

## Formal and Informal Institutions in Wal-Mart Case

JOSÉ G. VARGAS-HERNÁNDEZ  
ORCID No. 0000-0003-0938-4197  
[jvargas2006@gmail.com](mailto:jvargas2006@gmail.com)

University Center for Economic and Managerial Sciences  
University of Guadalajara, México

**Abstract** - This paper analyzes the strategies which are followed by Wal-Mart in different parts of the world from the viewpoint of theories of institutions, property rights and agency. The analysis of the questions what happens to these firms when they are in countries with high corruption index? It could answer this question in light of the theory of institutions, the theory of property rights and the theory of the agency. This paper specifically focuses on finding out if the above theories are applicable. The analysis concludes that the same firm adopts a different strategy in each place even if is in conflict with their values at home.

**Keywords** - Agent, financial incentives, regulatory pillar, principal.

### INTRODUCTION

According to the main page of Wal-Mart Sam Walton (29 March 1918 - 05 April 1992) opened his first store in Rogers, Arkansas in 1962. In 1991, CIFRA and Wal-Mart teamed up to bring more places its “low prices every day” (Wal-Mart, 2012; Alonso, 2012; El Universal, 2012). In 1997, according to the story posted on the front page of this store, Jeronimo Arango decided to pursue other projects and Wal-Mart acquired all of the shares of CIFRA. In addition to “Our commitment section” of the same web page mentions that Wal-Mart de Mexico and Central America is

a company dedicated to the trade sector operating in six countries: Costa Rica, El Salvador, Guatemala, Honduras, Mexico and Nicaragua.

Wal-Mart has a wide variety of formats, including discount stores (Bodega Aurrerá Express, Family Pantries and Pali), supermarkets (Superama, Supertindas Paiz, Pantry Don Juan, La Union and Más x Menos), wineries (MI Bodega Aurrerá, Maxi Bodega and Bodega Aurrerá), hypermarkets (Wal-Mart, Hiper Paiz e Hipermás), membership warehouse clubs (Sam's Club and ClubCo), clothing stores (Suburbia), restaurants (Vips, El Portón and Ragazzi) and Banco Walmart (Wal-Mart, 2012).

On April 27, 2012 El Universal published an article in which it is mentioned that in the last 10 years Wal-Mart reported increases of 10% in sales annually. Between 2009 and 2010 the number of units of Wal-Mart jumped from one 1, 466 to 2, 279. This jump is mainly due to the merger of its operations with subsidiaries in Central America. IT added that to date, Mexico compounds 87% of Wal-Mart's income to the parent, and the remaining 13% get it from Central America (El Universal, April 27, 2012, PGR and investigate the case Wal-Mart SFP). In the first quarter of 2012 sales in Mexico, according to the Mexican Stock Exchange, have been \$ 96,901,609.00, which represents \$ 72,761,097.00 more than its nearest competitor called Soriana (Mexican Stock Exchange, 2012).

Calculating a Herfindahl indicator with data from the Mexican Stock Exchange in Mexico, it is concluded that acts in an oligopolistic market in which the leader is precisely Wal-Mart (own calculation). As illustrated in Figure 1 sales represent 63% of sales from its competitors.

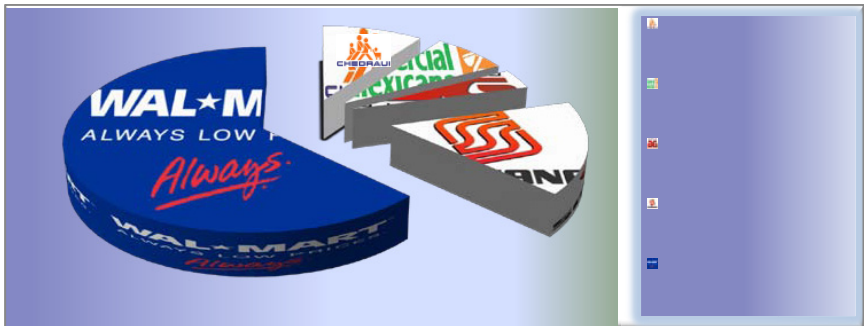


Figure 1: Sales-market share  
Source: Own elaboration with data from

This year, 2012, Wal-Mart plans to invest 19 billion pesos and open between 410 and 436 stores in Mexico and Central America. But the scandal reached to Wal-Mart

on 21 April 2012, when New York Times, declared: “Wal-Mart sent investigators to Mexico City, and within days was found evidence of widespread corruption. They found a paper trail of hundreds of suspicious payments totaling more than \$ 24 million. They also found documents showing that senior executives of Wal-Mart de Mexico not only knew of the payments, but had taken steps to hide to the Wal-Mart headquarters in Bentonville, Arkansas. In a confidential report to his superiors, the principal investigator of Wal-Mart, a former FBI special agent, summarized his initial findings this way: “There is a reasonable suspicion to believe that the Mexican and U.S. laws have been violated.” it is clear that these are \$ 24 million dollars (The New York Times, 30 de abril de 2012, 21).

With this, the prosecution conducted by the Public Ministry (Ministerio Público) said that would request information to United States (U.S.) to analyze the case Wal-Mart. In addition The National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores, CNBV) does not conduct any investigation to the bank or the issuing Wal-Mart, because the underlying issue about the alleged bribe payments made by the retailer to expand in Mexico, it said it is not competence for the financial authority (El Universal, 2012).

To vary, Milenio (2012) reports that Wal-mart announced that it will cooperate unreservedly with Mexican authorities, so shall make available the information on permits and licenses of their units in the country. In connection with the alleged bribes given for expansion in Mexico, Wal-mart established yesterday in a statement to the Mexican Stock Exchange a process to ensure that requests and petitions from the authorities are responded.

## **FRAMEWORK**

A theoretical framework of agency theory, theory of institutions-based and property rights can be shaped by many authors but there is going to be treated only a few starting with North (1990). North (1990) defines institution as any human being that designs restrictions to shape their interactions then it follows that it can be observed those informal institutions and of course it speaks of formal organizations, these formal institutions however, their development becomes even more complicated relationship of cooperation to achieve good results in the firm. North himself comments that institutions serve as guide to action for people, then it follows that decisions will be limited by them, think first in informal institutions.

In informal institutions there is no written code of ethics but the most important is framed as a set of values which are not leveraged but generate a significant competitive advantage, since it reduces the cost of monitoring even at zero. This is

mainly because the principal is expected to put their wealth in reliable hands. Who entrust their money to a person who has a criminal record for theft? Who entrusted the care of their home to someone who has a reputation for incendiary? For obvious reasons, the principals have strong incentives to select either the type of people who would trust their money.

The agent to whom it is delegated the responsibility of capital, not only is holding the principal's capital, but also control of the firm. So, the agent also will be careful not to incur a serious offense against society according to the ethics of the firm globally. North (1990) also mentions how important formal institutions are. Formal institutions are laws that have already been created before, as examples mention the U.S. Constitution. When violating the laws one would challenge the authorities in charge of enforcing them, therefore somebody violating the laws must face the penalties depending on the severity of the penalty.

Institutions according to North (1990) should not be confused with the organizations, including organizations as political bodies, which are released different types of associations like political parties, unions, family farms, cooperatives, rural production, etc. Are included there too corporate bodies such as churches, clubs, sports associations, etc., and finally also it includes educational agencies between which are mentioned: elementary, middle, high schools, universities, vocal training centers, etc. Then it can be concluded that organizations are groups of people associated with a common purpose to achieve a particular goal, while as already above, so to speak institutions are the rules of both formal and informal action. So the institutional framework influences the creation and evolution of each company and on the other organizations also generates changes in institutions.

Although North (1990) says that institutions are a creation of human beings is also evolving together. North also suggests that when taken as limiting institutions to make decisions that will reach uniformities generate less uncertainty as to the conditions to be presented by external decisions, these limitations can be linked with past decisions and future.

For an institutional analysis is necessary to analyze two important aspects of human behavior. These aspects are motivation and decrypt the environment (North 1990). Is important to notice that motivation can come in any way, such as ambition, the need or just by simple altruism, and secondly to decipher the environment is quite complicated because the same company may be subject to different cultural areas depending of the operation zones. For example if there is a successful business in the United States of America and moves to North Korea and observed that the success it had in the U.S. is not in this new country, why? Just for the environment in which it develops, something similar happens with informal institutions of a firm

when it develops in different geographical areas.

This is mainly because individuals process information differently depending on the culture in which they were developed (North 1990). That bias can be remedied or rather can be reduced with formal institutions, of which it is noted, are derived property rights. North (1990) mentions those formal institutions in developed countries and judicial systems, the body of law, agents such as lawyers and mediators all neutrals are more complete and reduce uncertainty to a large extent. Moreover in developing countries formal institutions are weak because there is ambiguity as to legal doctrine and even worse not know how the court system works.

North (1990) argues that the institutional framework provides guidelines for building knowledge and skills, and that management will be the deciding factor for the long-term development of a society.

A theory closely linked as already mentioned is that of property rights on this can summon Barzel (1989) mentioned that these rights of individuals over resources mainly consist of three aspects. Mainly the first is to have the right to consume the resource. The second is to obtain revenue from them and the third is the ability to transfer these resources. This concept is closely related to transaction costs, yet these transaction costs are defined as the economic costs associated with the transfer, capture and protection of rights.

Eggertsson (1990) notes that organizations and institutions are not immutable, organizations and institutions vary with time and place, with political arrangements and structures of property rights, with the technologies used, physical qualities of resources and services exchanged. This observation has much resemblance to the conclusions reached with North (1990). It is clear that the institutions are changing according to time and place, for example it is said that formal institutions are stronger in developed countries and weaker in developing countries and therefore will not have the same development either in the same time or in the same place.

Eggertsson (1990) refers to the rights of people to use the resources and property rights. The rights of people to use the resources, i.e., property rights, in any society are supported by protocol forces, social custom, ostracism, and are also compatible with the formal laws that are backed by the State's power of coercion.

Speaking of this very fact Mahoney (2005) says that the enforcement of intellectual property includes exclude others from the use of scarce resources. The exclusive proprietary calls expensive measures and the tracing of resources and compliance with property rights. The economic value of the exclusive rights of ownership depends, *ceteris paribus*, on the costs of enforcing those rights. That is, the costs of the exclusion of others, which ultimately depends on coercion. The exclusive rights enforcement is usually undertaken by both individual owners and the State

(Mahoney 2005:183).

To further clarify the concepts used in this work, it is important to cite Peng definitions e.g. talking about the vision based on the institutions he says that a perspective del leader holds that in addition to the conditions at the firm and industry, firms also have to take into account major influences from sources such as state and society to plan the strategy (Peng 2006:93). In another interesting definition of institution, Peng says that it is a humanly planned restrictions that structure interaction of people, known informally as the rules of the game (Peng 2006:93) The definition of institutional framework is a framework of formal and informal institutions that govern the behavior of the individual and the firm (Peng 2006:93). Following is given a definition of more formal institutions, as institutions consist of laws, regulations and rules (Peng 2006:93).

Another important definition is the regulatory pillar: as the formal rules, laws and regulations influence the behavior of individuals and firms (Peng 2006:93). Now it is necessary to know which means informal institutions: institutions represented by norms, cultures and ethics (Peng 2006:93). The author says that the training is the pillar formative as the values, beliefs and norms of other relevant players influence the behavior of individuals and firms (Peng 2006: 93).

In this paper the word standard is a term that means the prevailing practice of the major players affecting individuals and focus firms (Peng 2006:94). Cognitive pillar is understood as cognitive understanding of internal values and beliefs that are taken for granted and that guide the behavior of individuals and firms (Peng 2006:94). When it is said that transaction costs are thought in terms of costs associated with economic transactions, or more broadly, the costs of doing business (Peng 2006:94). Opportunism is mentioned as a term meaning the particular search of a benefit with fraud (Peng 2006:94).

Peng mentioned the word ethics referring to the rules, principles and standards of conduct governing the behavior of the individual or firm (Peng 2006:94). Ethical relativism means the relative thinking that ethical standards vary significantly around the world and that there is no universal consensus about ethical and unethical behavior (Peng 2006:107). The phrase referring to ethical imperialism refers to imperialist thinking that personal ethical standards should be applied universally around the world (Peng 2006:107). And a word to be used continuously is corruption which means: The abuse of public power for private gain, usually in the form of bribes (Peng 2006:109).

## OBJECTIVES OF THE STUDY

The study analyzes the strategies of Wal-Mart in countries with high corruption index reviewed from the theories of institution, property rights and agency.

## METHODOLOGY

In this paper it is used the exploratory method, since it gives a broad overview of various publications, as well as a careful analysis of the theories that are involved in this case. Information was taken from major newspapers in the country and other internationals as the case of the New York Times, where important news unfolded about the issue.

The issue is discussed in the light of the theory of institutions, the resource-based theory and the agency theory. There is described what some authors have written on the matter of these theories, besides giving views to apply these theories to the particular case, but this could be expanded a bit more when it is considered that it is a case that can be repeated many times in countries similar to Mexico. All of this in order to give some views on the issue and propose appropriate ways to apply existing theories successfully in firms around the world.

### **Application of the theory to the case**

As suggested by the agency theory, it should be taken some steps to reduce the asymmetry of information between principal and agent, which in this case would be at the corporate level, although it were not related to the Executive Director General, but to the executive group in Mexico. There is a quite serious failure of governance mechanisms, as several decisions were made without regard to the owners and the board. Also failed economic incentive system, because it did not regulated communication between the agent and principal, so emphatic on this issue exceeded the thought of Berle and Means (1932) when they wanted to be the agent as the driving force behind the direction.

Berle and Means (1932) also mentioned a very important point in saying that a control group outside owners can make profit diversions. If Wal-mart was made indirectly by choosing an option which was evident in the executive group in Mexico, in search of economic incentives to increase sales in the country, as mentioned at the beginning, representing 87% of sales perhaps they thought that their election would benefit the agent-principal however incurring in corruption dumb prestige for the firm.

The case has to be analyzed from the point of view of the theory of institutions that is closely linked to property rights. It is seen that formal rules were violated and the informal rules also, as mentioned disrepute decision came as a result of dirty, first expected that informal institutions were the basis for a principal-agent relationship properly, based on the pillar formation agent. What would have happened if the agent values were sufficiently large to yield to corruption? Possibly Wal-Mart's success would not be as overwhelming as the statistics show.

What happened to the formal institutions?, Taking as a base the explanation of Pang, the pillar regulator did nothing to prevent this type of petty corruption and worse only be sent to inform that solicited information. Institutions seem not work in Mexico, what informal institutions in the U.S.? The New York Times reported on April 21 had not taken action regarding bribes, had not notified anyone, and mentions that Wal-Mart is deliberately concealed information from corrupt acts.

As seen for the case, Wal-Mart touches many points in business theory such as theory of institutions where it is clear that the institutions in Mexico are very poor both formal and informal. Since the law shields these practices while that people who are in the municipal powers and governors tend to tarnish their reputation with widespread corruption. The ethical imperialism is a myth in this case, but rather applied ethical relativism.

Transaction costs were high in this case to settle by having to pay a bribe. And now comes to light when all this also has to pay a fine in the U.S. At least, it seems very difficult here that the government takes enforcement action. The rule to follow was to do everything possible to violate ethics although, not surprisingly, Wal-mart continues its expansion and its market share to become even stronger.

## **CONCLUSIONS AND RECOMMENDATIONS**

The main business strategy that was used in Wal-mart was based on institutions, particularly applying ethical relativism. As it is well known, this firm enjoys a reputation in the U.S. ethics one would think that Wal-mart acts under ethical imperialism framework for the role of culture, however it did not happen. It is therefore concluded that companies that do not operate under this same strategy will be at a disadvantage which prevent its market positioning.

The main recommendation is, although it may sounds sad, take advantage of all those conditions that allow the company to grow, market positioning and include SWOT analysis also the institutional framework, although this represents a breach of the rule which would have to be respected in home.



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