

The Role of Informal Institutional Risks on Firm Performance in Emerging Market Economies

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Abstract

This study aims at empirically examining the effects of informal institutional risks on the performance of more than 12000 firms in 39 emerging market economies. This study examines the influence of informal institutional risks, along five dimensions of cultural values, on firm performance. The results reveal that different cultural dimension have differential effects on firm performance. The findings show that while long-term orientation cultural value positively promote firm performance, other cultural values such as uncertainty avoidance, individualistic and masculinity negatively affect performance of firm in emerging market. However, the study further reveals when quality of informal institutions are measured by the extracted two-unique (uncorrelated) cluster cultural measure and alternatively by social capital they all have positive influence on firm performance. This highlights and provides caution on past research not to oversimplify on the roles play by different cultural values in influencing firm performance in emerging markets. They can have unique combined influence on firm performance which firm managers should take into account when devising strategies to boost the performance of their firms.

Keywords: Host's Institutional environment, Firm performance uncertainty avoidance (UA), Individualism, Masculinity, Long term orientation, Hofstede cultural components.

1. Introduction

In international business (IB), one of the risks that firms face is institutional risks, a risk that embeds in the host/destination countries. Since firms' strategic decisions and management are undertaken in such institutional environments, the quality of that environment could influence firms' performance. Therefore, understanding the host-countries' underlying institutional environment becomes an important ingredient for successful market entry and performance. Consequently, the importance of underlying institutions in influencing firm performance has been one of the main focuses and significance in IB research (Peng et al., 2008; Hennisz and Swaminathan, 2008; Griffith, Cavusgil and Xu, 2008).

Recent literature points to the important role of recipient countries' political risk in effecting multinational firms only focus on one aspect of institutional risks (i.e. political risks or cultural diversities) fall short of providing a comparative analysis (Kobrin, 1979; Miller, 1992; López-Duarte and Vidal-Suárez, 2010) on culture of host-country's institutional risks. Culture of countries' risks have increasingly emerged as one of the recent international business research agenda (Hennisz and Swaminathan, 2008; Griffith et al., 2008; Peng et al., 2008). Though political risk is important, it is just one aspect of formal institutions. the role of informal

institutional risks and cultural diversities are highly important for business performance, but overwhelming recent research focuses only on its impacts on firm strategic decision on the mode of entry into host country markets. A recent study found that these cultural diversities (i.e. informal institutions) determine bank-earning performance in the pre- and post-financial crisis (Kanagaretnam et al., 2011). The impact of cultural diversities on foreign firm performance is found to be much lacking in recent studies. This research aims at filling these gaps in both focusing on aggregate and disaggregate cultural diversity and how interact in influencing firm performance in emerging countries.

The general question of this study is: can culture factor affect firm performance? For informal institutions, this study relies on culture to reflect the quality of informal institutions present in countries. This culture indicator has five sub-components that capture five separate values, namely individualism, masculinity, power distance, uncertainty avoidance, and long-term cultural orientations. Since these cultural values reflect different dimensions of culture (formal institutions), the present study would examine the effect of each component on firm performance. We also complement this analysis with another measure of informal institutions, the social capital. Measures of culture are taken from Hofstede or GLOBE variables (see, Kirkman et al., 2006; Venaik and Brewer,