

## Article

# Institutional Distance versus Intra-Country Differences: Capturing and Leveraging the Diversity Within

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## AIB Insights

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The field of international business (IB) largely focuses on the inter-country institutional differences, however, very little focus and attention have been given to the social interactions of sub-cultural groups within the country. Could we be overlooking greater opportunities for understanding differences across the diversity within countries? This article aims to provide insights and practical suggestions on: (1) How does leveraging intra-country diversity affect firm performance outcomes globally? (2) Why understanding intra-country diversity is important to the field of IB? and (3) How can IB scholars, managers, and educators engage further as a discipline to explore strategies that achieve more diverse and equitable societal and economic outcomes?

### MEASURING INSTITUTIONAL DISTANCE

Understanding and identifying the institutional differences between countries has long been the focus of international business (IB) as a discipline. The primary goals of institutional distance learnings from this perspective are aimed towards reducing the liabilities of foreignness for MNCs and understanding the local market context to be better equipped to manage their subsidiaries. In the last decade, however, Bae and Salomon (2010) challenged IB scholars to bring together the disparate learnings on institutional distance to develop a more holistic approach of the institutional characteristics that have implications on firm-level performance. This meta-analysis of institutional distance measures revealed our biases as a field when studying institutional differences. IB scholars studying institutional distance most commonly only consider distance across countries, hence, intercountry differences (e.g., Perkins, 2014). Rarely, however, are we examining and challenging the intra-country differences that capture the diversity within (e.g., Tung, 2008). When considering the broadest definition of institutions – “humanly devised constraints that structure political, economic, and *social interaction*” (North, 1991: 97), Bae and Salomon (2010) point to the fact that across all of the types of institutional dimensions studied, most of the focus has been on the formal institutions including political, regulatory, economic or a more narrowly defined scope of informal institutions, namely national cultural.<sup>1</sup> Taking an overarching view of the conversations initiated over the last few decades in the field’s premier jour-

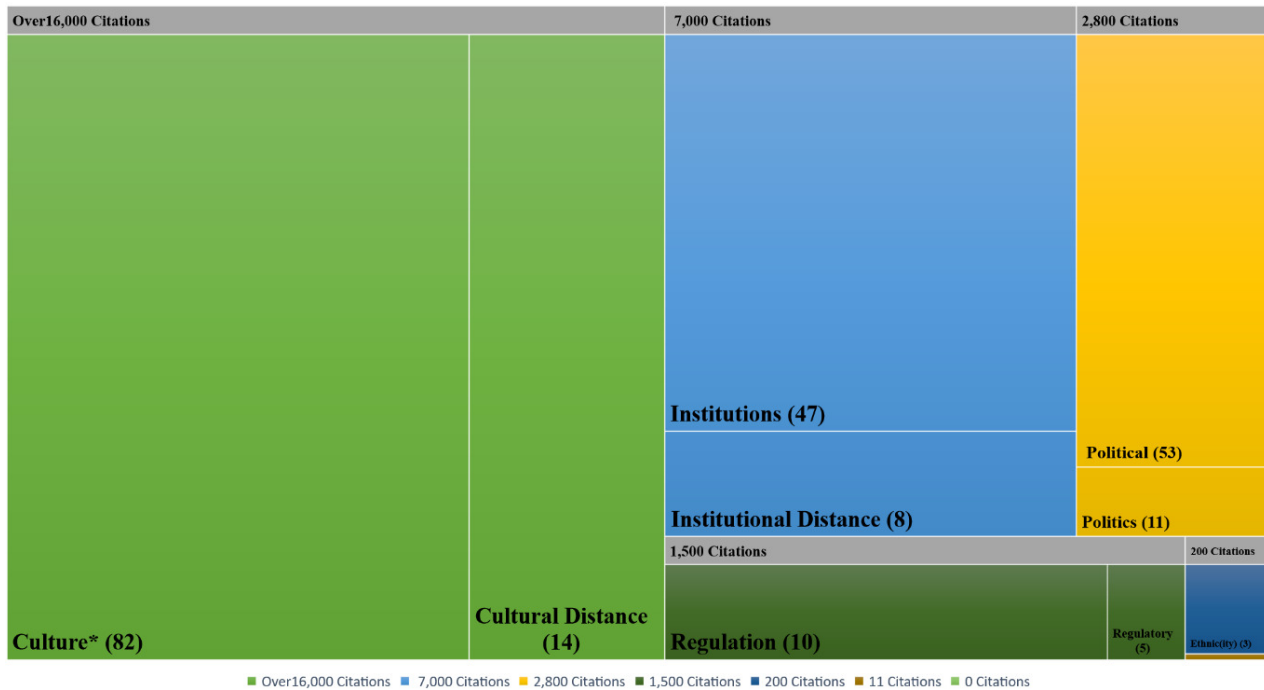
nal, *Journal of International Business Studies*, the overwhelming majority of attention given to this topic is focused on “institutions” in its broadest definition and national “culture” (see [Table 1](#)).

Very little focus and attention have been given to the *social interactions* of sub-cultural groups within the country. The field of IB’s neglected attention on intra-country *social interactions* specifically between race, ethnicity, and gender has resulted in a blind spot in our understanding of diversity, equity and inclusion (DEI). These research topics have largely been ignored despite the rising public attention to DEI issues and concerns globally. A paradigm shift is needed by IB scholars, managers, and educators alike to broaden our understanding of institutional distance to include sources of the variance in distance originating not only from intercountry, but also intra-county distance. Stated most poignantly, IB is the “management of diversity” (Lumineau, Hanisch, & Wurtz, 2021).

This article aims to illustrate and provoke further discussion on: (1) How does leveraging intra-country diversity affect firm performance outcomes globally? (2) Why is understanding intra-country diversity important to the field of IB? And (3) how can IB scholars, managers and educators engage further to explore strategies that achieve more diverse and equitable societal and economic outcomes? Diversity can be defined in many ways. This article explicitly focuses on racial/ethnic and gender inclusion, and not other important aspects of diversity. The hope is that the implication of this discussion expands to other diversity settings as well.

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<sup>1</sup> See Bae and Salomon (2010), Table 3 for a comprehensive list of institutional characteristics measuring distance.



**Table 1. *Journal of International Business Studies* Article Title Topics (1970-2022) and Citation Counts Generated**

Source: Web of Science, Citation Analysis, 2022; Sized by the number of citations; (#) Number of papers

\* Largely national culture

## LEVERAGING INTRA-COUNTRY DIFFERENCE AND FIRM-LEVEL PERFORMANCE: THE BUSINESS CASE FOR DEI

The business case for DEI at the global scale is clear. A recent series of McKinsey (2015, 2018, 2020) studies on global diversity and inclusion examined 1,039 large corporations across 15 countries<sup>2</sup> and revealed that companies with gender and ethnic diversity in the executive levels of management consistently outperformed their industry peers in profitability (e.g., EBITA). Those firms in the top quartile of gender representation in the upper echelon of the firm had 25% greater profitability on average than their industry peers. Similarly, having ethnic and racial diversity in the executive ranks was associated with 35% higher profits than their less diverse national industry competitors. Even further, these results demonstrated that when firms have higher participation rates of gender and ethnic diversity in the firm's executive management, that amplifies the performance gap between the most profitable and least profitable industry peers. More precisely, the performance difference between the most diverse company versus the least diverse in terms of gender diversity had a 48% difference in overall profitability (McKinsey & Company, 2020). The likelihood of outperformance of industry competitors is much higher for companies with ethnic/racial diversity than gen-

der, though both have positive and significant performance affects. So, leveraging the benefits of both gender and racial diversity can have great payoffs when companies consider the intra-country subgroup cultural differences within. The promise of leveraging intra-country diversity suggests that multinationals and organizations will benefit from higher levels of gender, racial and ethnic inclusion, resulting in increased creativity and innovation, better decision making and problem solving, and higher levels of participation overall. For those global companies not leveraging these benefits of diversity, the penalty for non-participation is also surmounting, leaving those firms as potential competitive laggards. Despite these possible gains from DEI within the business sectors globally, the downsides of overlooking the real challenges of diversity – unconscious bias, discrimination and racism – are also clear. Organizationally, learning how to overcome these challenges is the most difficult part (Ely & Thomas, 2020). A global study including 190 countries found that higher levels of intra-country diversity (e.g., racial/ethnic composition), when left unmitigated, is associated with lower economic growth (e.g., GDP) of the country (Alesina, Devleeschauwer, Easterly, Kurlat, & Wacziarg, 2003). Given the field of IB's understanding of institutions, distance, and differences across counties, might our insights help to capture these benefits of DEI globally?

<sup>2</sup> The 15 countries studied include Brazil, Mexico, US, UK, Australia, France, Germany, India, Nigeria, Japan, Singapore, South Africa, Denmark, Norway, and Sweden.

## INTRA-COUNTRY MEASURES THAT CAPTURE DIVERSITY AND INCLUSION

Recent criticism of IB research measuring distance suggests that “the assumption of country level homogeneity, and the simplistic and reductionist application of the distance construct, makes it difficult to explicate the underlying mechanisms leading to the observed outcomes, be they positive or negative” (Doh, 2021: 1641). When considering how to best capture the intra-country differences in ethnic and racial diversity, useful measures have already been developed in the fields of political science and economics. For example, Fearon’s (2003) cultural diversity measure covers 822 ethnic groups that made up at least 1% of the population in 160 countries. This ethnic/racial diversity measure captures three related structural aspects of diversity: the (1) composition and (2) proportion of ethnic groups within a country, as well as ethnic structures and the (3) cultural distance between groups based on the similarity of the primary languages spoken by each group. Fearon’s cultural diversity measure is calculated as an index from 0 to 1, where 0 represents completely homogeneous societies and 1 represents highly racial/ethnically diverse societies with greater distance between the ethnic groups. To further illustrate this variation, [Figure 1](#) provides an example of select country-level cultural diversity scores for North Korea, Brazil, Australia, China, Botswana, USA, Russia, Iran, and India, respectively. For example, one of the most ethnically homogeneous countries in the sample is North Korea (PRK) (cultural diversity = .002) and one of the most diverse is India (cultural diversity = .67). As a reference point, the United States’ cultural diversity score is .27, slightly below the global mean score of .396. This accounts for the frequency and proportion of racial/ethnic groups in the US (e.g., White, Black, Hispanic and Asian) and their linguistic differences (e.g., English versus Spanish), relative to a more diverse country setting such as Liberia with 14 different ethnic groups and over 20 spoken languages (see [Figure 2](#)).

Similarly, others characterize intra-country diversity by the level of complexity that exists to create societal inclusion. Economists Alesina and colleagues (2003) developed a measure coined ethnic fractionalization (EF) with a representative score for 190 countries where the EF Index score represents the probability that a fellow countryman is of another ethnic group. Both of these intra-country measures systematically capture the racial and/or ethnic diversity that actually exists within societies instead of presuming a country’s national culture is a monolith.

More recently, IB scholars’ research along with anecdotal evidence from countries around the world leans towards an awakening of a greater level of awareness and understanding of social tolerance with diverse others, which has prompted global strategies for more inclusion. Zanakis, Newburry and Taras (2016) constructed a cross country measure of global social tolerance (GST Index) across 56 countries using the World Values Survey (WVS) data to identify a stable and comparative measure of the within country societal perceptions of inclusion (or the lack thereof). Their multifactor index includes perceptions of gender, minorities, immigrants, and religious differences. Similarly, other IB scholars (Perkins, Cho, Phillips, & Toosi,

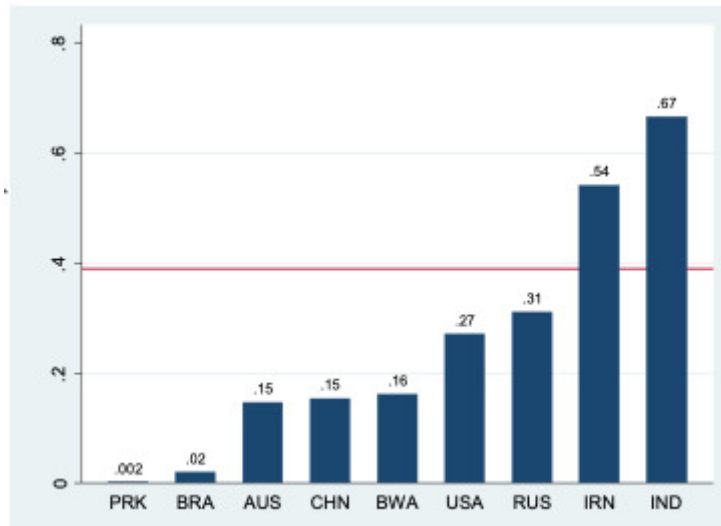
2020) also use the WVS data to capture a Tolerance for Diversity Index including perceptions from 245,000 respondents in 83 countries and find that countries with more racial, ethnic, and linguistic diversity are significantly correlated with higher levels of intolerance for diversity.

These findings, which might be surprising to some, seem relevant to the current global context calling for more social inclusion. Many country national leaders have addressed disparities of DEI at the forefront of their institutional agendas and have focused on policy changes to create more equity and inclusion across the diverse populations within their countries. For example, Trinidad and Tobago’s Prime Minister, Kamla Persad-Bissessar in 2012 developed a new government ministry in her cabinet, the Ministry of National Diversity and Social Integration, empowering this new institution “to create a socially inclusive and cohesive society” that was “charged with the responsibility of promoting diversity and inclusion through... policy measures and institutional reforms” to ensure equality and social integration of the different ethnic and religious groups. Michelle Bachelet, the former president of Chile (2006 – 2010; 2014 – present) reset the agenda for gender inclusion in her first term by appointing a cabinet representing gender parity (ten women and ten men ministers of Chile). This set the tone for her subsequent policy shifts aimed to alleviate gender inequalities in the workplace. Perhaps the most effective means to achieve parity, equality and representative diversity is through such policy changes that have the potential to reshape institutions and organizations. Other recent policy shifts found in both developed (e.g., United Kingdom) and developing nations (e.g., Rwanda) have adopted quotas as a strategy to increase female leadership presence in the parliamentary process.

To date, over 100 countries have made this strategic play towards gender parity. Most recently in 2020, the state of California (the world’s 5<sup>th</sup> largest GDP) created a racial and ethnic diversity inclusion policy for all publicly listed firms headquartered in the state to include at least one board member from an underrepresented racial or ethnic minority community or LGBTQ member on their corporate boards to ensure more social inclusion of diversity. This policy was a year subsequent to a similar California mandate implemented in 2019 for the inclusion of gender diversity. These are not just statewide or country specific institutional shifts but rather are examples from a global trend towards more inclusion and equity across societies. To date, the field of IB has not addressed many of these trends and shifts in DEI policies as societal awareness has shifted. A future focus on understanding how these policies effect multinationals and country-level managers is critical to the field of IB going forward.

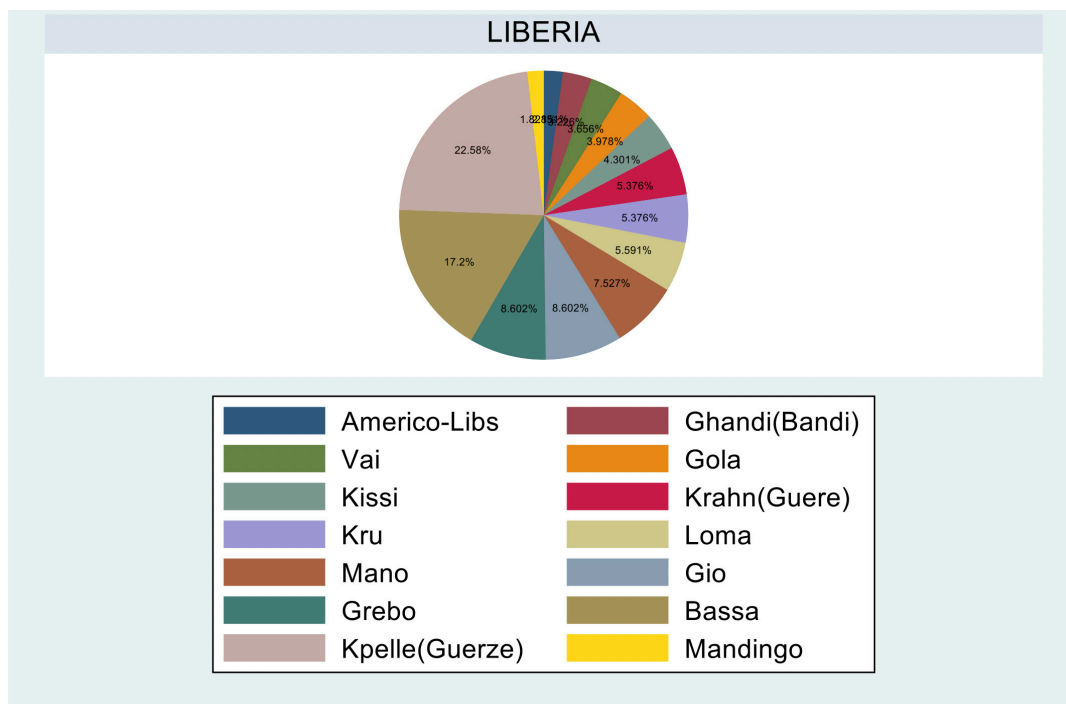
## DIVERSITY AS STRATEGY

Research in the field of IB provides evidence that firms can learn from their institutional context and apply those learnings across their internationalization paths (Perkins, 2014). So how can these intra-country level data on diversity and inclusion help us further learn about these institutional contexts? When applied most effectively, perhaps DEI



**Figure 1. Cultural Diversity by Country**

Note: India's (IND) cultural diversity score of .67 represents 12 different ethnic groups including Hindu speakers, Bengali, Telugu, Marathi, Tamil, Gujarati, Kannada, Malayalam, Oriya, Punjabi, Sikhs, and Assamese. Alternatively, North Korea's cultural diversity score of .002 is representative of Koreans. There are no diverse groups accounting for more than 1% of the North Korean (PRK) population (Fearon, 2003).



**Figure 2. Fearon (2003) - Proportional Ethnic Groups by Country**

strategies can become not only a source of organizational learning, but a unique competitive advantage.

Though many of the previous anecdotes were at the country level, diversity as a strategy can be applied at all levels – national institutions, global organizations, and individual social interactions. David Thomas's (2004) article, "Diversity as Strategy," points to examples of how global firms have succeeded at this in the past. One successful example is IBM. They successfully expanded their market base by leveraging the gender and multicultural network's within

the firm, which amplified their small to medium sized business-to-business (B2B) sales revenues from \$10 million in 1998 to over \$100 million by 2003. Through IBM's CEO Gersners' diversity taskforce initiatives, they overhauled diversity from a market-based issue and turned it into a strategic goal of the firm. Understanding and leveraging the differences among diverse groups resulted in 370% growth in the number of IBM's female executives and 233% growth in ethnic minority executives (US born). Amongst the most senior global executives on the IBM Worldwide Management

Council in 2004, 52% were women and ethnic minorities. Other great corporate CEO's have been equally successful in making their organization's ethnic and racial diversity a winning strategy that rewards inclusiveness (Groysberg & Connolly, 2013). In "Great Leaders Who Make the Mix Work," these authors interviewed 24 CEO's of leading global companies – including IKEA, Sweden; Discovery Health, South Africa; Bank of America; Avon; MasterCard; General Mills, Ernst & Young; Nissan Motors to name a few – that saw having a diverse and inclusive workforce as a strategic advantage, a business imperative, and often acknowledged the organization's diversity as "a source of creativity and innovation." Nearly half of these leaders stated that their most important role in creating a culture of inclusiveness was for them to set the tone for the organization's inclusive culture by demonstrating their own personal commitment and leading by example. Effectively, these inclusive strategies, be it in a company or at the country level, serve to empower a broader base that can contribute to the overall bottom line.

Other companies have utilized intra-country diversity as a global strategy by studying the migratory patterns of ethnic groups and deepened their presence based on population movement. In this case, MNC country location choice decisions were based on the market size and consumption patterns across the diaspora of specific immigrant ethnic populations. For example, the Philippines fast food restaurant chain Jollibee's international growth has been fueled by restaurants located globally in high penetration markets of the Filipino diaspora overseas. Intra-country diversity measures can help us understand the connectivity of ethnic and racial groups across countries and how MNCs can leverage these cross-cultural differences to create competitive advantages which leverage diversity both within and across societies.

## UNLOCKING THE BENEFITS OF DIVERSITY IS KEY TO GROWTH

### ACTIONABLE INSIGHTS FOR PRACTITIONERS

At a minimum, firms need to understand how the diverse mix of cultures within a country will affect their foreign direct investments and to what extent they will impact their global labor force. For example, in 2008 when Intel made the location choice to build their largest yet semiconductor manufacturing plant in Ho Chi Minh City, Vietnam, Intel was blindsided by a foreseeable cultural clash in their workforce between the Westernized and Communist influences because they assumed there was a homogeneous national culture within the country. To the contrary, strategies focusing on leveraging the differences between diverse groups and including those with underrepresentation can lead to topline growth.

For leaders who are interested in pursuing inclusive strategies like the exemplars above, here are some actionable next steps on how to engage:

- The best way to start is to be proactive. Studies show the most effective leaders set a DEI agenda from the top of the organization downward (Groysberg & Connolly, 2013). Don't be hesitant to facilitate inclusion

in areas where people don't feel supported in the workplace. Ely and Thomas (2020) have synthesized what types of DEI efforts have or have not worked best.

- Eliminate potential barriers so that all perspectives are valued. Consider going beyond individual's identities to instead consider aspects of social identity to better understand which out-groups might be feeling or have a greater likelihood of being excluded (Raskovic, 2020).
- Make leveraging your organization's diversity a business imperative and a clear part of the strategic plans. For relevant examples, see Thomas (2004).

### ACTIONABLE INSIGHTS FOR IB SCHOLARS

The key insight for IB scholars alike is to consider the difference within the country instead of fixating on overall country-level culture distance measures. Without doing so, MNCs and the field of IB run the risk of reinforcing negative cultural patterns that may result in inequities such as lack of inclusion of some social groups over others, apartheid, or other discriminatory practices. To be sure, managing diversity requires that we acknowledge and address organizational and country level group prejudices, conflicts, and biases at the institutional level from the top down. One lesson offered from the field of economics that we could expand upon in the field of IB is that when diversity (e.g., ethnic fractionalization) is left unmanaged, it is associated with negative economic growth of the country. Moving forward as a field, incorporating a more robust and clear lens of intra-country level differences in our analyses is key. Possible ways to do so are to:

- Use intra-country measures of diversity representing subgroups such as gender, racial and ethnic groups (e.g., WVS, EF, cultural diversity) to conduct future research on diversity and its impact on internationalization outcomes (e.g., economic inclusion and participation, FDI, subsidiary integration, MNE success).
- Consider conducting research on institutional policy changes (e.g., corporate board diversity mandates, parliamentary gender quotas) related to DEI to better understand the implications on both firm performance and societal outcomes. For more inclusive policy ideas, see UNESCO Inclusive Policy Lab ([en.unesco.org/inclusivepolicylab](https://en.unesco.org/inclusivepolicylab)).

### ACTIONABLE INSIGHTS FOR EDUCATORS

When teaching IB, consider internationalizing the curriculum to include a diverse set of protagonists' perspectives within the country, especially those of ethnic minorities, to underscore the differences across national cultures. For example, the Bougainvilleans, ethnic minorities of the Papua New Guinea region, have had a longstanding battle with Rio Tinto over property rights and other social injustices in their community (see HBS Bougainville Copper Ltd. case). Having a more diverse and inclusive mindset can be taught. Some approaches are through simulations, role modeling videos, and storytelling of ethnic minorities and their business dealings within the country and across borders as



well. Some helpful content collections and exemplar cases are:

- International joint venture creation of Grameenphone Ltd. in Bangladesh through diaspora entrepreneurship (Rana & Elo, 2017).
- The *HBS Creating Emerging Markets* videos series includes over 155 interviews from a diverse set of business leaders from around the world. Many share their diversity and inclusion strategies.
- The HBS case collection curated two helpful content sections: *Cases with Protagonists of Color* and *Cases Featuring Women Protagonists*. Both can assist with diversifying the IB syllabus to be more inclusive. Students entering the field could benefit from learning globalization from a worldview that is more inclusive.

As a collective community, we can move the needle forward on intra-country diversity, equity, and inclusion in these ways.

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