

LEGITIMACY, INTEREST GROUP PRESSURES, AND CHANGE IN EMERGENT INSTITUTIONS: THE CASE OF FOREIGN INVESTORS AND HOST COUNTRY GOVERNMENTS

WITOLD J. HENISZ

The University of Pennsylvania

BENNET A. ZELNER

Georgetown University

We offer a simple model of policy making, emphasizing socialization and limits on human cognition to explicate mechanisms of change in emergent (as opposed to established) institutions. Emergent institutions are more susceptible to change, and their opponents may use frames or existing reference points to illustrate inconsistency with prevailing notions of legitimacy. Broader institutional structures and specific organizational characteristics moderate pressure for change. This perspective has novel implications for strategy and policy design.

Despite the potential for mutual gains, the relationship between foreign investors and host governments is characterized by divergent interests resulting from the distributional process through which the policy-making apparatus allocates the costs and rewards of investment among various interest groups. Whereas investors are interested in maximizing returns, governments have more complex preferences shaped by multiple interest group pressures. Thus, the interaction of investors and governments throughout the investment cycle—that is,

from negotiation to investment to operation—is a protracted one in which a variety of contingencies and interest group reactions may undermine investors' initial assumptions and calculations.

Proponents of the bargaining power perspective have produced an impressive body of theory and evidence on investor-government interaction (Boddewyn & Brewer, 1994; Fagre & Wells, 1982; Kobrin, 1987; Poynter, 1985; Svejnar & Smith, 1984), but this has several limitations as well (Haggard, 1990). In particular, the literature has not yet met the challenge posed by Kobrin to identify “which events matter” and how “environmental processes affect investor perceptions,” toward which end he calls for “better definitions of the phenomena, a conceptual structure relating politics to the firm and a great deal of information about the impact of the political environment” (1979: 77). In this article we draw on neoinstitutional theories to generate propositions regarding the processes that trigger government attempts to overturn, alter, or reinterpret bargains made with foreign investors, as well as the country-level institutional structures and organization-level characteristics that moderate pressures for change.

BARGAINING POWER AND COMMITMENT

The central insight of the traditional bargaining power perspective is that the balance of

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"resources controlled by one party and demanded by the other" (Kobrin, 1987: 617) influences the division of profits between investors and the government. Investor bargaining power is posited to be at a maximum prior to investment, when the government needs access to scarce capital or technology, and then to decline secularly, once an investor sinks capital in the ground or its technology or expertise diffuses (Poynter, 1985; Vernon, 1977). As its bargaining power declines, an investor faces increased political risk because of the government's incentive to redirect the investor's returns to a broader set of interest groups (Fagre & Wells, 1982; Kobrin, 1987; LeCraw, 1984; Svejnar & Smith, 1984).

The canonical bargaining model can be expanded by characterizing the relationship between foreign investors and host country governments as a repeated game in which formal commitment devices or reputation moderates the pressure for secular decline (Janeba, 2001a,b). In this view, the central problem is analogous to the well-known "time consistency" problem in the government's choice of capital taxation: in order to induce investment, the government may pledge low tax rates to investors, but such pledges are not credible because the government has an incentive to redistribute investor returns once the investors sink capital in the ground (Fischer, 1980; Kydland & Prescott, 1977). The literature on time consistency in monetary policy (Auernheimer, 1974; Barro, 1983; Fischer, 1977) is also relevant in this connection. These bodies of literature suggest that "institutions" such as constitutional limits on retroactive taxation and independent central banks bolster the credibility of government commitments, thereby mitigating the time consistency problem and promoting capital investment.

INSTITUTIONS: ESTABLISHED AND EMERGENT

Structures intended to bolster credibility also play a critical role in securing new foreign investment, especially when the sector in question is "politically salient" as a result of economic, political, historical, or cultural attributes that create a widespread public interest in its operation or outcomes. Combined with large sunk costs and long payback periods, political salience creates the potential for conflict between investors and political actors, since the latter may face an *ex post* incentive to overturn a

bargain or to alter or reinterpret its terms in response to constituent pressures. Specific examples of credibility-enhancing formal structures that may be adopted in this case include a series of bilateral contracts between investors and the government, legally sanctioned market rules, and specialized administrative bodies charged with interpretation and enforcement.

Formal structures such as these do not, however, generate credibility by sheer virtue of their existence. In the various economic literature described above, including the bargaining power literature, researchers either take for granted "institutional" status and assume that it generates credibility, or they attribute credibility to the status quo bias that characterizes a formal legislative construction as a result of the political transaction costs of changing it (Dixit, 1996; McCubbins, Noll, & Weingast, 1989; Tsebelis, 2003)—that is, overturning it, altering it, or reinterpreting it. While we explicitly address the role and sources of such transaction costs below, we highlight two additional sources of stability that influence the probability that change will appear on the policy-making agenda in the first place and, thus, precede political transaction costs as a source of credibility: (1) a bargain's attainment of legitimacy, defined as "the generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" (Suchman, 1995: 574), and (2) the extent to which entrenched interests reinforce bargains from which they benefit.

Both of these potential sources of stability are especially germane to new foreign investment because they accrue to a formal structure only with the passage of time; however, structures adopted to govern new foreign investment are themselves often newly constructed. Indeed, according to the neoinstitutional perspective in organization theory, an institution's primary source of stability is legitimacy attained on "cognitive" (Suchman, 1995) grounds—that is, based on widespread, implicit acceptance resulting from the long-term process of "institutionalization" (Zucker, 1987).

In order to distinguish the newly created formal structures that we consider in this article from those that have attained cognitively based legitimacy, we refer to the former as *emergent institutions* and the latter as *established institu-*

tions (simply *institutions* in common neoinstitutional parlance). This distinction does not imply that emergent institutions are necessarily illegitimate. Rather, the critical contrast is that while the outcomes generated by an established institution are largely beyond normative evaluation, as a result of the established institution's "taken-for-grantedness," the outcomes generated by an emergent institution are still subject to evaluation, which—if positive—may provide a "moral" basis for an emergent institution's attainment of legitimacy (Suchman, 1995).¹ Consequently, whereas all investors face the risk that "politics or political players will have a negative impact on [their] firm's asset values, costs, or revenues" (Wilkin, 2000: 40), those whose "bargains" are governed by an emergent institution face heightened political risk.

A NEOINSTITUTIONAL MODEL OF THE POLICY-MAKING PROCESS

The traditional bargaining power perspective depicts an investor's level of political risk as a deterministic outcome of bargaining between the investor and a monolithic government. We expand this perspective by using various elements of neoinstitutional theory in economics, political science, and sociology to explicate the mechanisms that generate political risk over the course of an investment's life cycle. These mechanisms operate through the policy-making process, wherein interest groups that vary in their level of organization (Denzau & Munger, 1986; Lowi, 1969; Olson, 1965; Wilson, 1980) attempt to influence political actors seeking to retain office (Kingdon, 1984; Lau, Smith, & Fiske, 1991) within the constraints imposed by a formal policy-making structure (Gilligan & Krehbiel, 1980; McCubbins et al., 1987; Tsebelis, 2003; Weingast, 1981; Weingast & Marshall, 1988; Weingast & Moran, 1983). The main agents of change in an emergent institution are the organized interest groups (Becker, 1983; Olson, 1965; Peltzman, 1976; Stigler, 1975) that are most dissatisfied with how the entity accommodates their interests (Greenwood & Hinings, 1996; Holm, 1995; Seo & Creed, 2002; Sjöstrand, 1995). Although there are multi-

ple potential sources of misalignment between "an institutional arrangement . . . [and] the interests and needs of its participants" (Seo & Creed, 2002: 232), we focus on the common case of organized interest groups that perceive themselves to be disadvantaged by the distributional consequences of an emergent institution.

In contrast to the rational choice orientation that often characterizes interest group models of policy making, we emphasize the effects of cognitive limitations and social influences on the policy-making process. The strategies that organized interest groups pursue to instigate change in emergent institutions reflect both political actors' ability to consider only a limited range of issues (Kingdon, 1984)² and constituents' reliance on heuristics and preexisting beliefs and biases (Hilgartner & Bosk, 1988; Kahneman, Knetsch, & Thaler, 1986; McFarland, 1991; Zajac, 1995) to process the limited information available to them. Because the organized interest groups seeking change often are insufficiently powerful on their own to move the issue of change onto the limited policy-making agenda of cognitively constrained political actors facing multiple demands for legislative action (Hilgartner & Bosk, 1988; Kingdon, 1984), they attempt to enlist the support of a broad range of interest groups that, together, are capable of capturing policy-makers' attention (Baumgartner, 2002; Baumgartner & Mahoney, 2002; Denzau & Munger, 1986). These groups include other organized interest groups and diffuse, unorganized groups, whose members are either marginally affected or unaffected by the emergent institution (hereafter referred to as *secondary groups*).

In order to mobilize such groups, the organized interest groups seeking change attempt to influence the secondary groups' normative evaluation of the emergent institution. The secondary groups typically have not yet evaluated the emergent institutions themselves—the costs of doing so are high, because an emergent institution's structures, processes, and consequences are unknown and complex, and typically fail to justify the individual benefits of purposive evaluation available to cognitively limited members

¹ We focus on outcomes, but processes and structural type also may be used in normative assessments (Suchman, 1995).

² Individuals may be "informationally impacted" (Alchian & Demsetz, 1972) or "boundedly rational" (Hilgartner & Bosk, 1988; Simon, 1961; Williamson, 1996).

of diffuse groups (Peltzman, 1976; Stigler, 1971) or organized groups with their own focal issue.

A primary strategy used by the organized interest groups seeking change, thus, is to exploit this perceptual vacuum by attempting to "frame" (Benford & Snow, 2000) the emergent institution as conflicting with preexisting "cultural preoccupations and political biases" (Hilgartner & Bosk, 1988: 63; see also McFarland, 1991) in order to demonstrate its illegitimacy and thereby enfranchise secondary groups. The specific means by which they do so is drawing comparisons between the observable outcomes produced by the allegedly illegitimate emergent institution and those of established institutions whose legitimacy is not in question. Shocks or changes in circumstance and investors' own business practices may facilitate these efforts by producing distributional outcomes that the groups seeking change may portray as morally suspect and, therefore, as additional evidence of the emergent institution's illegitimacy.

Upper-level political institutions that create checks and balances in the policy-making process, as well as specific characteristics of the investing organizations themselves, may moderate pressures for change. In countries where formal political structures include multiple checks and balances, change in an emergent institution can occur only when there exists agreement among multiple political actors representing nonoverlapping interests. Systems characterized by greater formal checks and balances and heterogeneity of interest group pressures promote a status quo bias in policy that raises the threshold level of pressure any one interest group must be able to exert in order to effect change in an emergent institution (Tiller & Spiller, 1999; Tsebelis, 2003).

Moreover, even when such change does result from the formal policy-making process, investors may still be able to isolate themselves from its effects by lobbying pivotal political actors. Their efforts are more likely to be successful when they have negotiated *ex ante* an emergent institution that balances long-run profitability with legitimacy (Williamson, 1985, 1996) or when they possess distinctive knowledge of and capabilities to influence the policy-making process in the host country (Barney, 1986; Kogut & Zander, 1992; Peteraf, 1993; Teece, Pisano, & Shuen, 1997; Wernerfelt, 1984).

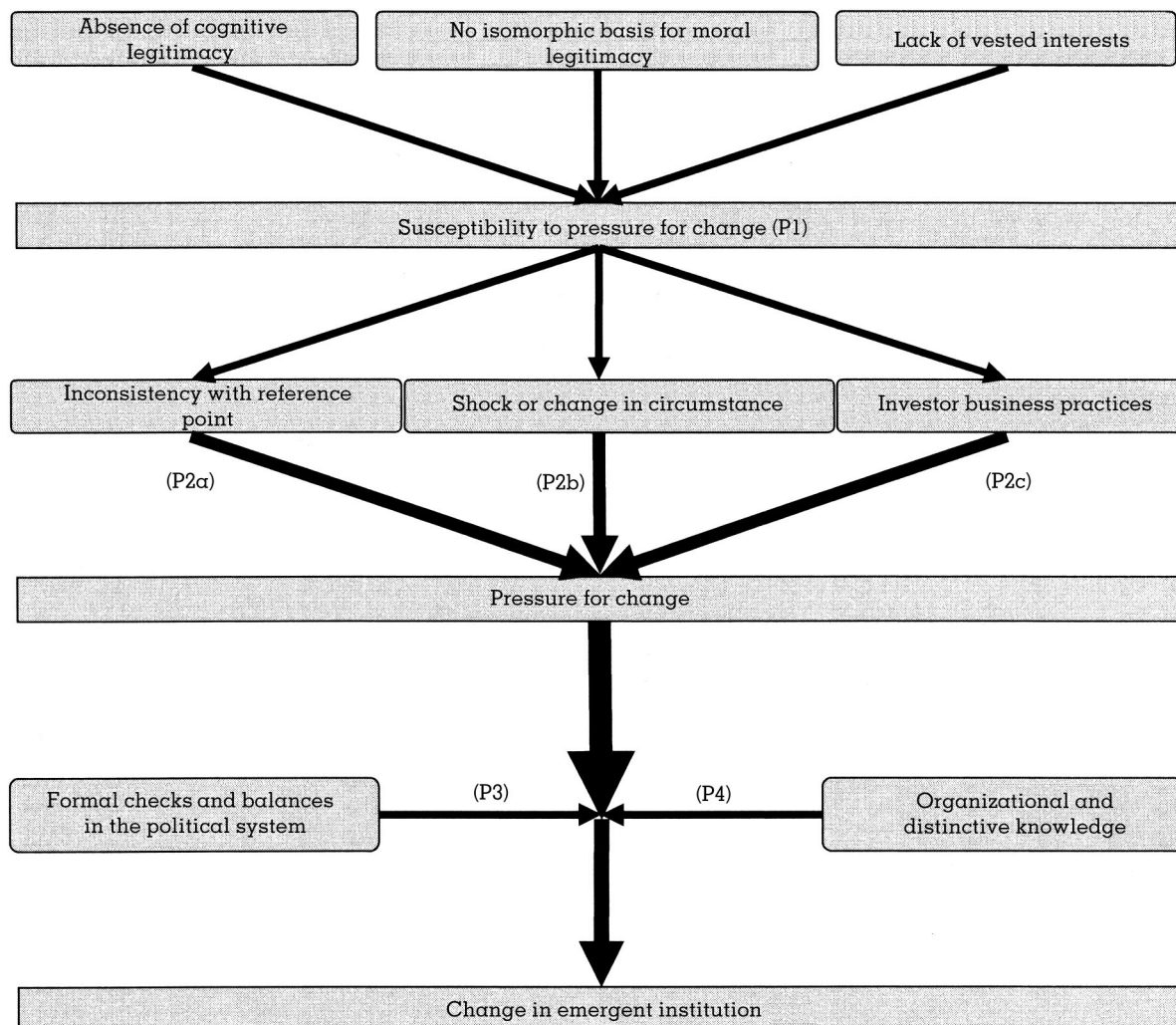
In the discussion that follows, we elaborate on these ideas to build a model of change in emergent institutions. Figure 1 summarizes the model. An emergent institution's lack of a cognitive or moral basis for legitimacy and dearth of vested interests render it susceptible to efforts to overturn, modify, or reinterpret it. Organized interest groups that perceive the emergent institution as inflicting substantial distributional losses on them exploit this susceptibility by publicly questioning the emergent institution's moral basis for legitimacy. They do so by creating interpretive frames for the broader polity and publicizing outcomes or other attributes of the emergent institution that appear to be inconsistent with those of established institutions representing prevailing notions of legitimacy. Exogenous shocks and investor business practices may provide additional fodder for these efforts. Political actors are more likely to respond to pressure for change if the supporting coalition is broad enough. However, formal political structures that create checks and balances, as well as organizational linkages and distinctive knowledge, may reduce political actors' sensitivity to such pressure.

ILLUSTRATION OF ELECTRICITY GENERATION

We illustrate our arguments with detailed evidence of the experience of foreign investors in electricity generation, as well as with examples drawn from other sectors. Private investment in electricity generation is an apt focal setting for illustrating our propositions because it is characterized by substantial conflict between the interests of political actors and investors as a result of large up-front capital costs, a long payback period, and susceptibility to claims of monopoly abuses (Levy & Spiller, 1994). However, because electricity generation represents what is perhaps an extreme case, we also provide several examples from industries that differ from electricity generation on at least one of these dimensions.

For much of the twentieth century, virtually every country embraced a norm of government ownership of electricity systems through state-owned enterprises (SOEs), which provided political actors with a means of pursuing specific distributional objectives. SOEs' construction of "white elephants"—large projects with ques-

FIGURE 1
Change in Emergent Institutions



tionable economic justification—promoted both equal access to electricity (Soto, 1999) and full employment (Savedoff & Spiller, 1999; World Bank, 1995). Retail pricing schedules further served to subsidize politically powerful classes of consumers, and nominal price freezes during inflationary periods mitigated the regressive effects of high inflation (Baer & McDonald, 1998; Bastos & Abdala, 1993; Soto, 1999). Similarly mixed public and private objectives influenced managers at SOEs in other sectors as well (Bertero & Rondi, 2000; Bourbakri & Cosset, 1997; Dewenter & Malatesta, 1997; D'Souza & Megginson, 1999; Megginson, Nash, & Van Randenborgh, 1994; Sheshinski & Lopez-Calva, 1998; Vining & Boardman, 1989; Willig, 1994).

By 1990, the system of public ownership in many developing country markets had begun to collapse under its own weight, threatening macroeconomic stability and growth. Years of revenue shortfalls and cost overruns had forestalled economically necessary new construction and had led to poor maintenance of existing facilities (International Energy Agency, 1999). In addition, fuel price increases, the collapse of the communist bloc, and unprecedented demand growth from the so-called East Asian miracle had combined to create a need for over \$100 billion of new capacity, bringing the pattern of decline to a head. The ultimate result was sharply reduced service reliability and, in some cases, an outright power crisis, including voltage reductions, usage restric-

tions, brownouts, and blackouts. Governments thus turned to privatization, in large part because they did not possess the capital to solve their mounting problems within the existing system of government ownership (Bortolotti, Fantini, & Siniscalco, 2000). A growing belief in privatization among international policy elites further bolstered the trend, particularly in industrialized nations (Megginson & Netter, 2001).

The potential for emergent institutions to be perceived as illegitimate under these circumstances was acute. The very notion of private infrastructure ownership itself—regardless of the specific emergent institutions—often conflicted with long-standing norms. Even though many citizens and organized interest groups in countries suffering from power shortages likely embraced the notion of reform in general, virtually all had spent their lives in a world where government ownership of this critical infrastructure was a rarely questioned fact; they not only accepted but expected the politicized pricing, output, and sourcing decisions associated with government ownership.

Indeed, political actors—with the assistance of multilateral agencies, international financial institutions, and international investors—in many cases mounted public relations campaigns to convince citizens of the need to shift from government to private ownership in the first place. At a minimum, then, the emergent institutions of private ownership did not possess a ready basis for attaining morally based legitimacy at the time of transition; the possibility of change created heightened political risk for foreign investors.

BACKGROUND INFLUENCES

The traditional bargaining power model posits that an initial bargain struck between the government and foreign investors becomes less resistant to change as investor bargaining power declines over time. In contrast, our analysis suggests that it is the very youth of the emergent institution embodying such a bargain that renders it especially susceptible to change.

Lack of Legitimacy

The defining characteristic of an emergent institution—and its main point of contrast with an established institution—is its lack of wide-

spread, implicit acceptance. Established institutions have been “retrojected into consciousness in the course of socialization” and, consequently, possess “a reality of their own, a reality that confronts the individual as an external and coercive fact” (Berger & Luckmann, 1967: 60–61). Once they enter their mature phase, established institutions “do not just constrain options: they establish the very criteria by which people discover their preferences” (Powell & DiMaggio, 1991: 11).

Actors in a society do not even attempt to evaluate an established institution that is subject to this level of taken-for-grantedness; the institution is legitimate by assumption. Studies undertaken in such varied contexts as the adoption of civil service reform by U.S. cities (Tolbert & Zucker, 1983), the spread of the multidivisional form among large firms (Fligstein, 1985), and the diffusion of total quality management among hospitals (Westphal, Gulati, & Shortell, 1997) all provide evidence that a presumption of legitimacy can trump “cost-benefit” calculations. Indeed, “taken-for-grantedness represents the most subtle and the most powerful source of legitimacy identified to date” (Suchman, 1995: 583). Legitimacy imbues an established institution with high resistance to change (Zucker, 1977); its very “essence” is one of “permanence” (Suchman, 1995).

An emergent institution is incapable of attaining legitimacy on such cognitive grounds (Suchman, 1995), because the conferring social process is a lengthy one. However, actors in society may still make a “positive normative evaluation” of an emergent institution’s consequences, procedures, or structural type (Suchman, 1995). Such an evaluation provides a “moral” basis for legitimacy; once made, it too provides the basis for a “generalized perception or assumption” supporting the propriety of the emergent institution’s conduct, which, in turn, reduces the emergent institution’s susceptibility to attack by those opposed to it.

Given the availability of a moral basis for legitimacy, political actors seeking to maintain future support presumably face an incentive to design emergent institutions that invite a positive normative evaluation—for example, through isomorphism with established institutions whose legitimacy is taken for granted (DiMaggio & Powell, 1983). Faced with a pressing economic or social need that threatens their

short-term survival, however, political actors may discount the future heavily and, instead, may seek the most expeditious solution, without regard for its sustainability. Their cognitive limitations (Hilgartner & Bosk, 1988), their expectation that they will no longer be in power when distributional consequences come to light (Barro & Gordon, 1983; Bornefalk, 1998; Landes & Posner, 1975; Olson, 1993), or their perception that they may have subsequent opportunities to modify the emergent institution (North & Weingast, 1989) may contribute to political actors' heavily discounting the future. Organized interest groups' increased willingness to defer (Williamson, 1993) or compromise when the costs of delayed resolution are high (Alesina & Drazen, 1991; Drazen & Grilli, 1993)—possibly compounded by their shifting influence following a crisis (Nelson, 1990) or their uncertainty about postcrisis outcomes (Fernandez & Rodrik, 1991)—further contributes to the possibility that an emergent institution will not be designed for the ready attainment of legitimacy on a moral basis.

Dearth of Vested Interests

An established institution enjoys the support of the interest groups that benefit from it and fight for its survival. Although emergent institutions also initially benefit from the support of certain interest groups, these groups may not be as numerous, well established, prestigious, or rich in resources as those with an interest in maintaining the status quo. For example, Jaffee and Freeman (2002) document a case in which established, prestigious law firms in Germany blocked an initiative to introduce employee stock plans that had the support of newer venture capital firms and the rapidly growing high-technology sector, both of which would have gained business and status from passage of the initiative. Generally, the most vigorous defenders of an emergent institution may well be foreign investors themselves, who have no direct voice in the electoral process and are susceptible to nationalist rhetoric (Kobrin, 1987) that casts doubt on any claims of legitimacy these defenders might make.

As an emergent institution matures, new groups of entrepreneurial actors devise ways to benefit from it and, therefore, "fight any attempt to reverse it" (Rodrik, 1994: 82). In Rodrik's focal context of trade liberalization, for example, "out-

ward-oriented policies generate new profit opportunities for entrepreneurs. . . . As new, previously unpredictable export activities appear, a new class of export-oriented businessmen is created" (Rodrik, 1994: 82). Furthermore, the emergent institution later develops the support of an entrenched bureaucracy, whose members take such actions as hiring like-minded individuals, mounting campaigns for autonomy from political oversight, and providing increased voice for interest groups benefiting from the emergent institution (Downs, 1966), thus bolstering its resistance to change.

Proposition

Regardless of the differences in legitimacy and vested interest group support between emergent and established institutions, both types of entities are always subject to demands for change by the organized interest groups they affect most adversely. In the case of an emergent institution, these groups may become more vocal once the need that precipitated construction of the emergent institution is resolved (Mondino, Sturzenegger, & Tommasi, 1996). In the context of the policy-making process, however, the primary significance of the background differences between emergent and established institutions is the greater opportunity that the organized interest groups seeking change have in the former case to mobilize the support of secondary groups (Leblebici, Salancik, Copay, & King, 1991).

Proposition 1: An emergent institution's susceptibility to pressures for change is greatest early in its life and declines with time.

Illustration

A comparison of the treatment private investors received in the Chilean and Argentine electricity generation industry illustrates the differential risk that investors face as a result of differences in legitimacy between established and emergent institutions. Chile was a pioneer in privatizing its electricity sector during the Pinochet regime, starting in the mid 1970s (Estache & Rodrigues-Pardina, 1998; Fischer & Serra, 2000; Philippi, 1991; Spiller & Martorell, 1996). Although the market principles underly-

ing the reforms originally engendered some public discord, debate eventually shifted away from core principles to focus on the regulatory apparatus itself. In the subsequent thirty years, members of Chilean society have been socialized under the declared principle that "the state should only assume direct responsibility for those functions which the [people] . . . are unable to deal with adequately" (Edwards & Edwards, 1991: 93), and they have witnessed multiple sector-level reforms that have increased the legitimacy of market principles. As a result of its strong public support, the Chilean system has been fairly robust to change, and, for most of its history, prices have "moved almost independently of politics" (Spiller & Martorell, 1996: 119–21), with one notable exception, following a 100-year drought in 1998.

Like the Chilean system, the Argentine system adopted in 1992 was part of a broad reform package intended to reshape the economy in accordance with more market-oriented principles; in fact, it reputedly was modeled largely after the Chilean system (Lalor & Garcia, 1996). Both share at their core a mathematical, apolitical formula to set prices. Some observers therefore initially believed that Argentina's system would function similarly to the Chilean one, characterizing the electricity market as "relatively unregulated where producers can charge what the market will bear" (Green, McWilliams, & Pearson, 1995).

However, within several years of the system's introduction, the Argentine government engaged in heavy-handed political intervention (Bastos & Abdala, 1993; Estache & Rodrigues-Pardina, 1998). Part of the public sentiment underlying this response was the "general sense of injustice" (Lapper, 2002) that Argentineans feel toward many government-sponsored reforms, which they believe "do not reflect society's point of view" (Lapper, 2002). The Argentine system, thus, has increasingly shifted away from "merit" dispatch, under which generators choose whether or not to produce based on the government's offer price, to "forced" dispatch, under which generators are obligated to produce.

More generally, investors in Chile have greater confidence that market-oriented reforms will succeed as a result of their attainment of legitimacy, in contrast to their counterparts in other Latin American countries. The lessons that Starr draws regarding competition policy in

much of Latin America are apposite: competition policy reform

takes years to develop. Much time is required to build institutions—to win legislative support for autonomous and well-funded competition agencies, to train staff, to change entrenched behavioral patterns in established agencies, and then to modernize the judiciary and build public support. . . . Simply put, competition policy runs counter to decades of accepted behaviors (Starr, 2002).

MECHANISMS OF CHANGE IN EMERGENT INSTITUTIONS

While emergent institutions are relatively susceptible to change, change actually occurs only through the efforts of "change agents"—in this case, organized interest groups that are dissatisfied with the distributional outcomes an emergent institution inflicts on them (Greenwood & Hinings, 1996; Holm, 1995; Seo & Creed, 2002; Sjöstrand, 1995). An important challenge such groups typically face is the mobilization of a broad enough coalition to move the issue of change onto the limited policy-making agenda (Baumgartner, 2002; Baumgartner & Mahoney, 2002; Denzau & Munger, 1986; Hilgartner & Bosk, 1988; Kingdon, 1984).

The pivotal role of such a coalition underscores the multilateral nature of the investor's bargain; this stands in contrast to the traditional bargaining power perspective, which treats the investor's bargain as a strictly bilateral one with "the government." The organized interest groups seeking change exploit potential coalition members' agnosticism about the emergent institution by offering evidence that supports a negative normative assessment, which provides a moral basis for a judgment of illegitimacy.

Framing and Reference Points

One mechanism that the organized interest groups seeking change use to mobilize unaffected groups is a "collective action frame" (Benford & Snow, 2000) that facilitates negative interpretation of this new and largely unknown entity according to preexisting beliefs and biases—for example, the "right" of citizens to control their country's critical resources or their "entitlement" to certain services. Social movement theorists have examined the use of such frames in

varied contexts—for example, national competitiveness frames used by interest groups seeking to influence standards for high-definition television (Dowell, Swaminathan, & Wade, 2002) and environmental justice frames in recycling policy (Lounsbury, Ventresca, & Hirsch, 2003).

A complementary mechanism for demonstrating an emergent institution's illegitimacy is to contrast its attributes with those of various reference points that reflect a prevailing standard of legitimacy (Gamson, Fireman, & Rytina, 1982). Kahneman et al. (1986) advance this notion in the context of consumer and labor market transactions between individuals and private firms. They provide empirical evidence that individuals assess the "fairness" of the prices or wages set by a firm they have not previously transacted with by comparing them to a prevailing price or wage level—a "reference transaction"—the fairness of which is not itself in question. In the social movement context, Minkoff (1997) effectively argues that the civil rights movement served as a reference point for the feminist movement.

Zajac (1995) develops this insight in a political-economic context, focusing especially on U.S. utility regulation. He contends that a normative principle of fairness requiring "like treatment of like cases" is "deeply ingrained" in many ("perhaps most") societies. Furthermore, "institutional framing"—whereby "the economic environment, operative institutions, and history . . . give specific meaning" to the fairness principle—determines "how and under what circumstances [this principle] will be applied" (Zajac, 1995: 106).³

The most compelling comparisons that disaffected interest groups draw in their coalition-building efforts may be between their own or other groups' pre- and postreform income, as well as between their own or other groups' postreform income and that of foreign investors. The larger the discrepancies such comparisons reveal, the greater the prospect that organized

interest groups will be able to convince others of the emergent institution's lack of legitimacy. More generally, an emergent institution in one sector whose consequences, procedures, or structural type differs from those of institutions governing other sectors, or an emergent institution that is adopted in isolation rather than as part of a broader "package" of linked, consistent reforms, is more susceptible to change than is an emergent institution that resembles established institutions or is adopted as part of a broader package of reforms. Furthermore, whereas emergent institutions adopted as part of a package are relatively difficult to unravel politically (Martinelli & Tommasi, 1997; Tollison & Willett, 1979), the singular nature of an emergent institution adopted in isolation—in response to a sector-level crisis, for example—provides organized interest groups with a ready "prognostic frame" for solving the problem of illegitimacy: the elimination of the offending entity itself.

Proposition 2a: The probability that political actors will overturn, alter, or reinterpret an emergent institution grows with the degree of divergence between the emergent institution and reference points whose legitimacy is not in question.

The crisis conditions under which electricity privatization occurred in many countries set the stage for institutional design efforts that were inconsistent with observable reference points and provided a ripe basis for invoking various frames challenging the existence of emergent institutions. A case in point is the policy that some governments adopted of offering bilateral "power purchase agreements" (PPAs) that granted highly favorable terms to private investors, typically in the absence of broader market rules. These contracts were unique in that private investors bore practically no risk (other than penalties for failing to begin operations by a specified date, along with the operating risk itself) but retained all of the upside potential.

An alternative emergent institution that provided for greater legitimacy in some cases was a set of sector-level market rules. These rules benefited investors by explicitly limiting the scope of government intervention. However, by mirroring the structure of other markets in the economy, they reduced the ability of interest

³ In a related line of research, Sidak and Spulber contend that a "regulator" (i.e., the government) enters into a "bargain" with a "utility" (i.e., a private investor), whereby "in return for assuming an obligation to serve and charging not more than 'just and reasonable' prices on a nondiscriminatory basis, the utility is guaranteed a franchise protected by entry regulation and income sufficient to earn a competitive rate or return on its invested capital" (1997: 4).

groups or political entrepreneurs to cast them as special deals deserving reevaluation.

Evidence that managers recognize the importance of consistency comes from the microprocessor industry, which is characterized by substantial capital costs but less political salience than electricity generation. In its negotiations with various governments during the site selection process for a \$500 million semiconductor plant, which Intel eventually located in Costa Rica, Intel stressed that any concessions it secured should be generally available to all firms making an investment of equal size, lest it be singled out as a recipient of special treatment and made the target of a populist backlash. Concessions to work around legal requirements for unionization actually eliminated Mexico from the running. Costa Rica, in contrast, altered its original proposal to comply with Intel's demand for consistency (Spar, 1998).

Exogenous Changes in Circumstance and Change in Emergent Institutions

In addition to exploiting existing reference points, organized interest groups seeking to change an emergent institution also may take advantage of exogenous shocks or changes in circumstance that increase the magnitude, scope, or salience of the emergent institution's distributional consequences (March & Simon, 1958). Such "focusing events" (Kingdon, 1984) often provide powerful images that constitute perhaps the most striking reference points of all. Organized interest groups seeking change may use these events to enfranchise groups that did not previously regard change in the emergent institution as a salient political issue (Hoffman, 1999; Seo & Creed, 2002), and also to enhance the cohesion of their coalition by constructing an injustice frame (Gamson et al., 1982) based on the contrast between the losses incurred by "victims" and the relative well-being of investors insulated by the emergent institution. They may further bolster the perception of injustice by pointing to the relative lack of public debate about the design of the emergent institution at the time of the threat or crisis that precipitated it (Kogut & Spicer, 2002; Milcoch, 1998).

Other actors may assist organized interest groups in their campaign for change following an exogenous shock or change in circumstance. "Political entrepreneurs," including incumbent

politicians, opposition politicians, and nongovernmental organizations (NGOs), may exploit the event in order to boost their own popular support (Cox & McCubbins, 1993; Jones, 1978; Schneider & Teske, 1992), especially during elections or other periods of political contention. McFarland's (1991) cyclical theory of interest group politics and the broader macroeconomic literature on political business cycles, which emphasizes how political actors may opportunistically manipulate policy levers under their control for the purpose of electoral gain (Alesina, 1989; Nordhaus, 1975; Rogoff & Sibert, 1988), are illustrative.

Media organizations with their own political agendas may play a role as well, especially in enfranchising diffuse, previously unorganized groups (Levy & Spiller, 1994; Weingast, 1981). Moreover, "new" groups, where members control inputs whose scarcity has increased following a disruptive event (Landes, 1998; North, 1990) or where members are better able to process and exploit new information than are the members of groups whose routines are adapted to prior circumstances (Ingram, 1998), may also join the coalition supporting change. At the same time, members of the original coalition supporting the emergent institution are more likely to defer or compromise if the cost of delayed resolution is high and change in the emergent institution—including its elimination—appears to be an expedient solution (Alesina & Drazen, 1991; Drazen & Grilli, 1993; Fernandez & Rodrik, 1991; Nelson, 1990; Williamson, 1993).

The presence of contrasting reference points, entrepreneurial political actors who seize upon them, and newly enfranchised interest groups significantly improves the ability of organized interest groups seeking change in an emergent institution to obtain such change. Indeed, the conditions that an exogenous shock or change in circumstance creates may play the pivotal role in determining whether such a group is able to secure major (or punctuated) change rather than incremental (or creeping) change, which is more common in the policy-making arena (Astley, 1985; Jones, Baumgartner, & True, 1998; Romanelli & Tushman, 1994).

Proposition 2b: The probability that political actors will overturn, alter, or reinterpret an emergent institution is higher after an exogenous shock or change in circumstance.

One prominent example of an exogenous shock is a macroeconomic crisis. Argentina again provides an example. After the 2001–2002 financial crisis there, President Duhalde, clearly attempting to bolster political support for himself, cited the extraordinary profits earned by foreign infrastructure investors as justification for the imposition of a retroactive emergency profits tax (Esterl, 2002). The 1997 East Asian financial crisis provides another example. Citizens and interest groups in these countries, which were already experiencing social and political strife as a result of the severe economic downturn, perceived PPAs that obligated cash-strapped government entities to pay private generators for unneeded electricity as illegitimate. Street demonstrations, riots, and even, in the case of Indonesia, the revolution that overthrew President Suharto were a direct or indirect reaction—often instigated by political entrepreneurs—to government attempts to honor the terms of PPAs.

Electricity investors have not been alone in facing pressure for change in the emergent institutions that govern their relationship with host governments. Investors in the telecommunications, automotive, natural resource, and financial sectors also have suffered similar calls to “share the pain” during the recent Argentine crisis and the ongoing economic turmoil in Bolivia, Venezuela, and Peru.

Investor Business Practices and Change in Emergent Institutions

The foregoing propositions suggest that, in addition to the traditional bargaining power model's emphasis on the *ex ante* conditions under which a bargain is struck, the play of the *ex post* execution phase is a critical determinant of the level of political risk an investor faces. Not only do the specific attributes and outcomes of the emergent institution influence the perception of legitimacy during this phase but so, too, may the behavior of investors.

All foreign investors' business practices are subject to public scrutiny. Decisions to lay workers off or otherwise increase profits at the expense of suppliers, consumers, or the government are easily identified and taken out of context; in some cases, they provide images as dramatic as those of major shocks and crises (Guillén, 2000). Organized interest groups seek-

ing change may tie such factors to injustice frames they have developed to mobilize support. For example, in order to reinforce local stereotypes regarding neocolonial exploitation by private interests, such groups may point to business practices that transfer rents from local interests to foreign shareholders. Even when such actions are “efficient” or in the long-term interest of the host country, they may still facilitate the formation of injustice frames.

Consider some of the specific practices recommended in the traditional bargaining power literature to protect infrastructure investors from political risk (Moran, 2000; Wells & Gleason, 1995). One such practice is the substitution of debt for equity, which reduces an investor's financial exposure. However, this practice also raises a project's rate of return, which can be framed as *prima facie* evidence of inequity. Similarly, the front-loading of risk through high “required” returns in the early years of a project's operation may increase the probability that investors will recoup their investment but may also produce higher service prices that can be labeled as *exploitative*. Other practices include the use of foreign partners to spread risk, which may feed the perception that a project is not “local” enough, and the use of government guarantees or commitments to pursue international arbitration, which may be characterized as “special treatment.” More routine practices such as laying off excess labor or soliciting competitive bids from foreign as well as local input suppliers also make effective targets.

Proposition 2c: The probability that political actors will overturn, alter, or reinterpret an emergent institution is higher when investors undertake new business practices that raise the project's rate of return at the expense of powerful local interest groups.

One example of a nominally routine business practice's generating pressure for change comes from Brazil. Support for the privatization program there waned substantially after a blackout in Sao Paulo during the Christmas holiday in 1997. Record heat and a poor preprivatization maintenance history were certainly contributing factors, but the press and the public focused largely on the 40 percent reduction in personnel (some of whom had to be rehired to teach existing workers how to repair jury-rigged transform-

ers), as well as the utility's record profits and weak regulatory supervision (Moffett, 1998). In Buenos Aires, customers who had been without power for almost a week of high temperatures following a fire at a power station operated by the Chilean firm Edesur marched in the streets nightly, banging pots and pans and setting tires and an automobile on fire (Zadunaisky, 1999). An engineer interviewed by the news media claimed that the delay in reinstating power was caused by Edesur's laying off of thousands of skilled Argentine workers like himself (Valente, 1999).

Even business practices that foreign investors undertake to enhance the strength of the interest group coalition favoring the emergent institution may later create pressure for change, following an exogenous change in circumstances. Investors in Malaysia and Indonesia, for example, took on host country partners with privileged political access, as recommended by the traditional bargaining power literature. This practice does not appear to redistribute returns away from local interests in any way; in fact, it might well be perceived as "spreading the wealth" from a successful project. Following the 1997 financial crisis, however, electricity investors in Indonesia, where the precrisis Suharto government had fallen, were labeled as corrupt on the basis of their ties to the government. In contrast, those who were closely linked through local partners to the surviving Matathir government in Malaysia benefited from their ties.

Another example from a capital-intensive but less politically salient sector involves the airport construction and services industry, where Fraport recently wrote off its investment in the new terminal at the Manila airport. The German company formed an equity partnership with a prominent local Chinese family and allegedly made substantial payments to cronies of former President Estrada. However, his successor, President Arroyo, made rooting out corrupt dealings the touchstone of her administration. After challenging twenty-eight specific terms of the contract, she declared the contract null and void, leaving Fraport with a loss of \$318 million (Landler, 2003).

INSTITUTIONAL MODERATORS

As discussed in the previous section, the magnitude and scope of interest group pressures for

change in emergent institutions must attain some "threshold" level in order for such change to appear on the policy-making agenda, because political actors are capable of considering only a limited number of issues at any one time. Given this limitation, political actors choose issues to address based not only on the political benefits that they will enjoy from "solving" an issue through policy making but also the "cost" that they must incur in terms of the time and effort that such policy making requires. This cost depends largely on the configuration of the country-level institutions—most prominently, the internal structures of and relationships among the legislature, the executive branch, the judiciary, and regulatory agencies—that govern the policy-making process itself (McAdam, McCarthy, & Zald, 1996; Moe & Caldwell, 1994).

Configurations that increase costs impede change, effectively mitigating interest group pressures for change (Tiller & Spiller, 1999; Tsebelis, 2003), whereas structures that reduce costs facilitate change, effectively increasing the potency of such pressures. The neoinstitutional perspective thus augments the traditional bargaining power model's list of country-level determinants of "renegotiation" by incorporating the institutional configuration of policy making as a determinant of the threshold level of interest group pressure needed to generate change in emergent institutions.

Analysis of the effects of country-level institutional configurations on the incidence of policy change derives from the regulative pillar of neoinstitutional theory, including contributions from economic history (North, 1990; North & Weingast, 1989), formal political economy models (Dixit, 1996; Laffont, 1999), qualitative evidence from recent policy shifts in infrastructure sectors (Levy & Spiller, 1994; Spiller, 1993) and elsewhere (Gely & Spiller, 1990; Gilligan, Marshall, & Weingast, 1989; McCubbins et al., 1987; Weingast & Moran, 1983), and quantitative evidence on infrastructure sector investment patterns (Henisz & Zelner, 2001, *in press*). Such institutions are usefully characterized in terms of checks and balances, including both *de jure* characteristics, such as constitutional separation of powers, and *de facto* characteristics, such as the extent of partisan heterogeneity within and across branches of government. Institutional configurations with stronger checks and balances require agreement across a broader

range of political actors to effect a shift in policy, increasing the effort required of any given political actor to change an emergent institution. In contrast, configurations that concentrate political power in the hands of a single actor facilitate change. Empirical evidence demonstrates the effects of institutional veto points on policy stability (Franzese, 1999; Hallerberg & Basinger, 1998; Persson & Tabellini, 1999; Treisman, 2000b).

For investors assessing the institutional configuration governing the policy-making process in a given country, recognition of the interplay among different governmental bodies is particularly important. For example, a veto point that constrains executive discretion on a constitutional basis, such as an independent legislature, may be entirely controlled by the executive's party (Henisz, 2000), effectively negating the constitutional separation of powers. MacIntyre (2001) provides illustrative evidence from Malaysia at the time of the 1997 Southeast Asian financial crisis: the parliament there appeared to have a fragmented party structure that would have impeded a rapid response, but, in fact, the government party controlled many of the ostensibly independent parties, generating a homogeneous preference structure and facilitating a rapid set of changes.

Even when partisan preferences in a legislative chamber are truly heterogeneous, the collective nature of the body may well mean that partisan checks and balances are less effective than those provided by freestanding institutional actors, such as regulatory agencies or judiciaries (Crepaz, 1998, 2002). Even these latter sorts of checks and balances must be scrutinized, however. For example, a regulatory agency or subfederal entity that is not monitored or constrained by other governmental bodies is prone to corruption and overspending (Blanchard & Shleifer, 2000; de Mello, 2000; Rodden, 2002; Treisman, 2000a; Wibbels, 2000) and likely to be more susceptible to interest group pressures for "reinterpretation" of an emergent institution.

Proposition 3. Given some level of interest group pressure for change, the stronger the effective checks and balances in the policy-making process, the lower the probability that political actors will overturn, alter, or reinterpret an emergent institution.

An example of the effect of country-level institutional veto points on change in emergent institutions is the different government treatment of private electricity investors in Thailand and the Philippines relative to that of investors in Indonesia and Malaysia following the 1997 financial crisis. At the time of the crisis, the parliamentary majority in the Thai legislature was divided among ten parties, and the Philippine government faced a razor-thin legislative majority that relied on the support of independents and other allies in both chambers. This fractionalization of preferences ensured that any new policy proposal or change in the status quo policy required the approval of multiple parties with their own competing interests.

The country-level institutions in Malaysia and Indonesia looked quite different. Dr. Mahathir, Prime Minister of Malaysia at the time of the crisis, and President Suharto, of Indonesia, effectively controlled the political systems of their respective countries, using the overwhelming majority of the National Front Coalition in the former case and the Golkar Party in the latter. In neither country was the judiciary considered independent.

Investors in Thailand and the Philippines, with their stronger institutional safeguards, fared relatively well following the crisis. The Thai government absorbed some of the exchange rate risk held by investors, and the Philippine government upheld private investors' PPAs, despite the fact that this policy adversely affected the state-owned electricity company NAPOCOR.

Electricity investors in Malaysia and Indonesia experienced much less favorable treatment once the financial crisis began. In 1997 the Malaysian government announced the suspension of the PPA for the country's largest private power project (the 2,400 MW Bakun hydroelectric project) and demanded substantial concessions from the remaining IPPs (*Global Power Report*, 1998). In Indonesia, the government announced in September 1997 that it would postpone or review infrastructure projects worth a total of more than 50 trillion rupiah (U.S. \$6 billion), and six months later sent a letter to its IPPs informing them that subsequent compensation would be less than one-quarter of the contracted rate (*Far Eastern Economic Review*, 1998).

As the burgeoning literature on veto players summarized earlier also suggests, not all fed-

eral systems include both the power of the states to check the center and the power of the center to constrain the states. Instead, states or provinces often exist as sources of unchecked political power. Brazil provides an example, in the form of a dispute between Itamar Franco, the former President of Brazil and newly elected provincial governor of Minas Gerais, and Southern Corporation and AES, which together purchased the local utility CEMIG in 1997. The inability of the national government to check the arbitrary, populist actions of Franco in a dispute regarding the corporate governance of CEMIG was a primary factor in the decision by AES and another private electricity investor, Duke Energy, to suspend their participation in a subsequent auction for the state utility Cesp Tiete.

Another country-level institutional relationship that moderates the behavior of political actors is the relationship between the regulator and the upper branches of government—in particular, the extent to which a regulator is able to check the behavior of political actors in these branches, and vice versa. Where the regulatory authority lacks autonomy, it cannot serve as an effective check on policy makers motivated to promote unfavorable policies toward investors. The Hungarian experience is a case in point. Numerous design features limit the Hungarian Energy Office's (HEO) independence (Newbery, 1998; Stern, 2000). Incidents such as a ministry-mandated reduction in the real price of electricity during the run-up to the 2002 election—in opposition to the HEO's recommendation—illustrate the fragility of emergent institutions in the absence of sufficient checks and balances.

ORGANIZATIONAL CHARACTERISTICS

To what extent do individual organizations differ in the level of political risk they face? The traditional bargaining power perspective links an organization's size, export potential, and technology to the rate at which its bargaining power declines and, thus, to the likelihood that it will be subject to adverse treatment by the government (Kobrin, 1987). In contrast to this "invariably passive and conforming" (Oliver, 1991: 146) depiction, in which the organization simply "responds" to the government's altered demands, neoinstitutional theories suggest mechanisms through which organizations may exploit their distinctive institutional traits *ex post*

to engage in "interest-seeking, active . . . behavior" (Oliver, 1991: 146) aimed at insulating themselves from change in emergent institutions. The more active depiction of the organization under this conception provides a considerably stronger basis on which to build a theory of strategy.

Organizations confronting the risk or reality of adverse change in emergent institutions face strong pressures to maintain legitimacy by acquiescing to such change (Oliver, 1991). Because the enforcement mechanism for emergent institutions is the coercive power of the state (Scott, 2001), the penalties for noncompliance are both tangible and severe (Oliver, 1991). At the same time, the imposition of a new or modified institution intended to meet broader distributional demands significantly restricts an organization's discretion in key decisions, such as "resource allocation, product or service selection, resource acquisition, or organizational administration (i.e., hiring, compensation, promotion)" (Oliver, 1991: 166), and more generally chafes against the "technical activities and efficiency demands" (Seo & Creed, 2002: 226) that support profitability. The prospect of substantial economic loss from conformity to the external mandates of the state therefore creates strong internal pressures for organizations to resist change in emergent institutions.

Specific characteristics of an organization affect its ability to resist change. One characteristic is the organization's interorganizational linkages. Although these are typically viewed as determining the diffusion or adoption of new organizational forms (Marsden & Friedkin, 1993), they are significant in the current context in the degree to which they provide an organization with channels into the policy-making process. Strong direct or indirect ties to relevant political actors—especially those who control resources sought by an organization—permit organizations to craft "side deals" with these actors for special contract terms or individualized exceptions to adverse changes in emergent institutions. Organizations lacking such ties are at a distinct disadvantage, not only because they cannot exploit the ties for defensive purposes during a period of flux but also because a well-connected competitor's gain during a period of upheaval may have a direct adverse impact on them.

A second characteristic is an organization's information-based resources and capabilities (Boddeyn & Brewer, 1994). Given the difficulty of assessing complex, evolving emergent institutions, managers who can look to their own past experience for an analogue to guide their current search for an organizational response or for accumulated learning (Baum & Ingram, 1998; Baum, Li, & Usher, 2000) are better equipped to make sound decisions under conditions of uncertainty. Henisz and Delios (2001), for example, found that prior experience in a specific host country reduces an organization's sensitivity to cultural or market differences. Lyles and Steensma (1996) argue that, as a result of the wide diversity of emergent institutions governing infrastructure projects, investors' management of their relationship with the government is an important organizational capability and key "factor of success" in such projects.

Proposition 4: Given some level of interest group pressure for change, the use of appropriate organizational linkages and distinctive knowledge lowers the probability that political actors will overturn, alter, or reinterpret an emergent institution.

The Czech Republic provides an example of the value of strong direct ties and the difficulties experienced by organizations that do not themselves possess such ties but whose competitors do. Oftentimes, a "privileged" organization, such as a long-standing incumbent, a state-owned enterprise or its privatized progeny, or a national champion, possesses the strongest ties to relevant political actors. In the Czech case, the government's desire to secure a high sale price for CEZ, the previously state-owned monopoly generator, is widely believed to be responsible for the promulgation of a new schedule of allegedly inflated prices that independent private generators must pay to CEZ for "ancillary services" (Financial Times Business Limited, 2000).

Indirect ties that may help moderate the organization-specific impact of change in emergent institutions include rating agencies, international banking syndicates, equity owners, government-sponsored political risk underwriters (e.g., OPIC, the Export-Import Bank, COFACE, ECGD, MITI, etc.), multilateral lending agencies (e.g., the Asian Development Bank and the Inter-

national Finance Corporation), and home country governments. Investors have different levels of access to these entities as a result of their size, extent and quality of historical interactions, past campaign contributions, and the like.

Enron's investments in Argentina provide a prominent example of the manner in which an organization may employ such indirect ties in an attempt to alter a policy outcome. A former regulatory official there (now an Argentinian congressman) claims to have received a phone call from George W. Bush (the son of then President-elect George H. W. Bush) that delivered "a subtle, vague message that [helping Enron] could help us with our relationship to the United States" (Corn, 2002: 5).

Evidence of the value of an organization's experience profile in moderating adverse changes in emergent institutions comes from Holburn (2001), who found evidence suggesting that organizations that have previously operated under rate-of-return regulation are better equipped to manage rate review, whereas organizations with experience in wholesale market competition are better able to manipulate prices under complex market rules. Similarly, organizations with experience in countries with centralized political decision making or multiple checks and balances, respectively, enjoy a comparative advantage in other countries with similar attributes.

Examples of firms from other industries whose competitive advantage appears linked to managing relations with the government abound, particularly in capital-intensive industries or those characterized by widespread consumption and a strong public interest. The two largest conglomerates in Hong Kong (Hutchison Whampoa Limited and First Pacific Limited) operate ports, telecommunication systems, electricity generators, retail chains, and hotels in thirty-six primarily emerging markets. South Africa's two largest cellular companies (MTN and Vodacom) offer service in Botswana, Cameroon, Lesotho, Morocco, Nigeria, Rwanda, Swaziland, Uganda, and Zimbabwe. Finally, the two largest Turkish construction firms (ENKA and STFA) manage projects in Algeria, Azerbaijan, Belarus, Croatia, Ethiopia, India, Iran, Iraq, Jordan, Kazakhstan, Kyrgyzstan, Libya, Oman, Pakistan, Qatar, the Russian Federation, Saudi Arabia, Turkmenistan, and Ukraine. It is doubtful that these firms rely primarily on technological innovation or

marketing ability to drive their internationalization; instead, they have more likely developed the capability to operate in an idiosyncratic institutional context (Henisz, 2003).

CONCLUSION

We have sought to augment the traditional bargaining power perspective by considering the institutional context in which bargains are struck and changed. In contrast to the traditional perspective's depiction of bargaining as a one-shot deterministic interaction between an investor and a monolithic government, our model depicts an ongoing process in the policy-making arena, consisting of interactions among investors, organized interest groups, citizens, and political actors, all of whom face cognitive limitations; differ in their preferences; and are subject to varying normative pressures, institutional constraints, and exogenous influences. Our approach thus broadens the traditional perspective's focus on *ex ante* conditions by building toward a "recursive, iterative model of institutional change" that combines consideration of "top-down processes" allowing higher-level structures to shape "the structure and actions of lower-level actors" with that of "counterprocesses . . . [allowing] lower-level actors and structures [to] shape the contexts in which they operate" (Scott, 2001: 196–197).

The specific points of distinction between our expanded model and the traditional perspective are numerous. In our model the bargain between government and investor assumes the form of an emergent institution, rather than remaining devoid of institutional content. A web of implicit contracts among political actors, interest groups, and foreign investors substitutes for the bilateral dependency between investors and government. Legitimacy augments relative dependence as a determinant of change. Institutionalization replaces secular decline. Country-level institutional structures and organization-level characteristics augment the traditionally acknowledged determinants of change.

Our expanded model also introduces core constructs that have no counterpart in the traditional perspective. "Events that matter" (Kobrin, 1979)—exogenous changes in circumstance or specific investor business practices—may be used to illuminate misalignment between the distributional rights enshrined in an emergent

regulative institution and various interest groups' perception of legitimacy. "Environmental processes" (Kobrin, 1979) play a key role, especially those through which organized interest groups enfranchise secondary interest groups to exert pressure for change in emergent institutions.

Strategic Implications

The strategic implications of our model for foreign investors are numerous and complex, sometimes extending those from the traditional bargaining power perspective and sometimes at odds with them. The first set of recommendations relates to the process of risk assessment. We highlight the maturity of an emergent institution, its initial design process, its susceptibility to framing and degree of consistency with existing reference points, and the expected distribution and nature of environmental disturbances as crucial determinants of political risk. We also point to the national policy-making structures and an organization's own internal capabilities as important determinants of political risk.

In the context of risk management, the traditional perspective advises investors to exploit their strong initial bargaining power to secure the strongest *ex ante* safeguards possible, such as front-loading their returns. Our model suggests that investors exercise caution in exploiting their initial bargaining power by negotiating for emergent institutions that balance profitability with legitimacy and, thus, are more resistant to interest group pressures for change. Similarly, whereas the traditional perspective advises investors to take ongoing measures such as protecting distinctive technology in order to maintain their bargaining power, our model suggests that investors should exercise caution in their attempts to maintain bargaining power, avoiding business practices for which the actual or perceived distributional consequences may engender perceptions of illegitimacy of the supporting emergent institutions.

The recommendation of the traditional bargaining power literature to cultivate local allies is further enhanced by the legitimacy such partners may provide to emergent institutions when incentive alignment among the various partners can be maintained. However, when a host country partner is well situated to threaten both the

economic interests and legitimacy of the emergent institutions supporting the foreign investor, the partnership strategy may itself be risky. Routines and capabilities to manage relationships with partners, interest groups, and policy makers all emerge as important success factors.

These findings also have strong implications for insurers and creditors evaluating the prospects of foreign investors in a host country. By assessing the fitness of an investor's political risk mitigation strategy, these financial actors may more accurately determine the proper scope and price for cover or credit.

Future Research

Substantial work clearly remains to be done. A depiction of an investing organization's internal decision-making process similar to the depiction of the policy-making process offered here would be beneficial, as would a more complete treatment of the differences in decision-making processes, external linkages, and capabilities among investing firms.

We believe that the determinants of the longevity of recent reforms in infrastructure sectors offer a fruitful starting point for empirical research. The legitimacy of privatization, deregulation, and liberalization in a given country can be proxied for by the level of public sector involvement in the economy overall. Measures of government ownership of assets, the government labor force, and government subsidies and transfers as a percentage of GDP can help sort among countries for which privately owned and operated infrastructure services are likely to be seen as more or less legitimate. We can also readily obtain indicators of the time since the initial reform, the subsequent distribution of macroeconomic shocks, institutional checks and balances, and, in some cases, relevant external organizational ties. Additional applications could include the adoption of bilateral investment treaties, commitments to multilateral organizations, and changes in trade policy.

While our analysis has emphasized the context of foreign investment in host countries and focused on the legitimacy of distributional outcomes as an impetus for change in emergent institutions, similar arguments may generalize to other institutional contexts in which legitimacy derives from other types of outcomes. Quantitative and qualitative studies in a range

of contexts will, we hope, complement each other in the further development of this framework for understanding change in emergent institutions.

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Witold J. Henisz is an assistant professor of management at The Wharton School, The University of Pennsylvania. He received his PhD. from the Haas School of Business at the University of California, Berkeley. His research examines the determinants of political hazards faced by investors and their strategies in hazardous environments.

Bennet A. Zelner is an assistant professor of strategy and policy at the McDonough School of Business, Georgetown University. He received his Ph.D. from the Haas School of Business at the University of California, Berkeley. His research examines how business organizations manage risks and opportunities in their external political environment.

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