coded in Nvivo. The observations were assessed and rated from 1 (strongly positive) to 5 (strongly negative) in the following six categories (see Table 3). The six categories were derived through a grounded theory methodology involving conceptual ordering and observation of recurring themes in the data (see Appendix). The six categories are as follows:

(1) Understanding of Basel II requirements;

(2) Perception of the cost-benefit ratio of investing in Basel II upgrades;

(3) Perception of Basel II implementation as a source of domestic and regional competitive advantage;

(4) Empowerment for organisational change;

(5) Extent to which banks are being privatised in the market;

(6) The stance of regulators towards Basel II implementation.

The dataset thus provides a rich characterisation of each individual bank's response to the technical change embodied in Basel II, reflecting the institutional context both within the organisation and within the market and regulatory environment. It is therefore possible to use these data to look for a meta-level characterisation of the systemic differences in institutional environments in order to develop a typology that can inform optimal strategic adaptation.

Step 2: Cluster Analysis

Hierarchical cluster analysis, without pre-specification of number of clusters and cut-offs (Everitt et al., 2001), is performed on the dataset. Figure 1 summarises the statistical classification of the 50 banks into clusters (each bank identified by number assigned in the second column of the figure) [1].

Insert Figure 1 about here

By analysing the commonalities within the statistically-identified cluster and the inter-cluster variation, the clusters can be interpreted as follows:

Cluster 1: Cosmetic Behaviour. In this cluster, actors exhibited a preference for the veneer of technical upgrading rather than implementing substantive change, perhaps due to prioritizing local cultural practices over the diffusion of international standards. The regulator in the market discussed below was not interested in pursuing Basel II, a reluctance matched by local banks, unless there was a shortcut to achieving it.

[1] Euclidean distance and average linkage within groups was calculated by SPSS software to produce Figure 1. In Figures 1 and 2, polarity of 1-5 scaling is reversed for ease of interpretation.

> A Board member of Bank 46 (November 24, 2004): [In absence of regulator imposed requirements, clients wanted cheapest option]. Reiterated EB's implementation is done from a top down approach and a holistic manner for a full grasp of risk management, with the goal of achieving strategic value. EB highlighted that if Bank N does not see EB's approach as strategic and a foundation for a long-term relationship, then Bank N would benefit from selecting another provider.
>
> Board member and Head of Risk at Bank 47 (August 20, 2004): Bank 47 is experiencing data collection problems because of internal IT inconsistencies. Bank 47 inquired specifically about systems implementation [to try to smooth over underlying deficiencies in data, thus defeating the transparency aims of Basel II].

Cluster 2: Instigative Behaviour. In this cluster, banks attempted to compel their regulator to raise standards to international levels. Local actors showed courage in stemming inaction of governmental authority, pushing reluctant regulators to adopt reform agendas. Instigative behaviour was motivated by organisations attempting to become competitive regionally if not globally, reflecting an unwillingness to be left behind due to domestic regulators.

> Bank 19's Chief Risk Officer (July 22, 2004): [Bank 19's Chief Risk Officer] has taken an aggressive approach to improving risk management at Bank 19, and he began this process by lobbying the Central Bank to require greater risk management moving towards Basel II requirements. He has required that EB pay a courtesy call to the Central Bank; such a call would be viewed favorably by Bank 19 [in terms of appointing EB as an advisor].
>
> Bank 19's Chief Executive Officer (September 9, 2004): CEO invited their regulator, the Central Bank, to the meeting in a well-calculated move to obtain regulatory approval for our appointment, and also to showcase Bank 19's proactive approach to addressing risk management improvements…CEO was particularly pleased with EB's response to some questions raised by the Central Bank regarding how EB's approach would combine broad frameworks issued by the Basel Committee with our practical experience, and that by doing so, the Central Bank would be promoting the optimal policy outcome for the banking sector [in the country as a whole].

Cluster 3: Disobliging Behaviour. This cluster is characterised by several variations, the first of which is actors whose desire to act is neutralized by regulatory intransigence. Strategic imperatives articulated by banks in this cluster ought to have led to robust pursuit of technical upgrading, but did not. Banks here understood the merits of Basel II, and that the progress of their institution would be served by pursuing technical upgrading. Stymied by regulators whose lack of encouragment hampered the upgrading progress, the banks took non-adoptive postures out of concerns of running ahead of their regulator. Although the quotations below indicated initial interest in pursuing technical upgrading, subsequent data on Banks 23 and 11 pointed to no action being taken on account of absence of support from the regulator.

> Head of International at a bank (June 29, 2004): [I]t is only recently that [Bank 23] has come to the realization that they need some serious help with risk management, hence [EB's] value proposition was well received….Regulatory lack of direction has resulted in no specific pressure for Basel II, but…[Bank 23] agreed that aggressive action was a matter of promoting their self-interest.

> Deputy Chairman of the newly privatized Bank 11 trying to adopt new practices (September 22, 2004): Deputy Chairman [X] has joined [Bank 11 – until recently, government held] from [a leading private bank], and described Bank 11 as having 'inherited much of the old ways'. Bank 11's goal is to become much more advanced and more 'western', even if it means exceeding the slow moving Central Bank's requirement with respect to Basel II. Being relatively new to the bank, EB's proposal could be just the sort of initiative for the Deputy Chairman to champion and he is very positive on EB.

Another variation in this cluster is regulators purporting to value technical upgrading, but for reasons not obvious to outsiders, failing to follow-up stated intentions with action. For example, the banks in one country as well as its regulator seemed to appreciate the benefits of Basel II, but took a calculated decision for non-adoption. The motivation for the decision was opaque, cloaked in outward signals of wishing to implement Basel II, but substantively quite far removed from doing so. The Central Bank had raised expectations throughout the sector for technical upgrading based on Basel II, but the ultimate requirement was for banks to provide superficial plans which were subsequently rubber-stamped by the regulator. One reason for this may have been an inability or unwillingness to invest economic resources at required levels.

> Board members of Bank 33 (August 10, 2004): By the end of December 2004, a roadmap needs to be submitted for Basel II initiatives to the Central Bank. There remains a need for clarification pertaining to some issues such as capital adequacy and Bank 33 is waiting for the Central bank to comment….EB pitched Bank 33 aggressively, part of this was a gap analysis offering that could help their preparation of a roadmap. The diagnostic and feedback would help Bank 33 in drafting a compelling story to the Central Bank on how they view the Basel II implementation.

A third variation in this cluster is of confounded actors, who however well intentioned, arrive at sub-optimal outcomes due to incomplete knowledge. In the example below, capital requirements for Basel II were miscalculated, an error then compounded by a communication gap between the bureaucracy and its regulated banks, resulting in confusion and possibly inadvertent cosmetic behaviour by Bank 50.

> Senior regulators of a banking sector (January 26, 2005): The regulator [Organisation 24] conducted an impact study which shows that Basel II will not greatly impact the

> banking sector (capital raising will not be an issue) and they will maintain an average BIS ratio of 11%…the results did not indicate significant capital stress on the banking sector.
>
> SEVP of Bank 50 in the same country (April 20, 2005): Bank M explained that the regulator did not give guidelines on Basel II standards, therefore making it challenging to update the models. [Totally at odds with government findings], Bank 50 fears that none of the banks [in Country X] will meet Basel II standards, ultimately resulting in higher capital costs. Concluded that Bank 50 would recognize the evolution of risk management as it is becoming more sophisticated, so either go with it or fall behind. [In the short-term] what can Bank 50 do if the government is not defining the regulations and guidelines – recognizing it will be a handicap, however, the regulators will have to change eventually.

Cluster 4: Reformist Behaviour. In the final cluster, government-led actions in support of technical upgrading were seen to result in change. Even though state-owned banks in the country below were laggards and unreasonably self-satisfied compared to the rest of the sector, a proactive regulator induced incipient reform utilizing a 'carrot and stick' approach.

> The Deputy Governor of a Central Bank [Organisation 17] regulating the bank sector (June 30, 2004): The Central Bank is applying strong pressure on [state-owned banks, Banks 14, 9, 13 and 42] to submit detailed restructuring plans by mid-August, the satisfactory submission of which will likely be a pre-condition for further recapitalization….The Central Bank is concerned about not rewarding previous sub-par performance by public sector banks through serial recapitalizations. Stringent requirements for business plans in August are meant to pressure greater restructuring delivery, potentially tying approval of such plans to future recapitalizations.
>
> Chairman and CEO of Bank 9 in the same country (July 20, 2004): Management appeared quite satisfied with their restructuring efforts to date, and felt poised for a privatization effort in the near term. Subsequent feedback from the Central Bank indicated that the regulator was far less impressed with Bank 9's progress, particularly in the area of risk management.

Reformist tendencies are also evident in institutional contexts reflecting aspirations to effect closer linkages with the comity of advanced nations at least in part through the financial sector. Backing up lofty rhetoric with action, the government shareholder in the quote below succeeded in selling a minority stake in a bank at a robust valuation to an international bank. The rationale for further divesting government owned shares in other banks such as Bank 27 included having the new investor make the necessary operational upgrades to international standards, including Basel II.

> A government ministry [Organisation 45] regulating state-owned banks (November 12, 2004): Ahead of privatization, the Ministry believes that Bank 27 should focus on asset composition and asset growth, phase out what was referred to as 'government privilege', and should operate on a commercial basis in the market and under a best

> practice governance framework….The Ministry respects the new management team at Bank 27, and EB is encouraged to contact them directly for Basel II advisory. The Ministry will encourage the bank to be 'open minded' about obtaining technical assistance advisory from EB.

Step 3: Typology of four types

Based on the variations between these four clusters, we can impute two meta-dimensions that capture the key differences between institutional environments which we have combined to create the typology shown in Figure 2. The x-axis depicts the first meta-dimension of the institutional environment: 'regulatory inclination for technical upgrading'. The y-axis depicts the second meta-dimension, 'organisational inclination for technical upgrading'.

Insert Figure 2 about here

The top-right quadrant of Figure 2 represents institutional environments with reformist tendencies (Type 4, Reformist). As we move downwards from this quadrant the reforming environment inside the organisations weakens, but even if banks are lagging, reform agendas instituted by regulators succeed in stimulating change. Regulatory leadership is a powerful motivator in the reformist institutional context.

The top-left quadrant, meanwhile, represents instigative institutional environments where significant change will only take place if it is initiated by highly motivated organisations that are prepared to challenge the intransigence of regulators (Type 2, Instigative). Instigative actors attempt to drive change in order to take advantage of strategic opportunities, often following growth strategies beyond the home market.

In the middle, touching all four quadrants but skewed towards the bottom half, the figure represents disobliging institutional environments where there may be some regulatory and organisational appreciation of the need for change and improvement (Type 3, Disobliging). Action in this institutional context is lacking or incomplete because change is seen as unwelcome or threatening, or regarded as being too difficult and costly to achieve when compared with the potential benefits.

Finally, the bottom left quadrant represents institutional environments where neither the regulatory stance nor the motivation within organisations in is favour of change and improvement (Type 1, Cosmetic). The institutional environment here is likely to favour purely cosmetic changes, if any, which lack substantive impact.

It is evident that the clusters we observed in practice sometimes span the boundaries of the basic types. Particular actors within the institutional environment, when facing uncertainties about the true nature of looming technical changes or strategic opportunities, and may wish to hedge their bets on what course of action to take. Boundary spanning is evidenced in the data by the relationship between instigative and disobliging types, and between cosmetic and disobliging types. The disobliging institutional context shows awareness of the importance of technical upgrades, but relatively few organisations are willing to take the risk to instigate moves to real change (for example, Bank 23 is classified in the data as instigative, but was discovered ultimately to tack disobligingly). Additionally, in certain cases of misapprehension of technical standards by regulators, disobliging contexts can lead to cosmetic decisions by banks (Bank 50 was disobliging based on the data but unwilling to challenge their regulator's mistakes, and then drifted in a cosmetic direction).

Step 4: Utilising the Typologies to Decide on Strategies for Adaptation

Each type within our typology suggests particular strategies for adaptation that are more likely to be successful in the respective institutional context identified. Using the example from the dataset, a Basel II advisory service, the strategic implications are that the service should be tailored to the institutional context of the target country. EB made the assumption that all emerging markets would make a rational decision based solely on the merits of adopting Basel II. As our analysis makes clear, however, responses to Basel II vary according to differences in institutional contexts.

Had EB possessed an up-front, operational view of how to characterise different institutional contexts, EB's advisory proposition might have been tailored more appropriately. Instead of having a single, one-size-fits-all value proposition for all potential emerging market clients, EB could have anticipated that not all potential organizations would respond

in the same way to proposed advisory services because the institutional contexts varied. Thus, a more responsive strategy could have been formulated from the beginning, better matching multiple value propositions to contexts.

The examples in Table 4 show how, by using the typology we developed, EB's strategy might have been more responsive to the institutional contexts of emerging markets. Implementing the adaptations indicated in the Table would have held the possibility of two favourable outcomes: first, increasing EB's chances of successfully achieving the business goals in selected emerging markets: and second, better managing reputational risks associated with adopting strategies inappropriate to the institutional context, and hence prone to spectacular failure.

Insert Table 4 about here

Emerging markets exhibiting reformist contexts are candidates for strategies that are highly sophisticated in terms of products and processes. Both reformist and particularly instigative markets afford scope for extensive collaboration with locals and highly tailored delivery of goods and services. Disobliging and cosmetic markets are higher risk, lower return markets, but this is not to say they cannot be profitable. Rather, the strategies in these markets might respond by offering simpler, entry-level services. Investing in longer-term market education in order to cultivate the market before full commercial entry might also be an effective strategy for disobliging and cosmetic institutional contexts.

CONCLUSION

There is increasing recognition that firms can improve their chances of success in foreign markets by appropriately adapting their strategies to local differences. There are well-developed tools and techniques companies can use to help them adapt to differences in measurable aspects of a foreign market, such as per capita income, growth rates and even many aspects of buyer behaviour. But a key source of variation between different markets, especially in emerging economies, is the prevailing institutional context. While it is now

widely accepted that companies should also adapt their strategies to respond to these differences in institutional context, such adaptation is difficult to achieve in practice.

The difficulties of adaptation in emerging markets reflect two inherent problems that we face in responding to institutional context. First, many of the dimensions of institutional context are difficult or impossible to quantify or measure on a consistent scale. Second, the inherently systemic nature of institutional context means that it is usually unrealistic to identify simple, one-to-one rules that link the variation to a particular aspect of the institutional environment and a particular adaptive response.

In this paper we argue that one fruitful way around these problems is to analyse the way in which actors in different markets respond to the same exogenous change (such as technical improvement or a new strategic opportunity). By analysing various dimensions of their behavioural responses and dividing these into different clusters, it is possible to impute a typology of institutional contexts that captures systemic differences in the institutional environment along a few meta-dimensions. In effect, this involves using the exogenous change in much the same way as a sonar pulse which, when it bounces of the complex terrain of an institutional environment, captures an image of the essential shape in the form of observed behaviour. The resulting typology can then be used as a practical tool to help inform firms in choosing appropriate strategies of adaptation to differences in institutional context.

Using data on the response to a technical change in the banking industry (in this case the Basel II Capital Accord), we showed how a typology of institutional contexts can be developed and deployed as a basis of improving the adaptation of strategies to local differences in institutional context. In so doing, we hope to provide a practical methodology for extending Prahalad and Doz’s (1987) integration responsiveness grid to enable characterisation of, and adaptation to, differences in institutional environment as well as more easily measurable economic variations between markets. The next step for future research is to explore whether this approach can be applied to the characterisation of other dimensions of institutional context and to test whether the approach can be generalised.

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Figure 1. Hierarchical cluster analysis dendogram

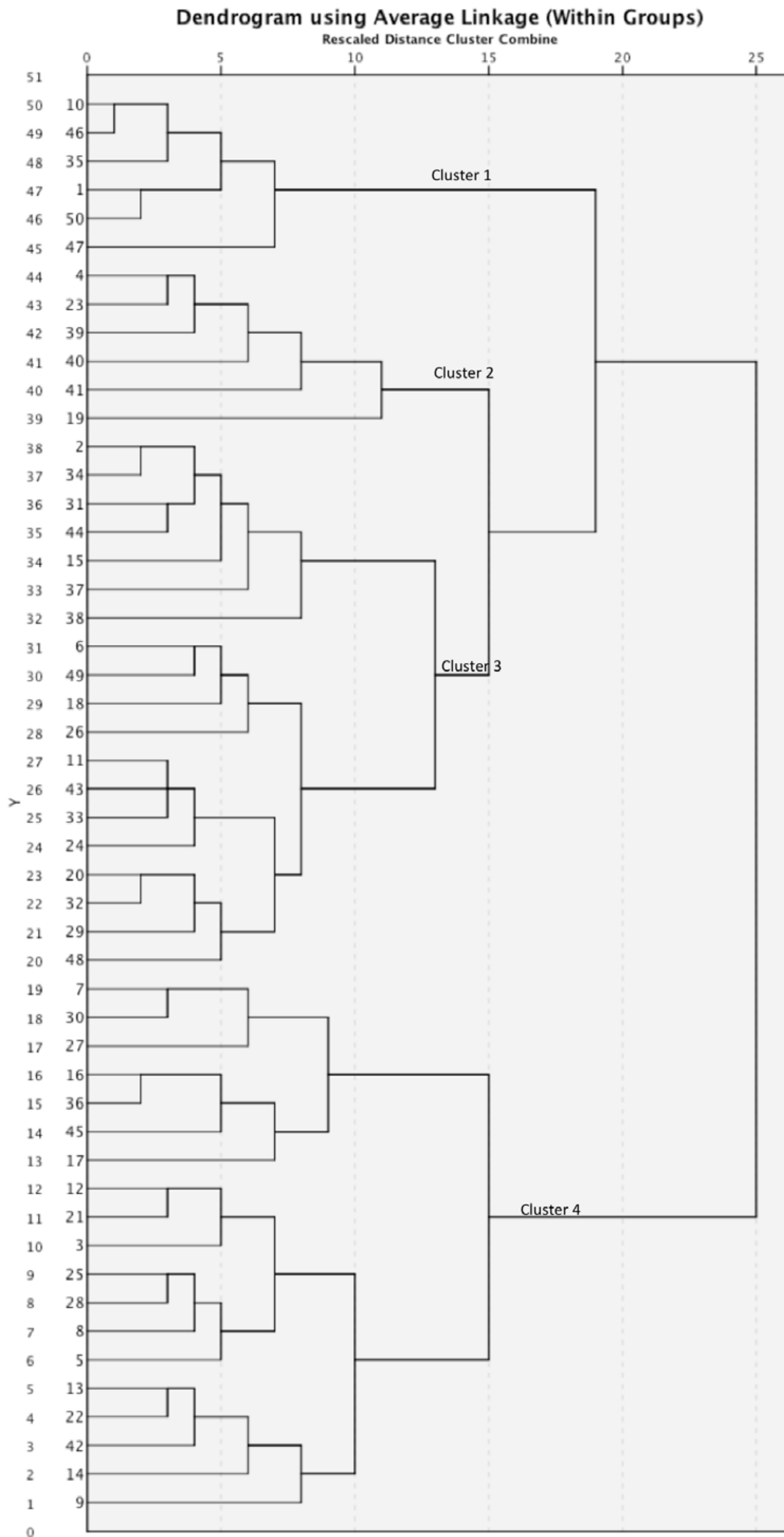

Figure 2. Typology plot and organisational groupings based on cluster analysis

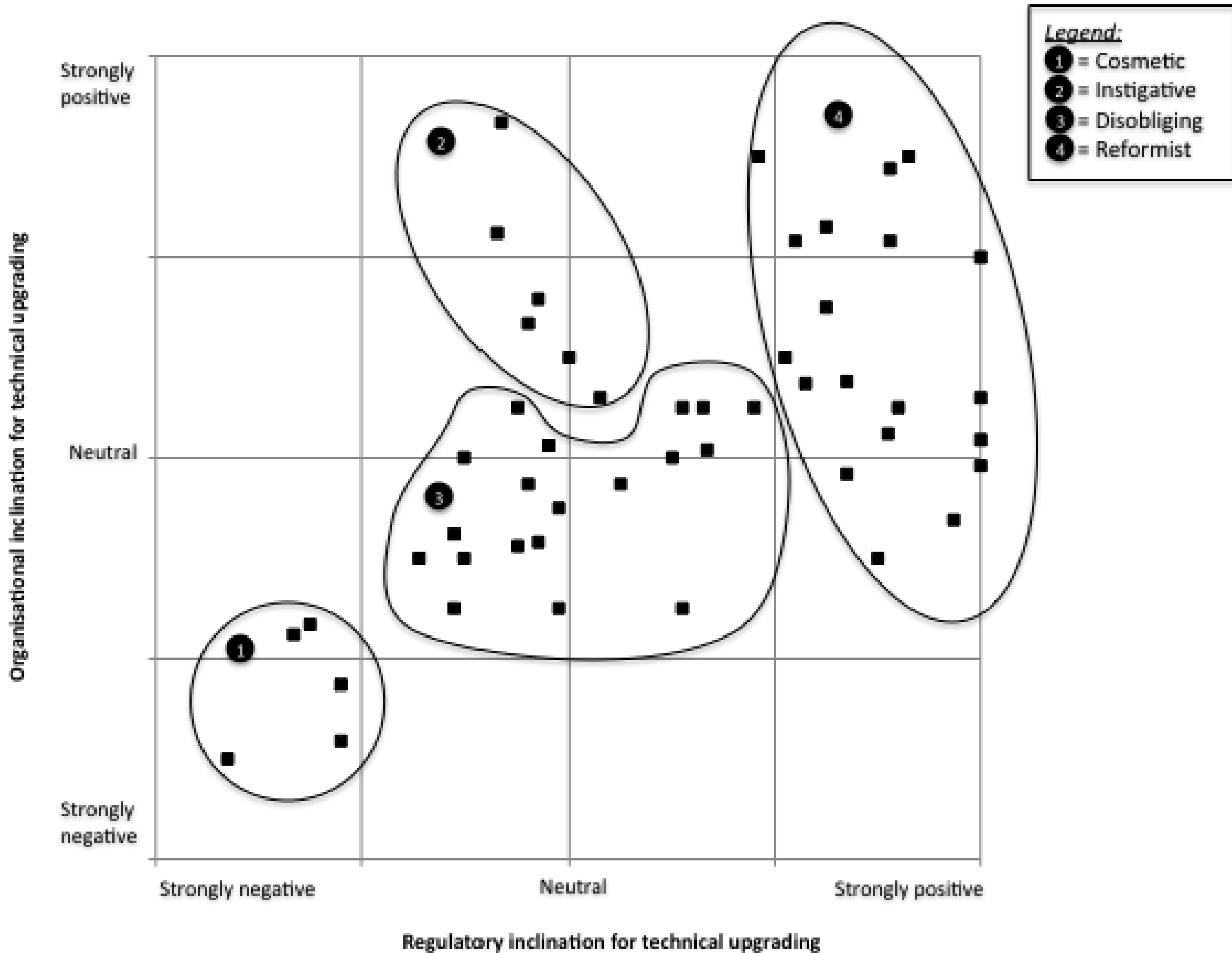

Table 1. Dataset summary

Data Sources	*Dates of data gathering*	*Total number*	*Actual records secured*	*Average length per record*	*Subjects (orgs)*	*Countries*	*Number of coding nodes*	*Observ-ations coded*
Action interviews	Jun 04-Jun 05	92	73	460 words	49	19	205	222
Weekly updates	Mar 04-Jun 05	44	44	4,707 words	82	24	816	1,027
*EB follow-up interviews	May 07-Jun 07	17	17	67 minutes	13	12	281	671
TOTAL	N/a	153	134	N/a	**91	**28	**138	1,920

* Interviews recorded and transcribed
** Columns do not add up because 'total' is the number of unique organizations, countries and nodes respectively

Table 2. Interviews utilised

	Country	*Organizations*	*Interviews*
1	Bahrain	1	1
2	China	3	4
3	Egypt	9	19
4	Greece	1	1
5	Hungary	1	1
6	India	4	4
7	Indonesia	2	9
8	Kazakhstan	3	6
9	Korea	3	8
10	Malaysia	1	1
11	Pakistan	1	1
12	Poland	2	2
13	Qatar	1	4
14	Romania	1	1
15	Russia	3	3
16	Taiwan	3	8
17	Thailand	5	10
18	Turkey	3	5
19	UAE	3	4
	TOTAL	50	92

Table 3. Data scaling

	Organizational Variables				Regulatory Variables	
	Understanding of B2 requirements	*Cost benefit perception of B2*	*Regional /global competitive advantage sought*	*Empowerment of org for change (internal & regulatory)*	*Privatization*	*Regulatory stance: pressuring for B2*
1 Strongly positive	Demonstrated understanding of B2 complexity	Investment in B2 seen as high NPV activity	Org sees its competition as regional not just national	Challenging regulator / org ambivalence	Driven to promoting changes that market will reward	Concrete pressuring to move banks in B2 direction
2 Moderately positive	Understand enough to recognize that technical knowledge needs to be acquired	Investment in B2 seen as advantageous but upfront costs seen as a challenge	Org is more concerned about national competition, but aware that they need to think regionally	Encouraging regulator / org proactiveness re: reform	Aware of need to be responsive to int'l investors, but building int'l profile secondary to domestic issues	General encouragement to B2, but no discernable pressure
3 Neutral, n/a						
4 Moderately negative	Oversimplified view of B2, belief that buying a software package will result in B2 compliance	Cut-rate investments in B2 if at all, results secondary	Aware of regional threats, but not motivated to respond	No push back on regulator or org if entreaties for reform or change declined	Executing the IPO an end in itself, or forced w/o mgmt buy-in. Post-IPO results irrelevant	Pressure applied moves banks away rather than closer to B2
5 Strongly negative	B2 requirements misinterpreted or oblivious to them	Cost not seen worth the results	Unaware of regional threats	No challenge to regulatory or org inaction	Limited prospect of privatization	Regulator discourages banks from B2

Table 4. Strategic implications of typology

	Typology	*Description*	*Strategy*
❶	Cosmetic	Regulator led, rubber-stamp adoption of watered-down standards. Also includes adopting only technical changes that, simply by utilizing a pre-packaged solution, can give the impression of change having taken place, but underlying practices remain the same.	Possible reputational risk from doing business in these markets. Low-cost, low-value added products and services, probably on low-margin are possibly the only option, or like disobliging, may pass on these markets.
❷	Instigative	Domestic actor attempts to force regulatory change by voluntarily adopting higher standards. International partnerships/advice sought to persuade regulators to raise the bar. Implementing higher, international standards seen as a source of competitive advantage by moving ahead of domestic/regional laggards.	Building long-term relationships and forging alliances could produce repeated successes. Investment in market education in partnership with domestic actor may be required.
❸	Disobliging	An evidently calculated decision of non-adoption of advanced standards – outward signaling of interest in adoption, but not carried forward into implementation due to i) lack of regulatory support; ii) fear of regulatory backlash by getting ahead of domestic rules; iii) socio-cultural norms that resist cultural behavioral change, even if certain technical change is accommodated. An alternative situation is well intentioned but ultimately misguided efforts to adopt higher standards, usually due to incomplete or misapprehended knowledge.	Best option may be to offer lower-cost, lower-value added products, probably on low-margin, or perhaps decide not to enter these markets at all. Greater investment of time and market education effort required, but must be prepared to be very patient with uncertain payoffs.
❹	Reformist	New practices adopted readily for stated purpose of producing sustained improvements. Top regulatory levels demonstrably encourage reforms and behavioral change. Examples are when privileged, government directed lending is replaced by market driven asset creation, cronyism is prosecuted, proclivity to privatize, transparency of restructuring milestones etc.	Advanced, scientized, professionalized products and services can be brought to bear, whether implemented directly by the client, or where advisors help the clients to help themselves.

APPENDIX: DATA COMPILATION

Analysis of the action research data described above is through the use of grounded theory. Following Strauss and Corbin (1998), the analysis moved in three stages: from description to conceptual ordering to theorizing. The typology presented in this paper, clustered through statistical classfication, represents the third stage of theorizing. Building on what Strauss and Corbin (1998:43,53) characterize as maintaining an objective stance that balances the impartial assessment of the phenomena under investigation with creative discoveries, the typology emanates from the process in Figure A-1.

Insert Figure A-1 about here

In the descriptive stage, the analysis was the telling of the story of Basel II diffusion, describing the experience of EB in proselytizing the benefits for emerging markets clients in procuring advisory services. No theoretical framework or preconceived research design was consciously applied to the data in this stage, though there were some underlying assumptions made by EB. The way in which EB initially presented Basel II to the interview subjects, made clear the alternatives of either a pure adoption of the standard or a modified implementation of the technical upgrading.

In the second stage of conceptual ordering, however, patterns emerged from nuances in the data, as responses to Basel II were considered. Recurring responses were eventually classified into six categories. From these broad classifications, the emergent conceptual ordering suggested the ability to plot on two axes the organizational forces and regulatory forces pushing towards Basel II adoption. The conceptual ordering suggested the possibility for multivariate analysis and a broader explanatory framework in order to capture the complexity of institutional contexts.

In the third and final methodological stage, analysis of relationships in the data allowed for observation of the phenomena at hand. A view of four types of institutional context emerged from multivariate classification. The key feature of the grounded theory

methodology for the Basel II dataset is that theory emerged and was not pre-determined, evidenced by statistical clustering during the third and final stage of theorising.

Dataset Limitations

The dataset is limited by personal, professional and cultural biases in the data gathering. These biases can be endemic to action research, particularly as the author was normatively isomorphic as a carrier of an advanced practice (Sahlin-Andersson and Engwall, 2002). There was a proselytizing aspect to the research, where the author was motivated in part by an abiding belief that Basel II adoption would be in the interest of the interview subject; therefore, the approach follows best practice for action research (Robson, 2002).

The implications of these biases for the results and conclusions is the risk of a tautology: the author's sense of mission in proselytizing defined success in terms of winning or losing business, and therefore outcomes in the data, may have affected the data. Given the nature of action research and use of appropriate controls therein (including multivariate classification), however, it is believed that the conclusions arrived at in this paper remain sound within the methodological framework employed. Controlling for tautological risk is accomplished through a reflecting on the effect of the author's presence in the meetings, considering the potential for retrospective bias in interpreting outcomes, and documenting in a log file the occasionally precipitous changes in interpretation of the data. As Figure 1 depicts, grounded theory allowed for reflection and successive reinterpretation to minimize the action research biases.

Figure A-1. Grounded theory methodology