

Defines institutions as
"cognitive, normative,
and regulative
structures



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Various definitions of institutions can be found in the existing literature. Scott (1995: 33) defines institutions as “cognitive, normative, and regulative structures and activities that provide stability and meaning to social activities” and North (1996: 344) definition is close in meaning, as he defines institutions as “formal constraints (rules, laws, constitutions), informal constraints (norms of behaviour, conventions, and self-imposed codes of conduct), and their enforcement characteristics. Henisz and Zelner (2005) further differentiate between emergent and established institutions and how they are challenged by incumbent organizations, the former referring to newly created formal structures and the latter having attained cognitively based legitimacy (Suchmann, 1995). Legitimacy is a long-term cognitive process of “institutionalization” through which an organization becomes embedded in taken-for-granted assumptions (Zucker 1977, 1989, 1991; Suddaby and Greenwood, 2005). As Suchman (1995: 575) has pointed out “legitimacy affects not only how people act toward organizations, but also how they understand them”, therefore organizations that are not awarded legitimacy are “more vulnerable to claims that they are negligent, irrational or unnecessary” (Meyer and Rowan, 1991: 50), it therefore seems inevitable that organizations strive towards gaining and maintaining legitimacy in order to succeed in the marketplace. Shortly said, institutions strive to obtain stability through legitimacy (Oliver, 1991; DeMaggio and Powell, 1983). Because this dissertation discusses institutional changes in the sense of changes in regulations, policies and political attitudes, Oliver (1991) seems to offer the most fitting definition of institutions, whereby institutions are defined as “regulatory structures, governmental agencies, laws, courts, and professions” (Scott, 1987: 498 as cited by Oliver, 1991: 147). Oliver (1991) <https://assignbuster.com/defines-institutions-as-cognitive-normative-and-regulative-structures/>

directly examines the effects of institutional pressures and processes on strategic responses, whereby she offers a framework for identifying and classifying strategic responses of organizations (acquiescence, compromise, avoidance, defiance, manipulation) as well as predictors for such strategic responses (Cause, constituents, content, control, context). Three major studies have tested and applied this framework on practical examples. Goodstein (1994) studied the effects of institutional pressures on employer involvement in work-family issues and the resulting organizational responses, whereby he utilized Oliver's (1991) framework and supports her previous theory that organizations do not respond uniformly to institutional pressures, but rather that their choices for a particular strategic response (acquiescence, compromise, avoidance, defiance) vary depending on the institutional pressures they experience. Ingram and Simons (1995) replicated and slightly expanded Goodstein's (1994) original study by integrating female managers as an additional operational definition of constituents and by altering Goodstein's measurement of responses. However, the study resulted in similar conclusions to Goodstein's, namely finding strong evidence to suggest that organizations do indeed have a strong urge to again and maintain legitimacy (DiMaggio and Power, 1983; Meyer and Rowan, 1977; as cited by Ingram and Simons, 1995). However, both studies only study four of the Oliver's (1991) strategic responses, leaving out manipulation, thereby ignoring an important facet in an organization's strategic responses. Etherington and Richardson (1994) research all of Oliver's strategic responses in their study of institutional pressures on accounting university education in Canada. Their main contribution was their ability to combine compromise and manipulation strategy outlined by Oliver

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(1991). They achieved this by arguing the five strategies could be determined by the level of activity (active to passive) and the pattern of resistance and compliance (negative to positive), whereby they finally combined compromise and manipulation in an active-positive category. Finally, Clemens and Douglas (2004) attempted to study Oliver's full framework in a specific industry setting, namely the steel industry. Their study generally supported findings from previous studies and strengthened Oliver's framework. However, based on their findings the authors question Oliver's (1991) conceptualization of a manipulation strategy. They believe a firm may not only engage in a manipulation strategy to relieve institutional pressures but may also do so to take a productive part in the institutional process. This finding relieves much of the negativity associated with Oliver's (1991) original definition of a manipulation strategy.

Effects of institutional change in the form of policies and regulations

In this dissertation, institutions are regarded as governments and regulatory agencies. Buchholz (1986) states that institutions in the form of governments can regulate the industry, thereby implying that institutions have not only an effect on organizations directly, but on the market as well, thereby indirectly affecting organizations participating in that market. In their article on institutional governance systems and variations in national competitive advantage, Griffiths and Zammuto (2005) further suggest that institutional policies and a firm's political and strategic behaviour are contingent by stating that " States can be influenced by and influence the range of management choices and actions through their policies. Several

studies have further discussed the effect of institutional public policies and regulations on organizations. For example, Dobbin and Dowds (1997) examined the effects of public policy on new firm start-ups in the Massachusetts railroad industry. They came to the conclusion that new policies create both constraints and incentives in the market, which have the result of influencing business strategy as organizations try to cope with the new environment. Holm (1995) opposes this view to some extent in his study of the effects of institutional changes on Norwegian fisheries, in which he concludes that while institutional change is triggered externally (for example via political upheaval or technological breakthroughs), the outcomes of those changes will be shaped internally by the organizations, based on their practices, ideas and interests and their interaction. Holm thereby indirectly supports Oliver's (1991) view in that organizational behaviour (strategic responses) might not solely be driven by interest mobilization, but by a preconscious acceptance of institutionalized values and practices. Further evidence of how institutional regulations and policies affect organizational behaviour is displayed by a study of how the Celler-Kefauver Act of 1950 discouraged mergers among firms that operate in the same industry, thereby causing firms to adapt their growth strategies and instead grow through cross-industry acquisitions (Fligstein, 1990; Haveman et al., 2001). Other studies on how institutional policies and regulations affect organizations have been provided by Swaminathan (1995), Birnbaum (1984), Schuler (1996), and Marquis and Huang (2009) in their respective studies of the effects of institutional regulations and policies on the wine, X-ray manufacturing, steel and commercial banking industries of the United States. All the studies confirm the theory that institutional changes in the <https://assignbuster.com/defines-institutions-as-cognitive-normative-and-regulative-structures/>

firm of policies and regulations do in fact affect organizations and their strategic behaviour. However, Marquis and Huang (2009: 1222) argue in their essay on the contingent nature of public policy and the growth of US commercial banking that “ organizations are embedded in and affected by multiple environmental conditions [...] policy is just one of the environmental conditions that organizations face”, suggesting that organizations are not only influenced by institutions per se as in the form of policies, governments and other regulations, but also in form of ethical standards as represented by customers or technological innovations, which can radically interfere and affect an organisational strategic orientation and direction, because in the end, organizations depend on their customers for survival. Therefore, results that suggest a link between institutional changes in the form of policies and regulations must be viewed and considered in the context that other extraneous factors might have influenced the strategic behaviour of an organization.

However, public policies introduced by the institutional environment of the organization do not solely affect the organization in negative ways, but may also prove helpful in creating opportunities in new fields which were previously inaccessible by the organization. For example, the deregulation of the European airline industry in the 1990s allowed airlines to choose which airports they would fly to and what fares they wanted to charge, allowing for network expansions in more airlines, thereby providing an example of a positive effect of government intervention and institutional change.

Most of the literature and empirical evidence of linkages between institutions and organizations has focused on the relationships between the two and the <https://assignbuster.com/defines-institutions-as-cognitive-normative-and-regulative-structures/>

effect it has had on new start-ups in an industry. But there is little information found on the effect of institutional policies on the business strategies of particular firms, although there is emerging literature on links between institutions and organizational practices. For example Guler et al. (2002) have studied global competition, institutions and the diffusion of organizational practices in the case of the international spread of ISO 9000 quality certificates. However, most literature that examines the organization at a microanalytical level focuses on business routines, logics and belief systems (Friedland and Alford, 1991; Lounsbury, 2001) and determines that institutional changes alter the perceptions within the organisation on how legitimacy is assessed. Such logics “ encode the criteria of legitimacy by which role identities, strategic behaviours, organizational forms and relationships between organizations are constructed and sustained” (Greenwood and Hinings, 1996; Scott, 2001; as cited by Suddaby and Greenwood, 2005: 38).

Important pieces of work on how institutions in the form of governments matter in regards to industries and organizations have been provided in the special topic forum of the 2005 Academy of Management Review, in which several authors discuss how government actions affect markets and businesses in a number of ways: government action can foster industry creation and economic development, corrupt governments can affect firm-level decisions, the attractiveness of political markets and the impacts those may have on firm-level strategies and finally on a more microanalytical level, how deregulation can affect the governance mechanisms of firms. (Ring et al., 2005)

Firstly, Kim and Prescott (2005) present a model that examines the effects that different forms of deregulation can have on the internal governance mechanisms by resulting in variations in the speed of adaptation of internal governance mechanisms and consequently firm performance. The authors argue that while regulation is employed to provide stability to industries, it is a market-structuring process that constraints a firm's strategic moves, therefore limiting a firm's investment opportunities (Gaver and Gaver, 1995; as cited by Kim and Prescott, 2005) and further acting as substitute for internal governance mechanisms (Walsh and Sewars, 1990; as cited by Kim and Prescott, 2005). By employing principal-agent relationship theory the authors further state that deregulation by regulating institutions, principally governments, will result in a shift towards an increased adaption of internal governance mechanisms. Kim and Prescott go on to present a model with four different forms of deregulation (frame-breaking, metamorphic, piecemeal, and plodding) based on the scope and pace of deregulation, whereby each form represents a different degree of substitution between governments and industries and examines the thereby resulting variations in the speed of governance and firm performance.

Frame-breaking deregulation is relatively quick and thorough, proposing that this will lead to the quickest adaptation of internal governance mechanisms. On the other hand, scope and pace of the plodding form of deregulation is relatively slow, and regulatory agencies maintain significant amounts of power of industry participants, thereby leading to the slowed adaptation of internal governance mechanisms.

The major importance of Kim's and Prescott's work lies in its exploration of how government policies can affect a firm's behaviour. It implies that tighter industry regulation will lead to a decrease in internal governance mechanisms and increased external control mechanisms by the regulatory institutions. This suggests that firms have to adapt their internal governance mechanisms to deregulatory environment, thereby significantly affecting its strategic direction and practice in order to survive the institutional and environmental change.

In their 2001 study, Haveman et al contribute to the question how regulatory policies affect organizations and their strategic orientations, whereby the authors focus on the flux many organizations find themselves in after regulatory punctuations, which they define as " sudden and extensive shifts in state constraints on business operations [which] alter both technological and institutional features of organizational environments" (Haveman et al., 2001: 254). The essay focuses hereby on the specific organizational issues of organizational domains, CEO succession and firm performance. The authors employ the relatively new punctuated-equilibrium view, which states that ' short bursts of discontinuous change are interspersed between longer periods of relative stability' (Eldredge and Gould, 1972; Gould and Eldredge, 1977; as cited by Haveman et al., 2001: 254), to examine the effect such punctuations in form of government policies can have, linking their idea back to institutional theory:

" Institutional theorists argue that organizations are driven by coercive isomorphic pressures to conform to the legal and cultural expectations of the states (Meyer and Rowan, 1977; DiMaggio and Powell, 1983). When major <https://assignbuster.com/defines-institutions-as-cognitive-normative-and-regulative-structures/>

changes in regulations occur, these coercive pressures cause organizations to adjust their structures, processes, and strategies" (Haveman et al., 2001: 255)

Clearly, considering this quote and the studies mentioned earlier in this literature review, there are indications that institutions and their regulatory policies seem to affect organizational strategies and even cause political activity by firms to relieve or shape institutional pressures. In short, public policy has become a new dimension of management (Buchholz, 1986).

However, as Haveman et al. (2001) have noted in their work, major regulatory initiatives rarely come as complete surprises to organizations, but rather stem from public debate, reflection and negotiation, which firms often try to influence by engaging in political behaviour.

In their work, Haveman et al. (2001) studied the effects of regulatory punctuations on organizational domains, CEO succession, and performance in the American hospital and savings and loan industries. They found that regulatory changes in the form of punctuations affected organizations in those industries in several ways: In the hospital sector they found, among other effects, removed barriers to entry, eroded boundaries between medical practice, insurance, and hospitals, and an intensifying competition. The findings were similar in the savings and loan industry, where uncertainty about optimal product/client portfolios increased, boundaries between thrifts and other financial services erode, and competition intensified after certain regulatory punctuations such as increased restrictions on thrifts' investments outside of the traditional residential mortgage market were reduced

(Haveman et al., 2001). They thereby came to the conclusion that the <https://assignbuster.com/defines-institutions-as-cognitive-normative-and-regulative-structures/>

examined regulatory punctuations did have an effect on organizational domains, CEO succession, and performance, though the severity of the effects differed among industries, suggesting that institutional changes have different effects in different contexts.

Buchholz offers further insights in his 1986 book, in which he discusses the business environment, public policies and the implications for management and strategy formulation. The author firstly argues that firms need to develop a broadened awareness of external environmental influences that act upon the organization. A firm must constantly evaluate its environment, stakeholder and firm internal strategies and practices in order to survive in a dynamic environment - especially in a heavily regulated industry such as the utilities sector, where changes in parliament can occur every few years and may entail regulative changes, which can significantly affect an organization's strategic orientation and practice. Buchholz even suggests in his work that a shift away from a mere profit orientation towards an inclusion of a sensitivity towards public policy issues and pressures of the external environment, including institutional pressures. Furthermore, Buchholz argues that managers need to develop an integrative ability in regards to public issues and policies affecting the organization. Quoting Tombari (1979), Buchholz (1986) calls for an integrative strategy of public policy issues and the objectives of the organization. Lastly, the author states that political skills are becoming increasingly important in the sense of mediating among various stakeholder groups and their interests. Though this logic is applied specifically for managers, this can be extended to the entirety of the organization. Although Buchholz (1986) identified the need for political skills

24 years ago, it is most certainly still true today, if not even more relevant as the public and regulatory institutions become increasingly important to an organization in the sense of granting legitimacy, as discussed earlier.

In regards to institutions and organizations, Buchholz (1986) argues that the federal government is the major institutional force which is involved in formulating public policy that shapes the behaviour of business organizations, thereby implicitly assuming that public policies, i. e. in the form of regulations, directly impact an organization's behaviour, such as a change in strategic direction or may trigger political behaviour in firms. He states that the government as institution can impact business in four aspects: competitive behaviour, industry regulation, social regulation and labour-management relations.

Buchholz (1986) further describes the relationship between businesses and governments in more detail. He describes it as "'adversarial' [meaning] having antagonistic interests, two parties acting against each other or in a contrary direction, opposite in direction" (Jacoby 1975; as cited by Buchholz, 1986), going on to describe government to be in an unfriendly relationship with businesses and businesspeople perceiving the government as obstacles and constraints to be overcome, while themselves showing an insensitivity to social values. This view is highly critical of businesses and governments and essentially excludes a mutually beneficial relationship between the two entities. Of course, from a simply economic perspective, businesses are solely interested in profit maximization and might see government and policies as disturbing towards reaching that objective. Employing this view, it also makes sense to argue that governments must keep those businesses in <https://assignbuster.com/defines-institutions-as-cognitive-normative-and-regulative-structures/>

check in order to overcome the social insensitivity displayed by businesses. However, this is only partly correct in modern business-government relationships, where public policies may also take place to help business, as seen during the financial crisis of 2007, also called the credit crunch, where, for example, the German government, amongst others, stepped in to prevent the bankruptcy of major banks. Furthermore, many businesses nowadays adapt the idea of sustainable businesses combined with environmental consciousness, while imposing self-regulatory initiatives. Therefore, to simply view the business-government relationship as a negative one as done by Buchholz (1986) is too simple of a view for this complex issue.

Further literature comes from Russo, who, in his 2001 paper, analyzed how a federal mandate (PURPA - Public Utility Regulatory Policies Act) for electric utilities, urging them to purchase power from private generating sources, caused the creation of a new field of independent power production in the United States between 1978 and 1992. He found that the regulatory measures spurred new start-ups and even created a new industry- that of independent power generating sources. Furthermore, he found that “ alternative energy projects and cogeneration projects were fostered by higher prospective energy prices, and alternative energy prices got a clear boost from federal tax subsidies” (Russo, 2001: 79). However, Russo discusses the effects on a macroanalytical level by focusing on the whole power generating industry, instead of specific firms. Moreover, as with many case studies that have been done using data based on the US industry, it is only partly applicable to the German parliamentary system, where regulatory

policies may change much more drastically and more frequently based on parliamentary coalition changes. Additionally, in the US political system, lobbying as a form of political behaviour is much more common than, for example, in parliamentary systems, where firms tend to establish long standing relationship to governments. This can take the form of co-opting, where an organization tries to actively manipulate the sources of pressures, for example by attempting to convince a member of the regulatory institution to join the organization's board of directors (Oliver, 1991) or by trying to establish a relationship in which the organization is able to influence the policy process of the regulatory institution in order to promote its interests and ensure continued legitimacy, or differently put, those institutional ties and coalition-building can also be used to " demonstrate the organization's worthiness and acceptability to other external constituents from whom it hopes to obtain resources and approval" (Benson, 1975; DiMaggio, 1983; Oliver, 1990; Wiewel and Hunter, 1985; as cited by Oliver, 1991: 158).

Political activity to influence institutional pressures

As discussed earlier, organizations need to obtain legitimacy by their various audiences in order to survive in the marketplace in the long-term, as firms that possess legitimacy are seen as more meaningful, more predictable and more trustworthy (Suchman, 1995) and are therefore more likely to succeed than organizations that have not been awarded legitimacy. Suchman (1988) therefore depicts legitimacy as an operational resource, which can be employed to attain increased value in the marketplace. Organizations must strive towards achieving, maintaining or regaining legitimacy. One way to do

so may be to engage in a dialogue with political institutions, as suggested by Oliver (1991) in all her strategic responses, but acquiescence. Furthermore, Oliver and Holzinger (2008) state “ firms choose to engage in political strategies to create or maintain their value” - in short, firms try to maintain their legitimacy to survive. To gain or maintain legitimacy, a firm may engage in various strategic responses in order to react to institutional pressures (Oliver, 1991). However, it is likely that a firm may want to engage in a political dialogue with the political institutions in order to influence the institutional pressures the firm experiences. As Bonardi and Hillman (2005: 397) have stated in their study on the attractiveness of political markets and the implications for firm strategy “ firms are most likely to engage in political activity when the government significantly affects their business” - furthermore, political strategies can be considered competitive tools for organizations. Oliver and Holzinger (2008: 499) refer to several scholars to name the reasons why firms decide to engage in a strategy with political institutions:

“ firms formulate political strategy to make their interests known to government (Keim and Baysinger, 1988), to gain collective or private benefits (Olson, 1965), to access resources from political institutions (Hillman, 2003), to purchase government policy or secure government inaction (Keim and Zeithaml, 1986), to reduce costs (Kaufman, Englander, and Marcus, 1993), or stop unwanted regulation (Yoffie, 1987), and to increase firm control and autonomy (Getz, 1993).”

It follows that firms that are able to establish close relationships with

government institutions are most likely better equipped to influence the
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policy making process and might influence this process in their favour. This relationship building can take on different shapes and forms: a firm can try to lobby government by itself or try to form interorganizational ties to promote an issue in a collective manner within the public policy domain - so called 'vesting', meaning that "the interests of a group are routinely taken into account by public authorities in the handling of state affairs" (Roy, 1981: 1289; as cited by Russo, 2001: 67). However, as all organizational resources are limited, firms may choose or have to focus their resources on specific political issues (Schuler, 1996), most vital to the organizational success and maintaining legitimacy.

Another relevant article in the special topic forum of the Academy of Management Review (2005) has been provided by Bonardi et al. (2005) in which the authors discuss how organizations may manage government influences and policies by entering political markets in order to promote their interests. Oliver and Holzinger (2008) as well see the political environment of a firm as a political marketplace, whereby firms engage with policy makers to execute political strategies.

Overall, the literature reviewed in this section has discussed the role of institutions in the market and their significance for organizations. Institutions can award legitimacy, but may also change the legitimacy criteria, for example through regulations. The literature and several studies have also examined how institutional changes, such as public policies and regulations by the government, can affect industries and organizations in the form of creating new industries, promoting new business start-ups, influencing competition, and regulating industries. However, a major theoretical

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weakness of the reviewed literature is the fact that the majority of studies and literature focuses on a macro level, meaning entire industries and sectors, thereby providing little evidence and knowledge on the variances and nuances found on a microanalytical, business level. This is where this dissertation hopes to make a contribution to existing knowledge about institutional changes and organizations' strategic responses. Focusing on a business level allows a more accurate depiction of the effects of institutional changes on firm's strategic responses, because variances among businesses in the same industry can be observed that are not visible with a generalized macro view. The dissertation aims at answering the research question if institutional changes in the form of policies, legislations and regulations affect the strategic responses of organizations by examining a specific firm in a specific setting. By contributing to existing literature on institutional changes and strategic responses, it can improve the current understanding and knowledge about institutions and organizations.