

THE NEW INSTITUTIONALISM IN STRATEGIC MANAGEMENT

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The recent collapse of the huge energy-trading company Enron has prompted a cry rarely heard in the American economy: to increase regulation. All the more rare, this call is coming from both consumers and employees, who fear the power of large corporations, as well as from the corporations themselves, who fear that an erosion in the trust and confidence of employees, investors, customers and suppliers will cripple their capacity to do business. The effect of the Enron shock is to remind us of something that strategists, managers, and designers of organizations frequently ignore – that the economy rests on an institutional bedrock. Particularly in the United States, where fundamental institutions have been so effective and so stable for so long, it is easy to forget that the state, along with the various organizations and social norms that promote trust and confidence in economic transactions, have a critical influence on which organizations and strategies will succeed.

This volume examines new-institutional theory, which takes as its explicit focus the influences that were hidden, or taken for granted, in the Enron debacle. The core claim of this theory is that actors pursue their interests within institutional constraints, such as the regulations that constrained (or were presumed to constrain) Enron. This idea is the basis of a growing, pan-disciplinary literature that seeks to explain the conduct and performance of individuals, organizations, and states. As the foundational theory about the nature and operation of institutions has been established, and as evidence on the operation and inter-relationship of alternative institutional forms has grown, the tools available for constructing new institutional explanations have been established. The accumulated research has reached a critical mass that creates numerous theoretical and empirical opportunities.

We begin this introductory chapter by addressing the question “why now?” for the new institutionalism in strategy. We identify a number of economic developments and scholarly advances that have helped to make clear the significance of institutions for strategic management. We then explain just what we mean by institutions, with a quick survey of the most relevant literature. In this survey we give explicit attention to the fact that there are a number of variants of new-institutional theory, which tend to

emphasize different types of institutions. Our response to this variety is to present a classification of institutional forms, and identify the literatures that have focused on each. Our own view is that a complete theory of institutions must be comprehensive in its definition of institutions, but also explicit about differences among institutional forms and interdependencies between them. In the third section of this introduction we identify a number of pressing questions for new-institutional theory. By applying the chapters of this volume to those questions, we show that research in strategic management can play an important role in the development of new-institutional theory, particularly by helping to explain how organizations affect institutions of other types. In the fourth and final section, we make the literature on strategic management the focus, and describe how new-institutional theory can help solve pressing questions in that literature.

WHY THE GROWING INTEREST IN THE NEW INSTITUTIONALISM IN STRATEGY?

Until recently, the idea of explicitly considering institutions to explain the content and effectiveness of organizational strategies would have seemed a little like building theories of strategy based on the fact that the human subjects of the organizations we study breathe air. Institutions, like air, probably make a difference, but why, given their constancy and pervasiveness, should we invest in understanding that difference? The naiveté of this position has been made clear by a number of recent developments in the international economy, and in the scholarly field of strategy.

Transition from state socialism. The most significant of these developments is the transition from state socialism among countries of the former Soviet-bloc and China. The theme of the somewhat crude analysis of the early days of this transition was that capitalist economies were more productive than state-socialist ones; the prescription was for the latter economies to adopt features of the former. The result of these early changes was a range of unintended consequences (Murphy, Shleifer & Vishny, 1992; Nee, 1992; Stark, 1996). These surprise outcomes of piecemeal changes indicated something under-appreciated about the economies in question – laws, organizations, and norms operated together in a complex fashion. Economies that were made to be similar on a subset of these might yet exhibit very different performance outcomes.

As Spicer and Pyle (this volume) show, attempts to create western-style markets in formerly state-socialist economies have been crippled by malfeasance on the part of some organizations, and the corresponding distrust that developed among the public. Simply, these problems arose because the designers of new institutions and organizations paid insufficient attention to the complex interdependence of the institutions that facilitate exchange in “free” markets. For example, Spicer and Pyle document the failure of the market for household savings in Russia. On the surface, that market looks something like markets in the United States – indeed some of the

most prominent American financial organizations tried to extend their operations to Russia. However, important institutional constraints that in the U.S. are provided by the state (regulation), organizations (auditing and rating of investments) and civil society (public awareness of the operation and risks of financial markets) were missing in Russia. The patchwork institutional framework that resulted enabled some organizational strategies and frustrated others.

Internationalization of business. Another development that points to the strategic significance of institutions is the recent increase in international trade, as well as the multinational operations of specific organizations. To be fair, international business is the one area where there is a long intellectual history of considering the impact of institutions on strategy. For example, concerns surrounding differences in national cultures (Hofstede 1980), and the risk of expropriation of capital by a host nation (Teece 1981), enter into prescriptions for operating a business internationally. Even in this area, however, there is rapid growth in attention to institutions. The significance of the international context for highlighting the role of institutions is that cross-national comparisons highlight institutional differences that may be taken for granted within a country.

Henisz and Delios (this volume) consider how multinational organizations can learn, and exploit their knowledge of institutions in the countries in which they operate. This is an integration of institutional forms that have been considered separately. There is a substantial literature that measures the legal and social environment for doing business in a given country (e.g. Henisz, 2000). And multinational organization has been characterized as an institutional mechanism for overcoming business risks, or other institutional shortcomings that exist in some countries. The learning theory that Henisz and Delios present forges a strategic link between those two literatures. Their arguments suggest patterns of design and expansion that can help multinationals succeed across a range of institutional environments.

Technological development. The interdependence between institutions and technology has been prominent in the new institutionalism. For example, North (1993) claims that technological advance by organizations forms the impetus for changing institutions – as new technologies develop, new institutions are required to effectively exploit them. Sometimes, changing technology highlights the significance of institutions because it exposes gaps in the institutional structure. For example, advances in medical transplant technology have created a market for the exchange of human organs, and exposed the unpreparedness of the law, the medical profession, and even the value-system of our culture, to govern that market (Healy, 2002).

In other instances, technological development makes institutions salient by setting off an episode of institutional creation or change. This is illustrated by Dowell, Swaminathan and Wade (this volume). They examine the role of social movements to

create institutions around the technology of high definition television (HDTV). The development of HDTV created an interest in changing institutions – for example the rights over the spectrum related to television broadcasts, and the standard that HDTV would follow in the U.S. Further, organizations that had previously been unsuccessful in their campaign to influence spectrum allocation were able to harness the interest associated with HDTV to affect institutional change in their favor. Dowell, Swaminathan and Wade’s account of this campaign highlights the strategic use of cultural concepts (framing) by the champions of various HDTV schemes.

Compromise and manipulation of existing institutions. The attention generated by the Enron collapse is not the result of new technology, internationalization, or the shift of political regimes. Instead, it emerges because institutions which were assumed to be stable and reliable were undermined, or otherwise shown to be lacking. For example, the failure of Enron’s auditors, Arthur Andersen, to identify questionable financial reporting practices is a violation of the role that auditors are expected to play in the institutional framework of western capitalism. Audit firms are in the business of selling surety. They vouch for the compliance by the auditee to familiar and accepted accounting principles, and thus allow investors to more reliably value the company (Strange, 1996). The objectivity of the auditor is key to providing this surety, and many of the professional policies of accountants – which include rules against accepting gifts from clients, and rules prohibiting over-reliance by the auditor on the fees of any single client--are designed to maintain objectivity. The very necessity of these rules points to a weak spot in the institutional framework. If an auditor could be influenced by the auditee, and convinced or deceived into inappropriately validating improper accounting practices, then stakeholders of many types – banks, shareholders, employees, customers – might be convinced to over-invest in the auditee.

The point of this is not to criticize a particular corporation, or auditor, but to illustrate that sometimes institutions, even those that are as venerable as auditing, are malleable and at risk of influence by their subject organizations. This malleability creates strategic opportunities for organizations. And although collusion with or deception of an auditor is illegitimate (although potentially profitable), other forms of institutional influence are more acceptable. Specifically, there is a growing attention to the possibility that organizations may influence for good or ill the institutions provided by the state, such as laws and regulations (Baron, 2001; Murphy, Shleifer & Vishny, 1993). In this volume, Holburn and Vanden Bergh, as well as De Figueiredo and de Figueiredo, build on this idea, using strikingly different methodologies. Holburn and Vanden Bergh present a formal model that helps to identify where organizations should aim their lobbying efforts. De Figueiredo and de Figueiredo use an experimental methodology to examine the question “how good are strategists at recognizing the opportunity to influence the state?” The clear significance of these questions, and the diversity of the research methods employed, point to the great opportunities for the

organizations that make institutions the focus of their strategies, and the scholars that study them.

Collapse of the tyranny of the here and now. The new institutionalism has always emphasized historical research. Classics in the field examine economic and organizational outcomes from the deep past (North & Weingast, 1989; Greif, 1994). The willingness to embrace history derives from two core precepts of new-institutional theory. The first is that core elements of the theory are timeless. The behavioral assumptions of the new institutionalism amount to bounded rationality. Institutions, as we will describe, are simply the rules that constrain the interest-seeking behavior of actors. The manner in which institutions operate is basically the same, whether the institutions are the self-policing policies of 11th century traders on the Mediterranean, or 21st century tax laws in Munich. Therefore, old institutions are understood to be as valuable as new ones for understanding economic performance – perhaps even more valuable, because historical institutions can sometimes be studied with fuller information and more objectivity. The second element of new-institutional theory that leads to historical research is the path dependence of institutions. We don't have complete theories of institutional change, but one thing that seems certain is that the options for new institutions derive in a large way from pre-existing institutions (North, 1990). So, even forward-looking analysts must understand old institutions, as they are the roots of future institutions.

The treatment of history in the new institutionalism stands in sharp contrast to the normal practice in research on business strategy. Strategy often suffers from a tyranny of the here and now, a desire to celebrate contemporary phenomena and slight historical ones.¹ This ahistoricism is one reason why research in strategy struggles for social-scientific legitimacy. By reveling in current affairs, and de-emphasizing their underpinnings in the past, strategy scholarship often undermines its own claims to develop explanations that transcend their contemporary context. In other words, the field of strategy struggles to develop good theory, because it downplays temporal transitivity and generalizability.

Clay and Strauss (this volume) illustrate these arguments. They provide a new institutional analysis of the phenomenon of Internet commerce. The treatment of this phenomenon in strategic management is a classic example of the cost of ahistoricism. The fashion (fortunately, not universal) in strategy has been to approach Internet commerce as “new” – it was a new economy, operated by new organizational forms, requiring new strategies.² This approach has yielded a set of thoroughly forgettable scholarship, which has not endured even the recent downturn in the technology sector, let alone provided a theoretical basis to guide organizations that attempt to transact in evolving internet-related markets. In contrast, Clay and Strauss begin by identifying the historical precedents for the contemporary struggles of those who transact over the Internet. They identify an analog to the challenges of Internet commerce in Richard

Sears' attempts to conduct business by mail in the late nineteenth century. Sears and his customers had the problem of building trust with strangers – for their transaction to be successful the customers needed to be confident that Sears would deliver high-quality goods, and Sears had to be confident that the customers would pay what they owed. Similar challenges arose for credit card providers and users in the mid-twentieth century. These problems are strikingly similar to those faced by sellers and buyers over the internet. As Clay and Strauss argue, potential solutions for contemporary internet businesses are similar to those employed by nineteenth century mail-order businesses and 1950s credit card issuers – institutions can modify the transaction so that both parties can approach it with confidence.

AN INTRODUCTION TO THE NEW INSTITUTIONALISM

There are a number of variants of “new-institutional theory” (Fligstein, 1997), so it is important to be clear just what we mean by institutions, and how we understand them to operate. We'll begin with this statement, which for us explains action in the new institutionalism: Actors pursue their interests by making choices within institutional constraints. This simple statement contains three elements that must be explained: who are the actors, how do they make choices, and what are the institutional constraints?

The Actors

The actors in the new institutionalism are individuals, organizations, or states. Each of these classes contains components that pursue interests, are subject to institutional constraints, and which supply institutional constraints that affect other actors. For researchers of strategic management, the idea that an organization can be, like an individual, an actor that pursues an interest, is uncontroversial. Without trivializing the fact that organizations have numerous and diverse stakeholders, the field of strategic management has shown repeatedly that there is utility in the simplification of organizations as actors. For example, in game theoretic treatments of entry deterrence, or models of competitive dynamics, an organization is an actor that can make “moves.” Likewise, it is central to the field that organizations have interests (otherwise, to what end would they have strategies?). New institutional arguments tend to be agnostic as to what the interests of individuals or organizations are, so the familiar candidates from strategic management – profit, market share, growth of employment, survival – are all feasible.

It may be more of a stretch to think of states as actors. This position reflects a recent trend in political science to characterize states as sets of organizations (ministries and agencies), which are like other organizations in that they are populated with individuals (bureaucrats and politicians) who use the state to achieve their goals (a paycheck, re-election; control over many subordinates, furtherance of an ideological

value). This is not to say that the state is just another organization – it has capabilities that other organizations can't match, such as the legitimate right to employ violence. The key, however, is that states represent interests, and take action to achieve those interests. We'll employ the typical definition of the state in the new institutionalism, as an organizational actor which, at a minimum, attempts to maintain its authority by exchanging justice and order for revenue and power (North, 1981; Skocpol, 1985).

Each class of actors produces its own form of institutional constraint: individuals produce norms (private-decentralized institutions in the classification we present below), organizations produce their rules (private-centralized institutions), and states produce laws and regulations (public-centralized institutions). In this sense, it can be said that actors lead a double life in the new institutionalism, pursuing their own interests within constraints, while producing constraints for other actors. The interplay between the actors can best be understood as a three-layered hierarchy, with states superordinate to organizations, which are superordinate to individuals (Williamson, 1994; Nee & Ingram 1998). States constrain organizations and individuals that are their subjects, and organizations constrain the individuals that are their participants. There is also upward influence in the hierarchy, as actors try to affect the institutions that constrain them.

Finally, we introduce a fourth relevant class, which we'll call civil society. It would be incorrect to call civil society an actor – it doesn't have identifiable interests, and it is incapable of forming or pursuing a strategy. Yet, in the catholic version of new institutionalism that we are developing, civil society has a role as the source of a fourth type of institution – culture (public-decentralized). As we describe below, culture constrains action in a manner that is comparable to other institutional forms. Culture also influences those forms, as when it is used to create favor for one legal option or governance form over another (Dowell, Swaminathan and Wade, this volume; Henisz and Delios, this volume).

Choice: Bounded Rationality

The new institutionalism treats actors as rational in the basic sense of making choices that further their interests, but distinguishes itself from neo-classical assumptions of rationality by attending to "cognitive costs" of decision making. The pursuit of benefits is limited by individuals' capacity to retain and process information; in other words, individuals are boundedly rational (Coase 1937, Simon 1957). Further, information is often costly (Barzel 1989). These two factors create transactions costs – the costs of writing and enforcing contracts – because individuals cannot foresee at the time of writing all contingencies that might be relevant nor can they observe all of the actions of their partners. And transaction costs give rise to the possibility of opportunism (Williamson 1975, 1985).

In the new institutionalism, a key implication of opportunism is the problem of credible commitment. It is illustrated by the dilemma faced by a kidnap victim whose kidnapper has a change of heart and decides to set her free (Schelling, 1960). The victim gladly promises not to reveal the kidnapper to the authorities in exchange for her freedom. However, the kidnapper realizes that once the victim is free she will have no incentive to keep her promise, and reluctantly decides the victim must be killed. More generally, the problem of credible commitment is faced by any party to an exchange that wants to promise in the present to do something in the future that may not be in their interests to do when the future actually arrives. The problem is endemic because in almost every exchange there is at least a moment where one of the parties has control over all or most of the goods, and must decide whether to follow through on the agreed upon bargain, or make a grab for more. It is clearly present, for example, in Richard Sears' attempt to get farmers to send him money for goods that he promised to subsequently send to them (Clay and Strauss, this volume).

The problem of credible commitment illustrates the positive role that institutions can play to smooth exchange (and by extension, to resolve all sorts of collective-action problems). Ideally, an institution can re-arrange the incentives of the parties of an exchange to allow them to make credible commitments. For example, what if it was possible for the kidnapper's victim to somehow post a bond that she would forfeit if she revealed the kidnapper's identity? And what if the farmer's friends maintained a norm to punish any vendor that mistreated any one of them, such that it was in Sears' interest to follow through on the bargain once he had the farmer's money? As we'll see, these examples do not describe all of the ways that institutions can affect economic performance of individuals, organizations and states. However, solving problems of credible commitment is one of the most positive functions of institutions, and one of the most significant for business strategy.

Institutional Forms

We employ an extension of the classification system for institutions that was first introduced in Ingram and Clay (2000). That system classifies institutions based on their scope (public or private), and how are they made and enforced (in centralized or decentralized fashion). The scope dimension defines which actors are subject to the institution. Public institutions apply without discrimination to all actors of a type. It is impossible to opt in or out of a public institution. Private institutions apply only to actors that are part of some group or organization, so actors have some influence over the institutions that affect them as long as they can choose which associations they are part of. The centralized-decentralized dimension refers to whether or not there are designated functionaries charged with creating and enforcing the institution. Centralized institutions rely on such functionaries, for example, laws may be made by legislatures and enforced by the police. The legislature and police are "third parties" in that they make and enforce the laws, even if they are not directly affected by their

violation. Decentralized institutions, on the other hand, emerge from unorganized social interaction, and really on diffuse individuals (often those directly affected) to punish institutional violations. These two dimensions create four institutional forms. We describe each form, as well as research on the form that is relevant for strategic management. Figure 1 portrays these basic institutional forms, and summarizes key information about each.

Figure 1. A Typology of Institutional Forms

	Decentralized	Centralized
Private	Archetypal form: norms Chief actor: social groups Representative theorists: Homans, 1950; Granovetter, 1985 Levers for strategy: human resource policy; corporate-culture building; inter-organizational networks	Archetypal form: rules Chief actor: organizations Representative theorists: Williamson, 1975; Greif, 1994 Levers for strategy: conventional strategy and structure tools; business groups
Public	Archetypal form: culture Chief actor: civil society Representative theorists: Meyer & Rowan, 1977, DiMaggio & Powell, 1983 Levers for strategy: partnerships with mobilized social groups outside the firm; framing	Archetypal form: laws Chief actor: states Representative theorists: North, 1990; North & Weingast, 1989 Levers for strategy: non-market strategy; business political activity

There are at least five ways that the public institutions provided by the state can be understood to affect its choices, and those of organizations and individuals. The first is particularly relevant to strategic management. The state may smooth exchange between its subjects by providing institutions that allow them to make credible commitments. This can be achieved if the state provides a legal system to protect property rights, decrease transaction costs, and enforce contracts (North, 1990). This function is particularly vital in modern economies, in which specialization and the division of labor give rise to the need for sustaining complex exchanges over time, across space, and between strangers, creating the need for trust between disconnected actors. An effective institutional framework facilitates this trust by penalizing actors who break the rules of exchange, for example, by applying legal sanctions to actors who violate contracts.

There is quantitative evidence of the role of public-centralized institutions for enabling credible commitments. Some studies exploit changes in laws governing specific industries to show that increased legal constraint on organizations causes them to flourish. Studies of populations as diverse as U.S. health maintenance organizations and telephone companies, Toronto day-care centers, Niagara Falls hotels, and Singapore banks have demonstrated that their failure is reduced by increasing government involvement in monitoring, certifying, authorizing and endorsing their activities (Wholey et al 1992, Barnett & Carroll 1993, Baum & Oliver 1992, Ingram & Inman 1996, Carroll & Teo 1998). Such government involvement can also affect the pattern of competition between incumbent firms and potential entrants, as demonstrated in Calabrese et al's (2000) study of the Canadian biotechnology industry. In the human therapeutics/diagnostics sectors, where FDA regulation is most strict, new products take a decade to come to market and short technological leads can become entrenched as regulators demand evidence of superior efficacy for later-to-market drugs. Incumbent firms' innovative activity suppresses new entry significantly more in human subsectors than in subsectors characterized by less onerous regulatory scrutiny. The effects of broader changes in public institutions are seen in Ingram & Simons' (2000) analysis of the effect of the formation of the Israeli State on the failure rates of workers' cooperatives in many industries. The transition from the weak British Mandate for Palestine to the strong Israeli State caused a radical improvement in the institutional support for credible commitment, and a corresponding sixty-percent decrease in organizational failure rates.

The second key feature of public-centralized institutions is whether or not the state can credibly commit to not subsidize subject organizations when they struggle. The recent transitions from state socialism have demonstrated that absent such a commitment, entrepreneurs will direct their energies towards "holding up" the state treasury rather than to producing economic value. As Stark & Bruszt (1998:119) put it, when the state hears organizations' "siren cry, 'Give me a hand, give me your hand,' it

must be bound to respond not simply that it should not, or that it will not, but that it cannot.”

The third key feature of public institutions is an outgrowth of the first two. A state strong enough to guarantee the property rights of its subjects, and to resist their calls for subsidies, is also strong enough to appropriate their wealth. Unless the state can credibly commit against such appropriations, its subjects’ incentives for productive economic activity will be greatly curtailed. Evans (1995) uses the term “predatory” to describe states that exploit their subjects for short-term gain. He cites Zaire of the Mobutu regime (1965 to the present) as an archetype. Mobutu and his state cronies “systematically looted Zaire’s vast deposits of copper, cobalt, and diamonds, extracting vast personal fortunes...In return for their taxes, Zairians could not even count on their government to provide minimal infrastructure (43).” The gains from this strategy to the state, and those who dominate it, are, however, short lived. Predation on the part of the state has the effect of discouraging productive activities by organizations of all types – why invest capital or labor if the state is likely to appropriate the rewards of this activity? This effect is apparent in the deceleration of the Zairian economy – GNP per capita declined 2 percent per year over the first twenty-five years of Mobutu’s rule. Eventually, there will be little left to plunder.

A classic illustration of the cost of a predatory state, and the institutional solution that eliminated that cost, is North & Weingast’s (1989) account of the Stuarts’ impact on the economy of 17th century England. After coming to the Crown in 1612, the Stuarts exploited their subjects in numerous ways: they sold monopolies (at the expense of industry incumbents and potential entrants), they sold special dispensations from laws, and even committed outright theft, as in 1640 when they seized £130,000 that private merchants had placed in the Tower of London for safekeeping. These abuses led eventually to the Glorious Revolution of 1688, which resulted in numerous institutional changes to reduce the Crown’s capacity to act independently of Parliament and the courts. This loss of Crown autonomy had, however, positive implications in that it enabled the Crown to make a credible commitment not to appropriate subjects’ wealth. The value of this commitment can be seen, for example, in the dramatic increase in the Stuarts’ capacity to borrow funds. More generally, a national constitution, with its delineation of enduring limits to government power, may be interpreted as an attempt by a state to commit not to become predatory over time (Weingast 1993).

Public-centralized institutions provided by the state are not always part of a grand effort to facilitate the credible commitments of actors. Sometimes they influence distributional battles over zero-sum interests, which is their fourth role (Knight 1992). These may be the battles between suppliers and consumers, as shown in analyses of the effects of regulatory policy on railroad foundings in early Massachusetts (Dobbin & Dowd 1997) or interstate trucking firm failures in the 1980s (Silverman, Nickerson & Freeman 1997). Or they may be the battles between rival organizational forms without

apparent efficiency differences, as in the case of thrift-savings organizations that fought as much in the legislative arena as in the market (Haveman & Rao 1997), or national coffee roasters in the U.S., that derived a competitive advantage over regional roasters through an international treaty (Bates 1997). Evans (1995) detailed numerous ways that states act to create economic transformations, for example, by lending money or taking responsibility for high-risk activities such as research and development. Such efforts are overwhelmingly selective, aimed at promoting particular sectors over others. Even efforts that are

Fifth and finally, public-centralized institutions may affect the legitimacy of particular organizational forms by influencing the definition of organizational propriety. This influence may be concrete, as when a law requires a certain organizational practice or office, or intangible, as when myths of efficiency develop to justify a practice that the state endorses but does not enforce (Dobbin & Sutton, 1998). Legitimacy, in turn, affects organizations' capacity to obtain the resources they need to survive (Meyer & Rowan, 1977). This feature of public-centralized institutions represents a link between this institutional form and the public-decentralized institutional form. Essentially, the state is in a particular position to influence culture – this is one of the characteristics that differentiates the state from other types of organizations.

Private-Centralized Institutions

The most ubiquitous role of private-centralized institutions is to internalize transactions in an organization. In his seminal paper, Coase (1937) addressed the question of why organizations exist. His central insight was that the governance of exchange within organizations as opposed to markets depended on the cost of transacting in each type of institution. In more recent work, Williamson (1985) and others have systematically investigated the effect of information, opportunism, and asset specificity on the governance of exchange, concluding that in some transaction environments, exchange is more efficient within an organization than the market. Further, the prevailing public-centralized institutions influence the attractiveness of various governance arrangements (Nee 1992). Ficker (1999) illustrates the relationship between the environment of public-centralized institutions and other factors, and the market/organization trade-off in the evolution of the Mexican Central Railroad (MCR). The MCR was founded in 1880 into “a country characterized by economic backwardness and an incipient and precarious institutional framework.” The company initially pursued a strategy of building main lines and depending on market transactions with railroads and other types of transportation organizations to supply freight. These market transactions did not materialize, however, due to the weak Mexican infrastructure, and the difficulties of organizational and technological coordination. In response to this failing of the market, the MCR switched to a strategy of internalization, extending its trunk lines and building branch lines to supply itself with freight.

Private-centralized institutions can also facilitate exchange between organizations. This can occur when organizations are part of a “super-organization” with its own rules and policies. An example is the diamond industry. Bernstein (1992) examines the rules that govern transactions in that industry, which rely on private-centralized institutions, and not the law. Members of a diamond bourse are governed by formal written rules that represent the codification of and are supported by industry norms. Bernstein finds that use of arbitration panels and mandatory pre-arbitration conciliation is a response to members’ need for speed, secrecy, and specialized knowledge of the industry. The industry enforces arbitration decisions with the threat of suspension of membership in the diamond bourse. In the case of noncompliance, a bourse faxes the individual’s picture to all other diamond bourses worldwide. Informed of noncompliance, members then refuse to trade with the individual in question because of the risk that they will be cheated. Through this reputation mechanism, the institution creates incentives for members to adhere to industry rules and norms in their transactions with other members.

Ingram & Simons (2000) describe a private-centralized institution that is even more comprehensive than the diamond bourse. They explain that in Palestine under the British Mandate (1922-1948), the state failed to provide public-centralized institutions to support economic exchange. A large group of cooperative organizations created a private-centralized substitute for these missing institutions, in the form of a comprehensive federation, called the Histadrut. The Histadrut has had as members, at various times, agricultural cooperatives (the kibbutzim and moshavim), workers’ cooperatives (in services, manufacturing and transportation), Israel’s largest conglomerate, a bank, credit cooperatives, housing cooperatives and consumer cooperatives. The Histadrut did a number of things to smooth transactions between these members. For example, the Histadrut directed its affiliated bank and its major marketing cooperative to give preferential service to other Histadrut members. It also arbitrated disputes for members, provided auditing services, gave seminars in accounting and management, arranged bulk purchases of raw materials, and maintained a pension fund. The institutional framework provided by the Histadrut was a major benefit to its members – they had a failure rate one-fifth that of non-members during the period of the British Mandate.

Private-Decentralized Institutions

The archetype of the private-decentralized institution is the norm. Although norms are often unwritten and unspoken, the real contrast to centralized institutions is in enforcement. Norms rely on social relationships for their enforcement – the ultimate penalty for violating a norm is the cessation of a relationship, or in the extreme, ostracism from a group. Penalizing violations of norms typically falls to the affected parties rather than third parties, and it is the value of the relationship itself that provides the motivation to maintain the norms that surround it. As Homans ([1961]

1974: 76) puts it, “the great bulk of controls over social behavior are not external but built into the relationship themselves, in the sense that either party is worse off if he changes his behavior toward the other.”

The operation of norms among individuals within organizations is familiar. An illustrative case is Homans (1950) re-analysis of the bank-wiring room from the Hawthorne studies. That study documents the norms of the workers, governing how much to produce on a shift. Normative enforcement through relationships is clear — workers who did not work hard enough were insulted, and excluded from games, gambling, and the sharing of candy. Although such group processes may at first seem tangential to the organization’s strategy and performance, the truth is that norms interact with the rules of the organization, and that interaction has a fundamental influence on organizational success (Nee & Ingram, 1998; Zenger, Lazzarini & Poppo, this volume). It was General Electric’s group piece-rate incentive system that set the background for the development of the norms in the bank-wiring room, which generally acted to encourage productivity. In other instances, sub-organizational norms undermine the control system of the organization, and inhibit its pursuit of its goals (Shibutani, 1978).

Norms, or their analogs, also operate in the inter-organizational context. There is important historical research that illustrates the function of private-decentralized institutions in long-distance trade. With this type of trade, merchants can often profit from using other merchants as agents to sell goods, collect debts, and so forth. This agency relationship, however, raises the possibility that the agent will act opportunistically, keeping some or all of the monies owed. The Maghribi traders in the 11th century Western Mediterranean (Greif 1994), and American merchants on the 19th century California coast (Clay 1997) overcame this problem by forming coalitions, which allowed exchange to flourish. In both cases, merchants in the coalition conditioned future use of other merchants as agents on those merchants’ having acted in accordance with group norms in the past. For instance, when a Maghribi merchant was accused of cheating in 1041-42, he found that “people became agitated and hostile and whoever owed [me money] conspired to keep it from me (Greif 1994: 925).” By tying future economic gains to past behavior as an agent, merchants were able to ensure that the future gains to membership in the coalition were greater than the gains to cheating and being punished.

Additionally, there is a rapidly expanding body of empirical research on the relational governance of inter-organizational exchange. Uzzi (1996) describes the embeddedness of exchange in the Manhattan garment industry. As in the examples above, participants in that industry followed norms that encouraged them to deal fairly and flexibly with each other. Zaheer, McEvily & Perrone (1998) apply related arguments to explain the purchasing practices of large organizations. They find that even among large corporations, trust between buyers and sellers is an important input

to reducing transaction costs. There is also a developing literature in strategic management that focuses on the role of relationships for the interorganizational transfer of knowledge (e.g., Darr, Argote & Epple, 1995).

Public-Decentralized Institutions

We have left public-decentralized institutions for last because they are different from the previous three institutional forms. The difference is in terms of intentionality. Laws, organizational rules, and norms are provided consciously and even strategically by states, organizations and individuals. These institutions don't always have the effects that their designers and enforcers intend, but none the less, they emerge from some intent. In contrast, public-decentralized institutions might be called "pre-conscious". As we have described, they are provided by amorphous civil society, and not by a specific actor. Public-decentralized institutions amount to culture – they are ideas about what practices and social designs are acceptable and desirable.

So why include public-decentralized institutions in the same theory as other institutional forms? The best reason is that despite their origins, public-decentralized institutions are comparable to other institutional forms in their operation (Scott, 1995). Cultural values structure the choices of actors, partly determining the alternatives that are considered and the attractiveness of each alternative. For example, a manager's evaluation of an alternative for an organization's strategy might be influenced by the alternative's propriety and legitimacy in much the same way that it might be affected by its legality (DiMaggio & Powell, 1983; Carroll & Hannan, 2000). Indeed, work on the cognitive processes by which public-decentralized institutions operate indicate that they influence the value of alternatives – for example, the stock of a company may be discounted because the company's activities do not fit legitimate categories (Zuckerman, 1999).

Additionally, although public-decentralized institutions are not controlled by any specific actor, actors may still be strategic in the face of them (DiMaggio, 1988; Roberts & Greenwood, 1997). All of this is not to oversimplify this institutional form. It is particular among the institutional classes in the pre-conscious manner in which it may emerge, and operate to affect action. Still, public-decentralized institutions fit the description of new-institutional action that we began with. The influence of propriety and legitimacy on the effectiveness of organizational designs and strategies is undeniable. Likewise, as we describe below, public-decentralized institutions have a critical affect on the development of other institutional forms, and thereby present important strategic opportunities for organizations.

WHAT CAN STRATEGY DO FOR THE NEW INSTITUTIONALISM?

So far, we've explained what the new institutionalism is, and why scholars in strategic management are paying more attention to it. But what is to be gained by the whole enterprise? Of course, the subsequent chapters will provide the answer to that question. But before we turn you loose on them, we'll give you our own interpretation. From the inception of this volume, we were convinced that there was a real promise of "gains from trade" by bringing together new institutional and strategy research. We see the benefits flowing both ways – strategy research can help solve some of the core problems of the new institutionalism, and vice versa.

The potential contribution of strategy to the new institutionalism comes from its sophisticated conceptualization of the action of organizations. Organizations are obviously key to new-institutional theory, not only as a source of private-centralized institutions, but even more importantly as the vehicles for the pursuit of the most important human interests, both economic and social (Hannan & Freeman, 1977). Yet, the treatment of organizations in the various institutional theories has been soundly criticized. DiMaggio (1988) charged theories of public-decentralized institutions with suffering from a "metaphysical pathos", denying the capacity of organizations and individuals for self-interested, and strategic, action. Similarly, Granovetter (1985) claimed the same theories presented an "oversocialized" view of organizations and other actors, underestimating their autonomy from cultural influence. Institutional economists on the other hand, have erred in the opposite direction in their treatment of organizations. North (1993), for example, identifies organizations as the chief vehicles of institutional change. Yet, his characterization of organizations as malleable, rational and decisive entities is in contrast to what we know about organizational change and strategy making.

Without a doubt one of the prime contributions of the chapters in this book is to develop more informed theories of the role of organizations in institutional change. Indeed, many of the chapters represent great leaps forward for this critical but understudied topic. Jaffee and Freeman, for example, offer a thrilling account of institutional change in real time. They courageously make predictions about the evolution of German taxation of stock options as the institutions are unfolding. Their analysis highlights the role of interest-seeking organizations in institutional change. German tax law forms the background for competition among established organizational forms and their challengers. The authors challenge and refine existing ideas (e.g., North, 1993) by identifying organizational inertia as a key determinant of the strategies that organizations pursue to maintain or change specific institutions.

The idea that legal institutions can be the object of organizational strategies is also prominent in other chapters. Holburn & Vanden Bergh present a formal model of lobbying. Their model explicitly reflects a key challenge to any organizational attempt to influence the law – that there are multiple options as to where lobbying efforts should be targeted. Should an organization lobby a state's executive, or its legislators?

Or perhaps the organization should bypass the law makers and go directly to the agencies that enforce laws and regulations? The model presented in this paper yields prescriptions that organizations can apply to their lobbying strategies.

De Figueiredo and De Figueiredo address a different stage of the same problem, using a radically different methodology. They follow on the under-developed literature on strategic decision making (e.g., Schwenk, 1984; Zajac & Bazerman, 1991). Implicit in their approach is a sophisticated idea that has been slighted in the new institutionalism, that the influence of institutions depends on the perception of those institutions by the relevant actors. Their experiments yield insights into the very practical problem of how to help strategists to correctly analyze the institutional environment, and recognize the opportunities and challenges that it presents. Their results are cause for optimism, evidencing the utility of business-school courses on the strategy of dealing with institutions.

Two other papers in the volume examine organizations' role in institutional change, but focus on culture, rather than the law, as the context for organizations' strategies. In other words, they venture bravely into the void between established institutional theories. Dowell, Swaminathan and Wade examine a fascinating instance of institutional entrepreneurship, the effort to establish standards for HDTV in the U.S. This chapter provides a uniquely lucid explanation of the sociology and psychology of "framing." Framing is a conscious attempt to use cultural values to support a given action, or in this case, a direction for institutional change. Framing therefore represents a vast set of strategic opportunities for institutional entrepreneurs. The clear and compelling treatment of the topic in this chapter will encourage its application to other strategies and studies.

Rao's chapter is similar in that it considers organizations' influence on public-decentralized institutions, but it considers taken-for-grantedness, rather than a technological standard. Taken-for-grantedness presents a dilemma for strategy – it has been convincingly shown to influence organizational performance, but what can be done with that knowledge? How can organizations affect what others take for granted? Rao's answer is that they can do so through demonstration. Specifically, he examines the demonstrations of reliability and quality that seeded the taken-for-grantedness of the automobile. In doing so, he gives fair treatment to the many other influences on the perception of the automobile. The result is a necessarily complex, but original and very promising set of ideas about the interdependence of organizations and public-decentralized institutions.

The interdependence between institutional forms demonstrated in Rao's paper (and in most of the papers in this volume) is itself a substantial contribution to the new institutionalism. Research has so far been mainly within the quadrants of figure 1, with interdependencies between the quadrants going unexamined to the detriment of the

theory. While the multi-form emphasis of so many of this volume's papers redresses that theoretical neglect, it also has implications for the field of strategy. Unpacking the simultaneous influence of different types of institutions is necessary for effective strategizing. In many ways the theoretical and applied contributions of these papers are intertwined, as the next section demonstrates.

WHAT CAN THE NEW INSTITUTIONALISM DO FOR STRATEGY?

The previous section described the benefits that new institutional scholars can gain from taking strategy research seriously. But this is by no means a one-way street. Our rationale for including a volume on new institutionalism in the *Advances in Strategic Management* series is predicated on the idea that the new institutionalism can help surmount some of the core challenges in strategy research.

The potential contribution of new institutional research to strategy comes from its highlighting of the interactive role that institutions play in both constraining and enabling organizational action. Institutions are frequently seen as background conditions or "shift parameters" that contour the expected payoffs associated with particular strategic actions (Williamson 1991). But more than that, institutions directly determine what arrows a firm has in its quiver as it struggles to formulate and implement strategy, and to create competitive advantage. Given the importance of institutions for determining the success or failure of specific strategies or actors, consideration of ways to influence the creation and maintenance of favorable institutions is fundamental to any organization's strategy. Hence, an understanding of institutional change, and the ways that firms can influence such change, becomes central to the study and practice of strategy.

Consider the taxonomy of institutions in Figure 1. The vast majority of strategy research focuses on private-centralized institutions such as firms and the formal actions that they undertake. Strategy research has generated a post-adolescent, if not quite mature, body of literature that offers strong predictions and prescriptions for firms' boundaries and competitive activity. Yet direct application of traditional strategy prescriptions to managing other types of institutions offers far less utility. How can a firm deal with private-decentralized institutions such as norms? Use of traditional strategic levers without consideration of variance in underlying norms of organization members can be ineffective, or can even backfire, as in Simon's (1957) "unintended consequences." As for altering norms themselves, this is frequently perceived as an organizational behavior or human resource management issue, and consequently outside the purview of strategy. Similarly, how can a firm deal with public-centralized institutions? With the exception of what is sometimes called the "non-market strategy" literature (Baron 2001), these are largely seen as exogenous institutions that influence strategic and organizational choices in much the same way as production technology. Finally, the link between strategy research and public-decentralized institutions has

generally been limited to the use of cultural distance measures (Hofstede 1980) to predict the rate and mode of entry of multinational firms into specific host markets (Kogut & Singh 1988; Hennart & Park 1993).

The chapters in this book contribute to the development of deep insights into the influence of all four types of institutions on firm strategy, and vice versa. Even more exciting, many of the chapters set forth into new terrain regarding the *interactions* across types of institutions as well as their relationship to strategy. For example, Zenger, Lazzarini and Poppo propose a novel and compelling extension to the theory of the firm by considering interactions between private-centralized and private-decentralized (or “formal” and “informal”) institutions. Starting from a few basic assumptions about differences in the characteristics of each of these types of institutions, they develop a series of bold propositions that potentially resolve several puzzles in the strategy and organization literature. The authors argue that although an organization cannot quickly alter private-decentralized institutions through the usual methods of changing formal organization structures, such formal changes can spark gradual changes in such norms. Coupling this argument with the common assumption that formal organizational structures are discrete (and hence can not be incrementally tweaked to achieve an optimal form), they provide a rationale for the seemingly constant oscillation of structures that many organizations demonstrate (Nickerson & Zenger 2002).

But the best way for us to convey what the new institutionalism can do for strategy research is to describe in detail the layout of this volume.

SPECIFIC RESEARCH QUESTIONS, AND THE LAYOUT OF THIS VOLUME

The above discussion noted general insights that can be fruitfully drawn from the new institutionalism into strategy research. We have organized the volume so as to highlight insights related to specific research questions in strategy. In their manifesto for the strategy field, Rumelt, Schendel & Teece (1994) suggest four fundamental questions in strategy research: 1) How do firms behave? 2) Why are firms different? 3) What limits the scope of the firm? 4) What determines success or failure in international competition? New institutional research, and in particular the research in this volume, speaks to each of these questions.

How do firms behave? Or, do firms really behave like rational actors, and, if not, what models of their behavior should be used by researchers and policy makers?

In “Policy and process: A game-theoretic framework for the design of non-market strategy,” Guy Holburn and Richard Vanden Bergh adopt a far-sighted rational action lens to explore interactions among agents of the state and their effect on how firms should try to influence legal/institutional framework. Expanding on positive political theory models of lobbying in the U.S., they demonstrate that different agents –

regulatory agency officials, legislators, other elected officials – become the pivotal actors depending on the distribution of preferences across these actors. Thus, a firm that wishes to influence a specific regulation should not necessarily lobby the regulator directly, but in many cases will need to direct its lobbying efforts towards other political actors.

In “Managerial decision-making in non-market environments: A survey experiment,” John de Figueiredo and Rui de Figueiredo test the assumption that managers are able to pursue far-sighted rational action. Noting that a large body of experimental literature raises questions about the rationality of managers, they conduct a series of experiments designed to test the ability of managers to make “optimal” decisions about activities designed to influence legal institutions, such as investing in lobbying activity. Their results indicate that although managers are competent at making optimal decisions when confronted with simple, single-stage problems, managerial decisions deviate significantly from optimal choices as problems become more complex.

In “Pretty pictures and ugly scenes: Political and technological maneuvers in high definition television,” Glen Dowell, Anand Swaminathan, and Jim Wade study institutional change regarding the allocation of broadcasting spectrum in the U.S. They provide a case study of the various attempts by television broadcasters to fight FCC regulations in the mid-1980s that would take away unused spectrum from broadcasters and allocate it to other uses such as cellular communication. Initial attempts to get Congress to overturn this regulation foundered, due both to the difficulty of overcoming a “collective action” problem among the diverse broadcasters and to the lack of a resonant “frame” to motivate Congress. Yet subsequent attempts succeeded, once the broadcasters found a way to frame their need for spectrum in terms of U.S. manufacturing competitiveness vis-à-vis Japan, a particularly resonant frame in the late 1980s. Dowell et al. explain these outcomes through the lens of social movement theory, and particularly the role of framing problems in ways that motivate desired action. Rather than far-sighted rational actors, the managers and policymakers in this lens are characterized by subjective perception, and the institutional outcome is determined during the battle to socially construct the frame of the institutional change.

In “The evolution of university patenting and licensing procedures: An empirical study of institutional change,” Bhaven Sampat and Richard Nelson take a still different view of actors’ behavior and motivation. Drawing on a routine-based view of organizational action, they argue that actors develop “social technologies” to manage their various activities. As these social technologies diffuse and harden into standardized patterns of behavior, they become institutions. Hence, institutions arise through the boundedly rational attempts of actors to solve problems, notably problems associated with production and exchange. Sampat and Nelson study the diffusion of different social technologies used by universities to manage their patenting and

licensing activities, culminating in the technology transfer office commonly found at research universities today. Interestingly, they note that the diffusion of this institution was facilitated by the passage of the Bayh-Dole Act of 1980, for which universities actively lobbied – and the motivation for which seems to have been based on erroneous and inaccurate evidence of a university-industry technology transfer “market failure.”

Thus the four chapters in this section all focus on firms’ efforts to influence public and/or private institutions, and each takes a slightly different perspective on the fundamental strategic question: How do firms behave? It is interesting to note that this difference mirrors the differences in strategy literature writ large. But the consecutive presentation of these perspectives in this volume is informative in a way that heterogeneity in the broader literature is not. The papers here point to the fact that styles of choice depend on their context. The types of institutions that most constrain an actor greatly affect the appearance of the actor’s decisions. Actors attempting to influence the complex, but well-defined institutional structure represented by the U.S. government may seem intentional and calculative, but occasionally confused. When culture is the object or key constraint, decisions follow different styles because the rules of decision-making are different. For example, the symbolic value of behavior may become more important.

Why are firms different? Or, what sustains the heterogeneity in resources and performance among close competitors despite competition and imitative attempts?

In “Competition, contingency, and the external structure of markets,” Ron Burt, Miguel Guilarte, Holly Raider, and Yuki Yasuda explore the implicit institutional foundation of market structure among industry competitors. They propose and demonstrate a network-based measurement of “effective competition” among rivals. They find that an apparent puzzle in prior literature can be explained by incorporating effective competition. Specifically, prior research has found that strong corporate culture is only erratically associated with firm performance. Burt et al. demonstrate that the relationship between corporate culture and firm performance is contingent on the level of effective competition faced by the firm – in highly competitive markets, strong culture enhances performance, while in low-competition markets culture has no impact on performance.

In “Institutional change in ‘real-time’: The development of employee stock options in German venture capital contracts, 1997 to 2000,” Jonathan Jaffee and John Freeman analyze the attempt by several young German law firms to gain legal clearance to implement “American-style” employee stock ownership plans for their clients who were start-up and venture capital firms, and the opposition to this from several large, well-established law firms who did less work with start-ups. Conceptually, their study shows how firms can influence the institutional framework – in this case, concerning the legality of certain stock compensation policies – to further

entrench their relative advantages over competitors. Institutions (and the ability to enact institutional change) thus become central features explaining sustainable performance differences among firms.

In “Institutional barriers to electronic commerce: An historical perspective,” Karen Clay and Robert Strauss study several historical precedents to Internet commerce. They note that Richard Sears, and later various credit card companies, faced challenges of opportunism associated with remote commerce that sound very familiar today, and they analyze the emergence of several institutions that ameliorated such opportunism in the past. In addition to pointing us toward institution-based solutions to the challenges facing current Internet businesses, Clay and Strauss underscore the competitive advantage that can accrue to a firm, or a group of firms, that successfully undertakes institutional innovation. By “solving” the remote commerce problem, Sears was able to grow quickly to dominate the mail order business in the late nineteenth century; thus, Sears’s institutional innovation provided the firm with a first-mover advantage that endured for nearly a century. Those businesses that establish private institutions to solve current challenges to Internet commerce may similarly enjoy enduring performance benefits. And, as in the preceding chapter, Clay and Strauss argue that performance differences between Internet- and brick-and-mortar businesses will turn largely on the outcome of battles over broad institutional issues such as taxation of Internet commerce.

These papers illustrate that sound new-institutional arguments are in the spirit of Henderson & Mitchell’s (1997) call for research that explores interactions between market effects and internal capabilities, Burt et al.’s study demonstrates how the competitive environment influences the value of a organization-specific institution (culture). Similarly, Jaffee & Freeman emphasize the significance of compliance between organizational form and the institutional environment. This valuable compliance creates strategic opportunities for organizations to manipulate the institutions that surround them. Finally, Clay and Strauss remind us that, given the appropriate market structure, a firm’s institutional innovations can potentially provide a source of sustained competitive advantage.

What limits the scope of the firm? Or, what is the function of or value added by the headquarters unit in a diversified firm?

In “Informal and formal organization in new institutional economics,” Todd Zenger, Sergio Lazzarini, and Laura Poppo note that prior scholarship on the theory of the firm has largely focused on either formal institutions such as contracts, or on informal institutions such as norms, and rarely on the interactions between the two. Beginning with a few basic assumptions about the characteristics of each type of institution, they explicitly analyze interactions between formal and informal institutions. Zenger et al. derive a series of startling propositions that potentially resolve a number

of puzzles that have challenged the theory of the firm over the last thirty years. Chief among these are 1) when will formal and informal institutions act as substitutes, and when as complements; 2) what explains some organizations' apparent predilection for cycling (and recycling) through organization structures frequently; and 3) what precisely limits the size of the firm? The chapter suggests a number of fruitful directions for empirical testing as well.

In "'Tests tell:' Constitutive legitimacy and consumer acceptance of the automobile, 1895-1912," Hayagreeva Rao explores the growth in consumer acceptance of the automobile in the years following its initial commercialization. In particular, he examines the role of several activities - both those managed by the firm, such as advertising, and those propelled by actors outside the firm, such as auto demonstration races sponsored by social movement-like organizations of car enthusiasts - on auto sales. This study contributes a novel look at the way that social movement theory may explain the effectiveness of particular public-decentralized institutions, such as auto clubs. It also demonstrates how advertising and social movement things are differentially effective at different times, and also work as substitutes. As such, the chapter provokes consideration of the conditions under which a firm should strategically consider mobilizing forces outside its formal boundaries to enhance its competitive strategy.

These papers suggest a reframing of the definition, often used in strategy, of the firm as a nexus of contracts. It may be more useful to consider the firm as a nexus of institutions. This broader characterization takes explicit account of the multiple institutional forms that affect behavior or and within organizations. A more strategically tractable understanding emerges by recognizing the multiple institutional forms that constitute organizations--law, culture, norms, and rules. As Zenger et al. show, an organization is not merely the agency-theory driven rules of employment, but also the norms that are associated, but not completely coupled to them. As Rao shows, organizations have cultural identities that are separate from their product profiles, but fundamental to their effectiveness.

What determines success and failure in international competition? Or, what are the origins of success and what are their particular manifestations in international settings of global competition?

In "Learning about the institutional environment," Witold Henisz and Andrew Delios note that prior literature on FDI typically treats firms as homogeneous while examining the relationship between FDI and national variation, or treats national institutions as homogeneous while examining the firm variation-FDI relationship. They explore the joint roles of heterogeneous firm experience and heterogeneous institutional environments in explaining the direction and mode of foreign direct investment. In their framework, a firm's experience provides firm-specific knowledge

that moderates the influence of variation in institutional environment, thus leading multinational corporations with different patterns of experience to pursue different entry strategies and expect different performance outcomes in international competition. By recognizing variation in both firm experience and institutional environments, they are able to propose a wide range of empirically refutable implications that significantly extend current strategy research on international business.

In "Institutions and the vicious circle of distrust in the Russian market for household deposits, 1992-1999," Andrew Spicer and William Pyle explore the apparent failure of public and private institutions in Russia to support the development of a private market for household savings deposits. They analyze the events associated with these development attempts, and argue that the initial "institutional backdrop" at the birth of this sector contributed to a self-reinforcing cycle in which private commercial banks were unable, either individually or collectively, to win the trust of potential depositors. Of particular interest to strategy researchers, their research demonstrates how several traditional strategic prescriptions are implicitly predicated on deep assumptions about the institutional backdrop. For example, although advertising is often seen as an investment to demonstrate high quality, Spicer and Pyle suggest that in Russia, where consumers had a low level of market savvy and where regulatory institutions were not set up to enforce certain behaviors among banks, advertising apparently had either no relationship, or even an inverse relationship, with bank quality. Their analysis reinforces our understanding of the difficulty of simply "porting" from one nation to another successful businesses, or even successful institutions, without the appropriate supporting institutional backdrop.

These papers point the way towards a theoretically-informed refinement of the international business environment. They illustrate that every country represents a complex web of characteristics. Traditional ideas of "foreign and local" or one dimensional characterizations of a country (e.g., collectivist or individualist; common-law or Napoleonic Code) are insufficient. But beyond that point, which should be uncontroversial, new-institutional theory can pave the way for a rigorous analysis of the multi-faceted institutional environment that each country represents. Indexes of institutional stability or the environment for investing (e.g., Henisz, 2000) present a real opportunity for both researchers and strategists to incorporate institutional sophistication into their country-characterizations.

THE LAST WORD

We hope that this volume will inspire scholars of both the new institutionalism and of strategy to explore the exciting research opportunities lying at the juncture of these fields. To the extent that it does, we are convinced that the methodological approaches demonstrated in this volume provide brilliant guideposts for such work. Let's do this again in ten years and see what we have wrought!

NOTES

¹ For example, at the Columbia Business School, the active policy is that the required strategy course in the MBA curriculum should not use any teaching case that is more than two years old. Other required courses do not have this policy.

² Some seemed even to believe that the topic required new forms of scholarship. We are aware of one unfortunate full professor at a top-twenty U.S. business school who changed his title from “Professor of Strategy” to “Professor of New Economy.”

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