

# Greenwich papers in political economy

## **Coping with Autocracy:**

### **Corporate political activity, institutional duality, and MNE – local firm rivalry during “institutional backsliding”**

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#### Abstract

This study contributes to the corporate political activities (CPA) and the “institutional duality” literature by investigating how MNE subsidiaries and local firms develop their CPA in an increasingly politicised environment in an emerging market (EMs). Our longitudinal case study, based on interviews with top-level managers in Hungary, supports the view that institutional duality is not just a constraint for MNEs, but allows even firms from institutionally distant economies to successfully transfer political capabilities to the host context, providing them with competitive advantage over local firms. However, we also find that the value of these capabilities changes as institutional change progresses in our post-socialist case. Therefore institutional duality needs to be understood as a time-dependent phenomenon.

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## Introduction

How do MNE subsidiaries develop their corporate political activities (CPA) in an increasingly and rapidly politicising emerging market (EM) environment? The literature on MNE subsidiaries' political activities has developed fast in recent years because non-market strategies are increasingly recognised as an important part of a companies' successful post-entry operations (Zhang et al., 2016; Blumentritt & Nigh, 2002; Hillman & Wan, 2005; Iankova & Katz, 2003; Luo, 2001; Mondejar & Zhao, 2013; Ahlstrom, Young, Nair, & Law, 2003; Hillman & Wan, 2005; Zimmerman & Zeitz, 2002). CPA, also known as corporate political strategy (Zhang et al. 2016; Oliver & Holzinger, 2008) or nonmarket strategies (Doh et al., 2012; Mellahi et al. 2016), captures companies' practices to manage their political and legal environment (Baron, 1995). The link between CPA and firm performance is increasingly well understood (Boddeyn, 2016), but researchers only recently turned towards investigating the determinants of firms' CPA choices (Zhang et al. 2016). The few recent studies that have addressed this important question found that institutional factors are key determinants of CPA (Blumentritt & Nigh, 2002; Blumentritt, 2003; Hillman and Wan, 2005; Lux et al., 2011; Mondejar & Zhao, 2013; Zhang et al., 2016). The relationship between institutional factors and firms' CPA therefore becomes an important, yet understudied, area of research (Zhang et al., 2016). In particular, the CPA literature emerged in the context of developed countries (Hillman & Hitt, 1999; Hillman, Keim & Schuler, 2004) and has hence little to say about how the (institutional) context of emerging economies affects CPA (Deng & Kennedy, 2010; Mondejar & Zhao, 2013; Zhang et al. 2016). This is despite the fact that CPA is particularly important in emerging market economies where the boundaries between the economic and the

political domain are blurry (Carney et al., 2016; Zhang et al., 2016; Nell et al., 2015; Luo, 2007).

We draw on institutional theory in IB to shed light on these questions. The institutional approach in IB (Kostova et al., 2008) suggests that MNE subsidiaries face particular challenges because they are exposed to different institutional environments (also Rodriguez, Siegel, Hillman, & Eden, 2006). Thus, institutional duality (Kostova, Roth, Dacin, 2008; Kostova & Roth, 2000; Kostova, 1999), which defines a situation where subsidiaries have to manage the pressures from the parent firm and the institutional pressures from their host country (Blumentritt and Nigh, 2002: 71), provides one way of analyzing this challenge.

Our study also contributes to the literature on “institutional capabilities” and their transfer in emerging market contexts (Carney et al., 2016). Carney et al. (2016) found that “network penetration” is the key political capability that EMNEs develop in their home country and transfer to the host country to establish crucial political ties; benefitting thus from an “adversity advantage.” Studies that do investigate the impact of EM institutional contexts on MNE subsidiaries’ CPA conceive of institutional duality in the conventional way as a potential constraint and competitive disadvantage for MNEs (Jackson & Deeg, 2008). Thus, Zhang et al. (2016) describe institutional duality as a ‘tug of war’ where home-country and host-country institutions exercise pressures on firms, which will ‘succumb’ to whichever pressure is stronger. However, recent scholarship found that MNEs can turn their complex institutional embedding into competitive advantages (Saka-Helmoult et al., 2016; Edman, 2016; Marano et al., 2016; Regner & Edman, 2014; Meyer et al., 2011; Kostova et al., 2008). Firms can consciously develop strategies around their “minority identity” (Edman, 2016; Regner & Edman, 2014), or experimentally learn new

practices in diverse institutional environments (Marano et al., 2016). From a resource-based dynamic capabilities approach (Oliver & Holzinger, 2008; Teece et al., 1997), this implies that institutional duality can become a resource rather than a constraint that allows firms to develop diverse capabilities. One recent study showed that MNEs can transfer institutional capabilities – including political ones – developed in the home country to host countries (Carney et al., 2016). However, this study focuses on the case of an MNE active in two emerging markets and the successful transfer of capabilities is hence explained by a so-called “adversity advantage.” The concept of institutional distance (Fortwengel & Jackson, 2016; Kostova & Zaheer, 1999) suggests that institutional duality, may become a more challenging constraint when home- and host country institutions are very different. In such cases, successful transfer of capabilities may be more difficult. We address this question by investigating the transfer and development of political capabilities by subsidiaries of MNEs from developed country (DMNEs) in an EM context, namely Hungary.

We further contribute to the CPA literature by combining the institutional duality approach (Kostova & Roth, 2002) with the resource-based dynamic capabilities view (Barney, 2001; Teece et al., 1997). The extant literature conceives of CPA as strategies and behaviors that build on combinations of firm-level resources and capabilities (Oliver and Holzinger, 2008; Frynas et al., 2006). Institutional capabilities – including political capabilities – are developed over time and sometimes over very long periods (Carney et al., 2016; also Johanson & Vahlne 2009). Similarly, institutional environments are not static either. In particular, in emerging market economies institutions can change rapidly and radically (Peng et al. 2008; Young et al. 2008; Peng, 2003). Therefore, institutional pressures are not a constant, but a permanently changing environmental element to which businesses strategically adapt (see Child et al., 2012; Cantwell et al., 2010; Meyer

and Peng, 2016; Peng, 2003; Peng & Heath, 1996; Young et al., 2008;). We go beyond existing studies, by conceiving of institutional duality as a time-dependent phenomenon, rather than a fixed contextual element. We therefore focus on the co-evolution (Child et al., 2012; Cantwell et al., 2010), of institutions and firm capabilities. This leads us to adopt a longitudinal case study approach (Carney et al., 2016, Boddewyn & Dieleman, 2012; Dieleman & Sachs, 2008).

Hungary, our country case, is currently experiencing a phase of rapid institutional change (Sallai & Schnyder, 2015), which we term “institutional backsliding,” from a more market- to a more relationship-based institutional system (cf. Peng, 2003). It constitutes therefore a natural experiment that allows us to investigate companies’ reactions to institutional change in a dynamic context. We gain further explanatory leverage that most existing studies on subsidiary CPA lack, by comparing subsidiaries to domestic firms (DFs). MNE-DF rivalry is indeed a promising area in IB, which has only recently gained some attention among IB scholars. We respond to the call for an inclusion of CPA into the rivalry literature (Mutlu et al., 2015).

Focusing on political capabilities, we propose a new, more fine-grained categorization into relational-, transactional- (market-based), and organizational political capabilities. Previous studies’ have investigating of the value of different types of capabilities in addressing institutional challenges (Carney et al, 2016). Here, we extend this literature, investigating how the value of different types of political capabilities changes over time, as the institutional environment changes too. We attempt to answer the question: How does institutional duality affect the development of political capabilities of DMNE subsidiaries in reaction to radical institutional change in emerging markets? And how do their CPA differ from local firms?

Since previous theories are lacking, we use a qualitative approach to assess the relative value of these different types of political capabilities as the institutional framework evolves from more relationship-based systems to more market-based ones and vice-versa (cf. Peng 2003; Ahmadjan 2016).

We find that DMNEs, contrary to EMNEs (Carney et al, 2016), may not directly benefit from an “adversity advantages” based on home-country relational political capabilities; but we find that – in line with previous literature (Johanson & Vahlne 2009) – they can successfully develop local relational capabilities over time and combine them with transferred transactional- and organizational political capabilities. This supports the recent idea that “institutional duality” may provide MNE subsidiaries with competitive advantages over local firms, in spite of the latter’s stronger embeddedness in the relational environment (cf. Saka-Helmhout et al. 2016). However, in the case of DMNEs, the competitive advantage is not based on an “adversity advantage” (Carney et al., 2016) but rather on a “prosperity advantage” whereby DMNEs leverage superior transactional and organizational political capabilities from the headquarters that local firms cannot imitate.

Our institutional duality account provides an explanation for why MNE subsidiaries seem to have done comparatively well during the early Orban years in spite of local firm’s stronger relational political resources. However, our longitudinal approach also reveals that the relative value of transactional, organizational, and relational political resources changes over time: As the institutional system slides back towards a more state-dominated and relational one, some of the MNE capabilities’ value decreases. We conclude that “institutional duality” itself needs to be understood as a time-dependent and dynamic phenomenon.

The paper is structured as follows. We first review the relevant literature and develop our theoretical framework. We then explain our methodology. Next, we present our empirical evidence and discuss our contribution. The last section concludes.

## Theory and Literature

### Institutional duality as a determinant of CPA

For MNEs, one of the key institutional determinants of their activity is “institutional duality.” This concept captures a crucial specificity of the MNE as an organizational form, namely that it is present in more than one country and therefore exposed to potentially contradictory formal and informal “rules of the game” and institutional pressures (Kostova & Roth, 2002; Kostova et al., 2008). MNEs need to establish and maintain their organizational legitimacy in the host country’s institutional environment, while complying internally with institutional practices imposed by the MNE headquarters (Kostova and Roth, 2002, Kostova and Zaheer, 1999). Navigating these tensions will influence what practices and strategies MNEs will develop. As such, institutional duality affects a firm’s competitive strategies in the market place as well as its political activities. Firms engage in CPA, which comprises activities aimed to affect the legal and policy environment and to influence decision-makers’ opinions (Nell et al., 2015), because the institutional context may constrain or facilitate their activities and their success in the market place (Feinberg et al., 2015; Doh et al. 2012).

However, comparative institutional analysis (CIA) recently stressed that institutions are not just constraints, but enabling factors for firms by supporting the development of specific capabilities and strategies (Ahmadjian, 2016; Saka-Helmout et al. 2016; Fainshmidt et al., 2016; Jackson and Deeg, 2008). Consequently, institutional duality is not solely a source of conflicting *constraining* pressures, but can be the source of *enabling*

forces that provide MNEs with institutionally-induced capabilities that can be transferred to host markets and provide competitive advantages (Ahmadjian, 2016; Helfat et al., 2009; Jackson and Deeg, 2008, Regnér and Edman, 2014; Saka-Helmoult et al., 2016).

Investigating the impact of institutional duality on DMNEs present in an emerging market is of particular theoretical interest, because institutional distance is particularly large (cf. Fortwengel & Jackson, 2016) and tensions between home- and host country institutional pressures can be expected to be particularly strong.

Given that resources and capabilities are derived and developed in response to institutional contexts, we can expect these tensions to affect the type of capabilities that firms have at their disposal. Here, the relationship-based nature of EMs systems is often considered *the* key difference between EMs and “arm’s length” developed countries (Ahmadjian, 2016; Peng, 2003). In arm’s length systems, transactions tend to be governed by the market, relationships are short-term, transactional, protected by contracts, overseen by clear rules, marked by information disclosure and third party enforcement (Ahmadjian, 2016: 17; Peng 2003). In contrast, relational systems are characterized by less transparency, the importance of personal relationships for sharing of private information (Hillman and Hitt, 1999, Luo and Zhao, 2013), and “relational contracting” as key type of economic organization (Peng 2003; Carney et al. 2016). Previous studies have found that foreign entrants adapt to local institutional and political contexts also regarding the relationship-based nature of doing business. Thus, Peng and Heath (1996) attribute the prevalence of network-based strategies among MNEs in transition economies to their successful adaptation to the institutional transition context (also Johanson & Vahlne, 2009). This difference has important implications for the type of CPA and political capabilities that firms develop.

## CPA and political capabilities

While the CPA literature has flourished and has made progress in explaining why companies engage in political activity, which political strategies are effective, and how they impact firm performance (Boddeyn, 2016; Dorobantu et al., 2017; Boddeyn & Brewer, 1994; Oliver & Holzinger, 2008), the determinants of firms' CPA choices are still not well understood (Zhang et al. 2016). The few recent studies that have addressed this important question found that *institutional factors* are key determinants of CPA (Blumentritt & Nigh, 2002; Blumentritt, 2003; Hillman and Wan, 2005; Hillman, 2003; Lux et al., 2011; Mondejar & Zhao, 2013; Zhang et al., 2016).

CPA is a particularly important element of firm strategies in emerging economies where governments' impact on economic life is often more substantial than in developed economies (Doh et al., 2012; Boisot and Child, 1996; Borragán, 2006; Luo and Zhao, 2013). Yet, the differences between emerging market and developed country institutional context mean that the type of CPA that allow companies to successfully influence their political and institutional environment differ too (cf. Oliver & Holzinger; 2008). Thus, in developed economies, CPA is "largely about legal, firm-level engagement with institutionalised political actors and structures" (Lawton et al., 2012: 87). CPA is an issue-driven activity, that follows more or less transparent and clear "rules of the game" (Griffin & Dunn 2004; McGrath 2005; Van Schendelen 2012) and which is mostly viewed as an "essential, legitimate and distinguishable activity, which supplements business activity" (Hadjikhani and Ghauri 2006: 391). In emerging markets, on the other hand, the "kind of structured CPA known in developed states has been largely presumed not to exist" (Lawton et al. 2012: 7). The public affairs culture is missing (Harsanyi and Schmidt, 2012) and the topic of CPA – including lobbying – remains a taboo (Sallai, 2013). Instead, CPA is

mainly limited to informal and at times illegal personal contacts between politicians, public officials, and managers. Informal network- and relationship-based types of CPA matter in developed countries too (King & Pearce 2010; McDonnell & Werner 2016); but they tend to be less important, more transparent, and less particularistic than in developing ones (Peng 2003).

Oliver and Holzinger's (2008) resource-based capabilities perspective on CPA suggests that companies base their political strategies on different types of political capabilities. This insight can be applied to the question of institutional determinants of CPA too: For firms to successfully develop CPA that are adapted to different institutional contexts, they require specific political resources that fit with the environment. Political resources are "any firm attributes, assets, human resources, or any other resources that allow the firm to use the political process to improve its efficiency and profitability" (Frynas et al. 2006: 324; also Boddweyn & Brewer 1994; Dahan, 2005). Political resources include human and organizational resources (Barney, 2001), networks (Carney et al. 2016; Lawton and Rajwani, 2011), but also expertise, financial, and relational resources (Carney et al. 2016; see Dahan, 2005 for a discussion). Firms develop political capabilities by bundling political resources through managerial actions, using both internal and external means and resource configurations (human, network and organizational) (Lawton et al., 2013). However, these resources and capabilities are not independent of the institutional context in which organizations operate. Carney et al. (2016) show that firms develop specific "institutional capabilities" in reaction to weak institutional environments in emerging markets, including political capabilities to handle the firm's relationships with the government. Moreover, EMNEs that develop capabilities to deal with weak institutional environments in the home country, can transfer them to institutionally

similarly weak host countries; a phenomenon that has been termed “adversity advantage” (Ramamurti, 2009).

Given that firm resources and capabilities are developed in response to institutional environments, we propose a categorization of political capabilities that differs from the usual distinctions between firm-level/internal and collective/external (Zhang et al., 2016; Oliver & Holzinger, 2008), or physical-, human, and organizational resources (Frynas et al., 2006). We distinguish three categories of capabilities that account for the key distinction between relationship- versus transactional/rule-based institutional systems (Peng, 2003): Transactional, organizational, and relational. Capabilities in the transactional category are characterized by their ‘formality,’ are based on expertise and information exchanged through formal channels, and involve publicly available information, and official, transactional contacts between the firm and decision-makers (such as responses to consultation procedures). Organizational political capabilities, like other transferable organizational capabilities (Jensen & Szulanski 2004) are those, which are readily available within the organization or may be acquired from the market thanks to organizational resources (e.g. expertise from external agencies). In contrast relational capabilities include formal and informal contacts and networks with political decision-makers. We further follow Zhang et al. (2016), who distinguish collective CPA from individual ones, by distinguishing relational political capabilities according to whether they exist at the individual level or at the collective level of the organization. Thus memberships in industry associations or interest groups are collective relational political resources, while a CEO’s personal network is classified as an individual political resource (cf. Zhang et al. 2016). In practice, the difference may not always be clear-cut. Thus, formal and informal meetings with public officials can occur either at the collective level (e.g.

managers as representatives of the company meeting with public officials) or the individual level (a top manager meeting with public officials based on friendship-, family-, or other personal ties).

In this paper, we use this capabilities-based framework in combination with the institutional based view to investigate the understudied question of the determinants of MNE subsidiary CPA in emerging markets. Given our interest in the effect of institutional duality on CPA capabilities, we increase explanatory leverage by comparing MNE strategies to domestic firms; an issue which we explore next.

### MNE-local firm rivalry in post-socialist emerging markets

In emerging markets, political capabilities may not be equally distributed between local firms and foreign entrants. MNEs compete with local firms that are more strongly embedded in networks and enjoy domestic privileges (Kostova and Zaheer, 1999) and may hence suffer from a “liability of foreignness” (Zhang et al., 2006). Yet, a recent study showed that MNEs from institutionally similar contexts may be able to successfully transfer their “institutional capabilities” to other EMs and thus develop successful competitive strategies in the host country (Carney et al. 2016). This hints at an “adversity advantage” (Ramamurti, 2009) that the foreign MNE subsidiary can draw on, i.e. it can mobilize capabilities developed in an equally adverse environment as the host country. Yet, it is not clear whether the same is true for an MNE from an institutionally very different home country, which can be expected to require different types of capabilities. Indeed, the more “institutionally distant” the host country, the more institutional pressures subsidiaries face to develop relational political capabilities from scratch (Luo and Zhao, 2013).

Some studies found that MNEs do manage to successfully build new relational capabilities, e.g. by appointing a local CEO or government affairs professional, who possess the relevant political networks (Meyer and Peng, 2016, Peng and Heath, 1996, Sallai, 2013), or through partnerships with local companies (Ahmadjian, 2016). Yet, building such relational political capabilities may take a long time (Carney et al. 2016). Therefore, one would expect that in the early phase of DMNE entry into an emerging market, the institutional environment is favorable to local firms that have more relational capabilities. DMNEs may lack the knowledge about the local nonmarket environment, government procedures, and socio-cultural norms (Jiang et al., 2015). Yet, other studies found that MNEs' stronger organizational capabilities, management skills, and strategies give them a competitive advantage over local firms even in the early stages (Jiang et al., 2015; Mutlu et al., 2015). From an institutional duality perspective, the latter finding suggests that DMNEs can indeed transfer certain resources and capabilities to the emerging host country.

An additional factor determining subsidiary-local firm rivalry, however, is that not only firms' capabilities change over time due to learning processes, but also the institutional environment evolves – and it does so particularly quickly and radically in emerging markets (Young et al., 2008; Peng, 2003). Peng (2003) suggests that profound institutional change shifts competitive advantage towards MNE subsidiaries over time, because transactional capabilities become more important as a country shifts towards a more established market economy, while the importance of relational ones declines. Post-socialist European countries provide some evidence for this. Here, the competitive advantages of local firms eroded relative to MNEs, as the "rules of the game" became more transparent, formalized, and institutionalized (Akbar and Kisilowski, 2015: 6).

Other studies, however, argue that MNEs' advantages may erode over time, because local rivals close the gap on MNEs both in technology and management knowledge through mutual learning processes (Mutlu et al., 2015). As a result, resource similarity between local and foreign firms increases, which allows the domestic firm to 'strike back' (Mutlu et al., 2015).

The rivalry question is further complicated by the fact that different post-socialist countries including Hungary have recently experienced "institutional backsliding": Rather than continuing their "transition" towards a Western-style, market- and rule-based economic system, several postsocialist countries have started to shift towards more authoritarian regimes at the political level ("democratic backsliding" Gretskevits, 2015) and towards a less market-based economy at the economic level (the "return of state capitalism" Kurlantzick, 2016; Bremmer, 2008; Orenstein, 2013; Sallai and Schnyder, 2015). Competitive dynamics between subsidiaries and domestic firms may be affected, due to differences in the type of political resources these companies can mobilize. The continuing transition of post-socialist economies (Meyer and Peng, 2016) provides researchers with a natural experiment that can shed further light on the development of political resources and the impact these have on the unsolved question of the rivalry between subsidiaries and local firms. We take advantage of this natural experiment to answer the questions how MNE subsidiaries develop political capabilities in an increasingly politicized environment and whether institutional duality provides DMNEs with a competitive advantage compared to local firms in the area of CPA. This allows us to contribute to the literature on "institutional capabilities", institutional duality, and CPA development.

## Methods

### *Case selection, sample, and data collection*

Our study is based on a longitudinal case study of the transition process in Hungary. Building theory from a case study involves using the case to create theoretical constructs, propositions and empirical evidence (Eisenhardt and Graebner, 2007). As the research question investigated in this study is a process-related question – focusing on how firms develop political capabilities in response to institutional changes – a qualitative approach was chosen. The focus of the study is to explore an actual phenomenon that has rarely been addressed and answered previously. In such cases, when “‘how’ and ‘why’ questions are being posed, when the investigator has little control over events, and when the focus is on a contemporary phenomenon” the case study method is the preferred strategy (Yin 2003: 1).

Since the start of its postsocialist transition in the 1990s, Hungary has been an important case for scholars (Martin, 2013, 2002; Whitley et al., 1996; Stark & Brustz, 1998). By the mid-2000s, it had advanced to one of the most consolidated democracies among post-socialist countries. The ‘bifurcated’ Hungarian business system – where one part was focused on and dominated by foreign capital, and the other one more domestically orientated (Martin 2002) – that emerged after a decade of transition, provided both domestic firms and MNE subsidiaries with opportunities (EBRD 2005). Martin (2002: 836) speculated whether the ‘politicized-managerial capitalism’ – characterized by an important role of politics in the economy, but a dominance of the economic elite over the delegitimized political one – would become a stable system, or would transform into something else. Since the 2010 elections, - when Viktor Orbán’s conservative party Fidesz acquired a two-thirds majority in the parliament – it has become increasingly clear that

the “managerial” aspect of the Hungarian brand of capitalism has lost ground to the “political” one, showing thus signs of a reversal of the power relations between the political and the economic elite. Since 2010, Hungary’s “democracy score” has declined, bringing it closer to some of the less developed semi-consolidated democracies, like Romania and Bulgaria (Walker and Habdank-Kořaczowska, 2012: 6). We call this new – from most theoretical perspectives unexpected- (e.g. Mutlu et al. 2015; Peng 2003) – phase of transition, a phase of “institutional backsliding.” While Hungary was a front-runner in attracting FDI during the 1990s, since 2010, the country has at times engaged in an aggressive political rhetoric against foreign capital and adopted unfavorable policies such as high taxes in MNE dominated industries (Sass and Kalotay, 2012: 1). Yet, domestic firms too are increasingly exposed to arbitrary state action. Hungary’s rapid backsliding into a relational- state-dominated system, makes the country a critical case and hence particularly suitable to investigate the impact of institutional change on firm capabilities, because patterns become more visible than in less turbulent times (Flyvbjerg, 2006). Although the representativeness of any case study is limited, the Hungarian case may not be unique. Indeed, several other states in the region – including Russia, Slovakia, and Poland – exhibit signs that suggest that they may follow a quite similar path of backsliding (Vliegthart, 2010).

Data collection and data analysis was carried out in parallel, which allowed us to develop theoretical insights and propositions, while testing and modifying these as the project evolved. Overlaps in data collection and analysis are beneficial, since it speeds up the analysis and “reveals helpful adjustments to data collection” (Eisenhardt 1989: 535).

The empirical study comprised 52 semi-structured interviews out of which 42 were conducted with business people and a further ten with experts such as political advisors,

or representatives of NGOs and associations. In-depth interviews are an insightful method for exploring the “often nuanced causal factors of specific managerial action” (Lawton et al. 2013: 231). Due to the exploratory nature of the research, the semi-structured interview technique provided a single framework for the different interviews – since it permits comparison (Flynn et al., 1990) – but also gave flexibility to ask questions in relation to previously not identified issues that arose from the interviewee’s responses (Bryman 2004).

In order to match the temporal and processual nature of the phenomenon under investigation, we chose a longitudinal case study approach (cf. Carney et al. 2016). Interviews were conducted between 2010 and 2016 in order to capture firms’ reactions to different stages in the process of backsliding that started with Orban’s accession to power in 2010.

Our sample is based on purposive sampling through predetermined selection criteria, as it is often the case in qualitative research (Miles and Huberman, 1984; 1994). We aimed at constructing a sample of companies from various sectors – including export-orientated and domestic ones – as well as containing the different ownership types that are commonly distinguished in the transition literature (SOEs, privatised incumbent firms, foreign new entrants, and domestic newly-established (*de novo*) firms (Martin 2008, Peng 2003).

Given the very sensitive nature of the topic of study and the political climate in Hungary, our sampling method necessarily was limited by our reliance on companies’ willingness to participate in spite of the possibility of political repercussions. Participants were guaranteed the strictest confidentiality. While a self-selection bias cannot be completely excluded, given that we are using an inductive, theory-building approach and also given the diversity of companies in our sample, we are confident that our results are not

affected by this shortcoming. Indeed, the sectoral composition of the sample is diverse: The single largest industry in our sample was banking with five companies, followed by the energy, retail and manufacturing industries with three companies each. Overall, our sample contains firms from fifteen different industries.

Given our interest in the ability of DMNEs to adapt to relationship-based systems, we only included MNEs from western countries with highly developed institutional systems. The interviewed subsidiaries originated from the UK, Italy, France, Germany, the Netherlands and the US.

Our interviewees comprised CEOs and Political Affairs directors at MNE subsidiaries and top managers at domestic Hungarian firms. We tended to interview only one person per company, because political activity in Hungary is virtually always limited to the very top of the managerial hierarchy especially for domestic firms (Sallai, 2013). Therefore, in most cases only the CEO or a responsible director was deemed to possess the necessary information to answer our questions. Due to the longitudinal nature of the study, we have interviewed in several cases the same respondents both in the early years of the Orban regime in 2010-2012 as well as recently in 2015-16. Due to staff turnover, repeated interviews were not always possible. Interviews were conducted in English and in Hungarian. Interviews in Hungarian were translated by one of the authors.

Table 1: Sample composition by type

| Type of firm                  | Number of interviews |
|-------------------------------|----------------------|
| MNE subsidiary                | 22                   |
| Hungarian state-owned company | 8                    |

|  |    |
|--|----|
| Hungarian privately-owned company                | 12 |
| Total number of interviews with business leaders | 42 |

To obtain multiple perspectives on the impacts of the new government on firms, we sought a range of opinions, including an additional ten interviews with actors from the ‘context’ of the case as recommended by Perry (1998: 798). These included political advisers (3), five non-governmental organizations (including a trade union and an industry association), a public affairs expert, and a Hungarian MEP. By comparing and contrasting views from different actors, we decreased possible bias and interpreted the data in a more nuanced manner.

We used additional secondary sources in order to increase our confidence about the reliability of the interview responses. These include information available on corporate websites, journalistic sources (including the Hungarian economic weekly HVG, Bloomberg.com, the Telegraph, Reuters.com, EurActiv, and The Economist) and reports by reputable NGOs such as atlatzo.hu and Transparency International. Due to the lack of scholarly research on these topics in Hungary, such sources are often the only information available and are more reliable than official government sources.

### *Data Analysis*

Interviews were coded and analyzed using the NVivo software. The software helped in identifying common themes and creating links between themes and patterns. After the transcription of the interviews the researchers coded the data according to themes that seemed to be recurring. Based on the “nodes” that formed, the researchers identified patterns and arranged key themes. In the analytical work, the framework of Miles and

Huberman (1994) was applied, and their codification procedures for qualitative analysis were followed - namely the process of reducing data, displaying data and drawing and verifying conclusions.

## Findings

### Differences in CPA capabilities of MNEs and Local firms

Our main interest was to identify the availability and use by MNE subsidiaries and domestic firms of different types of political capabilities as the institutional environment in Hungary shifted once again from rule-based to more relationship based institutions Table 2 summarizes the key findings in this respect and provides representative quotes from the interviews.

**Table 2: CPA capabilities at MNE subsidiaries and local firms**

|                             |  | Representative Quotes   |   |
|-----------------------------|--|---|---|
| Type of capability          | Examples   | MNEs  | Locals  |
| Transactional capabilities  | Political strategy<br>Policy papers<br>Coalition building<br>Intelligence<br>Policy monitoring<br>Policy replies | “Hungarian companies do it [lobbying] on their own, or they go through an association and plus they engage in their own ways as well, by finessing... At [multinationals,] it [lobbying] is coordinated. And in the associations our professionals prepare very serious documents and all the lobbyists of the industry say the same. We argue for industrial interests.” (Director of Stakeholder Relations, Subsidiary11, 06.09.2011) | “Our interest representation was not very effective before either, but today even less. There is [only] the media and our [informal] discussions with the decision-makers.” (Co-CEO, Local 9, 15.12.2011) |
| Organizational capabilities | MNE competence and experience<br>MNE standards and procedures  | “There is huge experience and background internally at these companies [MNE subsidiaries]. They have a professional for this  | “Hungarian companies do not have political departments, not even a person, who does it.” (Co-CEO, Local 9, 15.12.2011)  |

|                         |   |   |   |
|-------------------------|---|---|---|
|                         | Use of of MNE PA resources<br>PA expertise  | [lobbying/CPA] and international support. They collect international benchmarks; they hire consultants to write policy papers, and even legislative proposals.” (Director of Stakeholder Relations, Subsidiary11, 06.09.2011)   | Also: CEO, Local 1, 15.07.2016; Technical Director, Local 12, 20.06.2011  |
| Relational capabilities |   |   |   |
| Collective relational   | Membership in associations or interest groups<br><br>Direct formal and informal networks to political decision-makers (association level) | <b>Collective</b><br>“If we look at the last two years, what we could do – it is almost zero. There was no openness for negotiations, no cooperation. There is no way of entering [networks to government].”(CEO, Subsidiary14, 26,01.2012)<br>Also: CEO Subsidiary 2, 23.08.2016 | <b>Collective</b><br>“We can do lobbying through the engineering association that represents individuals, but we are also members of consultant engineers, the Hungarian chamber of commerce. We believe it is very important to be represented on events. Everything depends on personal contacts, you never know.”(CEO, Local 1, 15.07.2016)<br><br>Also: Head of Strategy, Local 16, 02.07.2011; Head of Strategy, Local 16, 02.07.2011; Vice-CEO, Local 5, 10, 07.03.2012; Chairman, Local 6, 07.03.2012) |
| Individual relational   | Direct formal or informal contacts with political decision-makers (individual level)<br>CEO’s professional networks                       | <b>Individual</b><br>“I know a lot of decision-makers. I organize meetings between leading decision-makers like ministers and state secretaries and the management of my company.” (Director of Stakeholder Relations, Subsidiary11, 06.09.2011)                                  | <b>Individual</b><br>“Therefore we have to have good contacts with the state. We know everybody. This is a small country.” (Chair, Local 10, 15.11.2011)<br>Also Chairman, Local 6, 07.03.2012  |

Our interviews show that while subsidiaries rely on all three types of capabilities (transactional, organizational, and relational) in their political activities, locals rely predominantly on relational capabilities in their institutional engagement strategies.

For instance, top managers of subsidiaries want to know who is dealing with any given policy in the different ministries, because their organizational resources allow them to prepare analysis-based lobbying documents that can be channeled into the legislative process early on (Director of Stakeholder Relations, Subsidiary11, 06.09.2011). This type of engagement strategy is frequent in market-based, transactional institutional settings, but is very rare in the Hungarian, relational institutional context. Subsidiaries therefore

seem to benefit from “institutional duality” by drawing on MNE organizational resources and political capabilities from the home country that can be used in the relationship-based context of the host country. Conversely, local firms do not have any similar transactional or organizational resources to draw on:

“Hungarian lobbying is more a surface type lobbying, not carrying hundreds of pages of professional arguments.” (Vice-CEO, Local 5, 07.03.2012)

Yet, at first, subsidiaries were at a disadvantage compared to domestic firms, because they lack relational resources to deal with the relational host context (e.g. CEO, Subsidiary 14, 26.01.2012). In this respect, their foreignness constitutes a liability with respect to their weak relationship-based resources. Local firms, on the other hand, are often well-connected to the state bureaucracy. As the Chairman of one local firm put it (similarly Chairman, Local6, 07.03.2012):

“[W]e have to have good contacts with the state. We know everybody. This is a small country.”  
(Chairman, Local 10, 15.11.2011)

However, over time some MNEs successfully pursue networking strategies and manage to establish contacts with politicians and the state bureaucracy, developing thus relational political capabilities. Interestingly, such strategies differ from domestic firms’s relational strategies, in that subsidiaries leverage their transactional and organizational political resources to pursue a different type of networking strategy. One important way in which MNE subsidiaries in Hungary acquire collective relational resources is by hiring well-connected local staff. Thus, the CEO of a local subsidiary stated:

“The best is to employ somebody, or a company who have done this [political activity] already in this country.” (CEO, Subsidiary10, 11.01.2012.)

Another way in which MNEs acquire (collective) relational political resources is by signing "strategic partnerships" with the government or contracting local consulting firms to open doors for them. As one respondent explained (similarly VP strategic programmes, Subsidiary15, 09.08.2015):

"The big change came with the signature of the strategic partnership with the government. [...] What these agreements can really help [with], is to build highest-level relationships. If I say that I have an issue they will arrange a meeting on the highest level. 2-3 times a year our European leader can meet the Minister and we get reassuring messages. We use this a lot more recently." (Director, Subsidiary 7, 16.08.2016)

Virtually all of our respondents stress the difference in the availability of transactional and organizational resources for MNEs and their absence at local firms (see table 2). Due to the lack of transactional and organizational resources, domestic companies are excluded from the regular, formal policy-making process, which allows subsidiaries to overcome the initial disadvantage stemming from their exclusion of informal and personal networks and provides them with a distinct advantage in their political strategies. This advantage is even increased by the fact that the Orban government tends to use formal channels of interest representation in very strategic and selective ways. Thus one respondent stated:

"When the government – reluctantly – sends documents for review or debate, it tries to prevent opinions by sending the document last night, requiring feedback by the following morning. Companies are normally not prepared to submit any feedback to these. But multinationals are prepared to give feedback even in 24 hours." (Director of Stakeholder Relations, Subsidiary11, 06.09.2011)

Some local firms too undertake certain types of transactional political strategies – e.g. systematic legislative monitoring (e.g. Head of Strategy, Local 16, 02.07.2011). However, these strategies appear less effective than MNE subsidiaries' activities due to the lack of organizational resources that allow subsidiaries to transform these resources into political capabilities (e.g. Co -CEO, Local 9, 15.12.2011; CEO, Local 8, 30.03.2012).

Our data suggest, also, however that over time MNE subsidiaries were able to transform the “liability of foreignness” into competitive advantage as transition progressed towards a more arm's length system. Indeed, before Orban's accession to power and in the early phase of his government, MNEs were able to leverage all three types of political capabilities, some of which were not available to local firms.

### The impact of institutional duality on CPA capabilities as transition evolves

Our data highlights that there is an asymmetry of capabilities between the MNE and the domestic firm in each phase of transition. In phases when the institutional system moves towards a more rule-based system, where transactional and organizational capabilities have a more important role in CPA than relational capabilities, MNEs are doing better than local firms, because they have stronger organizational and transactional capabilities due to their multinational nature. In this phase institutional duality positively affects MNE's CPA-related competitiveness as it helps them to draw on parent capabilities and know-how. The more market-based the institutional system becomes, the more disadvantaged local firms are as their transactional capabilities are weaker than MNE's and they mostly rely on relational capabilities, which become increasingly unnecessary.

In contrast, during the early Orban years, the role of relationship-based exchanges has started to become more important once again, although impersonal exchanges and official channels of CPA remained in place. During this phase, the competitive dynamics between MNEs and local firms started to reverse. As the Orban government consolidated its power – notably after the re-election in 2014, the regime adopted increasingly authoritarian features and transition started to “backslide,” towards a more relationship based system. During that phase, the value of transactional and organizational capabilities started to decline and institutional duality becomes more of a constraint than an advantage for MNEs. Indeed, as institutional pressures to engage in relationship-based exchanges become stronger, the effectiveness of subsidiary capabilities that derive from their embedding in an MNE decreases. Thus, CEOs of subsidiaries are losing some of their influence, notably due to the increasing nationalism of the government:

“First they [MNEs] need to find a good CEO, it is rare that a foreigner is allowed in this.”

(CEO, Subsidiary10, 11.01.2012.)

Even the strategy of hiring local CEOs to establish political ties with the government has become less efficient due to the constantly and arbitrarily changing formal and informal rules:

‘[T]he problem [with hiring well-connected locals] is that they knew the old mechanisms. The new mechanisms under this government are different.’ (CEO, Subsidiary10, 11.01.2012.)

Simultaneously, subsidiaries’ ability to engage in the new types of CPA required to cope with the increasingly relationship-based and authoritarian regime is limited by head quarter standards. Indeed, our interviews clearly show that with institutional backsliding money has once again become an important political resource. Put differently,

increasingly, access has to be literally bought through outright bribery; a phenomenon that had declined during the early phase of transition. As our interviewees put it:

“The raw truth is very sad. The most important element here is money. All the other things are a matter of techniques.” (CEO, Local7, 30.03.2012)

“Those who have money have real influence. Lobbying is very closely interlinked with party financing. The link is a lot stronger than 10 years after the political change. It is a lot more centralised than before.” (CEO, Local 7, 30.03.2012)

While acquiring information about corruption is obviously a very sensitive undertaking, our interviews suggest that, subsidiaries’ leeway in engaging in bribery to get access to the political arena appears more limited than domestic firms’, because MNEs tend to have stronger anti-corruption standards and are potentially exposed to stronger scrutiny of home-country media and anti-corruption activists than domestic firms from emerging markets. Thus, one respondent referred to a dilemma that “direct communication” with officials was important, but that he was reluctant to use such channels, because of what the company would have to offer in exchange (namely monetary payments):

“The official forum for lobbying is the [industry] association and they lobby with the public decision-makers. Of course there are some personal negotiations beyond this forum. It is a dilemma for me as it may be useful to have more direct communication, but the question is what do we say, what do we offer.” (CEO Subsidiary4, 15.07.2016)

More indirect forms of monetary transfers exist too. The most usual ones are supporting specific charities selected by people close to the governing elite, or to contract a consultancy firm specialised in public affairs, which then gains access to the political arena, without the subsidiary knowing what exactly goes on behind the scenes. One CEO described the way in which the consultancies treat the companies’ requests for access as ‘smoke and mirrors’ (CEO of Subsidiary5).

Therefore, institutional backsliding increasingly leads to tensions between the subsidiary and the MNE, not just because of corruption, but more generally due to the new difficulties that subsidiaries face in comparison to subsidiaries in other EMs.

Thus, one respondent explained:

“I send a newspaper article to the headquarters every second day and the reaction I get from the top management these days is “Hungary again?” They start to get tired of it, they do not understand. This is very bad for the Hungarian subsidiary, because there is an absolute passivity and resignation coming from the European leadership, which decreases not only our competitiveness, but also our lobby power within the firm [MNE]. Our lobby position is weakening, and this is true for my own position, for the legal director, the finance director. Despite us being in my opinion the strongest team in the four Visegrad countries, all these media campaigns erode our own personal credibility as well.” (Director, Subsidiary7, 16.08.2016)

In summary, our interviews show that up to the election of Orban as PM in 2010, the increasingly rule-based institutional environment allowed subsidiaries to leverage organizational and transactional political capabilities, which stemmed from their embedding in an MNE, to develop effective and successful CPA, by combining them with newly developed relational capabilities. During that phase, institutional duality provided MNE subsidiaries with a competitive advantage over domestic firms. Since 2010 – and even more since 2014 when Orban has received a two-third majority at the general elections the second time – however, the institutional environment in Hungary has once again become much less favorable to rule-based transactions, which in turn has led to a change in the required institutional capabilities for effective CPA.

The changes have not only decreased the value of transactional capabilities, but also of collective relational ones. The only remaining political resources that allow firms to have

their voice heard in the political arena are particularistic, personal relationships with politicians and public officials close to the Orban clan or outright bribery. Our interviews show that although, most subsidiaries seem to be aware of the "availability" of the necessary relational capabilities not all of them are prepared to acquire them, because they may not be compatible with home-country institutional pressures that MNEs are facing due to institutional duality. In this context, institutional complementarity becomes a constraint not a resource.

## Discussion

Applying the capabilities and institution based views to CPA, our findings suggest that subsidiaries do not merely adapt to relationship-based EM contexts by engaging in network-based (Peng, 2003b, Peng and Heath, 1996) or relational strategies (Luo and Zhao, 2013a), but design a localized "combined" political strategy in emerging economies that draw on newly acquired relational capabilities, but leverages them using existing MNE-related organizational and transactional capabilities. This allows MNE subsidiaries to gain a competitive advantage over local firms in spite of an initial lack of local, relational embeddedness.

Our study contributes to the literature on cross-border transfer of "institutional capabilities" by showing that such transfers are not limited to the case of EMNEs entering other emerging markets. Carney et al. (2016) showed that EMNEs can transfer to relatively similar host contexts institutional capabilities that they developed to cope with a politicized home country context, providing them with an "adversity advantage". We find that such successful transfers of institutional and political capabilities are not limited to transfers between emerging markets. The DMNEs in our sample successfully used transactional and organizational political resources derived from highly developed

institutional home countries in a relationship-based host context. Yet, the basis of the competitive advantage is different from the “adversity advantage” (Ramamurti, 2009) that EMNEs obtain. In the case of DMNEs, we find a “prosperity advantage” whereby the sheer amount of DMNE’s organizational and transactional resources simply cannot be matched by local firms.

In this respect, our study contributes to the “institutional duality” literature. During the early phase of transition, institutional duality allowed subsidiaries to leverage all three types of political resources to develop successful corporate political strategies in a transition economy, while local firms were more limited in the type of resources they could mobilize. In this respect, our study finds support for previous research that found that MNEs can tap into resources and capabilities from multiple local contexts and integrate them to create a range of competitive advantages (Kostova et al., 2008; Meyer et al., 2011; Regner and Edman, 2014; Saka-Helmout et al., 2016).

However, contrary to these previous studies, we conceive of institutional duality not as a static, but as a dynamic, time-dependent phenomenon. Indeed, the static view of institutional duality would be untenable given the quick and radical institutional changes that EMs are prone to experience (Young et al., 2008; Peng 2003). Therefore, the value of resources and capabilities that firms can successfully use during one phase of transition may decrease during another. Our findings are summarized in Table 4.

**Table 4: The dynamic capabilities framework of institutional duality**

| Transition phase | Institutional pressures           |                                       | Institutional capabilities required | Availability of capabilities to... |    |
|------------------|-----------------------------------|---------------------------------------|-------------------------------------|------------------------------------|----|
|                  | Market-based, impersonal exchange | Relationship-based, personal exchange |                                     | MNE                                | DF |
|                  |                                   |                                       |                                     |                                    |    |

|   |                       |                       |   |                                   |                                |
|---|-----------------------|-----------------------|---|-----------------------------------|--------------------------------|
| Shift to rules-based system (1989-2010) | Strong                | Moderate (decreasing) | Transactional<br>Organizational<br>Collective relational<br><br>Personal relational | High<br>High<br>Medium<br><br>Low | Low<br>Low<br>High<br><br>High |
| Early Orban years (2010-14)             | Moderate (decreasing) | Moderate (increasing) | Transactional<br>Organizational<br>Collective relational<br><br>Personal relational | High<br>High<br>Low<br><br>Low    | Low<br>Low<br>High<br><br>High |
| Backsliding (2014-17)                   | Weak                  | Strong                | Personal relational   | Low                               | High                           |

The table shows that during the period of “backsliding” since 2014, personal relational political resources – as opposed to collective relational, transactional, and organizational ones – become more valuable. Here we find that MNE subsidiaries tend to struggle more than local firms to develop the necessary personal relational political resources needed to engage with the changing institutional system. The required political resources for effective engagement with the increasingly autocratic state would require practices that are not (openly) supported by the MNE’s home institutional environment and head quarter standards. Therefore, the tensions created by institutional duality continue to increase for MNEs, which reduces – in this instance – their ability to adapt.

Institutional duality therefore has to be conceived of as a context-dependent and temporal phenomenon, which deploy their effect on MNE subsidiaries in an evolving interplay between home and host-country context.

### *Limitations*

One limitation of our study is that it is based on an extreme case. This was a conscious choice, as such cases are particularly revealing of important empirical phenomena (Yu 2003). However, this raises the issue of the boundary conditions with regards to this country case study. While there are certainly important institutional and political

differences among various postsocialist countries, it would nevertheless appear that several of them have recently experienced quite similar developments as Hungary – albeit to different degrees and at a different pace. Thus, Russia, Slovakia, and more recently even Poland have all experienced some degree of institutional backsliding (cf. Orenstein 2012). Indeed, we propose that the concept of “institutional backsliding” derived from the Hungarian case, should be viewed as a new phase that was hitherto neglected by existing theories of “institutional transition” in emerging markets (Mutlu et al. 2015; Peng 2003). This suggests that some of the dynamics in political capability development that we discovered in our study and the implications for subsidiary – DF competition may apply there as well. Further research should refine the characterization of the “backsliding” notably based on evidence from more cases.

A further limitation is that we did not distinguish differences in our MNEs subsidiaries home setting. While we can surmise that all highly-developed Western countries are close to a rules-based system in Peng’s (2003) sense, some of them use relationships more extensively than others. This may provide MNE subsidiaries from such countries with certain resources and capabilities that make them particularly successful in adapting to relationship-based systems in emerging markets (see Porter 1990 for the case of Italian companies in developing countries).

### *Managerial implications*

From a practitioner’s point of view, our findings hint at the important tensions that emerge for foreign subsidiaries due to the situation created by the “return of the state” in certain emerging market economies. It indicates that developing relational resources of both the collective and – increasingly – personal type seem key to a successful political strategy in such a context. However, it becomes also clear that faced with a government

that increasingly disregards formal channels of interest representation, foreign companies may face delicate ethical questions in establishing and maintaining crucial political ties. This may affect the overall attractiveness and the political risk associated with a given emerging market economy.

## Conclusion

This study responded to earlier calls for research to explore how context-specific resources are developed by interaction of global and local processes (Meyer and Peng 2006) and how the interaction between the parent and host-country forces exert influence on subsidiary political activities (Blumentritt and Nigh, 2002). We used the current phase of “institutional backsliding” in one post-socialist country as a natural experiment to investigate companies’ reactions to rapid institutional change. We show that “institutional duality” plays a key role in shaping subsidiaries’ CPA. Yet, the impact of institutional duality evolves over time: Duality constituted a resource during the early phase of transition, by providing subsidiaries’ with internationally transferred resources and capabilities that local companies do not possess. Yet, our study also shows that competitive advantage derived from institutional duality is a time-dependent phenomenon that evolves in parallel to the process of institutional change (Peng 2003). As institutional change continues and takes new, unexpected forms (“backsliding”), once valuable resource become less valuable and new capabilities need to be developed. As the system has shifted towards requiring more particularistic, relationship-based, and increasingly unethical (indeed at times illegal) practices, institutional duality become more of a constraint for DMNEs than a source of advantage. It remains to be seen what resources DMNEs can mobilize to harness their political strategies for the new situation.

Our study suggests that – partly at least due to the institutional complexity they face and the resulting diversity of resources and capabilities they can draw on – MNEs are particularly well placed to deal with even the most challenging environments and to quickly adapt to new institutional contexts.

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