What are ‘institutional voids’ and how do they affect the economic development

To understand what an institutional void is, we must first understand what an institution is. An institution is an organisation which sets the ‘rules of the game’. In the context of a nation, there are two categories of institutions; formal and informal. Informal institutions tend to focus on general social and psychological norms whereas formal institutions empower the political, legal and economic systems within a country. Institutional voids are a term that refers broadly to a lack of intermediary institutions that efficiently connect buyers and sellers in a marketplace. The lack of organisations and formal institutions to underpin the rule of law, administration and respect for private property, to name just a few essential functions, drives buyers and sellers apart through lack of anything more than informal trust alone. Because of buyers and sellers being unable to easily come together, transaction costs are increased. These are the costs associated with co-ordinating purchases, sales, or any business-related transaction. Market intermediation is scarce therefore market participants do not have the relevant information needed to make informed decisions. For example, comparing healthcare in the USA and India highlights the institutional voids in Asia. If you are in need of a doctor in India, apart from word of mouth recommendation there is very little information available to ensure the quality of care you will receive. On the other hand, in America there are various channels of information available to the public regarding quality, ethical standards and availability of healthcare which are easily accessible; whether that be in a governmental publication or a magazine that specialises in ranking healthcare.

These institutional voids can affect economic development in emerging economies because companies operating in these countries often have to overcome institutional voids by performing ‘institutional duties’ themselves such as: self-regulation, contract enforcement agents and banks. This can present a significant conflict of interest as although companies want to increase market intermediation so that business transaction costs are reduced, they are unlikely to act objectively should a dispute arise against them. This conflict of interest is the reason why a lack of trust between buyers and sellers and corruption within these markets will linger, at the cost of potential economic growth. However, institutional void can also present an opportunity for firms in emerging markets to privately implement institutions if done correctly. Scholars have argued that institutions are more than just background conditions (Meyer, Estrin, Bhaumik, and Peng, 2009), and directly influence the strategic actions available to an organization (Ingram and Silverman, 2002). In this way, firms can achieve and sustain competitive advantage by overcoming, moulding, and capitalizing on the nature of their institutional environments (Marquis and Raynard, 2015).

This can be exemplified in the case of Patrimonio Hoy (an example of institutional development), this institution was created by Mexican cement manufacturer CEMEX at a very bad time for the Mexican economy, a time of fiscal austerity and governmental ignorance to rising poverty levels. This resulted in the devaluation of the peso and some rebellions which is commonly known as the tequila crisis. CEMEX had the objective of being a social cause by providing housing to the poor in society yet also a self-sustaining business, but they faced multiple institutional voids, most notably the lack of availability of finance for housing for the poor and the lack of technical information. These voids were resolved by offering partners a flexible credit system whereby they pay for 20% of the materials needed to complete the construction project, with the remaining 80% given through credit without the need for any income prerequisites. And by setting up masonry training facilities for self-construction so that partners can receive training to build homes independently.

In doing this, CEMEX not only expanded their own business by creating a new channel in which they can sell their construction materials, but also forging wider economic and social benefits to the country. This institution directly generated more local jobs, increased local retailers' revenue which is likely to create even more positive impacts through the multiplier effect as well as the partners being able to use their new homes to start or expand their own business, making the local economy more innovative and self-sufficient. This multidimensional benefit illustrates how crucial institutional development can be for economic development in EMEs.

Institutional development in emerging economies often occurs by importing formal institutions from developed countries as they have a proven track record of success. However, when transferred to emerging economies they may have limited triumph for numerous reasons. Incumbent local institutions may be founded upon different principles to these imported formal institutions and thus would hinder the formal institutions due to the lack of vital supporting local informal institutions. An example of this would be it would be problematic to introduce VAT in an emerging economy where their business practices are such that receipts are rarely asked for or printed for customers.

Therefore, instead of solely imitating foreign institutions it is more widely successful to pair this with innovations specific to the country itself. Institutional imitation alone is often not enough to guarantee institutional development in emerging economies. An example of this is Japan. In this country the governance system and laws are imitated from the USA and some European countries, but with cultural influences embedded additionally. Specifically, the institution of long-term employment in Japan forbids companies to lay off staff unless it is crucial to the survival of the firm. This is influenced by Japanese firms' paternalistic attitude to its employees.