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Abstract

The paper unpacks the "black box" of informal institutions and theorizes about the role of informal networks in channeling continuity and change in informal institutions. Specifically, we argue that when informal institutions are enacted by informal networks that are "relatively affective" and "relatively closed," their persistence is higher than the persistence of informal institutions that are enacted by "relatively open" and "relatively instrumental" networks.

Keywords: Informal institution, informal network, informality, network typology, institutional dynamic.

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Introduction

It's been more than three decades since the Berlin Wall came down, and most transition economies have advanced in the development of their formal institutions and transparent, market economies. Yet in Kazakhstan, despite the trappings of a liberal economy, political appointments in the public sphere as well as recruitment and promotion in private companies still often comply with clan logic, or *rushyldyq* (Minbaeva & Muratbekova-Touron, 2013). The Chinese system of *guanxi*, a system of exchange of favors that emerged during the Maoist period to obtain scarce products, is still used to obtain business permits, jobs or purchase real estate (Yang, 2018).

Furthermore, even in established democracies with strong and effective formal institutions, some unwritten rules are still strong; for instance, in France informal practices such as *piston* (preferential treatment obtained through personal acquaintances) still coexist along formal recruitment and selection channels; traditional Confucian values still permeate South Korean society and lay the foundations for informal networks such as *yongo* and *inmaek* to flourish (Horak, Taube, Yang, & Restel, 2018), despite the country being one of the most advanced in the world, etc.

This begs the question: Why do informal institutions persist?

It is a part of the story that needs to be explored, because these informal codes of conduct have a pervasive influence. Indeed, informal institutions are defined as "a set of rules, compliance procedures and moral and ethical behavioral norms designed to constrain the behavior of individuals in the interests of maximizing the wealth or utility of the principals (North, 1990). As such, they are an integral part of the institutional framework that must be explicitly considered, for example, in international business strategy.

Unpacking the "black box" of informal institutions

In order to explain the persistence of informal institutions, we must unpack their relationship with formal institutions and understand the mechanisms at work in their interplay.

Overall, institutions, formal and informal, have been characterized as durable social structures that are relatively resistant to change. Across the disciplines, from sociology to international management, both types of institutions are viewed as dynamic in nature. We also find a common understanding that informal and formal institutions cannot be analyzed in isolation, but in relation to each other.

In fact, their relationship could be best described by borrowing a term from evolutionary biology: symbiosis ("living together" in Greek), a word usually employed to describe long-term interactions between two species, like ivy living on a tree or birds eating parasites off hippopotamuses' backs.
So how do formal and informal institutions live together?

The two dominant views of informal-formal symbiosis

Two approaches to defining informal institutions relative to formal institutions are widely established.

Advocates of the first approach take the general view that, in short, what is not formal is informal. For instance, political scientists often contrast unwritten, socially shared rules with those enforced through official channels such as state institutions (Azari & Smith, 2012). In that stream of literature, formal and informal institutions are seen as two ends of a continuum. In this case, institutional change starts with formal structures, and informal institutions follow because they act as "compensatory structures" to the former (Matten & Moon, 2003; Peng, 2003; Peng et al., 2009; World Bank, 2002). For example, they are expected to fill a void, with firms relying more on informal institutions if and when formal ones are lacking. Borrowing the evolutionary biology metaphor, this type of symbiotic relationship could be labeled "parasitic symbiosis" in the sense than one species benefits from the relationship while the other is harmed by it.

Advocates of the second approach follow a logic of formalization, i.e. "put informal first and formal will follow" (Baudrillard, 1987; de Soto, 1989; Gidden, 2013). The general idea is that informality is slowly absorbed into the institution-building process (Spiegel, 2005). One paradigmatic example of such "informality first" is offered by urban development studies. For instance, informal dwellings such as favelas in Brazil or slums in India start off as camps without sewage systems, running water or electricity; as these infrastructures are gradually brought in, the (originally) informal homes remain, because it is simply impossible to remove so many at once. Evolutionary biologists would call this type of relationship commensalistic: one of the species benefits (formal institutions) whereas the other is unaffected.

Beyond established approaches: introducing the role of informal networks

Despite the quality of these two approaches, we argue that there could be a third alternative in which formal and informal institutions benefit from each other. This third type of symbiotic relationship is called "mutualistic symbiosis". We suggest that coexistence does not indicate competing logics, nor can we determine whether formal or informal institutions came first.

Instead, we view the interplay between both through the prism of informal networks upon which informal institutions rest. We define this interplay as dynamic changes in social structures and social practices in response to changes in their formal and informal use, channeled through the informal networks upon which informal institutions rest.

We prefer the term "informal network" over "social network", as it better conveys the tension with formal settings and the ambivalence in the use of personal networks to get things done. An informal network can be defined as culturally embedded channels formed by informal dyadic ties between individual actors; it draws its cohesion from peer pressure.

The social practices and structures produced by the interactions among actors act as touchpoints with formal and informal institutions. Specifically, through social interactions, individuals develop a shared meaning of the "rules of the game" (Geertz's "local knowledge", Polanyi's "tacit knowledge"); as a result, when faced with a problem, individual actors rely on commonly accepted practices like *jeitinho brasileiro*. This technique of problem solving, which utilizes emotional ties between Brazilians, is just one example of a social practice that may work so efficiently as to potentially undermine the workings of formal institutions. In other words, informal networks have effects at the behavioral and structural level.

The ambivalence of informal networks as society's "plumbing"

Let's return to our key question: Why do informal institutions persist in the face of formal institutions?
In line with our definition of the interplay between both types of institutions, we argue that informal institutions persist because of their ability to change and adapt in the face of mature formal institutions, while enduring internal consistency, continuation and legitimacy (Deephouse & Suchman, 2008). This unique ability of informal institutions to remain stable and be flexible at the same time is enabled by the dual functionality of the informal networks upon which they rest.

It is all the more important to understand the complexity and the role of informal networks in channeling continuity and change in informal institutions as firms operating in foreign environments deal with informal institutions on a daily basis, whether they are aware of this or not.

Networks perform a dual function that originates from their "plumbing" role (Podolny, 2001). They are the channels through which "market stuff" – information, goods, services, payments – flow in market economies; when informal, networks channel mutual help, favors, and other emotional currencies, so to speak, that create competitive advantage, itself inalienable from the relationships that keep the informal networks together (Ledeneva, 1998; 2018).

Informal networks thus play a dual role: transmission and transformational. They both channel and adapt to changes brought about by informal institutions and guard the continuity of informal institutions. At the nexus between the behavioral and structural levels, informal networks create positive feedback loops, in autocatalysis mode (Padgett & Powell, 2012: 8). Indeed, as Owen-Smith and Powell (2008: 618) suggest, networks are "essential to institutional fields because they are both the pipes" through which the institutional flows circulate, while the networks "are the prisms" that individual network actors use to make sense of their actions.

An example illustrates this dual role of informal networks: in South Korea, *yongo* are networks based on blood ties, region of origin or university (Horak, 2014); they adhere to Confucian ideals of seniority and hierarchy, whereby women have historically been treated as secondary to men. Although formal legislation has been introduced in support of gender equality, it is not effective because local informal institutions (Confucian values) are strong, as are the male-dominated networks that guard and enact those institutions (Patterson & Walcutt, 2017; Pattterson, Bae & Lim, 2013).

In sum, informal institutions persist because informal networks enact, enable and advance them by serving two purposes. Informal networks mitigate the pressures brought about by changes in formal structures. At the same time, they enable the informal constraints, thus maintaining the continuity of informal structures.

Network features are factors of continuity or change

Some informal networks are vectors of increased change whereas others are factors of continuity, depending on their features. We differentiated among four types of informal networks, depending on their nature, open/closed and instrumental/affective.
> "Relatively closed" informal networks are relatively tight. Examples include kinship-based networks – kin being more or less loosely defined, through blood or marriage – and elite alumni networks (old-boy networks in the UK etc.). The strong sense of belonging can express itself as solidarity, with clans or extended families helping each other out during hard times, or as social domination, where alumni of France's *grandes écoles* create insider ties between government cabinets and the private sector.
> "Relatively open" networks can include members from different circles, through school, family or hobby connections developed over an individual's lifetime. Examples are *wasta* in the Middle East and *guanxi* in China.
In the same way as large-diameter pipes have higher flow rates, relatively open networks channel more change to their informal institutions than relatively closed networks do.

The second key feature of informal networks relates to the nature of ties between members and the affective commitment they are willing to make to the relationship itself. Relations can range from "purely instrumental" (based on calculation) to involving "a degree of affection", where personal sentiment is a primary component (Li, 2007).
But this is not a case of "either-or": both instrumentality and affection are present in all kinds of networks, though to different degrees.
We argue that informal institutions based on informal networks with affective ties exhibit a higher degree of persistence than those associated with instrumental ties. Instrumental relationships may disappear if no longer perceived as useful, possibly when economic change happens and formal institutions become more effective. Conversely, affective ties are a constituent part of personal identity and as such are "more sticky" – a bit like a viscous liquid flowing more slowly through a pipe.
For example, market-exchange networks, like *blat* ("useful" friendships) in the former Soviet Union to obtain scarce resource by bypassing the official system, may disappear over time – though whether modern-day *svyazi*, or administrative resources, is entirely new or merely a different name for *blat*, is open to debate.

To summarize, we propose that the persistence of informal institutions enacted by informal networks that are "relatively affective" and "relatively closed" is higher than the persistence of informal institutions enacted by "relatively open" and "relatively instrumental" networks. However, it is possible to move between these network types. Permeability may be as follow: an individual who benefits from elite school ties may also belong to a powerful clan and gain an advantage from kinship ties.

Conclusion

In today's highly network and interconnected societies, strong formal institutions may coexist with equally strong informal institutions using solidarity (clans in Kazakhstan) or domination networks (Oxbridge networks in the UK). Of course, it is hard to distinguish the borderline between survival strategies ("weapon of the weak", Scott, 1985) and the gaming of the system. Yet viewing the interplay between formal and informal institutions as symbiosis provides contextualization and will help professionals better understand informal networks for business or policy purposes. In particular, our typology of informal networks will be useful for multinational corporations operating in foreign markets, to respond to the complexity created by the interplay between home-based formal institutions and host-based informal institutions. For instance, companies need to "buy" or "borrow" human capital to achieve local embeddedness in markets with "relatively closed" networks, but "build" human capital in markets dominated by "relatively open" networks. In markets dominated by "relatively affective" networks, it is up to management to decide how ethical or risky it is to compose with local kinship rules.

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