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The Cross Cultural Relativity of Institutional Environment for Economic Transaction Governance

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Abstract

Despite the broad consensus that the institutional environment matters for firm strategies and outcomes, the question of how different social cultural settings enable a common set of basic governance mechanisms work with or against each other to form relatively different institutional environments in organizing economic activities has remained largely unanswered. This paper aims to integrate and extend previous research to answer the question and explain economic transaction governance across different institutional environments from a social cultural perspective. The starting point is that economic exchanges are often coordinated by a combination of spontaneous market forces, social relations, and legal restraints that serve as the basic governance mechanisms for shaping an institutional environment for economic transaction governance. This study further proposes that different social cultural attributes will shape different types of institutional environment that relies more on one mechanism but less on another between legal restraints and social relations, to supplement spontaneous market forces to regulate economic transactions.

Keywords: Institutional environment, economic transaction governance, social relations, spontaneous market forces, legal restraints, cross cultural relativity.

1. Introduction

How to make economic actors cooperate in transactions has been a prominent issue in organizing economic activities (Greif, 2000). An institutional environment provides both formal rules and informal norms that can coordinate human interactions including economic transactions (Greif, 2004; North, 1991). When economic activities must cross different institutional environments, such as those in global business, the heterogeneousness of rules and norms along with the different ways to apply and enforce them in different environments makes the understanding of the nuances and commonalities of the institutional environment for economic transaction governance more important (Aguilera & Grøgaard, 2019; Jackson & Deeg, 2019).

Prior studies on economic transaction governance, notably in the transaction costs economics (TCE) tradition, have taken the institutional environment as given (Williamson, 1996). Focusing solely on the choice of governance mechanisms based on relative costs while overlooking the availability and relative efficacy level of various governance mechanisms in different institutional environments, for instance, TCE is unable to extend to some international contexts where asset specificity does not necessarily raise transaction costs or lead to vertical integration which is against one of its major propositions (Dyer, 1997; Hamilton & Biggart, 1988). Similarly, for the studies that categorize and compare different governance mechanisms, structures, and organizational forms to explore how market, bureaucracies, and clans (Ouchi, 1980) or price, authority, and trust (Bradach & Eccles, 1989) interplay at firm or transaction level (Ebers & Oerlemans, 2013; Jones, Hesterly, & Borgatti, 1997), or how embeddedness could facilitate exchanges through network governance (Uzzi, 1997), the variation of different institutional environments is not sufficiently considered.

Some studies did compare different institutional contexts to explore the qualitatively different types of exchange arrangements in different societies. For instance, a group of studies extend governance frameworks beyond the traditional distinction between markets and hierarchies to include communities, the state, networks, and associations following “two underlying dimensions: the degree to which actors follow self-interest versus social obligations, and the degree to which power is distributed horizontally or exercised vertically” (Jackson & Deeg, 2008). With a similar approach, Biggart and Delbridge (2004) compared exchange systems by classifying them into price, moral, associative and communal systems along the two dimensions of “basis of action” and “structure of social relations”. Nevertheless, such studies focused mainly on the differences of institutional environments for economic transaction governance while overlooking the common mechanisms that shape them and thus fell short in explaining how different combinations of a fixed set of rudimental governance mechanisms interact with each other to form relatively different institutional environments for economic transaction governance.

More recently, a growing stream of research use ethnocentric lenses to view the institutional environment in emerging markets as “institutional voids”, in contrast to the developed markets as being with institutions (Khanna & Palepu, 1997; Stephan, Uhlaner, & Stride, 2015). This body of studies analyzed how business groups (Manikandan & Ramachandran, 2015) or family businesses (Luo & Chung, 2013; Miller, Lee, Chang, & Le Breton-Miller, 2009) help to fill or compensate for “institutional voids”, how formal and informal “institutional voids” influence entrepreneurship (Webb, Khoury, & Hitt, 2020), or how “institutional voids” affect firms’ resource commitment in emerging markets (Liedong et al, 2020), just name a few. This view on institutional environment in emerging markets as an “empty” institutional space has drawn criticism from some studies that either “propose abandoning the label institutional voids altogether” (Bothello, Nason, & Schnyder, 2019) or call to advance the concept by crossing interdisciplinary lines (Dieleman et al., 2022). Some of the critiques also argued to conceptualize institutional environments as “plural and contenting institutional arrangements” (Mair, Marti, & Ventresca, 2012). However, these critiques have not explicitly deciphered the intricacies and nuances of those “plural and contending institutional arrangements”. The literature still lacks a systematic explanation about what factors might have enabled different governance mechanisms to interact with each other and form those “plural and contending institutional arrangements” to coordinate economic transactions.

The objective of this article is to integrate and extend previous studies to explain how a common set of basic governance mechanisms form relatively different institutional environments to govern economic transactions from a social cultural perspective. The literature on economic transaction governance has classified the basic governance mechanisms in an institutional environment as spontaneous market forces, legal restraints, and social relations; and the classical market failure framework and the concept of relativity of the institutional environment for economic transaction governance further posit that institutional environments are relatively different in that some rely more on legal restraints while others rely more on social relations to compensate for the insufficiencies of pure market forces in regulating economic transactions. Building upon those works, I further identify a set of cultural behavioral and social structural factors, among others, that might have shaped different institutional environments for economic transaction governance. Particularly, I propose that individualism, cultural heterogeneity, egalitarian social structure, greater human mobility, and lower social network density will shape an institutional environment using legal restraints, while collectivism, cultural homogeneity, hierarchical social structure, lower human mobility, and higher social network density will shape an institutional environment relying on social relations, as the primary mechanism to supplement spontaneous market forces to regulate economic transactions. Those propositions help to explain how and why different governance mechanisms work with or against each other to form relatively different institutional environments for economic transaction governance and how social cultural factors, among others, have played a role in shaping different institutional environments for economic transaction governance.

In the next sections, I first delve into the classical roots of the relevant literatures to review the basic mechanisms for economic transaction governance within an institutional environment, i.e., spontaneous market forces, legal restraints, and social relations, as well as the concept of the relativity of the institutional environment for economic transaction governance. I follow up to identify and propose the cultural behavioral and social structural factors, among others, that could have played a role in shaping different institutional environments for economic transaction governance. I conclude the article by presenting its implications for research and practice.

2. Literature Background

2.1 The Institutional Environment for Economic Transactions Governance

The ability for economic actors to conduct transactions with each other plays a fundamental role in economic life (Greif, 2000). Economic transactions not only enable economic actors to complement one another with distinct material endowments but also allow them to capture the gains from specialization and create incentives that can encourage them to adhere to specialization and further maximize output (Alchian & Demsetz, 1972). The basic premise for economic transactions is efficiency and fairness, which in turn are safeguarded by governance mechanisms that can help to induce or coerce economic actors to comply with exchange terms (Coase, 1992; Williamson, 1985). The institutional environment for economic transaction governance provides such mechanisms that include rules, norms, and belief systems (North, 1991), which can be further classified as spontaneous market forces, legal restraints, and social relations (Bradach & Eccles, 1989; Campbell, Hollingsworth, & Lindberg, 1991). Table 1 provides a summary of the properties of the three governance mechanisms.

Table 1. Transaction governance mechanisms

	Spontaneous Market Forces	Legal Restraints	Social Relations
Premise	Fairness	Impartiality	Reciprocity
Transaction type	Discrete	Contractual	Relational
Organization form	Market	Hierarchy	Clan
Information	Complete (assumed)	Contingent	Approximate
Instrument	Price	Legal institutions	Norms
Enforcer	Individuals	The state	Community
Nature	Inducive/mimetic	Coercive	Normative
Duration	One shot	Definite term	Long term
Setup costs	Low	High	Contingent on sunken costs
Ideal context	Strangers	Non-specific	Communal
Conditions for failure	Small number; Complexity; Bounded rationality; Oppourtunism	Incomplete contract; Corruption	Social fragmentation

Among these three basic governance mechanisms within an institutional environment, spontaneous market forces have been considered by classical economists to be the “ideal type” of mechanism that can provide the most efficient governance to achieve the optimal allocation of resources through voluntary exchanges under an economic system driven solely by human propensity to “truck and barter” (Smith, 1776/1981). The governance of this ideal system is what Hayek (1945) defined as price-induced spontaneous adaptation or spontaneous governance by market forces where transactions are carried out through arm’s length deals. Nevertheless, economic reality manifests that the classical assumptions of perfect competition, flexible entry and exit, and free and full access to accurate market information are impossible to achieve which renders the working of a perfect price system backed up solely by spontaneous market forces less feasible (Grossman & Stiglitz, 1976; Zelizer, 1988). Consequently, the weakened governance power of spontaneous market forces would lead to the problem of market failure as defined by neo-classical economists (Arrow, 1971).

When spontaneous market forces alone fail to coordinate economic transactions through inducing economic actors to comply with exchange rules, formal legal restraints are often considered the standard institutional remedy (Williamson, 1996). Yet legal restraints are not the panacea for the governance of all economic activities. For example, when the costs of drafting contracts are too high or when contracts are not exhaustive due to bounded human rationality, contractual transactions upheld by legal restraints may not be sufficient or feasible to organize economic activities. In such cases, social relations can serve as a substitute or supplementary mechanism for economic transaction governance that can contribute to efficiency and productivity by enhancing stability, certainty, and cooperation in exchange relationships (Biggart & Delbridge, 2004; Poppo & Zenger, 2002).

Despite the unique features and the corresponding governance power of each of those three basic mechanisms in an institutional environment, economic transactions do not simply take place under the governance of a single institutional mechanism. Instead, they are coordinated by a combination of formal and informal institutional arrangements under a variety of cultural and structural settings (Granovetter, 1985; Zelizer, 1988). For example, even in the U.S. where legal restraints are the dominant means for compensating the imperfections of governance by spontaneous market forces, businesses still rely on “a man’s word or common honesty and decency” (i.e., social relations), in addition to legal restraints, to adjust exchange relationships (Macaulay, 1963). The concept of the co-existence of different governance mechanisms in each institutional environment falls within Polanyi’s view of economic relations as an always-embedded system, which suggests that any favorable economic dynamic has to be understood as flowing from the interactions among individual self-interest (i.e., spontaneous market forces), the actions of the State (i.e., legal restraints), and the dynamics of social relations (i.e., social relations) (Block, 2003). These three basic governance mechanisms work together in a way following the market failure framework suggested by neo-classical economists; that is, spontaneous market forces are ideal but not perfect in governing economic transactions and therefore social relations and legal restraints arise to supplement spontaneous market forces in organizing economic transactions (Arrow, 1971; Macneil, 1978). The three basic governance mechanisms form a unique combination to govern economic activities at each particular historical stage in an institutional environment and the variations reflect the relativity of institutional environments where different combinations of social relations and legal restraints are used to compensate for spontaneous market forces in organizing economic transactions (Sun & Chen, 2017).

Among the relatively different institutional environments featuring relatively different combinations of market forces, legal restraints and social relations for governing economic transactions, using social relations to facilitate economic transactions on the one hand reflects under-developed market system and limited effectiveness of legal institutions; on the other hand, the dominance of governance by social relations means that the hazard of opportunism that hinders economic transactions can be mitigated by embedding economic transactions in interpersonal relationships (Biggart & Delbridge, 2004; Bradach & Eccles, 1989). In contrast, using legal restraints as the dominant mechanism to complement spontaneous market forces to regulate economic transactions indicates that the conditions supporting social relational governance are weak but legal institutions instead are well-developed in the institutional environment.

2.2 Evolution of the Institutional Environment for Economic Transaction Governance

Like all institutions governing human interactions, an institutional environment for economic transaction governance is derived from the interactions among the three basic governance mechanisms, i.e., spontaneous market forces, social relations, and legal restraints. This is a typical co-evolution process between individual behaviors and social institutions that can help to construct favorable institutional environments for generating high levels of individually costly and group-beneficial behaviors (see Bowles, Choi, & Hopfensitz, 2003). To achieve more efficient and effective governance of economic transactions, those three basic governance mechanisms evolve and interact with each other over time to shape a unique combination to coordinate economic activities at each particular historical stage in an institutional environment.

The emergence and evolution of transaction governance mechanisms in human history has followed the chronological sequence of social relations, spontaneous market forces, and legal restraints, in that order. Social relations provided normative coordination for group living in early human history (Ridley, 1996). After human activities extended from intra- to inter-group interactions and social exchanges became more objectified and started to acquire the features of economic exchanges (Simmel, 1908/1950), spontaneous governance based on the price mechanism emerged as another governance device that can facilitate transactions between strangers beyond the communal boundaries (Seabright, 2004). When economic activities and market transactions were further complicated, social relations and spontaneous market forces became insufficient in regulating economic transactions. Therefore, formal legal restraints, which can support contractual transactions with impartial third-party sanctions, arose to fill the gap (Greif, 2004; Milgrom, North, & Weingast, 1990).

As noted earlier, the three basic governance mechanisms work together in a way where social relations and legal restraints supplement spontaneous market forces to govern economic transactions. Meanwhile, they also work against each other in the evolutionary process. For example, while social and legal restraints serve to guarantee property rights in order to conduct market transactions under the governance by spontaneous market forces, social relations and legal restraints on the other hand may also affect the efficiency and effectiveness of the governance by spontaneous market forces. That is why the market is not always clear: social relational factors such as fairness, gratitude, esteem, reputation, and long-term considerations are sometimes implicitly contained in price (Bradach & Eccles, 1989). Also, in modern market economic activities like auction, stock and commodity futures exchanges that are supported mainly by spontaneous market forces within a given legal framework, social relational practices like nepotism, cronyism, and insider trading are always a threat that may impede fairness and efficiency (Biggart & Delbridge, 2004). In addition, social relations and legal restraints can also provide protective countermoves to curb the insatiable “invisible hand” from engaging in activities that make sense from a pure economic perspective but are immoral or even illegal, such as abusing child labor, destroying the natural environment, or trafficking drugs and human beings (see Polanyi, 1944/2001).

Likewise, spontaneous market forces in turn can weaken the governance power of social relations and legal restraints. Spontaneous market forces disrupt social institutions by permeating all aspects of human life. For instance, spontaneous market forces may commodify politics, family life, friendship, education, arts, human settlement patterns, religion, and so on (Block, 2003). Spontaneous market forces can also “reduce the need for compassion, patriotism, brotherly love, and cultural solidarity" (Schultze, 1977). Spontaneous market forces may thus undermine the basis of social relational governance, corrupt impartial legal institutions, and render both social relational and legal governance less effective in regulating economic transactions.

As well, social relations and legal restraints can influence each other — the governance by social relations is reinforced partly by legal institutions, and laws are indeed formalized social norms (Cooter, 1998). In the meanwhile, social fabrics that constitute the foundation for social relations could impede legal governance. For example, the practice of nepotism and cronyism could undermine the impartiality of legal governance.

Each institutional environment for economic transaction governance has been shaped by the interplay of those three mechanisms through an evolutionary process. The evolution theory suggests that an organizational structure that is best suited to a particular environment is most likely to survive in that environment after going through an evolutionary process of natural selection (see Hannan & Freeman, 1977; Nelson & Winter, 1982). Similarly, the interactions among the three basic governance mechanisms will cause the waning of one mechanism and the waxing of another that can eventually evolve into a more efficient form of institutional environment, which would feature an optimal combination of spontaneous market forces, social relations, and legal restraints to govern economic transactions in each historical stage.

3. The Social Cultural Determinants

According to economic historians, an institutional structure that facilitates exchange and fosters economic efficiency is cultivated in a broader cultural and social process (Greif, 1994, 2000; North, 1981). Similarly, different cultural and structural settings will enable the mechanisms for economic transaction governance, i.e., spontaneous market forces, social relations, and legal restraints to interact with each other, evolve over time, and eventually form an optimal institutional environment for economic transaction governance that fits each particular historical stage. I identified a set of cultural behavioral and social structural factors, among others, that may play a role in shaping relatively different institutional environments for economic transaction governance.

Particularly, I propose that individualism, cultural heterogeneity, egalitarian social structure, lower social network density, and higher human mobility will shape an institutional environment where economic transactions will be governed mainly by legal restraints, while collectivism, cultural homogeneity, hierarchical social structure, higher social network density, and lower human mobility will shape an institutional environment where economic transactions will be governed mainly by social relations, when pure spontaneous market forces are insufficient to regulate economic transactions.

3.1 Culture

Culture is the common values, beliefs, ideas and thoughts that govern social and economic interactions between individuals within a group (Hofstede, 1980). Cultural beliefs provide the focal points and guidelines for predicting the behaviors of others, thereby coordinating individual expectations to facilitate exchanges; and such focal points and guidelines are the building blocks of an institutional environment for economic transaction governance (Greif, 1994; North, 1991). As such, the features of an institutional environment are partially determined by the cultural attributes that have shaped it. I propose that two pairs of cultural factors, collectivism versus individualism and cultural homogeneity versus cultural heterogeneity, can potentially affect the features of an institutional environment. Collectivism versus individualism denotes the social orientation of individuals, while cultural homogeneity versus cultural heterogeneity measures the diversity of cultures. Both sets of factors can impact how individuals interact with others in social and economic exchanges. Based on the features of social relational versus legal governance in organizing economic transactions, as described earlier in the paper, these two pairs of cultural factors potentially determine whether social relations or legal restraints are used as a dominant mechanism to supplement spontaneous market forces for coordinating economic exchanges in an institutional environment.

3.1.1 Collectivism versus individualism

Collectivism and individualism are a pair of key variables for measuring the social orientations of individuals (Hofstede, 1980; Triandis, 1994). Social orientation determines how individuals interact with each other, which in a long run can help to shape the rules of game for human interactions including the governance institutions for economic transactions (Greif & Tabellini, 2010).

With a collectivist cultural orientation, individuals interact with one another mainly within a given social group and business relations are an integral part of the whole web of friendship and kinship obligations within such groups. Exchanges between people with collectivist cultural orientation are long-term based and repeated among family members, friends, or acquaintances, but are rarely made between strangers. Such exchanges are facilitated through social relational arrangements based on trust, friendship, and interdependence and dispute resolution in such exchanges is aimed at arbitrating a compromise that is conducive to future transactions rather than enforcing an absolute rule (Fligstein & Dauter, 2007). Here social relations play a key role in regulating transactions because any breach of trust or social norms would damage personal reputation and impede future transactions with other members within the same group.

The social fabrics in a collectivist cultural environment on the one hand make the monitoring of deviant behavior easier and therefore support social relational governance; on the other hand, such relationship-based social contexts make impartial enforcement of legal governance difficult. In addition, a collectivist cultural environment usually has a large proportion of informal economy organized through family or clan, where informal business relationships do not generate business transactions that are complicated enough to require the support of an expensive and sophisticated legal system (Portes & Haller, 2005). Given these factors, a collectivist cultural environment relies more on social relations but less on legal restraints in regulating individual behavior to govern economic exchanges.

In an individualist cultural environment, however, people often treat all exchange partners the same way, regardless of being inside or outside a group or community. Transactions can often be one-shot and are not necessarily in long-term repeated patterns. Traders care more about a current transaction while future opportunities to transact with the same party are not a major concern. Transactions in such an environment are characterized as price-based impersonal exchanges within which sellers and buyers are driven more by self-interest and less affected by social relations (Greif, 1994). Legal documents (i.e., contracts), rather than social relationships, therefore become the key binding device for economic relationships. In addition, an individualist cultural environment lacks the social fabrics to support social relational governance, but impartial enforcement of laws is relatively easier because the parties involved often do not keep close personal relationships.

In sum, economic transactions in an institutional environment with a heritage of collectivist culture will be governed mainly by social relations, while those in one with a heritage of individualistic culture will be governed mainly by legal restraints, when spontaneous market forces are insufficient to organize economic transactions. Hence,

> *Proposition 1a: All else being equal, the more collectivist an institutional environment is, the more social relations will be used to compensate spontaneous market forces to govern economic transactions.*

> *Proposition 1b: All else being equal, the more individualistic an institutional environment is, the more legal restraints will be used to compensate spontaneous market forces to govern economic transactions.*

3.1.2 Cultural Homogeneity Versus Heterogeneity

Cultural homogeneity and heterogeneity measure the degree of cultural diversity that can explain whether homogeneous or heterogeneous cultural groups reside together within a shared social and political framework (Skelton & Allen, 1999). A more homogeneous cultural environment enables norms to evolve and regulate individual behaviors; while a more heterogeneous cultural context makes it harder for individuals to reach normative consensus, but in which formal legal rules must be developed instead to regulate social and economic interactions.

In a culturally homogeneous environment, indigenous people often live through generations without many external immigrants joining the population. Ethnic homogeneity enables commonly accepted norms to evolve on the one hand and people are all expected to follow such norms to behave on the other hand (Hofstede, 1980). In such an environment, deviation from normative behavior is rarely tolerated, and those who deviate will be socially penalized in the form of public shaming, ostracism, and excluding. Here the existence of rich norms and the willingness of individuals to sanction deviant behaviors allow social relations to play a major role in virtually every aspect of social and economic life, including the organization of economic transactions. Meanwhile, the development of an independent legal system for governing economic activities is less urgent.

A multicultural environment, in comparison, lacks consensus on norms. Cultural heterogeneity allows people to hold different beliefs and values and hence people may decide that no norm is universally correct. People in different cultural groups are often reluctant, and it is in fact difficult, to develop elaborate norms for crossing cultural barriers to interact with those in other cultural groups (Triandis, 1994). Due to the lack of commonly accepted norms and the different judgment and standards about deviant behaviors, social relational governance becomes less effective in a multicultural environment. Elaborate legal and political agreements, therefore, must be reached to regulate social and economic exchanges between different cultural groups. As such, social relations will be used as a predominant mechanism in organizing economic transactions in culturally homogeneous institutional environments. In contrast, legal restraints play a dominant role in economic transaction governance in culturally heterogeneous institutional environments. Accordingly,

> *Proposition 2a: All else being equal, the more culturally homogeneous an institutional environment is, the more social relations will be used to compensate spontaneous market forces to govern economic transactions.*

> *Proposition 2b: All else being equal, the more culturally heterogeneous an institutional environment is, the more legal restraints will be used to compensate spontaneous market forces to govern economic transactions.*

3.2 Social Structure

Like culture, social structure can also influence human relationships including how individuals interact with each other to conduct social and economic exchanges (Blau, 1977). I propose that three major social structural factors – social stratification, social network density, and human mobility, help to shape the type of institutional environment for organizing economic transactions. Among those three factors, social stratification measures social dominance which is the vertical dimension of social structure, social network density represents the social relational embeddedness that measures the degree of horizontal links of social structure, and human mobility is an indicator of social dynamics that may change both social stratification and social network density (Granovetter, 1985; Hummon, 2000). Based on the characteristics of social relational versus legal governance reviewed earlier in the paper, those three social structural factors can determine whether economic transactions in an institutional environment are governed predominantly by social relations or legal restraints when spontaneous market forces are insufficient to regulate economic transactions.

3.2.1 Social Stratification

Social stratification refers to people's differential access to power, prestige, and wealth in each social system (Weber, 1922/1968). Yet, the term is virtually synonymous with social inequality regarding power, prestige, and wealth in sociology literature (Haug, 1977). The degree of social stratification along the continuum between being egalitarian and hierarchical can potentially shape different types of institutional environments.

All societies consist of stratified members. Even in early human societies where people were supposed to share a common social standing, those individuals who had better abilities to get more food or other resources still enjoyed higher prestige than others. As societies evolved, some become relatively egalitarian where society's outputs and rewards are more equally distributed, while others become more hierarchical where society's outputs and rewards are distributed based on a hierarchical order among the members (see Triandis, 1994).

The stratification of a society along the spectrum of egalitarianism and hierarchicalism can eventually influence the governance of economic exchanges. Fairness or justice is the ultimate norm for exchange; yet injustice in human interactions is most likely to arise in the context of structural inequality such as in a hierarchical social structure and the greater the power imbalance in an exchange is, the more unequal or less fair the exchange is (Cook & Emerson, 1984). In unfair exchanges that most likely happen in a hierarchical social structure, the more powerful social members often use their clan type prowess from above to force those in an inferior position into exchanges. At the same time, those in weaker structural positions tend to use social relational strategies to reinforce their own social relational power to reduce their costs, to make the exchange happen (Molm, Quist, & Wiseley, 1994). Such social relational strategies must be renewed frequently by the members in an inferior structural position in order to weaken the overall social relational dominance of those in more powerful positions (Bourdieu, 1977). In addition, because of such unfairness in hierarchical social structures, legal restraints that are built upon the premise of impartiality fail to function effectively and play a limited role in regulating economic transactions.

In egalitarian social structures, however, individuals can often treat each other as equals without explicit discrimination based on power, prestige, wealth, creed, and social background, etc. Social and economic interactions under such a structure are coordinated mainly by universally accepted impartial laws instead of community-based social relational norms. Legal restraints thus become the dominant mechanism in organizing economic transactions in egalitarian social structures. In contrast, social relations become a hindrance to market transactions such as auction and bidding that require impartial enforcement. Hence,

> *Proposition 3a: All else being equal, the more hierarchical the social structure of an institutional environment is, the more social relations will be used to compensate spontaneous market forces to govern economic transactions.*
>
> *Proposition 3b: All else being equal, the more egalitarian the social structure of an institutional environment is, the more legal restraints will be used to compensate spontaneous market forces to govern economic transactions.*

3.2.2 Social Network Density

Network density is a major indicator of structural cohesion that represents the number of ties in a group relative to group size (Coleman, 1988). Network density affects the richness of social relationships and hence could determine whether social relations or legal restraints will be used as a major supplement when spontaneous market forces alone are insufficient to organize economic transactions in an institutional environment.

When social network density is lower, the possibility of anonymity among individuals will be higher which in turn poses structural limits to what can be achieved through relational ties (Sampson, Morenoff, & Earls, 1999). Because of people's cognitive, emotional, spatial, and temporal limits, lower network density weakens the ability to crystallize and enforce norms which makes free-rider behavior more likely to happen (Granovetter, 1985). For instance, in densely populated cities where social ties are less in proportion to group size and hence network density is lower, higher degree of anonymity among inhabitants makes community monitoring and checking less possible which renders social relational governance less effective. In such settings, an individual can violate norms in one group and avoid being sanctioned by joining another group whose members are strangers to the former group. As such, social relational governance is less effective in a densely populated region that often features lower social network density (e.g., big cities) (Fischer & Shavit, 1995). Instead, elaborate laws and regulations have to be set up to coordinate social and economic exchanges.

In an institutional environment possessing dense social networks, however, norms can often be well developed, clearly defined, and strictly observed which enables social relational governance work more effectively. For example, in rural communities, residents have formed strong and interwoven social relational ties through generations. Given the large number of social ties in comparison with small group size, people can have frequent interactions with almost all residents following commonly accepted norms. Such frequent interactions in turn can engender a higher degree of social approval and build up a higher degree of trust (Axelrod, 1984). In addition, a denser network contains more overlapped ties which can also increase the chances of exposing individual behaviors to group surveillance and make it harder for deviant behaviors to hide or to avoid being sanctioned (Festinger, Schachter, & Back, 1963). All those are conducive conditions for social relational governance to work more effectively.

Finally, dense social networks could also have economic activities embedded into social relational networks, which makes impartial legal governance less necessary, if possible at all, in regulating economic transactions. This is simply because thick social fabrics in a dense social network can often promote favoritism and cronyism that impede the impartial rule of law.

Taken together, social relations are more effective and hence play a more important role than legal restraints in regulating economic transactions in an institutional environment possessing dense social networks. In contrast, an institutional environment featuring lower social network density will have to develop efficient legal infrastructures to organize economic exchanges. Hence,

> *Proposition 4a: All else being equal, the higher the social network density of an institutional environment is, the more social relations will be used to compensate spontaneous market forces to govern economic transactions.*

> *Proposition 4b: All else being equal, the lower the social network density of an institutional environment is, the more legal restraints will be used to compensate spontaneous market forces to govern economic transactions.*

3.2.3 Human Mobility

Human mobility is defined as whether individuals have the freedom and capabilities to make geographical relocations physically, change membership between organizations, or cross hierarchical hurdles within an organization. From a social structural perspective, human mobility is often used as a synonym of social mobility that stands for the shifting of individuals from position to position and the circulation of social objects in horizontal and vertical directions (Sorokin, 1927). Normally, urbanized and industrialized societies should be characterized as allowing for higher human mobility, while a rural and agrarian society is marked with lower human mobility (McGinnis, 1968).

In an institutional environment that allows for lower human mobility, it is easier for individuals to have frequent interactions, build stable and long-term relationships, foster trust, promote cooperation, and develop and enforce behavioral norms. Lower human mobility increases physical proximity between social members and creates stable social structures which not only enable individuals to monitor each other's behaviors closely but also expose social interactions under the surveillance of the community (Bendor & Mookherjee, 1990; Kandori, 1992). Those are all favorable conditions for social relations to work more effectively in regulating economic transactions.

Contrary to the above, in an institutional environment featuring higher human mobility, a higher rate of residential turnover fosters institutional disruptions and weakens interpersonal ties (Coleman, 1990). Higher mobility makes patterns of relationship less stable and social norms such as the norm of reciprocity harder to enforce (Blau, 1956). With higher ability to relocate, individuals can violate behavioral rules in one place and avoid being sanctioned by moving to another place. Higher human mobility leads to residential instability that ruptures social networks and renders social relational governance less effective. Instead, legal restraints, delivered through contracts, lawyers, law enforcement, and the court system, are more popular and efficient in regulating individual behaviors and market transactions.

Hence, social relations will be used more predominantly than legal restraints to organize economic transactions in an institutional environment featured with lower human mobility. In contrast, legal restraints are used more predominantly than social relations in regulating economic transactions in an institutional environment marked by higher human mobility. As such:

> *Proposition 5a: All else being equal, the lower the human mobility in an institutional environment is, the more social relations will be used to compensate spontaneous market forces to govern economic transactions.*

> *Proposition 5b: All else being equal, the higher the human mobility in an institutional environment is, the more legal restraints will be used to compensate spontaneous market forces to govern economic transactions.*

4. Discussion

In this study, I took a social cultural perspective to explore the relativity of the institutional environments for economic transaction governance across societies. The starting point is that the three fundamental governance mechanisms, spontaneous market forces, legal restraints, and social relations, shape relatively different institutional environments for economic transaction governance in that some rely more on legal restraints, while others rely more on social relations, to compensate for the deficiencies of the governance of spontaneous market forces. I argued that cultural behavioral and social structural conditions, among others, could shape different institutional environments for economic transaction governance. Particularly, I proposed that individualism, cultural heterogeneity, egalitarian social structure, lower social network density, and greater human mobility will shape an institutional environment where economic transactions will be governed mainly by legal restraints, while collectivism, cultural homogeneity, hierarchical social structure, higher social network density, and lower human mobility will shape an institutional environment where economic transactions will be governed mainly by social relations, when spontaneous market forces alone are insufficient to regulate economic transactions.

This cross-cultural relativity view on the institutional environment for economic transaction governance makes valuable contributions to management literature. Both business practitioners and policy makers can draw insights from this study to guide their business operations or to formulate policies to regulate firm activities across different institutional environments.

4.1 Contributions to Literature

This study makes five major contributions to the management literature. First, research on organizational economics used to take the institutional environment as given when analyzing economic transaction governance. Although a few studies have implicitly recognized the hybrid nature of the institutional environment for economic transaction governance, few have made their analyses on a cross-cultural framework. By systematically exploring the relativity of institutional environments for economic transaction governance from a social cultural perspective, this study helps to extend the generalizability of a number of theories. One of them is transaction costs economics theory (TCE). TCE focuses on the choice of governance mechanisms based on relative costs. However, Dyer (1997) and Hamilton and Biggart (1988) found that TCE is unable to interpret economic organization in East Asia where asset specificity does not necessarily raise transaction costs, which is against one of its main propositions. Williamson (1994) admitted that the reason for these exceptions is that due to its preoccupation with governance costs, TCE fails to incorporate the variance of institutional environments that is an important determinant of the comparative efficacy and availability of governance mechanisms. By pointing out the social cultural determinants of the relative availability and effectiveness of legal restraints and social relations in an institutional environment as antecedents of the choice of transaction governance mechanisms in addressing the issue of market failure, this paper helps to systematically explain the empirical discrepancies of TCE-based studies across different institutional environments from a social cultural perspective: that is, TCE fails to account for social relational governance that also helps to reduce transaction costs in institutional environments where favorable social cultural conditions can facilitate strong social relational governance.

Second, when addressing the governance issue in emerging markets, some studies use ethnocentric lenses to see the dominance of legal governance as “having institutions” and the dominance of social relational governance as “institutional voids”, without explicitly recognizing the hybrid nature of the governance structure in every institutional environment. The concept of the relativity of institutional environments indicates that economic transactions are organized under different institutional arrangements in that some use more social relations while others use more legal restraints when spontaneous market forces alone fail to regulate economic activities. Social and cultural conditions partially shape the type of institutional environment within which economic transactions are organized. This social cultural perspective and hybrid view on governance institutions set up a common platform upon which we can compare economic transaction governance across different institutional environments. Upon this platform, the “institutional voids" are not "empty" institutional spaces; rather, they are institutional environments where social cultural conditions allow for strong social relational governance to address market failure or the imperfections of governance by spontaneous market forces.

Third, this study's systematic analysis of the dynamics of institutional environments corroborates with critiques against the assumption that the institutional environment within nations is homogeneous (e.g., Bothello et al., 2019) from a different perspective. According to this study, institutional environments are partially shaped by social cultural systems. Yet culture and social structure are ever-changing and dynamic; for instance, social structure may change over time and collectivist societies gradually shift to being more individualist as affluence level increases (Triandis, 1989). As such, an institutional environment will change along with the waning and waxing of the strength of legal and social relational governance mechanisms, as well as the increase or decrease of the power of market forces. That is why in emerging markets like China and India, rapid economic development has changed the institutional landscape in that the coastal areas experienced institutional assimilation to the West featuring a subnational institutional environment using more legal governance while the inland areas still maintain the traditional institutional environment featuring the dominance of social relational governance in regulating economic transactions. Capturing those variances can help to make better predictions about firm strategies and outcomes in international markets.

Fourth, this study offers a roadmap for future scholars to empirically test the relative power of spontaneous market forces, social relations, and legal restraints in different institutional environments based on the social cultural conditions. I have drawn a set of propositions to predict the variation of institutional environments with distinct social cultural characteristics (e.g., individualism versus collectivism, cultural diversity, social stratification, social network density, and human mobility). Empirical research can be conducted to examine the type of institutional environment and corresponding firm strategies across different markets.

Finally, this study focuses on the social cultural determinants of the variation of governance mechanism combinations at the environmental level. Meanwhile, it also implies the variation of governance mechanism combinations at lower levels. For instance, at industry level, given the different channel length between selling industrial and consumer products, social relational governance should be comparatively more efficient for selling industrial products that usually have shorter channel, while spontaneous market forces supported by legal governance should be more efficient for selling consumer products that have longer channel (Sun, 2017). Similarly, at firm level, firm ownership structure, size, age and other characteristics may also affect the combination of governance mechanisms that a firm adopts to make transactions with others. Using a similar approach, future empirical studies can explore how cross-level interactions of different governance mechanisms may affect firm strategies and outcomes.

4.2 Practical Implications

The concept of cross-cultural relativity of institutional environments for economic transaction governance is meaningful to both business practitioners and policy makers. It is particularly relevant to firms that have operations in emerging markets that feature weak spontaneous market forces and inefficient legal restraints but have favorable social cultural conditions for strong social relational governance in their institutional environments. Such firms need to adapt to the local institutional environment and learn to use the power of social relations in dealing with local partners. The other way around, with reverse foreign direct investment (FDI) increasing in recent years, a growing number of firms from emerging markets are shifting operations to developed markets that use strong spontaneous market forces and strong legal restraints but have weak social cultural conditions for social relational governance in their institutional environments. Those firms should acquire the necessary resources to cope with the new institutional settings, i.e., learning to organize economic activities in a foreign institutional environment where transactions are governed mainly by spontaneous market forces and legal restraints.

Governments in developed countries should take a fair look at the institutional environments in less developed economies. The standards that they hold for more advanced economies may not be generalizable in countries that have inchoate market and legal infrastructures (McCubbins, 2001), especially in those emerging markets featured with an institutional environment that has favorable social cultural conditions for using more social relational governance to organize economic activities. The cross-cultural relativity of institutional environments also suggests that the governments in the developed world may need to reconsider their policies in regulating the activities of multinational corporations in international markets. The engagement of host country business practices by multi-national enterprises that are sometimes considered illegal at home may actually be necessary for reinforcing social relational governance to secure contracts in emerging markets (The New York Times, 2007; Sun, 2016, 2018). Governments in some emerging markets that traditionally have rich social cultural conditions for social relational governance must understand that, to cope with industrialization and globalization, they should strive to shorten the transitional stage of relying mainly on social relational governance in their institutional environment and to expedite the construction of modern market and legal institutions.

5. Conclusions

This is the first study that explains the relativity of the institutional environment for economic transaction governance from a social cultural perspective. It makes significant contributions to management literature. This study also offers new and useful guidelines for business practitioners to manage different institutional environments properly, and for policymakers to regulate firm activities in different institutional environments more effectively.

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