

## **EXAMINING THE IMPACT OF INSTITUTIONAL ENVIRONMENTS ON THE HRM PRACTICES OF MNCs AND THEIR OPERATION AND THE PATH DEPENDENCY BETWEEN DEVELOPED AND DEVELOPING COUNTRIES**

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### **ABSTRACT**

*Purpose: This paper seeks to examine and understand how country institutional environments differently determine the Human Resource Management (HRM) of Multinational Companies (MNCs) from developed countries operating in developing countries, as well as MNCs from developing countries operating in more advanced market economies.*

*Approach: It adopts a qualitative desk-based research to provide an extensive review of relevant literature. The review focuses predominantly on the following strands of literature: (1) Institutional theory and the environment; (2) HRM practices and systems; (3) Path dependency and MNCs within the context of developed and developing countries.*

*Findings: The effort reveals that a gap exists in elucidating the impact of institutional environments on the HRM practices of MNCs, between developed and developing countries. The last few decades has seen a plethora of research on the HRM practices of MNCs which originate from developed but operate in developing countries. Most of these, however, tend not to consider in an explicit way the dynamics of the HRM practices of MNCs from developing economies operating in more developed and different institutional contexts where path dependency is also a crucial root for both groups of MNCs and its competitive edges.*

*Research limitation: The findings are based solely of secondary data and is a theory based paper, therefore, it is limited in terms of empirical evidence.*

*Practical Implications: A more complete understanding of the dynamic influences of institutional environments allows MNCs both contexts to orient HRM practice in a way that aligns with key institutional features in order to more effectively fulfil wider organisational objectives.*

*Value: The paper contributes to the comparatively sparse literature in term of the impact of institutional environments on HRM practices in both developed and developing country contexts. In particular, it examines institutional influences on the HRM practices of MNCs from developing countries operating in developed contexts.*

**KEYWORDS:** *HRM Practices, Institutional Environment, Path Dependency, Multinational Companies, Developed and Developing Countries*

**JEL CLASSIFICATION:** *E02, F23, L2, M5, O15, O43*

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### **1. INTRODUCTION**

There exist a plethora of research and academic articles on HRM. However, the majority of research into this dynamic and critically important phenomenon continues to be concentrated on HRM in advanced industrial societies (Thite, 2013; Thite et al., 2012; Chang et al., 2009; Farley et al., 2004) with only a limited number of researchers concentrating on HRM practices in the context of developing countries (Miah & Bird, 2007; Miah & Wali, 2012). Giving the emergence and recent strong economic performance of developing countries such as China, India, as well as Brazil, We increasing see MNCs originating from these countries internationalising to more developed countries. HRM can represent a major constraint for these MNCs seeking to operate in distinctly different business environments with particular cultural and institutional mechanism (Myloni et al., 2003). When MNCs consider adopting HRM practices, they inevitable encounter the dual pressures of the home and host country institutional environments – both push and pull forces (Farley et al., 2004). These dual pressures have an effect on their HRM practice within both developing and developed countries (Hofstede, 1993; Miah & Bird, 2007). On the basis of forgoing discussion, this paper aims to redress the imbalance of analysis of HRM practices in developing and developed countries. It attempts to identify the major factors of the institutional environment that impact on key HRM practices. Emphasis is placed on key HRM practices including industrial relations, training and development and recruitment and selection, performance appraisal, compensation and

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remuneration, in developing and developed contexts (Budhwar & Debrah, 2001). The overriding goal is to understand the role of institutional environments differently determining HRM practices of MNCs originating from one context but operating in another. However, there will be a major focus on MNCs from developing countries operating in developed economy. The rest of the report is structured as follows: section 2 reviews the literature on institutional environment as a proxy for understating the constituents of the business environments. Section 3 focuses on the importance of the institutional environment and how MNCs operate. Section 4 focuses on the effective HRM practices. In addition, it offers depth knowledge and understanding for the management of MNCs as adopting integrative SIHRM practices across countries. Section 5 reveals summary and discussion of the paper regarding consideration of HRM practices and finally conclusion.

## 2. INSTITUTIONAL ENVIRONMENTS

The institutional environment is seen as a well-established and structured pattern of behavior in any given society. In broad brush terms, it incorporates political institutions which are aligned to the national structure of policymaking, regulation and adjudication; economic institutions such as the structure of economic systems; and socio-cultural institutions such as informal or unwritten social norms, customs and values (Henisz, 2000; North, 1990). These distinct patterns of social and economic organizations profoundly influence the contexts of developed and developing countries (Brewster & Mayrhofer, 2012).

According to North (1991, p.97), 'Institutions are the humanly devised constraints that structure political, economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws, property rights)'. Similarly, Scott (1995, p.33) defines institutions as the 'regulative, normative, and cognitive structures and activities that provide stability and meaning to social behaviour'. Institutions are characterised by two dimensions – formal and informal. Formal institutions are more visible and tangible, such as the legal system. Informal institutions on the other hand are less visible and have fewer tangible representations, they exist at the deeper level of culture but are precisely interconnected to shape the formal (Redding, 2003). Together they act to codify the behaviour of firms and including MNCs operating in any business environment. All transactions are enacted in these specific social settings (Hollingsworth & Boyer, 1997) and organizations are pressured to adhere to specific formal rules as well as informal social norms in order to gain legitimacy and achieve efficiency (DiMaggio & Powell, 1983) through contexts of how firms play games differently on the basis of diverse institutional environments across countries.

This paper is, however, inclined to treat firms as homogeneous in their characteristics and responses to unambiguous configurations of institutional environments. Nonetheless, a key development in HRM practices, which have not been rationalized, is recognition of the policies and performance implications of resource and capability diversity across firms (Henisz & Delios, 2000) in developed and developing countries. This paper attempts to understand the strategies and performance of firms in term of competitive edges, these being the reflection of context and company's resources and capabilities. These represent the heterogeneity of firms among countries (Henisz & Delios, 2000) and how MNCs with diverse sets of resources and capabilities respond to variance in the institutional environment and how these resource and capabilities are codified by the influence of institutional environments in developing and developed contexts. For instance, there are three main institutions in a country, these being the national education and training system, the system of work organization and the national industrial relationship system, which are considered as determining HRM practices in the particular country (Maurice et al. 1979; Lam, 1996). In addition, employees' particular skills and qualifications, as well as management approaches, are characterized by institutional environments including its culture and institutions (Brewster et al., 2011). Culture is, however, the deep layer foundation of institutional environments, which is intangibly involved in codifying acts, norms, and beliefs in society (Hofsted, 1984), while institutions are the top layer of institutional environments that tangibly enforce or influence society members to perform institutional acts assuredly (North, 1990). There is, thus, the need to study and understand institutional environments, which are significantly interconnected with the issues of culture. In addition, institutions and culture differently determine HRM practices between developed and developing countries. There are noticeably more cultural influences in a developing economy, shaping its HRM practice. While, Institutions strongly determine the character of HRM practice in developed countries, due to the incremental change of culture and the high enforcement mechanism of institutions. Generally, developed countries are seen as being lower as regards cultural context than in developing economies (Hofsted, 1984). In such circumstances, the High-context cultures of developing countries are often significantly more traditional, as well as being not easy to change, that the context can remain stable over generations, in order to preserve their relationships among members of society. Contrarily, the low-context cultures of a developed economy have a tendency to be more changeable due to the context changing with dynamic generations. The relationships of members in a developed society are generally more impersonal, verbal, explicit, directed, as well as linear and task-focused (Hall, 2000). Importantly, institution and culture have a strong impact

on HRM practices in developed and developing countries. As a result, this study inclines to offer an in-depth understanding of culture, and the relationship of informal as well as formal constraints between developed and developing countries and how this impacts on the HRM practices of MNCs.

### **2.1. Informal institutions**

Informal institutions are enduring systems of shared meanings and collective understandings that while not codified into documented rules and standards reflect a socially constructed reality that forms cohesion and coordination among members of a society (Scott, 2005). In this sense, culture is an essential reflection of a country's informal institution as representing un-codified shared values (North, 1990; Peng et al., 2008). Informal rules are those traditions, customs, moral values, religious beliefs and all other norms of behaviour that have survived the test of time (Hofstede, 1980). These implicit rules are often referred to as the old ethos, the hand of the past or the carriers of history (North, 1990). They embody and represent the prevailing perceptions and faiths regarding the world, the collected wisdom of the past and a current set of values. Informal institutions are integrated into inherent customs, termed as culture. Although informal institutions change incrementally as culture is transmitted from one dimension to another and from one generation to the next (Rohner, 1984). They are maintained from one generation to another through various diffusion mechanisms such as imitation, oral tradition, and teaching (Peng et al., 2008). North (1990) goes as far as suggesting that culture be taken as a substitute element for informal institutions. While this can be a useful conception, in order to fully appreciate how these factors impact on the HRM practices of MNCs, it is important to question the relationship between culture and institutions, something that the next section attempts to address.

#### **2.1.1. Culture**

Culture is constituted of 'created and learned standards for perception, cognition, judgment or behaviour shared by members of a certain group' (Fu et al., 2004: 288). It is embedded in a nation's heritage (Greif, 1994), is durable, long-lasting and relatively stable, with only small incremental changes occurring over time. Culture represents societal members' norms and values, defining not only what actions are ethically accepted and desired (Reed, 1996) but also providing a platform for shared understanding of such expectations (Tsui, Nifadkar, & Ou, 2007). Although culture is tacitly understood and considered by societal members, this knowledge is generally acquired through the process of socialization (Greif, 1994). One of the more influential pieces of research in relation to national culture is the work of Hofstede (1980; 2001). Hofstede's framework is widely used by researchers and practitioners in the field of intercultural management. He proposes that differences in national responses to key considerations, including HRM practices, could be explained by four main dimensions: power distance, uncertainty avoidance, individualism and masculinity. Although some scholars such as (Bhagat & McQuaid 1982; Olie, 1995) have been critical as this somewhat simple way of measuring national culture, it does provide a useful starting point to understanding the dynamic influence of how people and by extension organisation in particular countries orient and enact their practices and behaviours. In this paper, rather than going through the entire gamut (including recent extensions) of Hofstede's dimensions, emphasis is placed on just two - power distance and individualism versus collectivism. These two dimensions lend themselves particularly well to understanding the particular institutional environments and issues observed in developed and developing societies' and their influence on the HRM practices of firms in both contexts.

#### **2.1.2. Collectivism versus Individualism**

Vertical collectivists perceive themselves as an aspect of an in-group but members of the in-group are different in terms of status. These cultures are characterized by patterns of social relationships that subscribe to the notion of communal sharing based around the requirements of key authority figures or in the distribution of resources according to rank and position. As a result, it typically refers to a social system that does not represent the values of individual freedom or equity. From this perspective inequality is the accepted norm, as serving and sacrificing for the in-group feature prominently and individuals and organizations have to operate from within this framework (Pereaux, n.d). For example, the majority of African and Asian developing countries are likely to see a positive attribute regarding inequality between older and younger members. Thus, older people are respected and put in position of authority and power. This can make it culturally difficult for young and talented managers to give orders or criticise older members of their organisation who are perceived to be more experienced and hence beyond rebuke (Branine, 2011). On the other hand, in many Western and North American developed countries, individualism seems to be the conventional practice. Here the self is autonomous and people are generally conceived as equals. These cultures are considered as forming the pattern of social behaviour that emphasizes equity in resources-sharing, according to contribution and hence the distribution of resources equally among members (Pereaux, n.d). For example, in developed countries such

as the UK and Ireland, the contribution of individual employees could be differentiated by the objective of performance measures (Branine, 2011). Table 1 shows individualism and power distance rankings between developed and developing countries.

**Table 1: Individualism and power distance index rankings for Hofstede indices**

Individualism		Individualism		Power distance		Power distance	
Score	Country	Score	Country	Score	Country	Score	Country
1	The USA	21	India	10	India	38	The USA
2	Australia	27	Brazil	14	Brazil	41	Australia
3	Great Britain	37	Hong Kong	15	Hong Kong	44	Great Britain

*Adapted from: Hofstede (1991)*

### 2.1.3. Power distance

Power distance relates to the extent to which societies accept that power in institutions and organisations is and should be distributed unequally. In organisational terms, this relates to the centralisation of authority and the degree of autocratic leadership. Societies with ‘high power distance’ are a reflection of hierarchical organisations where it is accepted as being appropriate that the superior is seen to be more powerful and incessantly dominating of subordinates. From a HR perspective this has implication on how organisations in these contexts are managed and operated. Many developing countries including the Philippines, India, China, [Bangladesh] and Nigeria to mention but a few are seen as high power distance countries. In contrast, developed countries such as the United Kingdom, Sweden and New Zealand as seen as low power distance countries who favour a more democratic style of management and flatter organisational structures (Harris et al., 2003) which has a different set of implications on how key resources including HR are managed and operated. For instance, with less of a gap between higher level manager and their subordinates, subordinates are more privileged or encouraged to exchange knowledge, experiences and skills. This can contribute to increasing the overall engagement and contribution to achieving organisational objectives (MacMillan, 2012) as compared to societies with high power distance (Harris et al., 2003). The argument here is that the distribution of power from management to subordinate levels might be more effective in increasing employees’ individual performance and productivity that enhances the competitiveness of firms and countries.

This question raises more attention regarding the relationship between culture and its two important components. They are collectivism versus individualism and power distance, which have direct and indirect impact on employees’ individual motivation. This is a significant source of employees’ individual performance relating to the firm’s competitiveness and country’s productivity.

### 2.1.4. Individual motivation

The need for understanding individual motivation is linked in specific national-level cultures and are affected by and express their cultural orientation through both ‘cognitive’ (what is perceived and interpreted) and ‘motivational’ (What is desired) individual-level mechanisms (Thomas, 2000). Motivational is the source of intrinsic, which can motivate people to achieve the high performance for firm or society for long-term sustainability, while extrinsic motivation might be for short-term processes such as the carrot and stick (McGregor, 1960). Although both approaches of motivation have micro-level implications for any management of a firm, this is also related into the macro-level of society, with formal and informal institutional environments. This might give a more competitive edge, by considering the following functions: autonomy, mastery, and purpose. ‘*Autonomy*: the urge to direct our own lives. *Mastery*: the desire to get better and be better at something that matters. *Purpose*: the yearning to do what we do in the service of something larger than ourselves’ (Pink, 2009). Essentially, institutional environments are the bridge between a firm and its employees, as how they perceive their style of management systems as well as how they will apply it, in order to offer employees’ *autonomy, mastery, purpose*.

Each individual will be distinguished in the stage to which characteristics of their culture are influential, however, in general there is more similarity within cultural groups than between cultures. Firstly, from a cognitive perspective, culturally different individuals are determined to learn a different set of values, which develop into cognitive frameworks (mental programmes) that are used to help organise and process information about situations and events such as human resource management practices. From the motivational point of view, essentially, human resource practices are connected to how people view themselves and their relationship to others. It makes a platform where employees are managed to interact with motivational mechanisms according to their own cultural root. Everyone values and evaluates activities according to the degree to which the activities contribute to personal self-worth and well-being (Erez & Earley, 1993). This motivation reflects a positive self-image, which is probably universal. In addition, a positive self-view is determined by the level to which individuals understand themselves as tied to or separate from others, as learned in their culture. The stage at which a policy or practices has value to the individual or to others with whom they feel connected can be seen as more or less applicable in diverse cultures, for instance,

understanding of MNCs in cognitive way, which might be best suited to a geocentric approach in the selection of expatriates' employees or HRM practices, however, the majority of MNCs are engaged in practicing their home approaches in a normative way that raises more conflict when they are in host contexts because they may ignore the understanding of the host's norms and its culture. It is, therefore, important that firms should consider, '*where from are they*', '*where they are*', '*what surrounding them*' (Kluckhohn & Strodtbeck, 1996). In this sense, MNCs obviously ponder their originations such as '*where from*'; they should consider its host contexts such as '*where they are*'; they should also consider the global impacts on the scenario of home and host, including the global perspective. '*what surrounding them*'. In this way, the management of MNCs should also consider or understand the impact of formal institutions.

## **2.2. Formal institutions**

Formal institutions embody structures of codified and explicit rules and standards that characterise the interaction among societal members (North, 1990), in essence, formal rules are constituted by statutes, common law, and other governmental regulations. They generally determine the political system (i.e., the governance structure and individual rights), the economic system (i.e., property rights and contracts) and the enforcement system (i.e., the judiciary and the police). Governmental authorities enforce formal rules by means of sanctions such as fines, imprisonment and execution (Pereaux, n.d). In formal institutions, political directions lead to economic system, although the causality runs both ways. This is property rights whereby individual contracts are enforced and specified on the basis of political decision making. In addition, the structure of economic interests significantly influences the political system (North, 1990). Three key systems of formal institutions are discussed below as follows:

### **2.2.1. Political system**

This is the way of authority to set up particular constitutions, as how country and its firms and including citizens can perform better and better (North, 1990). In this way, formal power is formed on the basis of country's compulsory regulations, formal public policies as well as court rulings including industrial or employment laws. For example, organizations are also engaged with affirmative action officers to fend off allegations of discrimination, according to the level of employment legislations (Meyer et al., 1981).

### **2.2.2. Economy system**

The higher level management of firms in liberal market economies (LMEs) in the USA and the UK have unilateral control over the firm, including substantial freedom to hire and fire. There is no obligation in firm to form representative bodies for employees such as works councils; and trade unions normally have no sufficient power, as compare to coordinate market economies (CMEs) in German (Hall & Soskice, 2001). While, Indian's market economy namely practices LMEs but strongly her trade unions are interlocked CMEs approaches (Budhwar & Debrah, 2001). In this case, Chinese approaches are also integrated with both ways, Chinese history between 1951 and 1987, labour unions are tightly restricted; this means that the right to strike was prohibited by law under martial law (Wade, 1990). In addition, majority market economies of developing countries' such as Bangladesh, Nigeria, and Kenya might be historically rooted from CMEs. In addition, they have been shifting to liberal market economy after Second World War by the impact of world institutions and advanced market economies (Budhwar & Debrah, 2001). However, they are neither in LMEs nor in CMEs. These market economies are significantly linked to political system, which codify countries' skills labour forces and the scenario of HRM practices in their firms.

In addition, CMEs in German encourage participating with vocational training, which is a joint venture between employer and the state. They also involve a combination of on-the job training and theoretical feedback from the academic knowledge (Dickmann, 2003). The case of UK, formal institutions focus on general skills because companies are reluctant to invest in apprenticeship schemes imparting industry-specific skills where there is a lack of particular skills for workers in job sectors. Consequently, a labour force is well equipped with general skills, especially matched to job growth in the service sector, for instance, Financial Services sectors in the UK (Hall & Soskice, 2001).

### **2.2.3. Enforcement system**

This is an obligation mechanism and viable impersonal exchange as how country's judiciary and the police sectors act perfectly, in order to secure property rights and distributing resource equally to its citizens. In addition, enforcement mechanisms act behind firms and its employees, in order to increase their overall performance (North, 1990). Organizations are precisely obliged to consider the government required compliance with guidelines matters, these being labour relations, taxation, as well as health and safety according to formal constrains of developed world (Dowling et al., 1999).while, 'In developed countries, have effective judicial systems include well-specified bodies of law and agents. In contrast, enforcement in Third World economies is uncertain not only because of ambiguity of legal doctrine, but also because of uncertainty with respect to behaviour of the agent' (North, 1990, p.59).

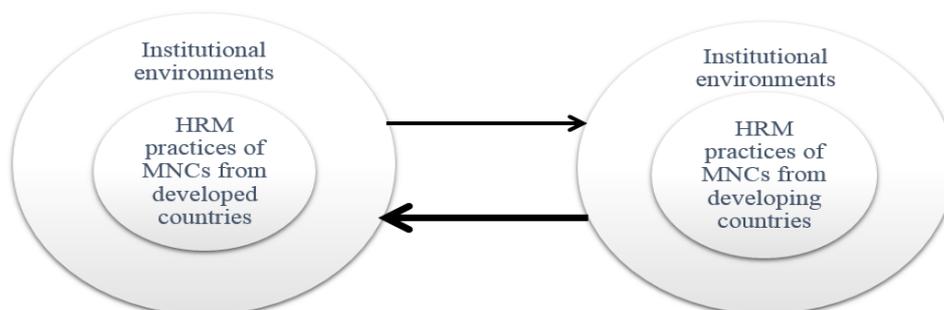
As a result, formal institutions always seek to improve citizens' potentials as how they will perform better and better. In this way, formal institutions are specially made more malleable, in that they are a product of human agency (DiMaggio, 1988). As a result, formal institutions seek to solve problems in society. These solutions are continuously

diffused until they crystallize into established rules and standards, which influence subsequent behaviour (Tolbert & Zucker, 1996). Apparently, formal institutions in society conform to these rules and standards are granted and routinized for implementing and practising, they are also reproduced in subsequent time periods (Powell, 1991) and the rules of formal institutions are accepted and recognised by the members of society (Witt & Redding, 2009). Thus, as DiMaggio (1988) defines, formal institutions represent the motivation and collective actions in the member of society, to identify solutions to problems in society. For instance, ‘the first is a familiar story in U.S. economic history- the growth of the economy in the nineteenth century. The basic institutional framework that had evolved by the beginning of that century (the constitution and the Northwest Ordinance, as well as norms of behaviour rewarding hard work) broadly induce the development of economic and political organisations (Congress, local political bodies, family farms, merchant houses, and shipping firms), whose maximising activities resulted in increased productivity and economic growth’ (North, 1990. pp.8). As a consequence of increasing productivity by the reward mechanism, the facilities rooted in HRM practices were introduced, and then later ‘the significant of economic and social context in shaping and reshaping HRM arena; the links between HRM and performance, new organisational forms and relationships, and the importance of knowledge’ management and learning in the workplace in late 1990s’ (Bratton, et al., 2007, p.446). This discussion refers that MNCs are significantly functioned according to the act of country’s formal institutions, which come together with informal institution as defining important of institutional environments.

### 3. IMPORTANT OF INSTITUTIONAL ENVIRONMENTS

The operation of MNCs from developed countries to developing countries is fundamentally problematical, this difficulty being potentially more prominent when MNCs from developing countries operate in advance of market economies (Thite, 2013). This is primarily because these MNCs are engaged in practicing HRM policies across national boundaries, involving different institutional environments (Scullion et al., 2007). MNCs from developing contexts are likely to involve smaller structure, with considerably less resources and international experience and expertise, compared to their counterparts in developed countries (Hussain & Jian, 1999; Lall, 1983; Wells, 1983). The key competitive advantages for these MNCs of developing countries are access to the advanced-level of economies with a vast pool of low-cost resources, such as production workers, engineers and natural resources (Engardio et al., 2006). The early stage of internationalization, with inadequate experience in MNCs originating from developing countries, is noticeably different regarding HRM practices due to the significantly different institutional environment (Hofstede, 2007). As a result, it is crucial for the management of MNCs to understand the influence of institutional environments on HRM practices, as understanding societal contexts or institutional environments of different countries provide sources of competitive advantage for both developed and developing country firms and contexts.

The rapid progress of some developing countries has resulted in increased foreign direct investment (FDI), that coming from the developed parts of the world; ‘FDI flows to developing economies reached a new high of \$778 billion, accounting for 54 per cent of global inflows’ (United Nations, 2014.p.2). While, investors from developing and transitional economies continued their expansion abroad and in 2013, ‘these economies accounted for 39 per cent of world outflows, 15 years earlier, their share was only 7 per cent’ (United Nations, 2014, p.5); such development demands efficient HRM practices. This is somewhat counterintuitive, given the recent impact of globalization, which emphasizes inter-dependency among countries. In addition, the shift of economic power from developed to the developing countries is significant, due to massive market, both in terms of natural and human resources, lower labor costs and production sites for Industrial MNCs (Austin, 1990; Kanungo & Jaeger, 1990; Napier & Vu, 1998), while developing markets are also more likely to expand their MNCs within industrial countries, due to reach or understand the existing of sophisticated technology and management experience, from their counterparts in developed countries.



**Figure 1.1: Institution determines HRM practices of MNCs in developing and developed countries**

*Source: Hossain, Md. (2015)*

It is of value to establish whether and how countries' institutional environments and culture, decision-making and control of subsidiaries in developing MNCs are different than their counterparts established in developed MNCs, due to differences in national institutions, culture, economic performance, resources and experience as global players (Dixon et al., 2010). In addition, it is also important to know how those global players are likely to be engaged with HRM practices within the firm, according to their own resources, and experiences and how they are confronted with different contexts, and with different institutional environments. Global players as firms and their performance are not single phenomenon, such as firms' capital, technology, resource, as well as experience those are rooted from its countries' history and path dependency.

### **3.1. Path dependency**

Thus, path dependency matters because 'actors are hemmed in by existing institutions and structures that channel them along established policy paths' (Wilsford, 1994, p. 251). In this case, history matters in understanding firms, as how and why some MNCs are performing better than others. In addition, path dependency represents the importance of firms and its inheritance over choice on the basis of country's institutional action (Rose, 1991). For instance, IBM maintain software leadership by essences of the United States, then the choice of technology according to firms' path-dependencies (Peter, 1995).

In this way, history matters. It matters not just because we can learn from the past, but because the present and the future are connected to the past by the continuity of a society's institutions,' (North, 1990: vii), historically, formal institutions significantly influence on countries' economies variable across nations. In this way, it is very difficult to identify today's choices and involve them in the modelling of economic performance, especially where present performances are linked, according to the incremental evolution of institutions. For example, in England, Parliament created the Bank of England and a fiscal system in which expenditures were interconnected or tied to tax revenues. As a consequences, financial revolution not only flourished under the government, on a sound financial root but set the ground for the progress of the private capital market, such as more secure property rights, the decline of mercantilist restrictions, which exerted expanding opportunities for firms in local and international markets (North, 1990). Contrarily, Khanna and Palepu (1997, 2000a, 2000b) observe that in many developing economies, there are more social constraints but also a lack of the key institutions necessary or rules for an organisation to function profitably. The early stage of a firm originating from developing country, with no adequate links with government banks or other financing institutions, will generally face extreme difficulty in raising capital, in order to get foreign investment or export requirement needs.

Thus, the dependency theory or path dependency arises more significantly in this question, as to why some countries and their firms are more dependent than others, according to the level of resources, state capacity, technology and power politics (North, 1990). This might involve exogenous shocks, such as increasing FDI investment and international trade, capital flows, as well as competition, which exert pressure on national economies to adapt their institutions as way of path dependency, in order to compete effectively and efficiently (Hancke et al., 2005). In this sense, developing countries are likely to rely on institutional isomorphic change by the pressure of international factors, such as global institutions and advanced economies. For instance, the influence of liberalism on Indonesia was bailed out in the mid-nineteen hundreds because the IMF imposed several conditions on Indonesia (Donlagic & Amra, 2010). It has also been used for instance, to illustrate the development of economic institutions in China (Guthrie, 1999) and in post-communist Europe (Stark & Bruszt, 1998) as well as in the advanced capitalist countries (North, 1990). Thus, dependency is not only rooted by the national institutional environments, it is also influenced by the world institutions as convergence effects.

Nonetheless, national culture and institutions, such as management style, meaning of work and values, social process, norms and beliefs as well as national labour laws, trade unions politics, labour markets (Budhwar & Debrah, 2001) including cultural heterogeneous across countries and the level of resources in countries, such as leadership, education, skills labours forces, and internal capacities of the 12 pillars of economics system of countries are imposed, to classify two streams of contexts, as developed and developing (Sala-i-Martin et al., 2010a) including the scenarios of the enforcement mechanism that is evident in divergent HRM practices, from one society to another. As to how society's internal players act and perform on the basis of country's enforcement mechanisms.

### **3.2. The enforcement mechanism versus informal constrains**

In addition, the most crucial factor is the incentive structure of society on the basis of enforcement mechanism, which determines the performance characteristics of a society. This involves significant interplay in a society in being more productive, creative and competitive (North, 1990). In a limited access society or developing economy, however, this is hindered by some of elite groups who are more powerful in economic, political organisations and firms, for instance: high power distance (Hofstede, 1980); autocratic leadership; hierarchical organisational systems (Bratton, et al., 2007). This is privilege of control that gives them more monopoly and rent seeking power in society; as to how game will be played; this domination of power minimises economic and political competition, including the growth of productivity

(North, 1990). In an open access society or advanced industrialised economy, however, there is a key feature of competition in both political and economic markets, which is achieved by establishing an enforcement mechanism. A limited access society is typically based on personal knowledge and personal exchange, according to relationships with persons, thus, it is difficult to implement an enforcement mechanism, such as the actions of judicial and police sectors (North, 1990).

Contrarily, an open access society is significantly concerned with impersonal relationships, including verbal, explicit and directed, as well as linear and task-focused (Hall, 2000), securing impersonal and well defined property rights, that normally treat and distribute resources to everybody equally (North, 1990), those relating to the engagement of transactions cost is more high in developing economy. Indeed, the low transaction cost is interconnected with effective judiciary and enforcement system, which gives a strong encouragement to exchange trade and economic growth efficiently and effectively (North, 1990). The enforcement mechanism offers a very crucial competitive edge for any context. This mechanism signifies a big gap between developed and developing countries. In addition, this is also privilege for a developed context, as the way of enforcement being implemented in their society (North, 1990). On the one hand, this explores opportunities for MNCs of developed countries, sustaining the privilege of 'push forces' toward subsidiaries. On the other hand, this creates conflicts between developed and developing contexts because of hard power or ethnocentric approaches (home countries' approaches) that typically would be controversial, when they only consider 'where from they are', ignore where they are; MNCs should also consider, 'where they are', 'what surrounding them' (Kluckhohn & Strodtbeck, 1961). In this case, soft power or integrative approach might be effective as an attraction ('pull forces'), with aspects which are formally and informally accepted for people of society in both contexts. Through the board discussion, this study inclined to understand and investigate about both contextual institutional environments, what the relationships, and how these impact on HRM practices of MNCs, now this turns to discuss regarding effective HRM practices of MNCs.

#### 4. EFFECTIVE HRM PRACTICES

As a consequence, MNCs face a significant challenge, as to how and which HRM practice should be transferred from the developed to the context of developing countries (Bratton & Gold, 2012), as well as from developing to developed contexts. Principally, there is a major concentration of MNCs practicing different HRM approaches in different countries, identifying by their contextual differentiations (Taylor et al., 1996). Bartlett and Ghoshal (1989) argue that MNCs are increasingly expanding across the globe and thus, MNCs should consider both global integration and including locals in their response. Essentially, strategic international human resource management (SIHRM) might be the 'best' fitted in adapting with global affiliates, as regards the three generic HR practices, which are adaptive, exportive and integrative:



**Figure 1.2 HRM in global affiliates**

*Adapted from: Taylor et al., (1996. p. 966),*

##### 4.1. Adaptive

Firstly, 'adaptive', SIHRM approach emphasises adopting local HR practices, by staffing with knowledgeable and experienced local HR experts. This apparently considers differentiation or divergence approach, rather than more integration or 'cross-vergence'. An adaptive SIHRM is involved in copying with HRM practices that are being used locally, by staffing with competent HR experts or professionals who are significantly experienced regarding the local context. An adaptive SIHRM emphasises, 'low internal consistency with the rest of the firm and high external consistency with the local environment', (Taylor et al., 1996. p. 966). Primarily, this approach is consistent with a polycentric approach, (Heenan & Perlmutter, 1979). The management of MNCs utilizing an adaptive SIHRM, is

locally based. In this case, developing MNCs might prefer this approach, as compared to the developed one. For instance, a new breed of Chinese and Indian multinational attempts to adapt with locally based conditions in a developed context, in order to, 'build their competitive ways such as ability to achieving Western managing style, ability to adopting with sophisticated technology, and understanding industrial market's formal and informal constrains. Thus, at early stage, the multinational corporations of developing countries generally derive their advantages from service rather than technological innovations and manufacturing MNCs that straddle a low cost and medium technology position' (Jonsson, 2008, p.6). Resulting from institutional environments, the impact on MNCs is in originating scenarios conveying their competitive capacity, such as human and natural resources, technology, management styles, as well as including informal and formal constraints (Budhwar & Debrah, 2001; North, 1990). There appears to be no major preference in MNCs in transferring HRM practices, either from the home countries to its overseas affiliates or between overseas affiliates (Taylor et al., 1996). Foreign affiliates, however, tend to achieve some experience from the host country's institutional environments but they attempt to contribute considerably to their home's stock of resources which in turn, strengthens the MNC, in order to reduce risk and uncertainty. If it is not then the problem of setting up operation in a host context with a very different institutional environment has its high transactions cost (Victoria & Dipak, 2014; North, 1990). For example, the regulation of context such as equality, work permit restrictions in many Western countries limit, even in developing countries such as in Malaysia, where the law protects ethnic groups and they practice affirmative action regarding the recruitment and training of native Malays (Branine, 2011).

#### **4.2. Exportive**

Secondly, the '*exportive*', approach implies replicating the MNCs' home-based HR approaches in term of convergence, which usually emphasises transferring the parent firm's HRM practice to its foreign affiliates, (Heenan & Perlmutter, 1979). This approach normally indicates that there will be, 'high internal consistency and low external consistency', (Taylor et al., 1996. p. 966). An exportive approach is similarly consistent with the ethnocentric approach. For instance, there is evidence that the Japanese as well as in Germany and even some UK and USA companies significantly try to replicate their own homogeneous institutional practices, often attempting to adopt them when operating overseas (Yeh, 1991). This might, however, not be effective and an efficient approach for MNCs, as indicated in the example of organisational case in Nigeria, that of, 'all BP's expatriate staff will be able to leave the country by the end of the month. There was no indication that Nigeria planned to take similar action against Shell. The government says that other foreign oil companies have nothing to fear as long as they respect Nigeria's policies and the feelings of its people', (Oil & Gas Journal, 1979). Another notable example was the case of BP (British petroleum), which tends to apply ethnocentric recruitment's approaches such as, 'foreign companies working in Azerbaijan ignore our laws. They prefer to build relations with their employees on the basis of the laws of their countries. For instance, BP is governed by British laws, which don't always dovetail with ours', (Baku, 2004). It is not only conflict between home and host, it is also expensive matters to staffing PCNs as providing continuous feedbacks, these being cross-culture training and development, compensations, including expatriates individual and family issues such as child education, supporting spouse to adopt with local culture and consideration of security issues (Dowling et al., 1999).

#### **4.3. Integrative**

Thirdly, the '*Integrative*', SIHRM approach, significantly recommends transferring the 'best' HR practices, which are essentially suited to any of the organisation's affiliates worldwide, as a global or international system [which is called 'cross-vergence'] in HR practices, (Bratton and Gold, 2012). By the recommendation of (Heenan & Perlmutter, 1979), it is indicated that the integrative approach might be consistent with a geocentric approach. The advantage of integrative SIHRM is that it combines both characteristics of the parent firm's HRM practices, with those of its foreign affiliates. Integrative SIHRM oriented organisations are those that depend on, 'high internal consistency and moderate external consistency', (Taylor et al., 1996. p. 967). In this way, HRM practices might also consider coordinating applicable policies of compensation that effectively make a balance between the needs and expectations of HCNs (Host country nationals), PCNs (Parent country nationals) and TCNs (Third country nationals). Compensation is a critical issue in the success or failure of foreign assignments within developed and developing countries. Generally, this differs according to the level of institutional environments of countries, such as geography, culture, politics, and economics and including location of city, policy of local company, inflation and taxation (Shen, 2005). This can also create a balance between 'internally equitable' and 'externally competitive', in order to sustain and attract essential people (Dowling et al. 1999; Logger et al. 1995). In addition, effective HRM of MNCs adequately considers the issue of cross-national training that potentially engages with the basis of host-contextual issues, as well as home factors, such as socio-cultural, legal, political and economic aspects (Shen & Darby, 2004) including Michael Porter's (1980) PEST (politics, economics, social as well as technological) factors. One of the major challenges for MNCs is suitably managing international performance appraisal across PCN, TCN, as well as HCN (Shen, 2005). Thus, in the UK, employees' performance can be measured by individual achievement, while in Africa, employees' performance can

be measured by age and experience (Kamoch et al., 2004). In Scandinavian countries, the collectivism cultural approach encourage becoming a member of trade union, where most disputes are settled by trade union’s intervention. Contrarily, in the USA, organisations are anti-trade union, while African and Asian trade unions are very weak in protecting employees’ rights (Jacson, 2004). As a consequence, the impact of effective HRM practice upon integrative SIHRM, has led to reaching the intended goal of MNCs. Principally, they moved toward an approach that is more balanced between global integration and local and home responsiveness, as integrative SIHRM (Bartlett & Ghoshal, 1989).

This review indicates that countries’ institutional environments represent their home stock of resources either human or capital including technology, which turn into either strengths or weaknesses for MNCs. However, there are more contradictions between home and host contexts. In this situation, MNCs are typically influenced and imposed to accept particular HRM practices by the impact of both contextual and global issues. MNCs and its home and host contexts, ‘not only do they have different cultures, but they also operate in different institutional environments-with differently educated and skilled workforces, in different economic situations, with different labour laws, trade union arrangements, government support or control, and so on’ (Brewster, et al., 2011, p. 71). However, they cannot change or cannot ignore the impact of institutional environments across countries rather they can adopt effective HRM practices in their firms according to the demand of contexts and its citizens so that they can sustain competitive edges in foreign affiliates.

**5. SUMMARY AND DISCUSSION**

HRM practices of MNCs are not only internal phenomena as what the firm prefers to apply for its operation, they are also external consideration matters. The purpose of SIHRM practices is to enable the firm as being success globally. Broadly, this study has attempted to explore a comprehensive discussion on the understanding of world institutions. They include WTO, IMF, ILO and its impact such as the trends of liberalism and FDI investment to developing countries, as well as the state policy and its market economy and those impact on HRM practices across countries. The paper has also discussed how countries institutional environments impact on HRM practices of MNCs and its implication with SIHRM across contexts. Table 2 shows consideration of HRM practices.

**Table 2: the consideration HRM practices in developed and developing countries**

	<i>MNCs of developing countries operating in developed context</i>	<i>MNCs of developed countries operating in developing context</i>
<i>(a) ‘where from they are’, (HRM practices: Staffing, Training and development, Compensations, and Industrial relations)</i>	<i>The history of economic and market economy, political systems including rules, regulation, judicial, trade unions and enforcement mechanisms, educational, technology, informal constrains</i>	<i>The history of economic and market economy, political systems including rules, regulation, judicial, trade unions and enforcement mechanisms, educational, technology, informal constrains</i>
<i>(b) ‘where they are’, (HRM practices: Staffing, Training and development, Compensations, and Industrial relations)</i>	<i>Market economy, political systems including rules, regulation, judicial and enforcement mechanisms, educational, technology, informal constrains</i>	<i>Market economy, political systems including rules, regulation, judicial and enforcement mechanisms, educational, technology, informal constrains</i>
<i>(c) ‘what surrounding them’, (HRM practices: Staffing, Training and development, Compensations, and Industrial relations)</i>	<i>World’s institutions (WTO,IMF, and ILO.), International HRM practices as SIHRM</i>	<i>World’s institutions (WTO,IMF, and ILO), International HRM practices as SIHRM</i>

*Adapted from: Kluckhohn & Strodtbeck, (1961); and Budhwar & Debrah, (2001)*

According to (Dowling et al., 1999, p.4), ‘In our view, the complexity operating in different countries and employing different national categories of workers is a key variable’, this indicates that the relationship between institutional environments and expatriates’ employees varies their performance rather than HRM activities. SIHRM can offer an

effective and efficiency direction to the implication of HRM practice for MNCs, in order to maximize its' competitiveness.

The issues of technology included skills, and competences are integrated with the root of countries' educational system and industrial relations on the basis of formal constrains, for instance a comparison between advanced country as the German and developing country as India, china, and Bangladesh. In this case, it can be classified that the root of Germany education is based on intensive technological and vocational training related education system by consulting trade union and employers' representatives including government's mutual intervention that produce skills workforce force (Dickmann, 2003). In contrast, developing MNCs have less capability to adopt sophisticated technology in their firm and to their employees' expatriates because the impact of institutional environments including informal obstacles and formal immaturity within their educational sectors, market economy, and political systems (Thite, 2013; Thite et al., 2012). In this case, at macro level a key contextual factor, has significant impact on the micro level factors, relating to the firm and those are usually connected around high performance practices including contextual and cultural influences, and it is also management wish to develop global competitive cadre. For example, the role of state and political system imposes to turn the structure of educational and labour market norms, as well as vocational educational training, those are functioned by the institutional pressure in order to form qualified and skills labour forces within a context (Brewster, et al., 2011).

As a result, when MNCs from developing contexts operating within developed economy, they need to adopt integrative staffing policy and match continuous training and development, in order to adopt increasing changes of technology at developed market. It is also essential to sustain scarcity of technological skilled people in the firm and would require applying the effective compensation strategy on the basis of SIHRM so that they can attract and sustain highly competences' applicants as leading competitive edges for MNCs. In this case, SIHRM based training programmes are very crucial matter in order to adopt with the continuous technological improvement and understand of the host-government and trade union's rules, regulations, as well as culture issues; it is also crucial for management of MNCs to consider compensation policy, which is not as 'a uniform compensation policy and taxed by one national government' (Dowling et. al., 1999, p.7). In the international contexts where diverse nationalities work together in a firm. Thus, if employees individually or nationally feel that discrimination occurring against them, it impacts on MNCs' overall performance, it means dissatisfaction, demotivation, and low productivity those leading to lower efficiency and competitiveness of the firm. Most of the cases, the employees' motivation in MNCs of developing country go down when they operating in developed context because of employees' family issues including restricted immigration, cultural shock as well as difficulty to adopt with sophisticated technology compare to their own context, this situation might happens another way in developing contexts for the MNCs of developed economy (Brewster, et al., 2011; Dowling et.al., 1999; Thite, 2013; Thite et al., 2012).

While, MNCs of developed countries confront with some others risk exposure when they operate within developing market, these being personal and family safety, civil unrest, political conflicts, terrorism and disease (Dowling et.al., 1999). For instance, in 2011, BP confronted with difficulty, in order to evacuate their staff and including staff's families from Egypt and Libya, due to civil unrest in both countries (Mekawi, 2011). There are, however, often interrupted by the government intervention directly or indirectly, as aforementioned the case of BP incident in Nigeria, those issues are imposed by the impact of institutional environment as 'high external consistency with the local environment', (Taylor et al., 1996. p. 966) toward the internal consistency of MNCs. If MNCs of developed economies operate within Chinese market then they should sincerely consider regarding industrial relationship, compare to other developing countries as Chinese history between 1951 and 1987, labour unions are tightly restricted; this means that the right to strike was prohibited by law under martial law (Wade, 1990).

According to Mahoney et al (1998, p.774), 'a newly internationalizing firm is likely to have few, if any experienced managers'. However, newcomer of developing firm relies on ethnic network as well as on labour-intensive technology, it may be very difficult in achieving competitive edges when they expand their firms into highly structure markets and sophisticated technology based markets in advanced economies (Zhang & Bulcke, 2000). In general, developing MNCs, they have lake of capital and insufficient government support, lake of qualified skills labour force, and hierarchical management system; typically, in developing context, labour force seems to be cheaper and government regulation is generally more pervasive (Dowling et. al., 1999), those are rooted from the country's history and the impact of institutional environments and its path dependency. In addition, there is also not enough adequate effective polices by world institutions for favouring of developing context and its MNCs. In addition, world institutions tend to play key role, in order to establish a positive image of employment practices across countries. According to WTO chief Mike Moore (1999), every organisation must obey to practice these particular coercive regulations as in HRM practices, for example of such 'effective abolition of child labour, and elimination of discrimination in hiring and employment practices. These fundamental rights are not such the property for one firm or state or one culture, but of all people'. The impact of world organisation on firms try to replicate convergence approaches of HRM practices.

However, every country has diverse types of institutional environments, which impact on HRM practices within the firm.

All these factors impose to make the relationship of MNCs between home and host including global approaches' HRM practices based on SIHM approaches. As to how these practices should be implicated on the basis of three core issues as the aforementioned in the Table 2.

## 6. CONCLUSION

Countries' institutional environments are key features in codifying how HRM practices of MNCs are determined differently from one context to another. Essentially, institutional environments represent the rootedness of countries' history on the basis of path dependency and how MNCs are capable in managing its competitive edges and including economics, human and natural resources, technology, management practices and so on. In this way, MNCs from developed countries have influenced those in developing countries, by representing the dominating power of intensive capital, sophisticated technology, and professional management, while, they generally encounter distinct institutional environments in the developing context, such as the experiences of BP in Nigerian and Azerbaijan. Contrary, developing economies attempt to expand their MNCs within industrial markets, due to congregated sophisticated technology and management experience from their counterpart in the western world. Nonetheless, developing MNCs such as China and India have a primary major preference to derive their advantages from service, including a low cost and medium technology position. However, they are confronted with formal constraints when they operate in the openness society. In addition, they seem to be high on cultural context, while, industrial markets are normally seen as being of low cultural context. These scenarios are also represented within a society as to how HRM practice should be in an organisation. As a consequence, developing society typically represent personal knowledge and personal exchange, according to relationships with persons, as being usually involved to determine the scenario of HRM practices, such as those involving performance appraisal, recruitment and selection, compensation, training and development, which are generally different compared to their counterparts in advanced market economies. While, industrial economies represent impersonal relationships, linear and task-focuses including the effective enforcement mechanism, such as well-defined property rights, the action of the judicial system, as being what influence the different HRM practices and competitive edge, compare to their counterparts in the developing context.

As a result, of distinct institutional environments between developing and developed countries arising, in term of different complexities of HRM practice of MNCs, it is imperative that in both contexts MNCs should consider the 'Integrative', SIHRM approach in HRM practice of MNCs, including its origination as 'where from'; they should cogitate its host contexts as 'where they are'; they should also consider the global impact as the scenario of home and host and include the global prospective of 'what surrounds them'. These will encourage the desired effective competitive edge to both groups of MNCs and also minimise uncertainty, high transaction costs, risks and conflict within global affiliates.

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