Navigating Institutional Differences in Africa: Moving Beyond the Institutional Voids Perspective

Journal Item

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Goriola Olusina Daniel, Loughborough University London, UK
Theresa Onaji-Benson, University of Pretoria, South Africa
Charles Mbalyohere, Open University, UK

Introduction

According to analysis from the McKinsey Global Institute, Africa has more than 400 companies with annual revenues exceeding US$1 billion. Many more are required to fuel the growth that will unlock the estimated US$5.6 trillion in Africa's business opportunities by 2025 (Bughin, Manyika, & Woetzel, 2016). Despite the success of these noted exemplars, MNEs operating across Africa often need to develop distinct capabilities that enable them to navigate and respond to weak or non-existent formal institutions – what Khanna and Palepu (2005) describe as "institutional voids." This description ignores the reality that institutions across Africa have evolved from a distinct history that accentuates the relevance of informal institutions in a manner that may be uniquely different from other regions, and worthy of closer examination, especially as most studies examine the institutional environment in Africa and its implications for firm performance and strategy from a predominantly Western perspective (Mair, Marti, & Ventresca, 2012; Khanna & Palepu, 2005).

We contribute to this debate by examining the institutional landscape in Africa from the perspective of MNEs operating across the continent. We draw on qualitative evidence from six advanced economy (AMNE) and emerging economy MNEs (EMNE) operating in Uganda and quantitative evidence from fifteen South African EMNEs operating across Africa to argue that the wide-scale reality of institutions that significantly differ from what some MNEs are familiar with should not necessarily imply institutional voids. This was a critical point of debate at the 2018 AIB Africa conference panel on "How MNEs navigate different institutional environments across Africa." We begin with a brief discussion on the relevance of institutions and the conceptual basis of our critique of the institutional void thesis. We then examine evidence from six in-depth case studies that outline how six MNEs developed strategies to participate in the liberalisation of Uganda's electricity sector. We build on these insights with further quantitative evidence from across the continent on the influence of transactional political strategies on the performance of fifteen South Africa MNEs operating across Africa.

Institutions Matter

Institutions matter and play a critical role in the function of markets and society as a whole, in developed economies, as well as in emerging and developing economies. There are, however, observed differences in the characteristics, operations, and maturity of institutions across economy types.

Institutions as distinct from the organizations that develop and enforce them, have been defined as "humanly devised constraints" or "rules of the game" (North, 1990) that shape the social and economic interactions between members of society. These so-called rule-based institutional environments have been shown to be conducive for firm performance, providing a predictable regulatory environment that reduces transaction costs and enables MNEs to plan ahead and focus on value-adding activities. By contrast, in emerging economies, formal institutions are often weak or absent (Khanna & Palepu, 2005; Peng, Wang & Jiang, 2008; Meyer, Estrin, Bhaumik & Peng, 2009). Where they exist, they are enforced poorly, or not at all.

While the institutional voids thesis provides a useful framework from which to explore and respond to the peculiarities of the institutional context firms operate in across emerging markets, some have questioned the accuracy of the term "voids" and what it implies. Olthaar, Dolfsma, Lutz, and Noseleit (2017), for instance, challenge the idea of an institutional "vacuum" implied by the term "voids," and have suggested that even where formal institutions that regulate the proper functioning of markets and economic activity are absent, or do not function as expected, institutions still affect firms; these can either be informal norms and practices or formal institutions from a different or adjacent practice or domain. Khanna and Palepu's (2005) arguments on institutional voids in emerging economies leans heavily on the new institutional economics view, which pays little attention to the normative and cognitive expressions of institutions. They assert that emerging markets are different from Western markets and are characterized by increasing transaction costs and an absence of (Western-style formal) institutions. This position ignores the role of informal institutions, which provide the essential legitimacy for formal rules and assumes that institutions can be transferred across differing contexts. In African emerging economies, the influence of informal institutions cannot be ignored (Bagire & Namada, 2015; George, Corbishley, Khayesi, Haas & Tihanyi, 2016, 2016; Zoogah, Peng, & Woldu, 2015). Though their enforcements are not regulated in the strict Western style, they form a significant part of the rules of the game that guide operations within these contexts.

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In reality, informal and formal institutions co-exist to establish the institutional mix of host countries, particularly in emerging markets. And depending on the context, can have a variety of configurations or interrelations, including, complementing and increasing their joint effectiveness, substituting informal institutions for non-functioning formal institutions, or informal institutions competing against ineffective formal institutions (Helmke & Levitsky, 2004). This is particularly true across Africa where distinctive economic, institutional, and cultural systems and norms have emerged from a unique history and culture to evolve a business environment that is distinctively different from other regions in many ways – a phenomenon that is best examined with evidence from the experience of MNEs that operate across Africa, as detailed in the following sections.

Divergent MNE Experiences with Institutional Environments in Africa

In gathering evidence about heterogeneous responses to institutions in Africa, we draw on six MNEs that entered Uganda's electricity generation industry shortly before or after the implementation of pro-market reforms in the electricity sector in 2002. The qualitative, multi-case sample consists of three emerging economy MNEs and three advanced economy MNEs, thus offering insights into diverse MNE responses. The findings (established through exposing the qualitative data to a grounded analysis), suggest that some MNEs are most competitive at the early stages of pro-market reforms, when formal institutions are least developed and effective and informal institutions are most prevalent. EMNEs generally adapt best at this stage, indicating an above-average possession of capabilities that are suitable for responding to informal institutions. Conversely, AMNEs adapt more effectively at later stages, reflecting capabilities to effectively respond to more formal institutions. When they enter strategic partnerships, however, EMNEs and AMNEs appear to create synergies and complementarity in the capabilities to respond to both informal and formal institutions. They hence get positioned to adapt well at both early and late stages of reform, irrespective of the evolving institutional constellation.

We conclude from these findings that the lack of effective formal institutions, something that characterizes the early stages of pro-market reforms in sub-Saharan African and other emerging and emerging markets, does not necessarily translate into a universal competitive disadvantage. Since the MNEs that derive advantage here do so using explicit institutional responses, we further infer that the response is not to "voids," but to a set of institutions that are not formal. The EMNEs in our study demonstrate extensive capabilities in responding to these informal institutions and understanding their dynamics. The capabilities are gathered in the host market and in other African markets that serve as incubators to nurture experience. In the end, some of the cases in the study acquired even more refined capabilities that positioned them well for entry into more challenging markets in the wider region. One of the cases, for example, leveraged its experiences in Uganda to win a new licence to develop a dam project at the border between Rwanda and the Democratic Republic of the Congo.

EMNEs are often better able to understand the rules governing informal institutions, and therefore develop the corresponding capabilities to respond competitively. Consequently, AMNEs that enter strategic partnerships with experienced EMNEs position themselves to fill the gaps they have in responding to these institutions (Mbalyohere, Lawton, Boojihawon, & Viney, 2017). In such partnerships, there is a complementarity between the two partners. One partner adapts to local informal institutions while the other partner adapts to global formal institutions. In our cases, the informal institutions constituted the norms surrounding African traditional religious beliefs, expectations about gifts and favours, and relationships with diverse stakeholders at the grassroots of community. Global formal institutions, on the other hand, were typified by the regulatory demands of the World Bank, environmental protection agencies and similar bodies. The synergies that develop from such strategic partnerships are ultimately important, not only at the early stages in helping AMNEs adapt to informal institutions, but also at later stages of reform in assisting EMNEs in the partnership to respond better to emerging formal institutions.

More broadly, we propose that what the MNEs in our study respond to are not institutional voids, but rather a constellation of institutions with generally different rules than those AMNEs from highly formally institutionalized contexts are familiar with. In light of the growing attractiveness of new frontier markets, like those in sub-Saharan Africa, for foreign direct investment, we suggest that these markets are increasingly emerging a more localized approach to institutions. Instead of seeking to further spend their meager resources to develop more sophisticated formal institutions after foreign templates, such countries have the strategic option to let institutions develop more organically, with a higher appreciation of informal institutions. This will, in turn, strengthen the strategic complementarity between informal and formal institutions. More importantly, it will provide a stronger context for the emergence and the nurturing of an African version of the free market economy. Since African economies are characterized by high rates of informality, informal institutions would be expected to have a significant influence under such circumstances.

Making the strategic institutional re-orientation in Africa even more intense is the growing entry of EMNEs from Asia, especially from China and India. Since these markets also have a strong history of informal institutions, experiences with these institutions in Africa are getting more complicated. We expect that hybrid experiences will emerge and influence what ultimately works or does not work in Africa. We also envisage that African countries will increasingly become more assertive in creating conditions in which local informal institutions get prioritized and are enabled to develop further.

The informal institutions at the bottom of the pyramid are particularly important, given that this accounts for the majority of Africa's population, and it is here that efforts to help people escape poverty have most impact. Consequently, MNEs involved in major projects located in the communities at bottom of the pyramid can respond to informal institutions in ways that either strategically support or undermine anti-poverty programs.

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Employing Non-Market Strategies in Sub-Saharan Africa

The reality of weak or different institutional environments requires that MNEs operating in Africa critically consider what strategies are being transferred from institutionally different contexts. In this section, we discuss the contradicting influence of transactional political strategies on subsidiary performance to what is obtainable in developed economies as indicated in previous research (Hadani & Schuler, 2013: Hillman, 2003).

Drawing on evidence from quantitative research surveys of senior executives of South African MNE operations across sub-Saharan Africa, we find that unlike in developed economies such as the United States, where transactional political strategies like lobbying and political action committee contributions are effectively part of the formally institutionalized system that requires that all firms declare their political expenditure policies, Africa has a different institutional environment. Our evidence suggests that transactional political strategies, employed as and when needed in Africa, do not necessarily provide competitive advantages for the firms (Hillman, Keim, & Schuler, 2004) in the long run. While they provide an entry point for the firm, to sustain performance, MNE subsidiaries need to develop relationships through constituency building, with stakeholders in the host environment. This may signal to MNEs to move away from such transactional political strategies to other relational-based ways of gaining influence, especially given the collectivist nature of sub-Sahara African societies, and the need to employ non-engaged approaches, like low visibility and rapid compliance to informal institutions in these environments.

Even though the use of transactional political strategies signifies a firm's buffering mechanism to proactively influence their environment, the evidence suggests that this does not apply in all contexts. Hillman and Hitt (1999) argue that within weak institutional environments, such transactional political strategies are more effective, the evidence suggests differently. Premised on our findings and corroborated by the positions of a number of scholars (Rajwani and Liedong, 2015; Mbalyohere, 2015; White, Hemphill, Joplin & Marsh, 2014), it can be argued that a transactional approach to political strategies is not a precursor to increased subsidiary performance, but rather MNEs need to exploit other political strategies (De Villa, Rajwani, Lawton, & Mellahi, 2018). For example, a relational strategy that thrives on a continuous maintenance of relationships, and constituency building may yield more positive results for MNEs. In Africa, where communal informal institutions abound, this remains important.

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Though similar to the relational motive of engaging in corporate social responsibility (CSR), relational political strategies are different, in the sense that unlike firms' use of CSR which seeks to influence the social environment and improve their triple bottom line, the application of relational political strategies seeks to, in a myriad of ways, influence the political environment by building its legitimacy within that environment. Such socio-political legitimacy is necessary to be able to adequately harness the MNEs political strategy as it relates to embeddedness in the environment.

Conclusions

This article re-examines the institutional voids perspective from the lens of MNEs operating across Africa. Drawing on qualitative evidence from the experience of six AMNE and EMNEs operating in Uganda and quantitative evidence from fifteen South African EMNEs operating across Africa, we propose that the use of the term to describe the institutional configuration of emerging markets proposes a judgement on contexts that are institutionally different from Western developed economies, which may limit our inclinations to actively interrogate these contexts to understand and co-evolve with them.

In reality, MNEs operating in Africa respond to a mix of informal and formal institutions that have evolved from a distinct history that accentuates the relevance of informal institutions in a manner that is distinctively different from other regions. Given this difference, MNEs need to critically consider what strategies can be transferred from institutionally different contexts; and what new capabilities are required to successfully operate across Africa.

The institutional environment in many African countries is still evolving, and informal institutions will continue to play a significant part in the rules of the game. We propose that strategic partnerships that incorporate non-market relational strategies that thrive on a continuous maintenance of relationships, and constituency building may yield more positive results for MNEs operating in Africa.

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Goriola Olusina Daniel (g.olusina-daniel@lboro.ac.uk) is the Coordinator of the Re:Africa Programme and Doctoral Researcher at Loughborough University's Institute for Innovation & Entrepreneurship. His research focuses on how MNEs navigate different institutional environments across Africa. He has also served as a consultant for private, public, and multilateral clients such as the African Development Bank.

Theresa Onaji-Benson (OnajiT@gibs.co.za) is the Manager, Centre for African Management and Markets and Doctoral Researcher at the Gordon Institute of Business Science, University of Pretoria, South Africa. Her research focuses on Corporate political strategy and non-market strategies of African MNEs.

Dr Charles Mbalyohere (Charles.Mbalyohere@open.ac.uk) is a Lecture in Strategic Management at the Faculty of Business and Law, The Open University Business School Dept for Strategy and Marketing. His research focuses on the Corporate Political Activity of MNEs operating in Africa, and has been published in leading international journals including the *Journal of World Business* and the *Journal of International Management*.