

# Institutions and Networks

## **Business network logic in the Chinese, Russian and West European institutional contexts**

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### Abstract

The paper analyses business networks in three different contexts: West-European, Russian and Chinese. In this paper three different ways of organizing business activities are discussed and compared. The paper proposes that business networks in different economies and contexts are constituted in their own manner because of underlying logics and principles. So far little attention has been given to the fact that national environments may differ quite remarkably. Specifically, the differences between Western and emerging markets are of such magnitude that they entail different strategic situations for the MNC, (Jansson, 2006). For instance, business networks in China and Russia differ sociologically, organizationally and economically from inter-firm networks in the west. The differences of these contextually distinctive business networks may limit the transferability of business strategies and organizational concepts between contexts. In the conceptual and comparative paper theoretical perspectives as well as practical business matters in the three settings are highlighted and analyzed. In the end core elements of the different network types are presented and compared together with implications. The paper suggests that business networks are part of and integrated in a cultural and institutional context. The business network can not be analyze nor understood in isolation from the context, instead the business network interact with the cultural and institutional context.

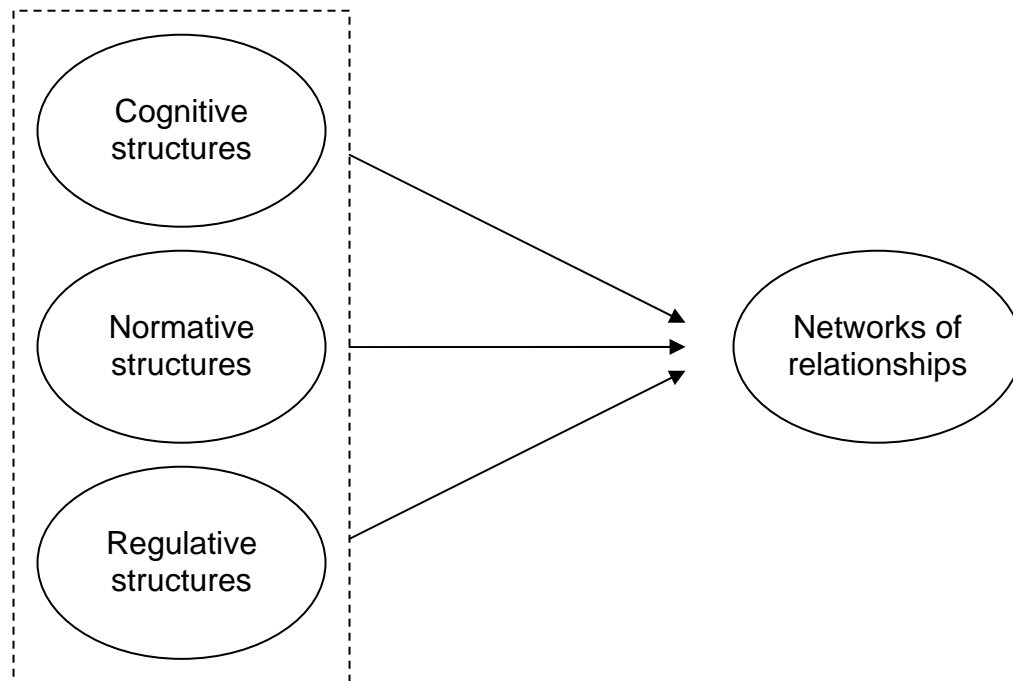
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### Introduction

One of the core ideas of the industrial network approach is that firms, and hence also networks are influenced by, as well as influence different elements in their environment (Håkansson, 1982, Turnbull & Valla, 1986, Håkansson & Snehota, 1995). Apart from typical elements in the environment, such as competitors, suppliers, producers, government, and trade unions, there is also an interchange between the firm and less visible elements in the environment, such as various regulations, norms, values and typifications and schemas. In fact, firms are subsystems of a wider social system, which is the “source of “meaning”, legitimation, or higher-level support that makes implementation of organizational goals possible” (Parsons, 1956). Granovetter (1985) emphasizes that social embeddedness of economic behavior and social relations between firms are important in bringing order to economic life. In other words, the ways in which business managers understand the business world and set priorities need to be studied in relation to the societal context (Whitley, 1991). Consequently, the main purpose of this paper is to analyze networks of relationships using institutional theory, where culture theory is used to substantiate various institutional dimensions. The focus is on three specific markets — China, Russia and West Europe — and we highlight and analyze how relationships and networks in these markets are embedded in an institutional context (see Figure 1). We base the analysis on Scott’s (1995, p33); idea that “Institutions consist of cognitive, normative, and regulative structures and activities that provide stability and meaning to social behavior”.

West-European business networks are seen to be mainly represented by the IMP perspective. Russian business networks have been selected because they are the major type of network in East Europe. Chinese business networks, on their part, dominate in East Asia. Knowing how these latter two business networks work is critical for understanding how business is done in emerging country markets. The basis for the comparison of the business network systems is the West European network. Both China and Russia are currently undergoing transition, which

makes the institutional context turbulent and unpredictable. This transition from planned to market economy is often defined as large-scale institutional change (Jansson, 2006; Peng & Luo, 2000). Both countries are leaving an economic system where the economic activities were organized by hierarchical plans based on commandos. Instead various governance modes have appeared, like both market transaction and business relationship. This development has been accompanied by a liberalization of prices. Corporate governance is undergoing a transition from state and collective ownership, with a very small portion of the economy in hands of private owners, to a mixture of state, private, collective and foreign ownership. Other institutional changes typical for the Chinese and Russian contexts are appearance of property-based legal framework, business legislation, capital markets, abolishment of entry barriers for new firms, the appearance of a bankruptcy act, changing political system, laws, regulations, and financial markets, underlying assumptions about economic activity, property rights legal framework, legitimating actors, practices, structures, and formal governance systems. It follows that the institutional context, which for a long time was characterized by stability and predictability has over the last ten years instead been dynamic, turbulent and unpredictable. An already weak institutional framework became even weaker due to the extensive transition. This weakness means that the actors cannot rely on the institutions to solve conflicts and problems. They must instead be solved in the network. In West Europe the institutional framework is stronger, more stable and more transparent than in China and Russia, which means that there is an option to solve conflicts and problems both within the network and through the institutions.



**Figure 1 Institutions and networks**

It is also true that in Russia and China there is a gap between existing and the desired institutional arrangements and governance systems. Institutional imperfection is understood as "the degree to which institutions are not well defined and established as well as the inconsistency between these institutions" (Roth & Kostova, 2003). This institutional imperfection leads to an institutional void, where it is likely that managers and firms often have to perform basic functions by themselves (Khanna & Palepy, 1997; Peng & Luo, 2000). Since formal governance systems are unable to support effective business activities, managers may have to rely on informal substitutes (Kostova, 2002).

There is no overwhelming reason to believe that organizational practices do not vary between different countries. On the contrary, research suggests that organizational practices can vary even greatly across countries because various practices are affected by their 'parent' socio-cultural-institutional environments (Lincoln, Hanada & McBride, 1986; Adler, 1995; Janssens, Brett & Smith, 1995; Kogut, 1991; Rosenweig & Singh, 1991). Therefore different business practices can also be expected to vary across countries (Kostova & Roth, 2002), and many studies have supported this view (Campbell & Lindberg, 1990; Cole, 1989; Hall, 1986; Jepperson & Meyer, 1991; Orru, Biggart & Hamilton, 1991; Whitley, 1991, 1992a, 1999). These studies show that firms from different countries operate according to different underlying logics and principles and exhibit dissimilar organizational and inter-organizational structures (Kostova & Roth, 2002). The fact that national environments may differ quite remarkably also means that networks in different contexts are likely to be governed by rather different principles, giving rise to context specific business networks.

The outline of the paper is the following. The paper starts with a review on relationships and networks, which is followed by a discussion about the relationship between context and institutions. The subsequent part of the paper focuses on three institutional structures (cognitive, normative and regulative) and we analyse how they are influencing the relationships and networks in the three markets. The third part of the paper discusses and concludes our main ideas on how institutions and networks are inter-related in three different contexts: the West-European, the Russian and Chinese.

## **Relationships and networks**

Despite clearly highlighting the social aspects of the environment, "the embeddedness of economic goals and activities in socially oriented goals and structures" (Granovetter, 1992), studies of industrial business networks according to the IMP perspective have previously seldom focused on the connection between the context and the network. This paper emphasizes the social embeddedness of relationships and networks. According to this perspective, relationship and network are socially embedded, although in different ways in different contexts. There needs to be a broad social approach that also includes cognitive and regulative aspects, especially in order to understand how networks differ between Western markets and emerging country markets. Finally, one characteristic of emerging country markets is that not only markets but society is in change or transition. Relationships and networks are rapidly changing, and these changes need to be understood in relation to the context.

Since the basis for the comparison of the business network systems below is the West European network, its fundamentals are now described. The industrial network (INT) approach has been developed and empirically tested, to a large extent, in the Nordic countries, whereas it is well suited for studying relationship and network behavior of Western firms (Jansson & Ramström, 2005). Its vocabulary, thought patterns and logic can directly be used to Western firms' relationship behavior. Hence, it is a good tool for understanding the Western network context, and how business relationships are developed in this context. The INT approach is strongly sociological in its orientation, its theoretical foundation being inter-organizational theory and network theory (see, e.g., Håkansson, 1982; Johanson & Mattsson 1987; Axelsson & Easton, 1992; Jansson, 1994; Håkansson & Snehota, 1995; Ford, 2002). Originally the industrial network theory was applied to buyer-seller relationships between European firms, but was later extended to firms from Asia, North America and Australia (Håkansson & Snehota, 2000). However, the approach is mainly valid for mature Western markets, especially the 15 mature European Union markets (Jansson, 1994, 2006).

The industrial marketing and purchasing (IMP) perspective of business networks is characterized by relationships being embedded in a social structure, mainly a specific market structure in the form of networks, whereas it has also been called the markets as networks approach (Mattsson, 1997). Thus, it contains a macro dimension, which is not found in other approaches to

relationship marketing (Jansson, 2006). However, this dimension is not much developed beyond the industry level. The fundament of the IMP-perspective was developed in the 1970's (Johanson & Mattsson, 2005), when West-European markets were more closed and imperfect than they are in today's Europe consisting of a common market encompassing 25 countries. According to Jansson (1994), this is a major reason behind its strong sociological base instead of having the economic base of mainstream marketing theory.

The market characteristics of European markets in those days are recognizable in the basic assumptions of the IMP perspective (Johanson & Mattsson 1987; Snehota 1990; Håkansson & Snehota 1995). The business relationship model involved concerns relationship marketing and purchasing behavior. Both the various exchange processes through which relationships develop and the adaptation processes that take place between parties in the continuous evolvement of relationships, e.g. through product modifications, changes in production, delivery routines and other behavioral rules, are analyzed. The central idea is that by establishing relationships firms make mutual commitment and relationship-specific investment, which, in turn, create interdependencies between the parties involved. This makes relationships continuous and stable. The more intensive exchange processes become, the stronger the reasons for adapting to each other and not replacing the other party. A mutual orientation is created which results in a preparedness to interact in a dyad. Change takes place within the relationship rather than of relationships with other parties. A mutual knowledge of and respect for each other's interests is established, which leads to cooperation and solution of conflicts. Mutuality is thus clearly characteristic of business relationships. This reciprocity is largely shaped by social exchange processes but also by business and information exchange.

One reason behind the complexity of relationships is these different types of exchange. Another is the many organizational units and large number of persons normally involved. Different forms of investment in relationships shape the future behavior of the parties involved, since they affect the parties' access to resources. It is less expensive to trade with firms that one has relationships with than with firms that one does not have relationships with. Aiming at establishing linkages involves realization of the fact that resources are heterogeneous. The same line of reasoning can be applied both to dyadic relationships and to networks of relationships. In the latter case, in particular, it can have a strong systemic impact on the marketing and purchasing possibilities of the firm involved. The firm's interactions are strongly affected by the access it has to resources from different types of networks. For example, how a seller interacts with its buyers depends partly on how the two-party relationships involved are connected to other, indirect linkages within the network or networks to which the seller has access, for instance influencing how the seller relates to its suppliers. Competitive strength is likewise affected by relationships. Within a given network different macro positions (relating to the whole network) and different micro positions (relating to given dyads) can be distinguished (Johanson & Mattsson, 1987b).

### **Institutions, culture and networks**

Institutions, culture and networks of relationships are stable continuous structures that tend to change only gradually. To describe institutions, words like codes, rules, habits, routines, and procedures are often used, which all imply that human behavior is regular and stable. A main characteristic of institutions is their rule-like or organizing nature, and a second characteristic is their ability to facilitate and constrain the relations among individuals and groups. North (1990, 2005) defines institutions as the rules of the game in society or as constraints created by humans, which facilitate economic and political interaction. Institutions also makes it possible to separate between preferred and desirable behaviour (normative structures), for instance making a profit (values), the appropriate ways of reaching them, for instance conceptions of fair business practices (norms). Values set standards to which existing structures or behaviour can be compared and assessed, while norms define legitimate means to pursue valued ends. Furthermore, they consist of formal written rules as well as unwritten codes of conduct (regulative structures) that underlie and supplement formal rules. In case someone breaks any of the rules, a

punishment is delivered. If using the analogy of 'institutions are the game and organizations the players' (North, 1990, 2005), the cognitive pillar identifies underlying assumptions about society ('the game is always played'), normative systems defines goals or objectives ('to win the game by x goals'), and also appropriate ways of reaching them ('this is how we are going to play'). The regulative pillar specifies legitimate from illegitimate action ('these are the rules and what will happen if you do not follow them').

The idea that institutions and culture are interconnected is stressed by a number of researchers (North, 2005; Scott, 1995; Hofstede, 1983; Douglas, 1986 Hofstede and Bond, 1988). By institution is often implied the social unit that houses regularized and stable behavior, for example a family, clan, organization, nation, market, game or ceremony. A specific characteristic of institutions is their ability to facilitate and constrain the relations among individuals and groups. Institutional theory implies a study of reality by seeing the world as consisting of regularities or rules. Likewise, culture is also from an institutional perspective seen as an assembly of informal rules. Thus, 'culture' theory and institutional theory are in many ways close to each other. For instance cognitive structures are often carried by culture (Jepperson, 1991). The cognitive and normative aspects of institutions are close to culture, whereas the regulatory dimension is unique to the institutional approach. Hence, culture is included in the theoretical foundation of this paper. 'Culture' theory is utilized in order to substantiate the different institutional dimensions in this study, i.e. the focus is not on 'culture' theory as such, rather on the content of it.

North (1990, 2005) makes a distinction between formal rules and informal rules, where the former include political and judicial rules, economic rules, and contracts. Informal rules are broadly viewed to include codes of conduct, norms of behavior, and conventions. Rules are a broad social concept expressing constraints on many aspects of human behavior. These rules are here condensed into four basic rules: beliefs, norms, values, and enforcement mechanisms. The main idea is that this infrastructure stabilizes strategic behavior by reducing uncertainty. Hence, institutions constitute a broad framework within which both social as well as economic transactions take place (Granovetter, 1992). In other words, institutions shape not only social but also economic behavior. This means that institutions are an inherent feature of networks (Salmi, 1995).

For instance, according to the IMP perspective trust and commitment are key dimensions in business relationships. Trust and commitment are developed and maintained through interaction between the actors. However, this interaction is guided by norms, values, formal and informal rules as well as social-cultural typifications. Through institutionalization, actors come to accept the shared definition of social reality (Scott, 1987). Simultaneously, according to the institutional network approach (Jansson, 2006) actors are also influenced by various organizational fields surrounding the relationship, for example legal systems like property rights and other judicial and penalty systems. Legal frameworks are in turn rooted in a 'deeper' logical or philosophical structure. Also the firms' embeddedness in reciprocal networks is related to particularities in authority and sanction systems. The goals and values of a network are guided by norms and values at the societal level, which means, that not only is the network shaped by institutions, institutionalization processes (institutionalization of relationships) also bring stability to networks (Håkansson & Johanson, 1992).

However, institutions are not only an exogenous framework shaping networks and network actors, but the networks and their actors are constantly undertaking various processes that shape and reshape their social and economic environment. Thus, the institutional setting does not entirely define actions by individuals. There is some freedom of action or agency. According to Salmi (2004): "For an individual actor in the network, the generally accepted rules form constraints to behavior and the framework for action. Basically, actors accept and follow these institutional rules, but on the basis of their strategic decisions they can also act against the rules or try to change them. For the latter, mobilization of other actors is usually needed as well."

There are three major types of institutional content: cognitive, normative, and regulative structures (Scott, 1995). These three factors operate within every institution, and the interplay between the factors varies and results in various behaviors. Additionally, as is clear from the studies by different 'culture' scholars, the cognitive and normative nature of culture is an important element when attempting to understand the connectedness and embeddedness of networks into the environment. The cognitive nature of culture is most often stressed in various culture studies although there is also a normative component to culture, which reflects shared values of a group (Kroeber & Kluckhohn, 1952). For example, cognitive structures and activities concern how people think, why they think in common, the way they do it and what talk, decisions and actions that result from this thinking. Thus, people of a certain nation tend to behave in a common way due to the specific mental program developed in this nation. This is evidently a specification of culture as a cognitive system, or thought world. Values and norms are also included in this definition of culture, since most mental programs carry a value component. Values, or societal norms as they are also called, are seen as the major factor influencing mental programs.

### **Cognitive structures**

The cognitive pillar of institutions reflects widely shared social knowledge and cognitive categories, such as for instance schemata and stereotypes (Ionascu, Meyer & Estrin, 2004). Routines are followed because they are taken for granted as "the way we do these things." Shared social knowledge and cognitive categories influence the way a particular phenomenon is categorized and interpreted (Scott, 2001). Wider belief systems and cultural frames are imposed on, and adopted by organizations. They comprise frames, routines and scripts used by individuals in one society to judge and assign meaning to a phenomenon and to solve problems (Ionascu et al., 2004). Cognitive structures also affect learning processes; it is easier to learn a new practice when it is consistent with the prevalent schemas than when it is inconsistent with these schemas. In other words, cognitive structures develop the identity system or the structures of the mind. Thus, from a cognitive point of view, institutions can be defined as established patterns of thinking or thought styles, which produce a self-activated regular behavior. Since the established patterns are reproduced over time, present day thought styles can be seen as the crystallization of history into the minds of people.

Cultural models that deal with cognitive aspects (e.g. Hofstede, 2001) can be used to describe the different thought styles. Hofstede's work is a rich source for finding material to describe major thought styles of several nations. Even if his model integrates mental programs with values and norms, the theory is mainly cognitive. As a consequence, the five dimensions can be used to develop the cognitive dimension of an institution. Furthermore, how organizational decision-making is related to the social context can be better understood through using cultural theory. By studying theories that deal specifically with world views or the cognitive aspect of social structures, the cognitive structure can be developed into a thought style. Thus, the people of a certain nation tend to behave in a common way due to the specific mental program developed in this nation. This is evidently a specification of culture as a cognitive system, or thought style. Inspired by Hofstede's work, but also on Ehn & Löfgren (1982) and Redding (1980), we advance the idea that cognitive structures can be understood along three dimensions: self, causality and time.

*Self* concerns how a person mentally relates to his social environment, for example if he looks upon himself to belonging to groups or not. This dimension is close to Hofstede's (1980) individualism/collectivism dichotomy. *Causality* is a dimension that directly focuses on the mental/thinking processes, for example, if the thought style is abstract or non-abstract, if logical connections are made between categories, and, if linear, sequential explanations are made. *Time* is about how people perceive time. Time can be explained as monochromatic or linear, for

example whether it is possible to divide and measure time in a precise way. Hofstede's fifth dimension – long-term versus short-term orientation – is related to this time theme.

<b>Cognitive aspects</b>	<b>West-European context</b>	<b>Russian context</b>	<b>Chinese context</b>
Self	Firms in networks Individualistic	Networks Collective	Networks Collective
Time	Mid/Long term Changing/Continuous	Short term Changing	Long term Lasting
Causality	Logical Brain	Logical Brain/Heart	Holistic Genqing/Heart

Table 1 Comparison of cognitive structures

### *Self*

The main focus of the West European network context is centered on the units in the network, i.e. the firms. The focus of the Chinese business network context, on the other hand, is on the network itself (Jansson, 2006). On the surface, the Chinese form 'classic' external business networks like those found in the west, but business networks in East and Southeast Asia differ sociologically, organizationally and economically from inter-firm networks in the west. Chinese do not join networks in the way westerners join organizations. Instead, the Chinese community itself has a network like structure by which principles the society is organized (Hamilton, 1996). Consequently, networks have become not only the organizing principle of society, but also the institutional medium of economic activity (Hamilton, 1996; Whitley, 1992b; Redding, 1990). Therefore it is not a question of becoming part of a certain type of network, but a question of becoming a trusted member in a networked society (Ramström, 1995). The situation is similar in Russia, where the informal social networks established during the period of the centrally planned economy are still important in business life (Berliner 1952; Ledeneva 1998). However, they are gradually changing with transition towards the West-European 'firms in networks' (Jansson, 2006). In the Western context as well as in Russia, it is mostly autonomous individuals of firms that are interconnected, and these relationships rest on rational and logical calculation and (voluntary) individual action. Chinese businessmen, on the other hand, tend to have a more holistic thinking.

As a result of the network structure of society in China, the level of collectivism is high. Every individual has a social network built around him, consisting of family, relatives, colleagues and friends. In Russia, there is a collectivist world view, where people think that it is important to belong to groups, where they avoid standing out, and where they risk becoming punished for own initiatives (Hofstede, 1994). But as discussed below, a basic value of Russian culture is collectivism. This group thinking seems more to be based on the working group than the family. In Western Europe, on the other hand, individualism is strong, and the rights of the individual are of the utmost importance (Halman, 1994). One interesting aspect of Western European society is that despite a high level of individualism there is still a sense of tidiness evident in most aspects of social and business life, and people show a high level of protestant work moral and loyalty. Most of the cultures in West Europe are performance-oriented, which means that each relationship should be developed and maintained on its own merits. A relationship has to be evaluated and if it is not viable, it should be terminated. A relationship has no value in itself. Loyalty inside the Chinese firm, on the other hand, is limited and conditional, unless there is strong personal obligation through family relationships. Because employees and affiliates are not able to advance to a management position, they often leave after a while to start their own business (Yip, 2000).

### *Time*

Because of a low level of employee commitment and also low level of inter-family trust in the Chinese context, the development of long-term inter-firm commitments is restricted. What is



interesting is that the relatively small size and high specialization of firms would imply high levels of interdependence between them. But interdependence is managed on a short-term contractual basis policed through reputational networks rather than by long-term mutual dependence relationships (Whitley, 1991). Social relationships, on the other hand, are long-term, often life-long. Because social relationships are long-term oriented, business relationships may lay dormant for long periods, but can be activated at any time when needed. While western business tends to focus on relationships between firms, the Chinese tend to prefer long-term, personalized and mutual cooperation as the basis for most of their business dealings. The Chinese believe that one should first build a long-term relationship, and if the long-term relationship is successful then transaction will follow. This is in contrast with West European networks, where transactions are first built and if this is successful a relationship may follow. This makes Chinese business networks relatively strong, last over the long term, representing a continuity of collective common interests (families, communities and sets of friends and relatives). Relationships between West-European firms are more lateral, less strong, and generally represent more mid-term economic interests. Even if networks according to the IMP perspective are also seen as long-term, the social basis for the continuity is another. This also makes such networks more unstable and changing (Håkansson & Johanson, 1993). The relatively low tendency to avoid uncertainty means that most actors are not afraid of change as long as they mean something that is perceived as an improvement. Thus, relationships in West Europe are preferably dynamic and make up an arena for product and technology development. Changing the content of the relationship can even be viewed as a prerequisite for survival and growth.

Besides attempting to ensure continuity of collective common interests, another possible explanation for this type of long-term view in Chinese business networks is the perception of time. A linear Western time perception is contrasted to an Oriental circular time perception. In the West European context, on the other hand, time is divided into linear pieces, meaning that as one piece has occurred, it is 'forever lost'. Russians have a short-term orientation. There is little planning for the future, the focus is on the past and the present, and managing is done on a day-by-day basis. There is high uncertainty avoidance, where risk taking is discouraged and where people avoid taking responsibility (Jansson, 2006). The short-term horizon prevailing in Russia, the absence of trust and reputation (Blanchard & Kremer 1997; Gurkov 1996; Peng & Heath 1996) and the reluctance to make relationship-specific investment, because of the strive to not become dependent, make changes of the network in terms of dissolved and terminated relationships to a common characteristic (Davis, Patterson & Grazin 1996; Gurkov 1996; Hallén & Johanson 2004a; Johanson 2004b), rather than changes within the relationships, like improved storing, transportation, payment and so forth (Hallén & Johanson 2004b, Johanson 2004a).

### *Causality*

The Chinese linear time perception might also explain Chinese decision-making. The business logic is guided by intuition and business is based on feeling. While West European business people make decisions rationally, the Chinese decide emotionally, and the way of thinking is not logical in the sense that westerners understand. Business decisions are also perceived as emotional because the ethnic Chinese take into consideration personal and mutual relationships. Chinese firms are also seen to engage in rather little pre-planning, and it is not always clear how the organization works. This could be interpreted as a result of the tendencies of Chinese firms' flexibility, i.e. that they are likely to seize unrelated opportunities as they present themselves. Related to this aspect is the strong emotional theme or 'genqing' of the Chinese. A common metaphor for this strong emotional content of the relationships is the heart, while the brain more symbolizes the less emotional western business relationships. There is for a mix of 'genqing' when the Chinese act as the buyer and logical thinking when acting as the seller. 'Heart' is an important part of the Russian business culture. Russians are seen as affective and are not afraid to show their feelings. They have a more Latin mentality, which expresses lots of emotions, physical contact, voice-raising, and immediate reactions, both verbally and non-verbally (Trompenaars, 1994). On the other hand, controlling and planning are, because of the high uncertainty avoidance and the lack of trust, viewed as critical activities and reflect the brain of the

cognitive structure. To control and to monitor employees and customers and suppliers is the way business is expected to be made in Russia.

### Normative structures

An important characteristic of institutions is that they provide normative rules telling what actions are acceptable or not (Scott, 2001). Institutions define what accepted moral behaviour is and clarify legitimate from illegitimate action. At the same time, institutions support and empower activities and actors, provide guidelines and resources for acting as well as prohibitions and constraints on action. The normative aspect of institutions provide guidelines for the interaction, so that one know, or can learn, how to behave in various occasions, for instance how to greet friends on the street, drive a car, buy food, borrow money, start a business, or whatever else it can be (North, 1990). In line with this, normative structures influence how firms exchange resources and establish relationships. The normative structures consist of values and norms. Values are the root of cultures and behavior, for example the importance of business values such as hard work, honesty, self-discipline, financial success, and working toward common goals, personal achievement, creativity, and respect for learning. Norms work as prescriptions for acting that create "expectations about behavior that are at least partially shared by a group of decision makers." (Heide & John, 1992, p. 34). Norms can also be seen as the normal or acceptable behavior in a social group, a convention or praxis. A system of norms is the normal pattern to which behavior should conform. Since normative constraints are means to realize states which are highly valued by the social group favoring them, norms are closely related to values, and may be difficult to separate. But values are viewed more broadly to mean infusing the organization with value, for example by inculcating values in individuals. Such standards do not only involve broad goals like missions and other priorities but also form the major part of the firm culture in general. Thus, cultures, structures, and organizational routines are infused and prescribed by normative structures such as values and norms, thereby constituting their institutional contents (Jansson, 2006).

When the purpose is to describe normative structures Trompenaars' (1993) and Hampden-Turner & Trompenaars' (2000) six dimensions of values provide a theoretical framework. Five of them come from the "pattern variables" established by Parsons & Shils (1951), to which the time dimension is added. There are also other culturally based dimensions, or themes, that can be used to describe the normative pillar of institutions, such as morality, rationality, formality, and trust. The theme *morality* deals with for example what is right or wrong, good or bad, and virtues. The theme *rationality* concerns the goals or reasons behind relationships. The next theme, *formality*, regards how formal relationships are. Finally, *trust* indicates how relationships between individuals are built and maintained.

Normative aspects	West-European context	Russian context	Chinese context
Trust	Organizational / professional trust	Individual / social trust	Individual / social trust
Morale	Efficiency Conflict base	Legitimacy Conflict / Harmony	Harmony / Yin-Yang Harmony / Face base
Rationality	Achieved mutuality Profitability Open	Blat Favors Closed	Guanxi (Ascribed) Renqing Closed
Formality	Impersonal (formal)	Informal	Personal (Informal)

**Table 2 Comparison of normative aspects**

*Trust*

In Chinese culture, economic life cannot be segregated from life as a whole (Koopman, 1991). Successful business relationships are built on intimate personal relationships, where the parties are supporting each other, both economically and spiritually. Personal relationships are mutually binding, and permeate all aspects of the firm (Lasserre & Schutte, 1995). Personalistic networking is a response to the difficulty of establishing reliable horizontal relationships across social interactions, because institutionalized law is inadequate for underpinning transactions. In order to compensate for a lack of a tradition of institutional trust, such as for instance law, trust has evolved as a central ingredient of interaction (Kao, 1996). A crucial component for the development of a relationship is a therefore reputation for honesty and competence (Whitley, 1991). Violations of a spoken promise can lead to banishment from society. If a business owner violates an agreement, he will become blacklisted, and this is far worse than being sued because the entire network will refrain from doing business with the guilty party (Rauch & Trindade, 2002). In other words, in order to enable economic transactions, i.e. to guarantee reliability of exchange processes, transactions come to be guaranteed by bonds of personal, individually based trust (Redding, 1991; Whitley, 1992a, 1992b). Trust between firms in the West European context, on the other hand, is organizational and professionally based, and employees have a professional role. Trust between firms from a western context is seen to develop as business partners repeatedly interact with each other (Friman, Gärling, Millet, Mattsson & Johnston, 2002). It is believed that trust can only be built during a process of acts and counteracts. Trust can be an economic issue, which means that one firm trusts another based on knowledge of the firm's skills and capabilities. On the other hand, trust is also considered a very time consuming activity that not all managers are willing to invest in (Mavondo & Rodrigo, 2001).

According to Trompenaars (1993) Russia is a highly particularistic society, where relationships and unique circumstances override the importance of abstract rules in determining what is right and good. Relationships and trust for individuals weigh higher than legal contracts, but relationship establishment usually starts from a situation of suspicion. The expectation, inherited from experience, is that one would be cheated. Decades of one-sided plan-governance and centuries of authoritative state have resulted in that trust is only in place, if the actors are extensively embedded and inter-locked in the same network, that is, the consequences for cheating are perceived as more severe than the eventually rewards for behaving trustworthy, or through an long an iterative process that starts from suspicion. The result is an environment, where different perspectives of reality exist and where friends stand up for one another regardless of past agreements. Close personal relationships are important as well as politeness and hospitality together with care for the weak

#### *Morale and rationality*

Personalistic and mutual networking in China and Russia is in sharp contrast with relationships in Western Europe, where relations between economic actors are fundamentally competitive. While cooperation through relationships in the West European business network context largely evolves around profitability and efficiency issues, business cooperation in Chinese business networks evolves around harmony. It is created through the Yin and Yang ('both-and') principle of having a balance between major alternatives rather than choosing the best alternative according to an 'either-or'/optimization principle. Westerners approach an exchange situation by emphasizing formal agreements while the Chinese seek to determine whether the other party can be trusted or not (Yau et al., 2000). While the Western European inter-organizational networks are built on mutual economic interests, the inter-personal Chinese networks are built on the persons having some kind of common background or 'Guanxi'. Guanxi and renqing often combine to make the business networks closed or secret rather than open and therefore hard to enter. This low transparency is behind the corrupt practices – the 4th dimension – typical of the 'crony capitalism' of Southeast Asia.

There are striking similarities between the Chinese 'Guanxi' network and the Russian 'Blat' network inclusive of the 'Nomenklatura' network. Both are social networks based on favors and

gifts, long-term and strong personal relationships as well as social trust. During the centrally-planned era, the 'Blat' network was an informal barter system, where exchange of favors was built on favors of access to goods and services ('social resourcing'). With transition to a market economy, the 'Blat' network has changed character from being based on friendship corruption to money corruption. It has transformed from being based on moral and ethical considerations to having an explicit financial expression, being more materialized and pragmatic than emotional and human (Agapitova, 2003). The main difference lies in that the Chinese business system is mainly based on family connections, while the Russian network is based on secondary groups such as friends, neighbors, and co-workers in addition to the family. Moreover, in Russia the balance and the harmony, which prevail in China, are not important. Nevertheless, personal relationships are viewed as a mechanism to enjoy favors and to receive gifts. Personal relationships are also critical in business relationships as the state and governmental institutions are so weak.

### *Formality*

While transparency is low in the Chinese and Russian context, it is high in West Europe. In this latter context, firms are autonomous legal and financial entities facing largely anonymous and impersonal market pressures and both the networks and transactions are formal and to a degree impersonal (Whitley, 1992a, Lindell & Arvonen, 1996, Koopman 1991). Contractual and transactional relationships between the actors are often formed based on goals of the actors, which may be individual, idiosyncratic, and opportunistic (Lasserre & Schutte, 1995). A large part of relationships in business are entrepreneurial or transactional, and there is rarely an emotional element to business relationships. Business network relationships in the Chinese context are governed by relational norms rather than contractual obligations, and personal and mutual relationships are preferred to entrepreneurial- and transactional relationships. In fact, the Chinese paradigm is much more informal, and characterized by affection, diffuseness, particularism, ascription, and collectivism. The boundaries between formality and informality are quite clear in the West European context, while they are blurred in the Chinese. The Russian context is characterized by a combination of desire to formalize in order to avoid uncertainty and informality and a lack of transparency. This paradox is present also in the relationship where, on the one hand, contract and documents are needed, and, where, on other hand, the firms are aware that no one follows the content of the contracts and documents.

### **Regulative structures**

Values and norms expressed as priorities specify the actions that a set of individuals regards as correct or incorrect, according to which they are expected to decide and act. But such normative rules do not specify what happens if expectations based on them are not materialized, i.e. if behavior supposed to be following from the norms do not take place. So, for behavior to be effective in organizations, incentives and sanctions must also be present. The regulative aspect related to this norm concerns how to construct the incentive system to best reward both the individual and the firm together with establishing a surveillance and assessment system to control the enforcement.

The regulatory component of an institution reflects the existing law and rules of a particular environment that reward certain types of behaviour and punish others. They may operate through diffuse informal mechanisms such as shamming or shunning activities, or may be highly formalized and assigned to specialized actors, such as the police or the courts. Hence, the regulative dimension of institutions produces economic and social control through direct regulations. Sometimes the rules and informal codes are violated and punishment is enacted (Ionascu et al., 2004). Hence, another important aspect of institutions is that they produce economic and social control through direct regulations. Regulatory processes involve the capacity to establish rules, inspect others conformity to them, and as necessary, manipulate sanctions, such as rewards or punishments, in an attempt to influence future behaviour. These enforcement

mechanisms can be either formal (e.g. wage reductions or increases) or informal (losing or gaining face). It means that this pillar of institutions constrain as well as regularize behaviour. The power of the regulative pillar is the costliness of ascertaining violations and the severity of punishment (Scott, 2001).

Authority systems are therefore a central aspect of the regulative dimension. For instance, powerful actors may either impose their will on others, provide inducements to secure compliance, or use authority, in which coercive power is legitimized by a normative framework that both supports and constrains the exercise of power (Scott, 2001). Thus, the authority system is a major regulative factor of the organizations involved in networks, having a decisive effect on how relationships are organized. Authority is defined from a relationship perspective by Kakar (1971, p. 298) as "a relationship between two individuals, one the superior and the other the subordinate, the relationship lying not in the individuals but in the positions they occupy in the formal hierarchy of the work organization." Kakar (1971) distinguishes four basic ideal authority patterns or cultural forms. The parental ideology has two dimensions. The authoritarian or assertive aspect, where emotional affiliation is low and task control by the superior of the subordinate high, emphasizes the superior's right of decision. The nurturant aspect, where emotional affiliation is high, emphasizes the concern of the superior for the subordinates. In an assertive relationship the status is not only legitimized on formal hierarchical grounds but also contains a cultural or ideological element. According to the nurturant ideology a superior's area of competence is vaster compared to a modern bureaucracy. In the nurturant relationship, the parent-child relationship is extended to the superior-subordinate relationship in organizations. The nurturing mother is the dominant person and the mother-son relationship the basic dyad and ideal for human relations. The father is a distant figure, usually stern and aloof, who is not much involved in the child's upbringing.

The parental ideology is a relic from a traditional pre-industrial society. It is personal and the legalization is based on everyday routine and an unchanging past. People obey out of respect for the ruler's traditional status and decisions are limited by customs and traditions. As noted above, however, authority in Western organizations is legitimized by impersonal laws and rules, which are based on agreed principles of rationality. Authority is limited to areas of competence defined by these laws. This type of authority is usually called formal or hierarchical authority. The right to a competence field is determined by the capacity of a person within this field and is not as in traditional societies, considered to be the property of a person's family or caste. In a Western organization with a professional ideology superiors legitimize their power and control of subordinates by their formal authority. The essence of civil-service integrity and fairness involves acting in a stately, considered manner according to invariant, impersonal rules. The emotional affiliation and task control are both low in such a rule determined organization. When the emotional affiliation is high, the ideology is characterized as fraternal. From the parental authority patterns follows a social interaction which is characterized by obedience and conformity and not by a personal power of initiative. Security for the subordinate is obtained by relying on the superior.

<b>Regulative aspects</b>	<b>West-European context</b>	<b>Russian context</b>	<b>Chinese context</b>
Authority	Hierarchical Decentralized Formal	Parental assertive Centralized Formal	Parental assertive / nurturant Centralized Informal
Sanction Mechanism	Formal: Laws	Informal: Customs	Informal: Face
Type of Sanction	Incentive	Punishment	Punishment

**Table 3 Comparison of regulative aspects**

### *Authority system*

Social position is important in the Chinese context because individuals do not feel comfortable unless they are in a hierarchical relationship with clearly defined roles (Kraar & Shapiro, 1994). In other words, business networks in the Chinese context are hierarchically structured, *inter alia* following the hierarchy of the family firm. Relationships in a person's network are therefore dyadic and hierarchical as well as normatively defined. This is in sharp contrast to Western Europe where business networks are more lateral and the social position of a business partner has no relevance to the initiation or performance of the business relationship.

The authority system of Chinese business networks as well as organizations is highly paternalistic and best characterized according to the authoritarian assertive aspect, in particular with non-family members. The superiors have the right of decision, the emotional affiliation is low and task control by the superior of the subordinate high. The Russian authority pattern also falls within this category. The authority pattern with family or clan members, on the other hand, involves more of the nurturant aspect, since emotional affiliation is higher. The superior also takes responsibility for aspects of the life of employees outside actual work, for example, the families of the subordinates. Moreover, the regulative structure in the planned economy in the Soviet Union did not provide any incentives for firms to legally compete or to co-operate (Mattsson 1993), that is, the institutional structure in the Soviet Union did not promote relationships, which developed through a mutual exchange and adaptation process between the firms. Relationships between firms were initiated and governed through the authority planning system (Johanson 2004b). However, the official authority system is usually not trusted by business managers, which prefer to solve conflicts and disputes through their personal relations rather than by relying on the legal system (Hendley 1997).

In West-European business networks, there is formal or hierarchical authority. The right to a competence field is determined by the capacity of a person within this field and based on integrity and fairness, involving acting in a stately, considered manner according to invariant, impersonal rules. The emotional affiliation and task control are both low. However, these networks have a certain fraternal ingredient, since the emotional affiliation is mostly high. Social interaction is characterized by personal power of initiative and not by obedience and conformity as in the parental authority pattern. Authority is often delegated down, and it rests on formal rules and procedures. Autocratic behavior is rarely seen in the organizations, and authority linked to expertise and formally prescribed positions (Whitley, 1992a; Koopman, 1991). Because relationships are formal and well defined, a large part of relationships in business are entrepreneurial or transactional, and there is rarely an emotional element to business relationships.

### *Sanction system*

A vital aspect of the authority system is the sanction system. One major aspect relates to type of sanction mechanism: laws or customs. Another aspect concerns type of sanction: incentives or punishments. An important aspect of control mechanisms in the Chinese context is the concept of face. Face is an informal sanction mechanism or custom, which is difficult to define precisely. It involves issues such as a man's respect, and status that fall within the regulative aspect. But it also intimately related to the normative dimension through its moral base of shame. The fear of losing face sets barriers to the Chinese's behaviour and one's word and opinion are spoken with uttermost care. Loosing face is the equivalent in the Finnish / Swedish society of loosing trust and honour (Huotari & Rosenberg, 1995).

Sanctions are in West Europe mainly formal, in China informal and in Russia a mix of formal and informal depending on whether it relates to firms or the 'Blat' network. Authority and responsibilities within the Western context are well defined and often law-like as they are formulated in text. These formal sanctions are based on well developed legal system, where rules apply equally to all. The rights of the individual are best guaranteed through property rights, and there is a preference for written, rather than oral, contracts. The law is respected, and contracts signed by individuals and are legally binding, and breach of contract results in legal sanctions (Buuri & Ratschinsky, 2000). Commercial institutions build on and are protected by the state's legal institutions, and commercial organizations in both the public and private sector rest on strong legal institutions. Firms are typically derived from and share a common reliance on legal-rational norms and bases of legitimacy (Whitley, 1992a). Because of high confidence in legal institutions, there is no need for sanctions working through personal relationships in order to guarantee contracts and commitments. However, legal institutions have not had a central importance in China and Russia and the legal framework is still weak. There are various degrees of legal uncertainties due to lack of credible enforcement of the rules that exist. The parental assertive authority does in the Chinese business system what law does in the West, and one reason why paternalism has evolved is that individual and corporate rights are only weakly protected by a legal infrastructure.

## **Conclusions**

Firms in networks are institutionalized actors. By acting in accordance to various norms, values, rules, regulations, schemas and thought styles, actors are socialized into the network by taking on roles in relation to others. In other words, networks can be viewed as collective cognitive, normative and regulative frames. Over time, the network develops a shared understanding, and network actors come to accept a shared definition of social reality through institutionalization. Over times institutionalized activities acquire a rule-like status that renders them persistent and highly resistant to change. They are then taken for granted.

Traditional cosmologies and beliefs about the natural and social world often structure attitudes towards risk, planning horizons and preferences about specialization and formalization within authority structures. In this sense, business life in the West is dependent on contractual agreements and that actors not honoring them will be punished. This reliance and dependency on the working of contractual agreements is a result of the working of another institutional factor, namely norms in the form of a high degree of trust in the legal institutions. Hence, business transactions in Europe are based on written and formal contracts (Tixier, 1996a). In the Chinese context written and formal contracts are less common, and social contracts in the form of verbal agreements and promises are often the basis for agreements and transactions. Individual trust in the Chinese context is important because a lack of a tradition of trust in organizations or formal laws (Kao, 1996). Thus, norms like trust could work as substitutes to regulations. Punishments are not necessary if people follow the rules due to that they trust one another to do that. In the Chinese context trust cannot be assumed and institutionalized law is inadequate for underpinning transactions. Therefore transactions come to be guaranteed by bonds of personal trust (Whitley, 1992a, 1992b). In order to enable economic transactions, i.e. to guarantee reliability of exchange processes, trust in personal relationships is of prime importance. There is little need for lawyers and analysts because there is a great deal of reliance on personal obligation-bonding (Redding, 1995).

In a more general sense, because of weak legal institutions Guanxi relations in China and blat relations in Russia have become a substitute to the legal system, securing protection of private property rights and fulfillment of contracts, and it serves as a more efficient coordination mechanism for production and exchange (Simon, 1998). The end result is that as the government strives to rule by law, the Chinese values of trusting the Guanxi system leads to regulations being ignored. Values could also work as an alternative institutional factor to the regulative system. In the Western context, especially the northern European context, an important element in inter-

personal relationships is honesty. The basis for trust and commitment are previous contacts, personal and organizational skills, and profitable relationships (Johanson et al., 2002). Functional roles are more important than personal qualities and rules are more salient than relationships (Tung & Worm, 1996). The Chinese context is loaded with personalism. Personalism is the tendency to allow personal relationships to enter into decision-making; it is not what you know, but whom you know. Personalistic networking is a response to the difficulty of establishing reliable horizontal relationships across social interactions.

Also, a the long-term orientation, high power distance and a relatively high willingness to avoid uncertainty combined with a weak, unpredictable and non-transparent institutional context, which characterize the environment of most Chinese business networks, means that actors have to make extensive investment in the network and demonstrating that they are committed before they can be accepted as legitimate business actor. They have to earn their trust, which means that demonstration of commitment is instrumental for development of trust. In the Russian network, short-term orientation is typical, which means that there is no patience. Firms do not have the time to wait. Firms are usually suspicious and assume that they will be cheated. As they are not willing to accept uncertainty, they prefer to control and monitor other actors. Demonstrating commitment and trusting others are risky and is something that is just spared specific firms. In West Europe, a more rationale approach prevails, where firms' trust and commitment evolve in an iterative process, where uncertainty is gradually reduced as result of satisfaction and positive outcome from doing business in the past.

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