1 Introduction: Applying Institutional Theory to Strategy

For many reasons it is difficult to write about how institutional theory is relevant for strategic management. These include it not being clear what exactly an institution is, what it explains, and how it is to be explained. Some argue that institutional theory is not a theory at all and more a brand with which researchers identify (Alvesson et al., 2019). Rather than taking these reasons as an excuse to declare institutional theory as useless and as having to get its act together, we can take this criticism as indicative of the complex world that organizations must deal with. When we do that, we open up a rich and nuanced understanding of what can be deemed as ‘strategic’ importance, or indeed to understand what strategic management is about. Institutional theory not only adds to what we must consider when thinking about the content of our strategies. It also has things to say about the process or management part; about how strategy might be realized or implemented.

Despite the proliferation of definitions of ‘institution’, there are some common threads. Firstly, institution is an expression of social order; of a regularity in human activity, which tends to occur time and time again. Social order is the bedrock of society. Without social order, society would not exist. Moreover, institution refers to something that is experienced as real yet is largely virtual and intangible; associated with norms, values, understandings, meanings, ideas, and cognitions. For strategic management, institutional theory potentially provides a range of different understandings of how firms and any other types of organization can and must function in society at large. Maurice (1979) described institutions as ‘the societal effect’.

Moreover, by recognizing that organizations are little societies by themselves, institutional theory has something to say about how these can and must be managed as well.

The proliferation of the many variants of institutional theory that we have is a consequence of the many ways in which ideas have been developed about how to understand society and about how it could and should be governed. The concept of institution is a prominent feature in sociology, economics, and political science. Increasingly, the words ‘institution’, ‘institutional’, and ‘institutionalization’ appear in management and organization theory (Greenwood et al., 2008), often as derivatives or ‘borrowings’ of theorizing in sociology, economics, and, to a lesser extent, political science.

Secondly, legitimacy is a key term in theorizing about institutions. Again, there are many definitions in existence (Suchman, 1995; Suddaby et al., 2017). As a common thread, legitimacy tries to capture that for an organization to be able to exist and function in society, its activities in some way must be acceptable, suitable, tolerable, effectual, or something of that nature. For business firms, legitimacy compares with the requirement of being competitive or having
competitive advantage. Some institutional theorists in management and organization see legitimacy as a contributor to competitive advantage – legitimacy helps a firm to be more competitive. Others see it as an additional requirement – firms must be both competitive and legitimate. And there are those who see competitive advantage as being defined by legitimacy – legitimacy tells what the competition is supposed to be about.

There is also a resemblance with the concept of value in that there are many declarations that organizations must produce value to be economically viable or justified. Value tends to be closely associated with money. What an organization delivers is compared with the costs or the price that has to be paid. Legitimacy tends to rely on a broader justification, albeit money considerations often are part of it. The difference is reminiscent of the Oscar Wilde quote about knowing the costs (money) of everything but the value (understood as legitimacy) of nothing, although this comparison might do an injustice to the multi-facedness of the notion of value (cf. Lepak et al., 2007). Nevertheless, organizations – and even business firms – can be considered legitimate without ever making a profit or despite forever exceeding their allocated budgets (Meyer & Zucker, 1989).

There are branches of institutional theory that concentrate more on institutionalization than on institutions. Their concern is about how legitimacy is gained and lost, or more fundamentally about how what is legitimate changes, rather than about how to fulfil the requirements of legitimacy as these might exist. These theories offer explanations about how organizations contribute to maintaining societal demands and expectations, how they help changing these to their advantage, or sometimes more altruistically, how people and organizations can make society a better place to live in.

Organizations and especially business firms being actively involved in changing what is seen as legitimate to their advantage points towards a serious ethical concern. To what extent is it right or legitimate for commercial or other partial interests to tell society what is right and what is wrong? Institutional theorists who see competitive advantage as a requirement separate from legitimacy often argue that legitimacy is the responsibility of government whose task is to set out the playing field so that firms then can compete within this (often with an expectation that this government is democratically elected). Institutional theorists who see legitimacy and competitiveness as intertwined do not have it that easy, ending up with theories that not only explain but also take up moral positions.

Legitimacy considerations can be converted into strategic management applications, and indeed some of them already have. Besides, while discussing strategy, managers can find themselves using argumentations that resemble one of the many variants of institutional theory without them knowing it.
In trying to implement strategy, they might be informed by their own – maybe intuitively derived – ‘theory-in-use’ (Argyris & Schön, 1978), that is the way they understand how they can be effective as a manager. A strategist’s theory-in-use could well be a variant of institutional theory.

What this text has on offer is not the ultimate or best institutional theory for strategic management. Instead, it provides an opportunity for readers who are practicing strategists to compare their understanding of strategic management and how they do it, to the translations into the realm of strategy of several prominent but different variants of institutional theory. For researchers, the text delivers an overview of the state-of-affairs regarding institutional theory and its relevance and maybe irrelevance for the field of strategic management. It will also develop some ideas for further research and what interesting research questions would be, at some point even boldly suggesting to re-direct the strategy field towards becoming more sociologically informed.

To get to grips with institutional theory and its applicability in strategic management it is useful to understand that the theorizing is stratified. There is a foundation of basic theories derived from economics like methodological individualism (Von Mises, 1949), or derived from sociology like social construction (Berger & Luckmann, 1966), structuration theory (Giddens, 1984), or actor-network theory (Latour, 2005), which have worked their way into variants of institutional theory like Old Institutionalism (Selznick, 1957), New Institutionalism (DiMaggio & Powell, 1991), institutional logics (Thornton & Ocasio, 2008), or institutional work (Lawrence & Suddaby, 2006), and into more specific institutional theory applications like Non-Market Strategy (Mellahi et al., 2016), or into International Business/Strategy (Hotho & Pedersen, 2012) and strategic change (Hinings & Greenwood, 1988a).

The text will trace these lineages, starting with economics-derived New Institutional Economics and its applications in strategy. This will be followed by exploring the more sociological variants and their basic theoretical roots as well as their (potential) application into strategy. Often enough, there is a clearly recognizable ancestry from basic theory to strategy application, aided by academic texts referencing the associated literature. Nevertheless, in many cases, there is more reading between the lines required to make the connections, having to rely on recognizing similar argumentation that appears in basic theory, in management and organization theory and research, and in strategy applications. Referencing and mutual criticizing does provide many clues about where authors get their ideas from. Albeit some contributions are a bit promiscuous, combining ideas with different parentage.

A complication in making all these variants of institutional theory relevant for strategic management is the presumption of agency that is built into the
notion of strategy. Strategic management assumes a strategist to have ‘strategic choice’ (Child, 1972); to have sufficient command over the process by which an organization performs to be able to direct this process towards a desired outcome. From an institutional theory point of view, this presumption of agency is problematic because the very notion of institution proclaims that something extra-individual imposes social order on to this process, determining how this process proceeds towards maybe different outcomes than the strategist had intended. Within institutional theory, this complication started being referred to as the ‘paradox of embedded agency’ (Holm, 1995; Seo & Creed, 2002). Alternative variants of institutional theory differ from each other regarding what is proposed as a solution to this paradox, or whether this is made a point of at all.

Each variant of institutional theory has different presumptions of how process proceeds, or as it will be referred to in this text: process principles. That is, among the many layers in every alternative version of institutional theory there is a specific presumed process philosophy of how process progresses, from which the extent of presumed agency or strategic choice can be derived. These process principles can be traced back to basic theories like methodological individualism, social construction, structuration theory, or actor-network theory, which underpin the many variants of institutional theory. Moreover, different process principles have different ideas about what animates the process, or what is the deus ex machina that make it ‘go’. The main objective of specifying the process principles is to recognize the distinctions and what each variant has to say about strategic management.

This is expected to help not only in understanding how and why different institutional theories are different, but also to recognize how a strategist’s theory-in-use compares and to add to a strategist’s repertoire of different ways by which strategic problems can be appreciated and dealt with. A similar usefulness is envisioned for the researcher in that demarcating the differences between as well as the lineages of the many conversations in the field can point the way forward towards interesting future research questions in relation to strategic management. What is deemed impossible is to synthesize everything into one ‘grand’ institutional theory. The fundamental differences are just too large.

The relevance of institutional theory will be assessed on the basis of a depiction of the strategy process that distinguishes between three different spheres (Sminia, 2022) (see Figure 1). In its broadest sense, there is a process of firms and organizations surviving and being successful in a larger environment. The textbook understanding in the strategy field is that this sphere is characterized by competition and that survival and success depends on having competitive advantage (cf. Barney, 1986; Porter, 1980).
Zooming into the detail of this environmental survival process there are all these firms and organizations each engaging in their own organizational strategy process, expecting that this somehow will aid the organization’s success and survival. The textbook recommendation for this sphere is that there should be a form of explicit strategic planning in place by which a strategy is formulated (cf. Ansoff, 1965). Ideally, such a plan should describe how the organization should position itself in the competitive environment, how the organization’s unique capabilities pose a competitive advantage that allows for this positioning, and how this positioning should be executed.

Zooming in even more, there are people – individual strategists – who contribute their thinking and acting to the organizational strategy process. In this third sphere, the textbook strategist is depicted as a rational decision-maker who processes all the relevant information to make the right choices. Realizing a strategy then is a matter of executing a plan (cf. Hrebiniak & Joyce, 1984), of designing and structuring an organization, of putting the right culture and people in place, of acquiring the finance and investments needed, and of monitoring key performance indicators (cf. Kaplan & Norton, 1996) to check whether the implementation is on track.

In a way, sketching out strategic management as a planning process that deals with competition is a bit of a caricature, yet is still the dominant theory-in-use with strategy practitioners as well as with many strategy scholars. Most of the strategy textbooks are written around and endorse this model. It is the distinction between the three spheres of the environmental survival process, the organizational strategy process, and the activities of the individual strategist which will help with pinpointing how various variants of institutional theory...
have questioned and changed how each sphere can be understood. In doing so, the traditional planning model and the problematization of strategy as being about competitive advantage has been amended or on occasion completely dismissed, although there are instances where the planning model has been maintained with contributions being offered accordingly. What we will end up with is not only an appreciation that there is much more to strategic management than what the basic textbook model tells us. Applying institutional theory to strategy also tells us how basic the textbook model is.

There already are various overviews of institutional theory. These either describe the intellectual development over time (Glynn & D’Aunno, 2023; Scott, 1987) or attempt to provide a synthesis (Micelotta et al., 2017; Scott, 2014). There also are earlier attempts at describing how institutional theory can be made relevant for strategic management (Ingram & Silverman, 2002; Raynard et al., 2016; Smets et al., 2015a; Suddaby et al., 2013). The attempts to make institutional theory relevant for strategy tend to concentrate on one or just a few variants of institutional theory. The overviews do not relate institutional theory specifically to strategy. This text fills that gap. It works its way through all variants that can be made useful for strategy. These are New Institutional Economics, Old Institutionalism, New Institutionalism, institutional entrepreneurship and change, intra-organizational institutionalism, institutional logics, and institutional work. There is some arbitrariness in how the different variants of institutional theory have been distinguished. It follows the precedents set by previous overviews but also was led by the distinctive contributions to strategy by which different variants can be characterized.

Each of these institutional theory variants will be treated to a concise description of how it came about, what it tries to explain, how this explanation is provided, the underlying process principles, and how it develops the notion of institution. Table 1 provides an initial, yet course, overview. From this, the application of each variant to strategic management is developed by indicating what it has to say about the environmental survival process, the organizational strategy process, and the strategist. With some variants, applications have already been developed or research in the strategy field has referenced them, and this will be made use of. This concerns Non-Market Strategy, some research in international business/strategy, research on strategic change, and some research under the Strategy-as-Practice banner. Particular attention will be given to what each variant does with the notion of ’strategic choice’ because this is so pivotal for the whole idea of strategic management.

1 The first version of this book appeared as Scott (1992).
Table 1 Overview of Institutional Theory Variants

<table>
<thead>
<tr>
<th>Process Principals</th>
<th>Institution</th>
<th>Agency</th>
<th>Process animated by</th>
<th>Provides explanation of</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Institutional Economics</td>
<td>rules of the game</td>
<td>individual choice with cognitive limitations</td>
<td>efficiency</td>
<td>economic exchange</td>
</tr>
<tr>
<td>Old Institutionalism</td>
<td>an organization infused with value</td>
<td>leadership within negotiated compromise</td>
<td>meaning</td>
<td>whether an organization is an institution or a bureaucracy</td>
</tr>
<tr>
<td>New Institutionalism</td>
<td>norms and values outside organizations</td>
<td>determined by norms and values</td>
<td>compliance</td>
<td>isomorphism/how an organization behaves</td>
</tr>
<tr>
<td>Institutional entrepreneurship</td>
<td>regular and recurrent activity patterns</td>
<td>implicated by the duality of structure</td>
<td>reflexivity</td>
<td>episodic institutional change</td>
</tr>
<tr>
<td>Intra-organizational institutionalization</td>
<td>an organization’s interpretative scheme</td>
<td>implicated by the duality of structure</td>
<td>reflexivity</td>
<td>incremental change alternated with strategic change</td>
</tr>
<tr>
<td>Institutional logics</td>
<td>an institutional logic distributed among many actors</td>
<td>individual reflection</td>
<td>heterogeneity/accommodation</td>
<td></td>
</tr>
<tr>
<td>Institutional work</td>
<td>regular and recurrent activity patterns</td>
<td>implicated by the duality of structure</td>
<td>reflexivity</td>
<td>institutional complexity and change</td>
</tr>
<tr>
<td>Institutional performative work</td>
<td>regular and recurrent activity patterns</td>
<td>agencement</td>
<td>teleoaffectivity</td>
<td>constant institutional becoming</td>
</tr>
</tbody>
</table>
Eventually, some synthesis will be provided by proposing three different strategic management styles as emerging out of the applications of institutional theory to strategy. These are competitiveness-based strategic management, legitimacy-based strategic management, and performativity-based strategic management. Each style provides an outline of how strategy is to be done with which a strategist can compare their own theory-in-use. Each style also is suggestive of further research in the strategy field. More specifically, while the competitive-based style would utilize institutional theory to further develop mainstream strategy research by adding additional variables and considerations for explaining and managing competitiveness, the legitimacy-based style and particularly the performativity-based style have the potential to be developed into much needed alternatives to mainstream strategy research. In this way, institutional theory offers an opportunity for the strategy field to re-think what strategy and strategic management is about.

2 Institutions as Constraints: New Institutional Economics

Economics’ dominant neo-classical approach has little room for institutions or arrangements of social order that somehow influence what people do. It assumes a *Homo economicus* or rational actor who is free to make any choice based on information that is equally and universally available for everybody. Thorstein Veblen (1909) was an early dissident voice who argued that people when making economic decisions might not be as rational as assumed. He suggested that economists should develop economic theory assuming that people are creatures of habit. They seldomly make deliberate and rational choices. Instead, they just do what they are used to do, because it is customary or due to tradition. This alternative to neo-classical economics lingered on for quite some time under the label of institutional economics. The basic idea is that habits develop into institutions that tell people what to do and how to do it, rather than them being free to rationally choose what they like.

Douglas North (1986, 1990, 1991) eventually took this on and developed what is now referred to as New Institutional Economics (NIE). He was awarded the Nobel Prize in 1993. His project concentrates on answering the question how economic activity can be explained when we abandon the neo-classical ideal of frictionless exchange. Frictionless exchange is what rational actors do in perfect markets when making buy and sell decisions with all information being available. His basic argument is that economic exchange is far from frictionless, especially because of cognitive limitations in human information processing. Drawing on Herbert Simon (1957), he assumes economic actors are only capable of bounded rationality. To him: ‘Individuals make choices based
on subjectively derived models that diverge among individuals and the information that actors receive is so incomplete that in most cases these divergent models show no tendency to converge’ (17). This lack of convergence is what is responsible for generating uncertainty. People just cannot know how other people will act because everybody thinks differently. In turn, this uncertainty adds transaction costs: the costs of engaging in economic exchange. For economic exchange, some kind of effort is required, which translates into what can be understood as the costs of doing business. To North, economic exchange is far from frictionless.

The reasons why this inherent uncertainty about how other people might think and act adds transaction costs is twofold. One reason is that because of this inherent uncertainty some kind of assessment or measurement is required for both parties in the transaction regarding what is being exchanged. Will the seller deliver value? Will the buyer be able pay up? Before doing the deal, people want to know what they get out of it. They need to put effort, time, money into investigating what they will get. The other reason is the costliness of enforcement. Especially if a deal is not instantaneous but requires a seller to perform for a buyer over an extended period and payment comes in instalments, some form of mutual supervision is required to make sure the seller keeps its promise and the buyer pays up.

The solution to this inherent uncertainty is institutions – which are defined as ‘the rules of the game in a society’ (North, 1990: 3) – that constrain economic activity. These are rules that prohibit or permit what economic actors can do. This can be a good thing or a bad thing because institutions can be efficient and inefficient. North’s (1990) argument is that if there are rules that constrain people’s behaviour, uncertainty would diminish. Institutions that accomplish this are considered efficient. Institutions that only manage to complicate economic exchange and add transaction costs are considered inefficient. Moreover, he argues that economic activity cannot exist without institutions.

Institutions as rules of the game and as constraints are either formal or informal. Informal constraints are ‘part of the heritage that we call culture’ (North, 1990: 37) with culture referred to somewhat simply as ‘knowledge, values, and other factors that influence behavior’ (citing Boyd & Richardson, 1985: 2). Informal rules are also referred to as being ‘embodied in customs, traditions, and codes of conduct’ (North, 1990: 6) as well as ‘(1) extensions, elaboration, and modifications of formal rules, (2) socially sanctioned norms of behavior, and (3) internally enforced standards of conduct’ (40). A distinguishing feature that sets them apart from formal rules to North is that informal rules tend to be self-imposed and emerge somewhat spontaneously.

It feels as if North (1990) sees informal rules as all norms and values that have not been formalized, albeit recognizing that formalization is a matter of degree.