Journal of International Business Studies (2019) 50, 36–47

www.jibs.net

COMMENTARY

Adjusting to and learning from institutional diversity: Toward a capability-building perspective

Sarianna M. Lundan[1,2] and Jiatao Li[3]

[1] *Chair in International Management and Governance, Faculty of Business Studies and Economics, University of Bremen, Enrique-Schmidt-Straße 1, 28359 Bremen, Germany;* [2] *Aalto University, Helsinki, Finland;* [3] *Lee Quo Wei Professor of Business, School of Business and Management, Hong Kong University of Science and Technology, Clear Water Bay, Hong Kong*

Correspondence:
SM Lundan, Chair in International Management and Governance, Faculty of Business Studies and Economics, University of Bremen, Enrique-Schmidt-Straße 1, 28359 Bremen, Germany.
Tel: +49 (0)421 218 66550;
e-mail: s.lundan@uni-bremen.de

Abstract

This paper identifies two main dimensions – institutional diversity and dynamism – in the research stream that has substantively engaged with the important contribution of Jackson and Deeg (J Int Bus Stud 39(4):540–561, 2008). Taking into account their core criticism that institutional analysis in international business research is often de-contextualized, and building on these two dimensions, we present two possible paths for institutional analysis that are sensitive to context. The first is a methodological shift towards configurational analyses, and specifically the analysis of counterfactual scenarios that could reveal new information about decision alternatives. The second is a shift away from a focus on costs, and towards the possibility of MNEs building capabilities in an exploratory manner when confronted with institutional diversity. Both approaches build on an understanding of MNEs as strategic actors that co-evolve with their environments.

Journal of International Business Studies (2019) **50**, 36–47.
https://doi.org/10.1057/s41267-018-0198-9

Keywords: institutional theory; institutional diversity; institutional change; dynamic capabilities; qualitative comparative analysis; decade award

INTRODUCTION

In this commentary, we examine the role of the important contribution by Jackson and Deeg (2008) in shaping the subsequent discourse in international business. We find that in those contributions that have substantively engaged with the paper, the themes of institutional diversity and dynamism emerge prominently. We build on this finding, as well as the criticism by Jackson and Deeg (2008) that much of institutional research in international business is de-contextualized, by presenting two emerging areas of research that engage with institutional diversity and dynamism, while also being more sensitive to context.

Among the past winners of the JIBS Decade Award, purely conceptual articles are slightly outnumbered by papers that make a contribution both empirically and in terms of theory development. The award-winning article this year thus represents a minority, but a minority that has often been quite influential in terms of its impact on subsequent research. The paper eschews some of the

Received: 4 September 2018
Accepted: 1 October 2018
Online publication date: 27 November 2018

more common techniques used to establish novelty in a conceptual or theoretical contribution, such as presenting a new model or framework that represents a synthesis or an amalgamation of existing ideas and concepts. Instead, the paper presents a very thoughtful and structured review of the dominant institutional perspectives that are of relevance to international business (IB) scholars. It focuses specifically on comparing two strands of institutional theory at the macro level, the comparative capitalisms approach (Hall & Soskice, 2001; Whitley, 1999), which mainly draws on the sociological and political science literatures, and the IB view on institutions, which tends to draw on economic and organizational approaches (North, 1990; Scott, 2001).

The analytical method employed in the paper is to identify the 'moving parts' in each of these approaches, and then to look for complementarities and contrasts between them. It specifically sets out to identify areas of cross-fertilization between the two approaches, and finds that there are considerable complementarities between the two strands of institutional analysis that could benefit from closer collaboration. Specifically, the authors suggest that the institutional discussion within international business would benefit from adopting a more nuanced understanding of institutions as systems that is prevalent in the comparative capitalisms literature. They criticize IB scholars for being too influenced by reductionist economic approaches where the complexity of institutional systems is de-contextualized and reduced to a small number of variables that can be measured and compared across borders. At the same time, they concede that the comparative capitalism literature has sometimes had a tendency to explain things in a top-down structuralist fashion, where the characteristics of the key institutions such as labor market or financial market institutions are taken to determine how economic activity is organized in the rest of the economy. They suggest that allowing more room for the agency of firms and other influential actors, and examining the interaction and co-evolution between MNEs and the institutional environment, would yield a more dynamic approach.

This paper will proceed as follows. We begin by tracing the citation pattern of the article to demonstrate its significance in terms of the growing number of citations, but also to gain a sense of the context in which it has been cited. This brief analysis then leads to two emerging areas of research that build on the themes of institutional diversity and dynamism. The first of these is a methodological connection linking the systemic and dynamic way of thinking about institutions advocated in the article and qualitative comparative analysis (QCA). The second research area is to do with the empirical context of emerging markets, and the possibility that as a consequence of institutional diversity and rapid change in these markets, firms may also need to develop new capabilities.

To extend the work of Jackson and Deeg (2008) and to make the research on institutional diversity more actionable for international business scholars, in the concluding section we explore the idea of managing institutional diversity as a dynamic capability, thus making a closer link between institutional perspectives and the global strategic management literature. Institutional diversity captures the extent of variation of the institutional environments that MNEs are exposed to, and constitutes an important dimension of task heterogeneity. Task heterogeneity increases organizations' effectiveness in learning and developing dynamic capabilities (Zollo & Winter, 2002). MNEs operating in diverse institutional environments have to make deliberate cognitive efforts to learn and uncover the interdependences between the multi-dimensions of institutional diversity and the strategy–performance relationship. Provided they possess the requisite (human) resources, MNEs can learn how to generalize their experience from one institutional context to another, and deal with patterns of institutional dynamism taking place in similar institutional contexts.

PATTERN OF CITATIONS

By June 2018, when this analysis was conducted, the paper had been cited 212 times in the Web of Science, excluding self-citations. Of these papers, 183 were empirical, 19 were conceptual, and the rest were either editorials, perspective papers, or research notes. The papers citing Jackson and Deeg (2008) are overwhelmingly empirical, which is not surprising since empirical papers represent the clear majority of all published work in the business and management area. By the same token, this fact underlines the importance of substantive conceptual pieces, as they often help to underpin a large number of subsequent empirical studies.

In order to examine the empirical context of these papers, we classified them as having either a developed market focus, an emerging market focus, a joint focus on both domains, or no discernible emerging-market or developed-market focus. We found that while the citations to the paper have been steadily increasing over the past decade, the empirical context in which the paper has been cited has been quite evenly divided between these two domains, with 74 of the citing papers having a clear developed market focus and 69 an emerging-market focus. The relatively large number of studies examining the emerging market context is not very surprising, given the emphasis in the literature on the influence of the dynamic institutional context. Additionally, we wanted to know if the emerging-market analyses were predominantly related to an emerging home country or an emerging host country. We found that 40 of the papers (or 58%) had a home country focus, while the remaining 29 papers were focused on emerging host countries.

In the next step, in order to better understand the intellectual context in which the paper has been cited, we looked in detail at the 32 papers published in JIBS that had cited Jackson and Deeg (2008). In most cases, the citations were nonspecific, meaning that the article was cited to emphasize the importance or significance of institutional analysis without making reference to the comparisons or recommendations contained in the article. We gather that this follows the predominant pattern for the citation of many conceptual pieces. It indicates that scholars had found the paper useful in shaping their own thinking, but were often not able to specify precisely in what ways they were influenced by it.

However, there were also instances where the work was cited in a more specific manner to highlight a characteristic that is emblematic of this type of institutional analysis. A selection of these quotes is provided in Table 1. It is apparent from here that institutional analysis provides a way in which scholars are able to discuss different facets of the complexity of the environment confronting multinational firms. One part of this complexity stems from *diversity*, which can be understood as the number of parts that need to be considered to comprise the system as a whole. These are characterized in the citations as the diversity of ways in which countries differ, the holistic nature of economies, and a myriad of regulative differences. The other main component of complexity is *dynamism*. In the citing papers, the process of institutional change is characterized as dynamic and interconnected, particularly in the context of emerging markets, reflecting a dynamic of change where multiple actors are interconnected and where processes of co-evolution take place. Another component of institutional complexity that is more prominent in the more recent quotes, and involves both diversity of actors and institutional change, stems from the idea of organizational agency. This is described on one hand as the influence of institutions in shaping the capabilities of firms, while on the other hand institutions are seen as partial and malleable by firms.

UNDERSTANDING DYNAMIC INSTITUTIONAL SYSTEMS

In the Northian (1990, 2005) tradition, institutional systems comprise both the formal (explicit, legal and administrative) and the informal (implicit, customs and norms) systems of rules that provide stability and predictability to human relations in general, and economic transactions in particular. Therefore, institutional systems also incorporate elements that are not functional from an economic perspective, but represent social custom or ceremonious deployment of institutions

Table 1 Examples of the context in which Jackson and Deeg (2008) has been cited in JIBS

Diversity
"the rich diversity of ways in which countries differ" (Berry, Guillén, & Zhou, 2010)
"depict institutional frameworks of a larger number of economies without abandoning the holistic nature of each economy" (Schneider, Schulze-Bentrop, & Paunescu, 2010)
"detailed analysis of different components of the institutional environment…a myriad of regulative differences" (Brouthers, 2013)
Agency and dynamism
"institutions as combinations of public and private resources for strategic coordination and collective action that shape the capabilities of firms" (Corredoira & Mcdermott, 2014)
"institutional pressures are rarely uniform and coherent across a country; instead, institutions are partial in their coverage and malleable in the hands of large firms" (Edwards, Sánchez-Mangas, Jalette, Lavelle, & Minbaeva, 2016)
"institutional changes in emerging economies should not be treated as static and discrete but rather as a dynamic and interconnected process" (Shi, Sun, Yan, & Zhu, 2017)

that may have ceased to reflect their original function and purpose (Parto, 2005; Witt & Redding, 2009; Zhu, Zhu, & De Cieri, 2014).

This is particularly prevalent in the informal part of the institutional system, but since this is never entirely separate from the formal part, it will also have an influence on the functioning of formal institutions (North, 2005). Because the invisible layer of institutions influences the functioning of the system as a whole, there is not one optimal institutional configuration, but rather all real-life configurations embody some irrational and dysfunctional aspects, at least when looked at from an economic perspective. The result of this is that institutional systems are not only the result of human design but also evolve as part of a long-term and path-dependent change process (Cantwell, Dunning, & Lundan, 2010).

The essential problem in much of the international business research identified by Jackson and Deeg (2008) is the de-contextualization of institutions. While many authors may be sympathetic to the idea of institutions as interconnected systems, the dominant methodologies in business and management research tend to favor some kind of a reductionist approach. In the comparative capitalism literature, this is less of a concern, as this literature explicitly incorporates institutional diversity as variation in the combination of elements that make up the institutional system, or the way in which these work together. However, even here there is a need to reduce the potentially infinite number of institutional dimensions to a core set of institutions that could be used to explain the (economically) relevant sources of variation or diversity across countries (Casson & Lundan, 1999). This process generates a limited number of archetypes, such as the liberal and coordinated market economy types, that vary in the detailed composition of the institutional system, but that share a similar over-arching logic (Hall & Soskice, 2001; Witt, de Castro, Amaeshi, Mahroum, Bohle, & Saez, 2018).

In the management and economic research, the reductionist perspective is characterized by studies focusing on a limited number of dimensions and employing quantitative metrics to assess different dimensions of institutional quality across borders. In international business and economics, this includes studies examining the role of formal and informal institutions in inward foreign investment (Holmes, Miller, Hitt, & Salmador, 2013) or studies that look at the impact of specific institutions like intellectual property protection (Beukel & Zhao, 2018; Luo, 2001; Smarzynska Javorcik, 2004) or corruption (Cuervo-Cazurra, 2006; Wei, 2000; Weitzel & Berns, 2006) for investment attraction or MNE performance. The assumption is that such core institutions are salient enough so that they can be separated from the rest of the local context, and their impact examined across borders.

A further step towards de-contextualization is taken by studies that quantify the degree of difference between countries on such individual dimensions as some type of a distance measure (Berry et al., 2010). Aside from the effects of de-contextualization, the concept of institutional distance has been criticized on methodological grounds. First, the concept of distance implies a symmetrical relationship (Shenkar, 2001). However, if distance is simply a proxy to signify the costs that economic agents have to bear to effectively perform in an alien environment, there is no reason why such costs would be symmetrical. For example, the adjustment costs of a German firm in Ghana are likely to be quite different from the adjustment costs of a Ghanaian firm in Germany. Second, in many studies employing institutional distance measures, distance is measured from one (usually developed) home country to multiple host countries. This has the problem of confounding institutional profile effects with institutional distance (Van Hoorn & Maseland, 2016).

The Effects of Diversity and Dynamism

While the extant research in international business has focused largely on institutions at the level of countries or regions, the institutional environment is very diverse, involving institutions at many different levels (city, state, region, country), and involving different types of actors and different degrees of dynamism (Arregle, Miller, Hitt, & Beamish, 2016; Heidenreich, 2012). In the international business literature, the diversity in institutional environments is generally treated as a source of increased costs.

The costs that arise from institutional diversity have been depicted as transaction costs (Brouthers, 2002, 2013), or more broadly the costs of learning or adjustment that have to be undertaken for the firm to be able to effectively operate in a new environment (Fortwengel, 2017; Regnér & Edman, 2014; Saka-Helmhout & Geppert, 2011). The key question of managerial relevance is which aspects of the institutional environment are the cause of most of the costs for the investors, and which of these costs can be mitigated by the firm's own actions?

In addition to diversity, the second relevant dimension of institutional complexity concerns the effects of institutional dynamism or change. Conceptually, there are difficulties in dealing with institutional change in a discourse where institutions are treated as a source of stability, and that help to reduce uncertainty. Nonetheless, the rise of emerging economies has demonstrated the importance of examining the dynamism of institutional environments not only as a process of comparative statics, but in terms of how the process of change unfolds, and particularly what impact this has on the adjustment costs of firms (Santangelo & Meyer, 2011).

If institutions are thought to create predictability and stability in social interaction, institutional change should be relatively rare, and there should be a preference by most actors for retaining the *status quo*. Indeed, this is largely consistent with what we observe in most developed economies. However, when institutional change is rapid, such as in emerging markets, this is often the result of several groups of actors simultaneously expending resources to affect changes in the 'rules of the game'. The instigating group can be the government, but it can also be individual political parties or charismatic politicians, and in some contexts it can also be NGOs or MNEs (Brookes, Brewster, & Wood, 2017; Corredoira & Mcdermott, 2014; Fogel, Lee, Lee, & Palmberg, 2013). In a system in flux, path dependence and inertia exert a much smaller influence, and the possibility of institutional change alters the cost–benefit calculation for the diverse actors.

One way for firms to deal with the costs of variety is by engaging in experimentation in volatile environments. This is at the core of the argument put forward by Cantwell et al. (2010), who suggested that the process whereby multinational firms develop new proto-institutions and redefine the rules of the game is the result of processes of conscious experimentation in response to the diversity and dynamism of the institutional environment. In this case, it is reasonable to assume that firms have different capabilities in terms of adjusting to new environments. All firms would use prior learning and experience as a starting point, but they have differing abilities of developing problem-solving routines that can lead to the creation of new proto-institutions (Dunning & Lundan, 2010; Teece, 2014). We return to this idea of the development of dynamic capabilities in the concluding section of the paper.

From a methodological point of view, to depict such processes of change, it can be useful to adopt a methodology such as QCA where different configurations of actors and resources can produce similar outcomes depending on the context, and where some actors may be entirely absent in some configurations, whereas they are present in others (Ragin, 2000, 2008). From an international business point of view, it is particularly intriguing to examine those configurations where multinational firms play a catalytic role in these change processes.

Configurational Analysis and Counterfactuals

The variety that stems from institutional diversity and dynamism in the home and host countries presents an opportunity to employ configurational methodologies to better understand the importance of the different component parts. Configurational approaches allow for different combinations of factors to lead to similar outcomes, and they can be used to parse out conditions that are necessary and sufficient for particular outcomes to occur in a given context. This provides a more structured way of dealing with the effects of institutional diversity, which nonetheless comes at the cost of some reductionism, since only a limited number of factors can be included in such configurations for small samples.

Of the 212 papers citing Jackson and Deeg (2008), 27 used the methodology of qualitative comparative analysis or QCA, with six of these papers appearing in JIBS. Within the field of IB, QCA is clearly not a mainstream methodology if compared to for example different types of regression analysis, but the field is beginning to welcome an increasing plurality of qualitative methods (Birkinshaw, Brannen, & Tung, 2011). In political science and other social science fields, QCA has gained a notable foothold, and it is also increasingly being applied in business and management studies (Misangyi, Greckhamer, Furnari, Fiss, Crilly, & Aguilera, 2016). QCA is a methodology that challenges the conventional thinking about causation, and consequently it will have a particularly challenging path to acceptance in fields that are rooted in the economic tradition, where the ability to produce predictive models is taken to signify the maturity of a field.

The key attributes of QCA are that it is conjunctural, equifinal, and asymmetrical (Ragin, 2000, 2008). It is conjectural because several conditions working together produce an outcome. The presence of equifinality means that that different configurations of conditions can lead to the same outcome. At the same time, the conditions that lead to the absence of the outcome do not necessarily mirror the conditions leading to the outcome, so the analysis can be asymmetrical.

As its name implies, QCA is a qualitative comparative methodology, but particularly in its fuzzy-set variant fsQCA, it is a methodology that combines both qualitative and quantitative elements in the analysis. QCA uses a set-theoretic logic, where data such as an investment by firm X in country Y is treated as a case. The cases are compared to each other based on a limited number of conditions. These conditions are much like the independent variables in regression analysis; they can be discrete or continuous, and through a process of calibration it is determined whether a particular case belongs to a particular condition or not. By comparing the cases across the different conditions, one obtains different configurations that lead to a specific outcome (e.g., more or less greenfield investment).

QCA has provided a set of tools with which interconnected systems can be analyzed in a more systematic manner. An excellent review of its origins as well as applications in different fields has been provided by Misangyi et al. (2016). In international business, this toolset has been used to examine, e.g., the role of institutions in inward investment (Pajunen, 2008), which institutional configurations lead to better export performance in high-technology industries (Schneider et al., 2010), which conditions lead firms to adopt a shareholder or stakeholder orientation (Crilly, 2011), and what model of capitalism delivers both economic efficiency and an equitable distribution of wealth (Judge, Fainshmidt, & Lee Brown III, 2014).

QCA also offers the possibility of employing counterfactual analysis of configurations that could exist, but that have failed to materialize in reality (Ragin, 2008; Soda & Furnari, 2012). This can arise for three main reasons: first, it can be simply because of the limited variability in any data set, suggesting that with more cases, the unobserved configurations might become observed; the second possibility is that the unobserved configurations represent combinations that for one reason or another are impossible or exceedingly unlikely to appear in reality; the third possibility is that the configurations are feasible, but have not been undertaken because of for example path dependence and inertia.

As an example, consider the process of the benchmarking of best practices. Policymakers and managers often use benchmarking as a shortcut to the adoption of new practices. However, the resulting hybridized institutions are alien to the rest of the institutional system, and therefore present challenges of system-wide integration. Alternatively, consider the case of a policymaker or a manager who is prepared to develop new institutions, but is faced with a path-dependent and sometimes nonrational trajectory of secular institutional change that may favor outcomes that are dysfunctional. By presenting a novel way for analyzing the road not taken, institutional analysis employing QCA could offer the possibility of creating the equivalent of a behavioral 'nudge' (Thaler & Sunstein, 2008) to encourage policymakers or managers to consider alternative options (Lundan, 2018). This would, however, necessitate some methodological advances, since in the extant research, the counterfactuals have usually been dealt with by adopting simplifying assumptions about their plausibility, since no established methodology for examining the full range of counterfactuals has been put forward (Soda & Furnari, 2012).

INSTITUTIONAL DIVERSITY AND CAPABILITY-BUILDING

Institutional diversity represents the extent of variations of the institutional environment that MNEs have been exposed to. International business scholars have increasingly recognized the pivotal role of the institutional environments in shaping MNE international activities (Meyer, Estrin, Bhaumik, & Peng, 2009; Peng, Wang, & Jiang, 2008). The institutional environments vary substantially across different countries (Berry et al., 2010; Jackson & Deeg, 2008). Although MNEs by their nature operate in multiple countries, the extent of diversity of the institutional arrangements they are exposed to is not homogenous. Two MNEs operating in the same number of host countries can have very different levels of institutional diversity because the host countries of one MNE may be very similar in terms of institutional conditions (i.e., low institutional diversity) while those of the other MNEs can be very diverse (i.e., high institutional diversity).

We suggest that the institutional diversity experienced by MNEs from their international expansions can facilitate the development of dynamic capabilities. MNEs can build up dynamic capabilities from institutional diversity because wrestling with heterogeneous stakeholders in distinctive host countries equips MNEs with knowledge diversity, adaptive organizational processes, and more arbitrage opportunities.

Dynamic Capabilities

Dynamic capabilities are defined as 'the firm's ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments' (Teece, Pisano, & Shuen, 1997: 516). Dynamic capabilities can generally fall into three categories, namely, the capacities to: (1) sense opportunities and threats; (2) seize opportunities; and (3) periodically transform the business enterprise's intangible and tangible resources (Teece, 2007). Teece et al. (1997) explain the creation of dynamic capabilities as largely shaped by firms' evolutionary path that they have adopted in the past, along with their asset positions. Applying the dynamic capabilities framework in the MNE context, Teece (2014) suggested that "the capabilities of the MNE stem in part from the diverse environments in which they operate and compete" (2014: 24).

The dynamic capabilities perspective is particularly relevant in the MNE context as MNEs operating across multiple countries with heterogeneous environments confront substantive dynamism in the external environment (Lessard, Teece, & Leih, 2016). These dynamisms are not limited to industry dynamism related to changes in technologies, customer demands, or competitor activities (Schilke, Hu, & Helfat, 2018; Teece, 2007), but more importantly include institutional dynamisms that derive from heterogeneous political regimes, regulatory structures, and social norms of different countries (Jackson & Deeg, 2008; Kostova & Zaheer, 1999). To achieve and sustain competitive advantage in the global contexts, MNEs should continuously renew and reconfigure their resource mix to accommodate the dynamic environments (Dunning & Lundan, 2010; Matysiak, Rugman, & Bausch, 2018; Teece, 2014).

While studies have examined the strategic and performance implications of dynamic capabilities on international operations (Barkema & Vermeulen, 1998; Brouthers, Brouthers, & Werner, 2008; Fang & Zou, 2009), how MNEs build up dynamic capabilities is relatively less clear. In the seminal article, Teece et al. (1997) explain that "the competitive advantage of firms lies with its managerial and organizational processes, shaped by its (specific) asset position, and the path available to it" (Teece et al., 1997: 518). They draw on the evolutionary theory of the firm (Nelson & Winter, 1982) to define organizational processes as routines or patterns of practices that are highly path dependent. Zollo and Winter (2002) resonate this evolutionary view and suggest that dynamic capabilities are developed through learning, including both experiential knowledge from learning-by-doing and deliberate learning efforts.

In the MNE context, internationalization is an evolutionary process that involves organizational learning and knowledge accumulation (Kogut, 1989; Kogut & Zander, 1993). When MNEs expand into different countries, they continuously engage in searching, trial and errors, and the creation of new routines to solve problems (Nelson & Winter, 1982). Such processes of international expansion become the key sources of MNE distinctive knowledge and capabilities that bring competitive advantages (Hutzschenreuter & Matt, 2017; Nachum & Song, 2011; Zhou & Guillén, 2015). As MNEs' capability building largely lies in their historical internationalization path, one aspect of the evolutionary path, the diversity of MNE institutional environments is likely to be related to the development of MNE dynamic capabilities.

The Effects of Institutional Diversity on Capabilities

Differences in institutions have often been framed negatively as a source of barriers, uncertainties, and liabilities, whereas the potentially beneficial effects of institutional diversity have been less explored in research (Stahl, Tung, Kostova, & Zellmer-Bruhn, 2016). Rather than only focusing on reducing institutional distance, MNEs could gain advantage by exploring diversity in institutional arrangements, thus employing institutions as *resources*. While it is clear that MNEs should exercise caution and maybe even restraint in dealing with diverse institutional environments, an undue emphasis on the downside may inhibit MNEs to recognize and take advantage of the resources and opportunities generated from institutional diversity.

Institutional diversity exposes MNEs to multiple stimuli that provide them with diverse knowledge and broader learning opportunities (Li, Tian, & Wan, 2015; Xie & Li, 2015, 2018). Different institutional arrangements often breed distinctive technologies and business practices (Berry et al., 2010; Jackson & Deeg, 2008). MNEs with the exposure to alternative technologies, practices, norms, and behaviors are more likely to build up a broader mindset and higher *sensing capabilities* to identify new links among diverse knowledge bases (Li & Wan, 2016; Xie & Li, 2015, 2018), and thereby are more likely to generate innovations. It is worth noting that the innovations resulting from institutional diversity may not be limited to new products or business models (Barkema & Vermeulen, 1998), but may be reflected in new ways of managing different stakeholders and institutional pressures. MNEs with cross-border operations often confront legitimacy pressures from multiple stakeholders, including not only customers, suppliers, and competitors but also governments or local communities (Kostova & Zaheer, 1999; Li, Yang, & Yue, 2007). MNEs that have previous experience in diverse institutional environments are likely to be aware of alternative possibilities, thereby widening the available repertories of institutional responses (Greenwood, Raynard, Kodeih, Micelotta, & Lounsbury, 2011).

Institutional diversity also bolsters the development of *seizing capabilities* as MNEs with experience in institutionally diverse countries are more likely to develop adaptive organizational processes that facilitate timely responses to new opportunities. Each time an MNE enters an institutionally different market, the need to adapt to the new foreign settings may trigger failures of established practices and searching for new solutions (Eriksson, Johanson, Majkgard, & Sharma, 1997; Yang, Li, & Delios, 2015). MNEs with high institutional diversity go through such processes of problem solving more frequently. This is likely to foster organizational learning and the accumulation of experiential knowledge that gets stored in organizational processes and routines (Nelson & Winter, 1982; Zhou & Guillén, 2015) that in turn become the building blocks of dynamic capabilities.

Institutional diversity promotes *reconfiguring capabilities* by providing arbitrage opportunities between different institutional systems (Jackson & Deeg, 2008). MNEs may strategically locate different parts of their value chain in different countries as a way of taking advantage of the comparative advantages of different locations (Jackson & Deeg, 2008). In this sense, the institutional diversity fosters MNE *reconfiguring capabilities* to recombine dispersed resources on a global basis to promote overall efficiency.

However, there are also limits to learning from institutional diversity. It is an opportunity, but the benefits do not outweigh the costs for every MNE. The benefits of institutional diversity do not automatically lead to dynamic capabilities if MNEs do not put deliberate efforts to absorb, assimilate, and reflect from their experience in diverse institutional environments (Zollo & Winter, 2002). MNEs' heterogeneities that determine the incentives and capacities of learning may largely shape the development of dynamic capabilities from institutional diversity.

One contingent factor that may inhibit learning from institutional diversity is the pace of MNE international expansion, e.g., as reflected in the number of foreign subsidiaries established each year. The speed of international expansion influences the efficiency of MNEs to transform diverse experiences into meaningful learning (Eisenhardt & Martin, 2000). To achieve benefits from institutional diversity, MNEs need to first absorb the diverse knowledge and then to recombine it with their established knowledge base. This assimilation and reconfiguration process is highly shaped by the speed of their internationalization. MNEs that expand into diverse institutional environments rapidly are more likely to suffer from time compression diseconomies (Dierickx & Cool, 1989) because it is difficult for them to absorb, assimilate, and combine acquired knowledge into innovative capabilities in a short period of time (Vermeulen & Barkema, 2002). Moreover, high internationalization speed may overstretch top managers' absorptive capacity and push them to cognitive limits that inhibit efficient learning and capability building from institutional diversity (Vermeulen & Barkema, 2002).

Another contingent factor is the age of the firm when it initiates international operations (Coviello, 2006; Sapienza et al., 2006). MNEs that initiate internationalization at a younger age, as in the international new venture (INV) context, are more likely to develop adaptive routines and accumulate knowledge efficiently from institutional diversity because the younger the age at international initiation, the more likely the internationalizing firm will have a flatter organizational structure with low hierarchy and shared responsibilities (Mathews & Zander, 2007; Prashantham & Floyd, 2012; Sapienza et al., 2006), which facilitates knowledge sharing and transforming. Consequently, we think that future research could usefully explore the influence of contingent factors that either enhance or inhibit the process of building dynamic capabilities.

CONCLUSION

We began this paper by exploring the impact of the Jackson and Deeg (2008) article, and identified institutional diversity and dynamism as two prominent themes in the subsequent research. Their contribution opposes the reductionist idea that the complexity of institutional environments can be reduced to a few salient aspects that matter for value creation. Instead, theirs is a view that sees institutional systems as consisting of the interplay between many different parts, involving multiple actors at different levels, with no guarantee that the system would follow an efficiency-driven path of institutional development.

In this view, to understand the origin of the firms' adjustment costs when confronted with institutional diversity, one not only needs to understand how the different parts work together but also to appreciate that the parts that are required for the institutional system to function may also contain elements that are dysfunctional. If these elements can simply be ignored or the firm isolated from them, the problem could easily be solved. However, a systemic view of institutions suggests that the seemingly irrational aspects are part of the essential variety, and therefore present an inseparable part of the costs of learning that firms need to overcome.

To better understand the sources of these costs, we explored the potential of a configurational methodology such as QCA to deliver more nuanced analyses concerning the impact of institutional diversity. While we believe this approach offers great promise, it does leave open the possibility that the outcome will simply be a more sophisticated way of saying that institutions matter, but in which ways will depend on the context. This would not generate advice that would give either managers or policymakers much guidance on how to reduce the costs of adjustment, which would be unsatisfactory, even if prediction is not a characteristic of configurational models. However, we see potential in the examination of counterfactual scenarios that consist of combinations of institutional factors or paths that could have occurred, but that are not visible in the data that has been collected. Such cases might allow researchers to suggest possible alternatives and to explore the opportunity costs of the paths that were chosen, which is not something conventional regression analyses are equipped to do.

In the final part of the paper, in an effort to link the institutional analysis to the research on firm strategy and to make it more actionable, we examined how MNEs confront institutional diversity and change through processes of learning and capability building. In contrast to much of the extant research that has examined the costs of institutional diversity, we focused on the recognition that firms develop capabilities for dealing with institutional diversity. By examining these learning processes, we are in effect peering into countless firm-level experiments where firms exposed to costly variety are developing routinized ways of dealing with these challenges. Since each firm does this in a specific institutional context, the variety of 'recipes' developed is informative both of the sources of problems and their potential solutions. This offers a way for international business research to contribute to both improved policy design and managerial decision making (Buckley, Doh, & Benischke, 2017; Lundan, 2018), particularly in connection with 'grand challenges' such as the Sustainable Development Goals, where private investment in a variety of sectors and across an enormous range of institutional contexts is required.

ACKNOWLEDGEMENTS

We are grateful to Editor-in-Chief Alain Verbeke and two anonymous reviewers for their insightful feedback during the review process. The research is supported in part by the Research Grants Council of Hong Kong (HKUST#16501814 and #16505817). This commentary benefited greatly from joint work on dynamic capabilities with Jialin Du and Jingtao Yi.

REFERENCES

Arregle, J. L., Miller, T. L., Hitt, M. A., & Beamish, P. W. 2016. How does regional institutional complexity affect MNE internationalization? *Journal of International Business Studies,* 47(6): 697–722.

Barkema, H. G., & Vermeulen, F. 1998. International expansion through start-up or acquisition: A learning perspective. *Academy of Management Journal,* 41(1): 7–26.

Berry, H., Guillén, M. F., & Zhou, N. 2010. An institutional approach to cross-national distance. *Journal of International Business Studies,* 41(9): 1460–1480.

Beukel, K., & Zhao, M. 2018. IP litigation is local, but those who litigate are global. *Journal of International Business Policy,* 1(1–2): 53–70.

Birkinshaw, J., Brannen, M. Y., & Tung, R. L. 2011. From a distance and generalizable to up close and grounded: Reclaiming a place for qualitative methods in international business research. *Journal of International Business Studies,* 42(5): 573–581.

Brookes, M., Brewster, C., & Wood, G. 2017. Are MNCs norm entrepreneurs or followers? The changing relationship between host country institutions and MNC HRM practices. *International Journal of Human Resource Management,* 28(12): 1690–1711.

Brouthers, K. D. 2002. Institutional, cultural and transaction cost influences on entry mode choice and performance. *Journal of International Business Studies,* 33(2): 203–221.

Brouthers, K. D. 2013. A retrospective on: Institutional, cultural and transaction cost influences on entry mode choice and performance. *Journal of International Business Studies,* 44(1): 14–22.

Brouthers, K. D., Brouthers, L. E., & Werner, S. 2008. Resource-based advantages in an international context. *Journal of Management,* 34(2): 189–217.

Buckley, P. J., Doh, J. P., & Benischke, M. H. 2017. Towards a renaissance in international business research? Big questions, grand challenges, and the future of IB scholarship. *Journal of International Business Studies,* 48(9): 1045–1064.

Cantwell, J., Dunning, J. H., & Lundan, S. M. 2010. An evolutionary approach to understanding international business activity: The co-evolution of MNEs and the institutional environment. *Journal of International Business Studies,* 41(4): 567–586.

Casson, M. C., & Lundan, S. M. 1999. Explaining international differences in economic institutions: A critique of the "national business system" as an analytical tool. *International Studies of Management & Organization,* 29(2): 25–42.

Corredoira, R. A., & Mcdermott, G. A. 2014. Adaptation, bridging and firm upgrading: How non-market institutions and MNCs facilitate knowledge recombination in emerging markets. *Journal of International Business Studies,* 45(6): 699–722.

Coviello, N. E. 2006. The network dynamics of international new ventures. *Journal of International Business Studies,* 37(5): 713–731.

Crilly, D. 2011. Predicting stakeholder orientation in the multinational enterprise: A mid-range theory. *Journal of International Business Studies,* 42(5): 694–717.

Cuervo-Cazurra, A. 2006. Who cares about corruption? *Journal of International Business Studies,* 37(6): 807–822.

Dierickx, I., & Cool, K. 1989. Asset stock accumulation and sustainability of competitive advantage. *Management Science,* 35(12): 1504–1511.

Dunning, J. H., & Lundan, S. M. 2010. The institutional origins of dynamic capabilities in multinational enterprises. *Industrial and Corporate Change,* 19(4): 1225–1246.

Edwards, T., Sánchez-Mangas, R., Jalette, P., Lavelle, J., & Minbaeva, D. 2016. Global standardization or national differentiation of HRM practices in multinational companies? A comparison of multinationals in five countries. *Journal of International Business Studies,* 47(8): 997–1021.

Eisenhardt, K. M., & Martin, J. A. 2000. Dynamic capabilities: What are they? *Strategic Management Journal,* 21(10/11): 1105–1121.

Eriksson, K., Johanson, J., Majkgard, A., & Sharma, D. D. 1997. Experiential knowledge and cost in the internationalization process. *Journal of International Business Studies,* 28(2): 337–360.

Fang, E. E., & Zou, S. 2009. Antecedents and consequences of marketing dynamic capabilities in international joint ventures. *Journal of International Business Studies,* 40(5): 742–761.

Fogel, K. S., Lee, K. K., Lee, W. Y., & Palmberg, J. 2013. Foreign direct investors as change agents: The Swedish firm experience. *Corporate Governance: An International Review,* 21(6): 516–534.

Fortwengel, J. 2017. Understanding when MNCs can overcome institutional distance: A research agenda. *Management International Review,* 57(6): 793–814.

Greenwood, R., Raynard, M., Kodeih, F., Micelotta, E. R., & Lounsbury, M. 2011. Institutional complexity and organizational responses. *The Academy of Management Annals,* 5(1): 317–371.

Hall, P. A., & Soskice, D. 2001. An introduction to varieties of capitalism. In P. A. Hall & D. Soskice (Eds.): *Varieties of capitalism: The institutional foundations of comparative advantage*: 1–68. Oxford: Oxford University Press.

Heidenreich, M. 2012. The social embeddedness of multinational companies: A literature review. *Socio-Economic Review,* 10(3): 549–579.

Holmes, R. M., Miller, T., Hitt, M. A., & Salmador, M. P. 2013. The interrelationships among informal institutions, formal institutions, and inward foreign direct investment. *Journal of Management, 39*(2): 531–566.

Hutzschenreuter, T., & Matt, T. 2017. MNE internationalization patterns, the roles of knowledge stocks, and the portfolio of MNE subsidiaries. *Journal of International Business Studies,* 48(9): 1131–1150.

Jackson, G., & Deeg, R. 2008. Comparing capitalisms: Understanding institutional diversity and its implications for international business. *Journal of International Business Studies,* 39(4): 540–561.

Judge, W. Q., Fainshmidt, S., & Lee Brown, J., III. 2014. Which model of capitalism best delivers both wealth and equality? *Journal of International Business Studies,* 45(4): 363–386.

Kogut, B. 1989. Research notes and communications a note on global strategies. *Strategic Management Journal,* 10(4): 383–389.

Kogut, B., & Zander, U. 1993. Knowledge of the firm and the evolutionary theory of the multinational corporation. *Journal of International Business Studies,* 24(4): 625–645.

Kostova, T., & Zaheer, S. 1999. Organizational legitimacy under conditions of complexity: The case of the multinational enterprise. *Academy of Management Review, 24*(1): 64–81.

Lessard, D., Teece, D. J., & Leih, S. 2016. The dynamic capabilities of meta-multinationals. *Global Strategy Journal,* 6(3): 211–224.

Li, J. T., Tian, L., & Wan, G. 2015. Contextual distance and the international strategic alliance performance: A conceptual framework and a partial meta-analytic test. *Management and Organization Review,* 11(2): 289–313.

Li, J. T., & Wan, G. 2016. China's cross-border mergers and acquisitions: A contextual distance perspective. *Management and Organization Review,* 12(3): 449–456.

Li, J. T., Yang, J., & Yue, D. 2007. Identity, community, and audience: How wholly owned foreign subsidiaries gain legitimacy in China. *Academy of Management Journal,* 50(1): 175–190.

Lundan, S. M. 2018. From the editor: Engaging international business scholars with public policy issues. *Journal of International Business Policy,* 1(1–2): 1–11.

Luo, Y. 2001. Determinants of entry in an emerging economy: A multilevel approach. *Journal of Management Studies,* 38(3): 443–472.
Mathews, J. A., & Zander, I. 2007. The international entrepreneurial dynamics of accelerated internationalisation. *Journal of International Business Studies,* 38(3): 387–403.
Matysiak, L., Rugman, A. M., & Bausch, A. 2018. Dynamic capabilities of multinational enterprises: The dominant logics behind sensing, seizing, and transforming matter! *Management International Review,* 58(2): 225–250.
Meyer, K. E., Estrin, S., Bhaumik, S. K., & Peng, M. W. 2009. Institutions, resources, and entry strategies in emerging economies. *Strategic Management Journal,* 30(1): 61–80.
Misangyi, V. F., Greckhamer, T., Furnari, S., Fiss, P. C., Crilly, D., & Aguilera, R. 2016. Embracing causal complexity: The emergence of a neo-configurational perspective. *Journal of Management,* 43(1): 255–282.
Nachum, L., & Song, S. 2011. The MNE as a portfolio: Interdependencies in MNE growth trajectory. *Journal of International Business Studies,* 42(3): 381–405.
Nelson, R., & Winter, S. 1982. *An evolutionary theory of economic change*. Cambridge, MA: Harvard Business School Press.
North, D. C. 1990. *Institutions, institutional change and economic performance*. Cambridge: Cambridge University Press.
North, D. C. 2005. *Understanding the process of economic change*. London: Princeton University Press.
Pajunen, K. 2008. Institutions and inflows of foreign direct investment: A fuzzy-set analysis. *Journal of International Business Studies,* 39(4): 652–669.
Parto, S. 2005. Economic activity and institutions: Taking stock. *Journal of Economic Issues,* 39(1): 21–52.
Peng, M. W., Wang, D. Y., & Jiang, Y. 2008. An institution-based view of international business strategy: A focus on emerging economies. *Journal of International Business Studies,* 39(5): 920–936.
Prashantham, S., & Floyd, S. W. 2012. Routine microprocesses and capability learning in international new ventures. *Journal of International Business Studies,* 43(6): 544–562.
Ragin, C. C. 2000. *Fuzzy-set social science*. Chicago, IL: University of Chicago Press.
Ragin, C. C. 2008. *Redesigning social inquiry: Fuzzy sets and beyond*. Chicago, IL: University of Chicago Press.
Regnér, P., & Edman, J. 2014. MNE institutional advantage: How subunits shape, transpose and evade host country institutions. *Journal of International Business Studies,* 45(3): 275–302.
Saka-Helmhout, A., & Geppert, M. 2011. Different forms of agency and institutional influences within multinational enterprises. *Management International Review,* 51(5): 567–592.
Santangelo, G. D., & Meyer, K. E. 2011. Extending the internationalization process model: Increases and decreases of MNE commitment in emerging economies. *Journal of International Business Studies,* 42(7): 894–909.
Sapienza, H. J., Autio, E., George, G., & Zahra, S. A. 2006. A Capabilities perspective on the effects of early internationalization on firm survival and growth. *Academy of Management Review*, 31(4): 914–933.
Schilke, O., Hu, S., & Helfat, C. 2018. Quo vadis, dynamic capabilities? A content-analytic review of the current state of knowledge and recommendations for future research. *Academy of Management Annals,* 12(1): 390–439.
Schneider, M. R., Schulze-Bentrop, C., & Paunescu, M. 2010. Mapping the institutional capital of high-tech firms: A fuzzy-set analysis of capitalist variety and export performance. *Journal of International Business Studies,* 41(2): 246–266.
Scott, W. R. 2001. *Institutions and organizations* (2nd ed.). Thousand Oaks, CA: Sage.
Shenkar, O. 2001. Cultural distance revisited: Towards a more rigorous conceptualization and measurement of cultural differences. *Journal of International Business Studies,* 32(3): 519.
Shi, W. S., Sun, S. L., Yan, D., & Zhu, Z. 2017. Institutional fragility and outward foreign direct investment from China. *Journal of International Business Studies,* 48(4): 452–476.
Smarzynska Javorcik, B. K. 2004. The composition of foreign direct investment and protection of intellectual property rights: Evidence from transition economies. *European Economic Review,* 48(1): 39–62.
Soda, G., & Furnari, S. 2012. Exploring the topology of the plausible: Fs/QCA counterfactual analysis and the plausible fit of unobserved organizational configurations. *Strategic Organization,* 10(3): 285–296.
Stahl, G. K., Tung, R. L., Kostova, T., & Zellmer-Bruhn, M. 2016. Widening the lens: Rethinking distance, diversity, and foreignness in international business research through positive organizational scholarship. *Journal of International Business Studies,* 47(6): 621–630.
Teece, D. J. 2007. Explicating dynamic capabilities: The nature and microfoundations of (sustainable) enterprise performance. *Strategic Management Journal,* 28(13): 1319–1350.
Teece, D. J. 2014. A dynamic capabilities-based entrepreneurial theory of the multinational enterprise. *Journal of International Business Studies,* 45(1): 8–37.
Teece, D. J., Pisano, G., & Shuen, A. 1997. Dynamic capabilities and strategic management. *Strategic Management Journal,* 18(7): 509–533.
Thaler, R. H., & Sunstein, C. 2008. *Nudge: Improving decisions about health, wealth, and happiness*. New Haven, CT: Yale University Press.
Van Hoorn, A., & Maseland, R. 2016. How institutions matter for international business: Institutional distance effects vs institutional profile effects. *Journal of International Business Studies,* 47(3): 374–381.
Vermeulen, F., & Barkema, H. 2002. Pace, rhythm, and scope: Process dependence in building a profitable multinational corporation. *Strategic Management Journal,* 23(7): 637–653.
Wei, S.-J. 2000. How taxing is corruption on international investors? *Review of Economics and Statistics,* 82(1): 1–11.
Weitzel, U., & Berns, S. 2006. Cross-border takeovers, corruption, and related aspects of governance. *Journal of International Business Studies,* 37(6): 786–806.
Whitley, R. 1999. *Divergent capitalisms: The social structuring and change of business systems*. Oxford and New York: Oxford University Press.
Witt, M. A., de Castro, L. R. K., Amaeshi, K., Mahroum, S., Bohle, D., & Saez, L. 2018. Mapping the business systems of 61 major economies: A taxonomy and implications for varieties of capitalism and business systems research. *Socio-Economic Review,* 16(1): 5–38.
Witt, M. A., & Redding, G. 2009. Culture, meaning, and institutions: Executive rationale in Germany and Japan. *Journal of International Business Studies,* 40(5): 859–885.
Xie, Z., & Li, J. T. 2015. Demand heterogeneity, learning diversity and innovation in an emerging economy. *Journal of International Management,* 21(4): 277–292.
Xie, Z., & Li, J. T. 2018. Exporting and innovating among emerging market firms: The moderating role of institutional development. *Journal of International Business Studies,* 49(2): 222–245.
Yang, J., Li, J. T., & Delios, A. 2015. Will a second mouse get the cheese? Learning from early entrants' failures in a foreign market. *Organization Science,* 26(3): 908–922.
Zhou, N., & Guillén, M. F. 2015. From home country to home base: A dynamic approach to the liability of foreignness. *Strategic Management Journal,* 36(6): 907–917.
Zhu, J. S., Zhu, C. J., & De Cieri, H. 2014. Chinese MNCs' preparation for host-country labor relations: An exploration of country-of-origin effect. *Human Resource Management,* 53(6): 947–965.
Zollo, M., & Winter, S. G. 2002. Deliberate learning and the evolution of dynamic capabilities. *Organization Science,* 13(3): 339–351.

ABOUT THE AUTHORS

Sarianna M. Lundan holds the Chair in International Management and Governance at the University of Bremen in Germany. She is a Fellow of the AIB and EIBA and Editor-in-Chief of the *Journal of International Business Policy*. Her research centers on the co-evolutionary processes whereby MNEs influence both institutions and policy in their home and host countries. She is currently a Distinguished Visiting Professor at Aalto University in Finland.

Jiatao Li is Chair Professor of Management and Lee Quo Wei Professor of Business, Hong Kong University of Science and Technology. He is a Fellow of the AIB and an editor of the *Journal of International Business Studies*. He served as the Senior Associate Dean of the HKUST Business School from 2013 to 2017. His current research interests are in the areas of organizational learning, strategic alliances, corporate governance, innovation, and entrepreneurship, with a focus on issues related to global firms and those from emerging economies.

Accepted by Alain Verbeke, Editor-in-Chief, 1 October 2018. This article was single-blind reviewed.