Institutional Theory

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Abstract

This chapter investigates the term institutions and institutional theory itself. It explores the boundaries of institutional thought by delving into the conceptualization of institutions and the diverse landscape of institutional theory. The chapter engages in a broader examination of the literature on institutions, emphasizing the various 'approaches' to institutional theory and underscoring how these approaches shape the theorized impact of institutions. The contention is that specific institutional approaches offer distinctive theoretical perspectives for comprehending the institutional environment and analyzing their potential influence.

Keywords:

Institutions; Institutional Theory; New Institutional Economics; New Organizational Institutionalism; Comparative Capitalism

Key Points:

- The term 'institutions' carries varying meanings for researchers depending on its context of use and institutional theory approach.
- The concept of institutions is broad, exhibiting a diversity of meanings and, as a result, often presents challenges.
- The three major scholarly areas where the institutions term is utilized: economics/business, sociology, and political science.
- From a New Institutional Economics (NIE) standpoint, institutions are defined as "humanly devised constraints, informal constraints, and their enforcement characteristics."
- For New Organizational Institutionalism, institutions are regarded as established patterns of acting and transacting, originating from shared 'regulative, cognitive, and normative frames.'

- Comparative Institutionalism approaches aim to discern substantial intrinsic differences among capitalist nations, viewing institutions as "distinct national configurations that generate a particular systemic logic of economic action."
- For International Business, "institutions" encapsulates concepts from different institutional theory strands, resulting in varied, theoretically contingent, complex definitions of their impact on multinational firms.
- How one sees the institutional context depends on one's definition and approach of institutions.

1. Introduction

This chapter investigates the term institutions and institutional theory itself. It explores the boundaries of institutional thought by delving into the conceptualization of institutions and the diverse landscape of institutional theory. The chapter engages in a broader examination of the literature on institutions, emphasizing the various 'approaches' to institutional theory and underscoring how these approaches shape the theorized impact of institutions. The contention is that specific institutional approaches offer distinctive theoretical perspectives for comprehending the institutional environment and analyzing their potential influence. The primary goal of this chapter is to foster an understanding of 'institutions,' examining their impact in the realm of economic agency while explaining the multitude of potential institutional approaches. This chapter then extends to discuss institutional approaches and applications within International Business (IB). For IB, institutions encapsulates concepts from different institutional theory strands, resulting in varied, theoretically contingent, complex definitions of their impact on multinational firms. This chapter defines and illustrates why 'understanding the breadth institutional theory' is imperative when considering the definition and impact of institutions.

2. Institutions and Institutional Theory

> "Institutional theory is not a homogenous domain but characterized by a wide plurality of approaches that provides a range of potential analytical perspectives and definitions of institutions."
>
> (Woodhouse & Johnston, 2023, p. 663)

2.1 Understanding 'Institutions'

Without a shared understanding of how others will respond and the effectiveness of sanctions in addressing potential opportunistic behavior, interpersonal and business interaction becomes impossible (North, 1987; 1991; Hodgson, 2007). Economic actors, such as firms, engage in transactions only when they trust and have confidence that their expectations will be fulfilled. The exchange between agents, often repetitive and frequent, necessitates predictability, smoothness, and security. This demand for reliability in exchanges embodies what is termed 'transactional trust.' Consequently, human interactions, whether economic or non-economic, rely on various forms of confidence established by rules and regulations that guard against unpredictable and opportunistic conduct. Emerging from institutional theory, these rules and regulations are collectively known as 'institutions.'

The study of institutions derives from institutional theory. In the realm of social sciences, institutional theory has emerged as a prominent area of interest, providing fresh analytical perspectives for scholars in business management, economics, sociology, and political science. While the application of institutional thought has been diverse, its primary focus lies in explaining and examining the broader economic, social, and cultural environment and their impact on behavioral and economic outcomes (Scott, 2008; Kenworthy, 2006; Jackson & Deeg, 2008; Hodgson, 1998; 2001). In this way, institutional theory has introduced a novel viewpoint to many advancing social sciences, challenging established arguments that have become the accepted norm in mainstream disciplines, such as neoclassical economics and business management (North, 1990; Hodgson, 2001). Given the complexity and evolution of the economy, institutional theory naturally diverges from the neoclassical economics notion of equilibrium as an enduring state.

The term 'institutions' carries varying meanings for researchers depending on its context of use. Despite its central role in theoretical claims, the definitions and interpretations of the term remain diverse and diffuse, largely influenced by the disciplinary context in which it is employed. The concept of institutions is broad, exhibiting a diversity of meanings and, as a result, often presents challenges (Jackson & Deeg, 2019; Redding, 2005). Unfortunately, there is no universally agreed-upon definition for 'institutions.' To provide a clearer understanding, this section gives a brief exploration of the central themes, concepts, and insights from the three major scholarly areas where the institutions term is utilized: economics/business, sociology, and political science. These three disciplines form the core foundation of the 'neo-institutionalist' approach to institutional theory, in contrast to the much debated and critiqued wave of 'old institutional theory' rooted in the work of Veblen (1898).

In the field of economics and business, institutions have made a substantial contribution, particularly through the lens of 'New Institutional Economics' (NIE), rooted in the works of Coase

(1937), North (1990), and Williamson (1975). This perspective underscores the significance of institutions in the economic system. NIE recognizes that institutional factors play a pivotal role across all levels of the economy, encompassing the structure and functions of firms, the serving of markets, and the diverse forms of state intervention. From an economic standpoint, institutions are defined as "humanly devised constraints, informal constraints, and their enforcement characteristics" (North, 1994, pg. 360). These institutions consist of both written and unwritten rules, norms, and constraints that humans create to mitigate uncertainty and regulate a given environment, thereby shaping the 'incentive structure' of economies and societies. This structure is grounded in (i) written rules and agreements governing contractual relations and corporate governance, (ii) laws, constitutions, and regulations that govern society and its functions, including government, politics, and finance, and (iii) unwritten codes of conduct, beliefs, and behavioral norms. In this context, institutions serve as the "rules of the game" (North, 1990), comprising of both formal and informal institutions. They enable and constrain how businesses act.

Sociologists approach institutions with a distinct viewpoint, as exemplified by their 'new organizational institutionalism' approach. Derived from the core of organizational theory and sociology, this perspective places emphasis on organizational forms and practices rather than the national level 'rules of the game.' By reinterpreting economic action as social action, sociology underscores the persuasive and crucial role of social institutions in business and economic life. In this context, institutions are regarded as established patterns of acting and transacting, originating from shared 'regulative, cognitive, and normative frames' (Morgan & Kristensen, 2006). The dissemination of common rules, traditions, and norms among organizations and business leads to the institutionalization of organizational forms, primarily due to the associated rewards. Adhering to conformity or 'institutional isomorphism' (DiMaggio & Powell, 1983) enhances organizational legitimacy, yielding benefits from resources and transactions that ultimately prolong the organization's survival (Meyer & Rowan, 1977). These institutionalized behaviors are guided by normative pressure and cognitive thought systems (Scott, 1995; 2008), as opposed to the formal institutions perspective of New Institutional Economics (NIE).

Political scientists adopt an alternative institutional approach, which is divided into two subdisciplines: 'comparative governance' and 'political economy.' These subdisciplines offer distinct perspectives on how political science view institutions. In the case of the comparative governance approach, institutions are defined as "legal frameworks and administrative arrangements characterizing particular governance structures" (Scott, 1995, p. 6). From this standpoint, institutions are understood within the context of 'governance,' encompassing diverse forms such as constitutions, bureaucracies, parliamentary norms, and legal methods. These components collectively form the governance structures that influence political, social, and business behaviors.

In contrast, political science approaches rooted in 'political economy' exhibit variations, particularly within the realm of 'comparative institutionalism,' also known as comparative capitalism. This perspective focuses on evaluating the institutional effectiveness of constituent sub-spheres that together form the economic environment. Essentially, comparative institutionalism seeks to elucidate and characterize the diversity in the socioeconomic institutional framework across countries. In a formal sense, political economy approaches aim to discern substantial intrinsic differences among capitalist nations, viewing institutions as "distinct national configurations that generate a particular systemic logic of economic action" (Hall & Soskice, 2001; Jackson & Deeg, 2008). Capitalism manifests in various institutional forms and arrangements, with national distinctions in institutional organization influencing political, social, and business/economic actions. From this standpoint, institutions are significant because societal institutions offer distinct resources, competencies, and normative practices to agents operating within that context. However, it is the diversity of these 'institutional configurations' that fosters unique yet divergent patterns of economic and technological specialization (Hall & Soskice, 2001; Allen 2013).

While there are diverse definitions of institutions, a common thread emerges in terms of the overarching impact of these structures. Essentially, institutions serve to both enable and constrain the activities of agents, whether they are firms, individuals, or nation-states. These structures establish general incentive frameworks that facilitate business/economic, social, and political interactions, operating across diverse classifications and levels. In doing so, institutions create incentives for specific courses of action, functioning as both agents of structure and catalysts for change (Noseleit, 2013). Nevertheless, it is the abundance of varied institutional definitions and meanings that provides researchers with the potential for a multitude of analytical approaches to institutions, yet one that fails to offer one definition of institutions.

2.2 Plurality of Institutional Theory and Approaches

Considering institutional theory as a singular body of theory results in a significantly misconstrued comprehension of the extensive and diverse of institutional literature. Theoretically, three major categories of approaches can be discerned in the study of institutions within the context of business management. These include the new institutional economics approach, the new organizational institutionalism approach, and the comparative institutionalism approach.

2.2.1 New Institutional Economics (NIE)

Rejecting the conventional neoclassical assumption that individuals possess perfect information, unbounded rationality, and an inclination for instantaneous market transactions, 'institutional economics' has introduced a valuable departure from the mainstream approach to analyzing economic systems and economic actors, such as firms. In this perspective, institutional economics offers an alternative viewpoint, asserting that individuals operate with incomplete information and limited cognitive capacity, contingent on the 'bounded' information available to them. Consequently, market participants contend with uncertainty regarding unforeseeable outcomes, leading to the incurrence of 'transaction costs' to acquire information. In an effort to mitigate risks and transaction-related expenses, humans establish institutions, encompassing formal entities like regulations, laws, and contracts, as well as informal elements like belief patterns, thought habits, and cultural norms. This endeavor to integrate the analysis of institutions into economic thought gave rise to new methodological approaches within economics, now recognized as 'New Institutional Economics' (NIE).

Primarily pioneered by notable economists such as Thorstein Veblen (1898), Mitchell (1910), and Ayres (1944), these American scholars are regarded as the founding figures of what is now known as 'old institutional economics.' It was these distinguished economists who examined the framework of laws and prevailing thought patterns that influence individuals' interactions, thereby shaping economic behavior. In essence, institutions play a crucial role in determining economic performance.

This foundational concept was further developed by the seminal works of Douglas North (1987; 1991), Oliver Williamson (1975), and Ronald Coase (1937; 1960), forming the key theoretical foundation of 'New Institutional Economics' (NIE). As a means to offer a more comprehensive approach than mainstream economics, NIE emphasized the theme of transaction costs. These costs introduce frictions to economic exchange, fundamentally influencing both production and transactions, and consequently, economic outcomes (Coase, 1937; North 1991).

More specifically, the shift towards analyzing the frictions associated with economic/business exchange provided insights into the specificity of assets involved in a transaction. These 'specificities of assets' (also known as ‘asset specificities’) give rise to non-market transactions, particularly in the form of hierarchical exchange, as seen in the establishment and growth of firms. This nuanced approach in microeconomics contributes to understanding why firms are formed, known as the 'theory of the firm.' In turn, NIE has emerged as a prominent heterodox approach challenging the core assumptions of neoclassical theory, where markets are envisioned as frictionless and the sole, rational means of coordinating behavior through perfect information available to all agents.

While the New Institutional Economics (NIE) is commonly associated with the scholarly contributions of Williamson (1981), North (1991), and Coase (1937), its impact extends significantly into adjacent disciplines like developmental studies and business management. By highlighting the pivotal role of institutions and their conceptual influence on behavior, NIE offers a potent and micro-analytical framework for investigating institutional impacts within the realm of social science. Unlike traditional economic approaches, which are considered 'static,' NIE advocates a dynamic perspective in studying economic life (Menard & Shirley, 2005), thereby mobilizing economics and institutional theory for practical applications in distinct disciplines (Hodgson, 2007).

In a formal sense, NIE delves into the study of institutions and their interactions with organizational arrangements. In this context, institutions encompass both written and unwritten norms, rules, and constraints crafted by humans to reduce uncertainty and exert control over their environment (Menard & Shirley, 2005). They are described as the "rules of the game in a society" (North, 1991, pg. 3), determining human agency to coordinate societal actions.

Analytically, NIE proposes that the nature of exchange processes and various market 'frictions' depends on the institutional context in which they occur. For institutional economists, the institutional context - also referred to as the 'institutional framework,' 'institutional regime,' or 'institutional environment' - comprises 'one-best-way' sub-institutions that regulate the economic behaviors of individuals and the strategic 'fit' of organizations. This includes systems of informal conventions and routines, alongside formal regulatory structures that constrain and control socioeconomic behavior. Specifically, the effectiveness of private property rights and contract enforcement within the institutional environment affects the level of transaction costs (Williamson, 1975; Coase, 1937). The institutional context essentially "dictates the margins at which organizations operate" (North, 1991, p. 110) and serves as a valuable vantage point for understanding the actions of economic agents, primarily businesses. From this standpoint, the institutional environment is perceived as a set of overarching structures establishing the foundation for economic exchange and production (North, 1991).

In the realm of new institutional economics (NIE), institutions encompass both formal and informal elements (North, 1991). Formal institutions involve roles played by constitutions, rules, regulations, and contracts, while informal institutions encompass norms, values, and customs influenced by more enduring cultural and religious patterns. Although NIE recognizes the presence of both formal and informal institutions, its application has primarily leaned towards the exploration of formal concepts. Specifically, there has been a significant focus on understanding how rules and regulations impact the choice of governance arrangements for organizing economic activities.

A crucial distinction between 'old institutional economics' and 'new institutional economics' lies in the perspective on institutions' role. The Veblen (1898) viewpoint argues that institutions serve as conditioners of individuality rather than mere configurations for adaptive constraining. According to this view, individuals shape their institutional creations independently of cultural preferences (Mayhew, 2008), treating informal institutions as constants. From the NIE perspective, the institutional regime influences which governance arrangement minimizes exchange friction (hence deemed most 'efficient'). Consequently, NIE is often perceived as offering a converging and 'narrow' view on institutions (Woodhouse & Johnston, 2023). Given the linear nature of transaction costs, the institutions providing the highest efficiency are considered the 'best.' This leads to the notion of a 'one best set' of institutions, often aligned with more 'market' and 'liberal' orientations in formal institutions (Rodrik, 2008), often synonymous with ‘Western’ economies and organizations.

The key conceptual anchor for New Institutional Economics (NIE) lies in market-oriented institutions, as these institutions exert influence on economic performance and shape economic/business activities (Williamson, 1975). Consequently, NIE has often been linked with 'liberalization' in public policies, aligning with the idea that the 'best' institutions are those that introduce minimal distortions to economic exchange, thereby maximizing the productive efficiency of the economy. At a broader level, institutions establish the context within which all individuals operate. The fundamental unit of analysis is the cost nature of transactions, with the economization of 'transaction costs' achieved by assigning transactions to governance structures in a selective manner (Williamson, 1975).

In a country, institutions determine the feasibility of engaging in specific forms of economic activity, such as foreign direct investment, by influencing the costs of transactions and production (Coase, 1998). 'Effective' institutional regimes are the exclusive means of reducing transaction costs by eliminating the need for ex-ante expenses, especially in the absence of sufficient 'transactional trust.' Consequently, high transaction costs exert an overall negative impact on economic productivity and, by extension, economic growth (North, 1990). Therefore, the analysis of transaction costs posits that institutions play a central role and purpose in economizing transaction costs. Alternatively, transaction costs offer a natural analytical standpoint for comprehending how institutions influence the actions and agency of economic agents, considering transaction costs as the "cost of running the economic system" (Williamson, 19 75), thereby adopting a liberal 'best way' perspective (Rodrik, 2008).

2.2.3 New Organizational Institutionalism

Grounded in sociology and organizational theory, 'organizational institutionalism' perceives institutions as intra-organizational forms, practices, and activities enforced through coercive, mimetic, and normative mechanisms (DiMaggio & Powell, 1983; Scott, 1995). By concentrating on organizational practices and structures, organizational institutionalism offers a more nuanced, organization-level approach that goes beyond the national-level perspective predominant in new institutional economics. Its conventional understanding of institutions as organizational structures has brought greater relevance to the analysis of the dissemination of organizational patterns and the exploration of various similarities and differences in organizational practices.

This perspective has given rise to literature exploring the internal and external legitimacies of firms (e.g., Kostova & Zaheer, 1999; Kostova & Roth, 2002), sparking a productive strand of applications within organizational institutionalism. While somewhat less explicit, the essence of organizational institutionalism becomes clearer when comparing the 'old' organizational institutionalism to the distinctions present in the emerging 'new' organizational institutionalism.

A cohort of early organizational institutionalists, particularly Selznick (1949; 1996) and Clark (1960; 1972), is widely regarded as the pioneers of 'organizational institutionalism.' In contrast, the 'new' organizational institutionalism is characterized by approaches led by DiMaggio & Powell (1991) and Scott (1995). According to Selznick (1996) and Clark (1960, 1972), organizations develop distinctive patterns of characteristics in both practices and competencies. Practices become 'institutionalized' through the interplay between the internal and external environment, shaping the unique 'character' of individual organizations. The distinct organizational forms become deeply entrenched creations due to the nature of path-dependent institutionalization, providing insulation against external pressures for conformity (Selznick, 1996). Old organizational institutionalism perceives the process of institutionalization as an adaptive mechanism for organizations (Selznick, 1996), creating orderly and socially integrated patterns that ensure internal legitimacy and stability.

The primary point of contrast between old and new organizational institutionalism perspectives lies in the locus of institutionalization - whether it occurs within a particular field or within specific individual organizations. For old organizational scholars, institutions are seen as intra-organizational patterns promoting a specific activity format, with the organization being the primary analytical focus (Ranson et al., 1980). In contrast, new organizational institutionalism views institutionalized forms of the organization as part of a broader set of shared belief systems (Scott, 1995). Consequently, new organizational institutionalism employs its perspective to explain the homogeneity of forms and practices found within organizations. This stands in direct contrast to 'older' forms of institutionalism, which seek to emphasize differences between organizations through the lens of institutionalization.

In explaining organizational uniformity, new organizational institutionalism regards institutions as "taken for granted ways of acting, which derive from shared regulative, cognitive and normative frames" (Morgan & Kristensen, 2006, p. 1470). Rules and norms collectively constitute a shared set of belief systems that are prevalent across all organizations, with the institutionalization of forms and conventions being steered by the organizational 'field' rather than individual organizations (Powell & DiMaggio, 1991). According to Meyer and Rowan (1977), as organizational conformity results in a 'reward' through increased organizational legitimacy, organizations strive for institutionalized convergence in pursuit of financial benefits. Organizational conformity, facilitated by internal legitimacy, grants organizations access to resources, ultimately ensuring organizational survival (Kostova & Roth, 2002; Meyer & Rowan, 1977). These pressures are commonly referred to as 'institutional isomorphism,' explaining the convergence in organizational structures and forms.

While new institutional economics posits that economic actions are constrained by formal institutions, scholars in new organizational institutionalism argue that social behavior is additionally influenced by normative and cultural 'scripts' (Scott, 1995; 2008). This naturally establishes a contrast in institutional focus and application, contingent on the discipline at hand.

The existence of isomorphic pressures, leading to a distinct character of organizational forms shaped by their institutional environment, has generated criticism similar to the determinist perspectives found in institutional economics (Tolbert & Zucker, 1999). Seeking a more dynamic perspective within organizational institutionalism, Holm (1995) and Seo & Creed (2002) propose a counter-intuitive viewpoint, emphasizing how actors can influence and alter their deeply embedded environment. They argue that the presence of contradictory institutional logics offers actors choices, creating pressures that can reverse the processes of institutionalization (Oliver, 1992). Instead of conforming to the institutional environment, as the determinist view suggests, actors may opt to 'manipulate' or 'defy' them (Dacin et al, 2010). Consequently, in situations where the institutional environment introduces unstable institutional logics, actors may act as 'institutional entrepreneurs,' striving to influence the legitimacy of organizational forms and practices (Garud et al, 2007).

At a more practical level, the advancement of new organizational institutionalism has predominantly stemmed from the contributions of Kostova and co-authors (1997; Kostova and Zaheer, 1999; Kostova and Roth, 2002). Their work posits that the increasing institutional 'duality' across diverse institutional environments heightens the organizational and business pressure to uphold both internal and external legitimacy. Consequently, this diminishes the effectiveness of organizations operating in multiple country contexts. New organizational institutionalism suggests that the expanding variance between the home and host institutional environments exerts pressures on organizations to uphold organizational legitimacy (Kostova & Zaheer, 1999).

The greater the institutional 'duality' experienced by local subsidiaries, the more complex the challenges faced by organizations. This complexity hampers the effective transfer of organizational practices to foreign affiliates (Kostova & Roth, 2002), resulting in a lack of effective cognitive, normative, and regulative frames. The pressures to maintain internal and external legitimacy explain entry mode decisions (Davis et al., 2000; Meyer, 2001) and the location strategies of multinational enterprises (Xu & Shenkar, 2002). Additionally, this institutional approach has been employed to elucidate the international variation in organizational practices, such as corporate social responsibility (CSR) measures and human resource (HR) procedures (Gaur et al., 2007).

2.2.3 Comparative Institutionalism & Comparative Political Economy

In contrast to other branches of institutional theory, the core idea behind comparative institutionalism perspectives is that diverse socioeconomic models do not represent nearly identical versions of the same 'market capitalist economy' nor a random assembly of economic institutions. This perspective challenges the notion that there is a single 'right' growth model for maximizing economic performance, as pursued by current governments, and rejects the idea that structural reform should aim for homogenized liberalization and deregulation. Capitalism as a political economy, in this view, is perceived as consisting of institutionally varied production regimes, adopting diverse institutional configurations and forms. Therefore, replicating identical institutional areas (such as institutional sub-spheres or domains) across different political economies would not result in identical growth trajectories, especially considering path dependencies and institutional complementarities (Amable et al., 2011).

A fundamental principle of comparative institutionalism is that societal institutions influence the organization of economic activities and, consequently, various organizational, business and country-level outcomes (Jackson & Deeg, 2008; Hall & Soskice, 2001; Hotho, 2014). Here, institutions are identified by their 'divergence' and ‘diversity’ contrasting with the 'convergence' perspective of both new institutional economics and new organizational institutionalism (Woodhouse & Johnston, 2023).

Within the framework of comparative institutionalism literature, national political economies are characterized by the specific 'logic' of economic agency developed by distinct typologies of institutional configuration. This theory suggests that the character and interests of actors are conditioned by a given arrangement, influencing the development of actors' resources, strategies, and capabilities. In other words, comparative institutionalism proposes that institutions shape the 'supply-side' of a given economy, determining the collectivism of capitalist inputs (land, labor, capital, products) available to the businesses within it (Hancke, 2009).

The comparative institutionalism approach to institutional theory is built upon four key theoretical principles. Firstly, it emphasizes the complementarity and interdependence of institutional sub-spheres, where the presence and efficiency of one institution enhance the returns from another, giving rise to diverse paths of capitalist development. This distinguishes it from idiosyncratic studies and parallel streams of comparative economic analysis, asserting that the 'building blocks' of capitalism are functionally inter-reliant.

Secondly, institutional change is viewed as incremental and path-dependent, absorbing external pressures through 'institutional combination' and interdependence. Despite arguments for global convergence, the perspective suggests that change is more difficult, costly, and gradual, supporting the idea of 'equifinality' and challenging sociologically based arguments of 'institutional isomorphism.'

Thirdly, the literature on comparative institutionalism underscores institutional diversity, positing that distinct advantages or disadvantages exist for various economic activities. Different institutional configurations offer countries comparative advantages, influencing divergent patterns of economic activities and business specializations.

Lastly, with its interdisciplinary background, comparative institutionalism emphasizes the embeddedness of economic activity in a deep social context, contrary to the 'new institutional economics' focus on markets and hierarchies as prime governance mechanisms. It allows for the analysis of socio-politico-economic phenomena, coexisting with informal institutions of social networks and societal cohesion.

In summary, comparative institutionalism provides a nuanced understanding of the interplay between diverse institutional sub-spheres, incremental institutional change, the advantages and disadvantages of institutional diversity, and the broader socio-politico-economic context of economic activity. The crucial themes of these institutional approaches are captured within Table 1.

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3. International Business and Institutional Approaches

The importance of institutions in international business (IB) is widely recognized, yet the precise impact of institutions remains a debated and expanding area of study (Jackson & Deeg, 2019). Multinational enterprises (MNEs) navigate diverse external environments shaped by the extensive institutional diversity within the political economy landscape. These diversities play a defining role in establishing the institutional context, influencing a spectrum of economic actions and business activities. Consequently, the resurgence of institutions in IB has gained acknowledgment as a promising area for scholarly development. Scholars increasingly employ contextual and institutional arguments to explore this domain (e.g., Woodhouse & Johnston, 2023).

Critics of IB research have often pointed out deficiencies in how contextual factors are understood and approached (Redding, 2005). Recognizing that institutions form the contextual framework that impacts the "duality of firms" in foreign activities, integrating institutional perspectives has become imperative in advancing IB research.

However, how institutions influence IB outcomes depends on their conceptualization (Rana and Morgan, 2019). In the interdisciplinary realm of IB research, institutions are approached through the various disciplinary approaches highlighted, e.g. economics, political science, and sociology. The diversity of institutional approaches fuels debates on the meaning of institutions, which is contingent on the chosen institutional theory. Institutional theory, drawing from economics, political science, and sociology, encompasses the diverse theoretical and methodological perspectives explored beforehand. As one would therefore expect, the label "institutions" in IB encapsulates concepts from different institutional theory strands, resulting in varied, theoretically contingent, complex definitions of their impact on multinational firms. Some argue that IB has adhered to a "narrow" and "thin" understanding of institutions (Woodhouse & Johnston, 2023), focusing primarily on NIE institutional approaches with little attention to comparing institutional diversities.

Recognizing the importance of incorporating institutions into IB research has gained scholarly acknowledgment. However, there is still ambiguity in the application of institutional perspectives, leading to uncertainties in defining institutions and understanding their impact on multinational firms. Institutional theory is diverse, as outlined in the previous section, offering a variety of analytical perspectives and definitions within IB. This diversity presents a significant challenge as the term "institutions" in IB encompasses various approaches to studying and applying institutional theory (Woodhouse & Johnston, 2023).

Institutional approaches within the field of IB vary significantly in their conceptualization, level of analysis, and explanations of the relevance of institutions. The diversity of these approaches prompts a need to unravel and clarify the concept of institutions in IB. To enhance our comprehension of the role of institutions in IB, it is crucial to explicitly identify and acknowledge the institutional theories in use. This transparency establishes a credible connection between institutions and the IB phenomenon. Recognizing the diverse menu of institutional approaches empowers IB research to incorporate fresh theoretical perspectives and align research efforts with specific strands of institutional theory. Currently, IB research primarily draws from three main institutional approaches outlined in Section 2: (1) New Institutional Economics; (2) New Organisational Institutionalism; and (3) Comparative Capitalism.

3.1 New Institutional Economics in International Business

The prevailing institutional paradigm in IB research, NIE, is deeply rooted in microeconomics (Hodgson, 2007). For IB, this approach revolves around scrutinizing how the institutional environment can ensure private property rights and enforce contracts, ultimately minimizing the "transaction costs" associated with market transactions (Coase, 1937; Williamson, 1975). According to new institutional economists, institutions act as the national level "rules of the game," humanly crafted to shape societal interactions (North, 1991) and business decisions. Although NIE recognizes both formal and informal strands of institutions, the IB focus tends to be predominantly on formal institutions - rules and regulations influencing the choice of governance structures for organizing economic activities. From an IB standpoint, institutions gain significance as the formal and informal institutional framework of host countries directly impacts transaction costs and uncertainties encountered by multinational enterprises (MNEs) regarding resource acquisition, entry mode selection, and firm boundary decisions. Strong institutions, in this context, serve to reduce transaction costs and the level of uncertainty faced by firms (Meyer, 2001).

Considering this, NIE approaches have offered an IB framework for comprehending various issues such as subsidiary roles/performance (Chan et al., 2008; Chan and Makino, 2007), entry mode strategies (e.g., Brouthers and Hennart, 2007), export performance (He and Brouthers, 2013), and the explanation of firm boundaries (Coase, 1937). Referred to collectively within IB as the "strategic tripod," this institutional theory, in conjunction with the resource-based and industry-based perspectives, has conventionally underscored the interactions between institutions and firms, shaping specific strategic choices and performance outcomes (Peng, 2003; Koch, 2022). The NIE strand has played a pivotal role in addressing fundamental questions in the IB field, namely, the drivers of strategy in IB and the determinants of global firms' success and failure (Peng, 2003). With the growing focus on emerging markets, NIE now stands as a robust foundation for studying institutional change, adaptation, and transition (Nayyar and Prashantham, 2021).

3.2 New Organizational Institutionalism in International Business

Conversely, new organisational institutionalism directs attention to organisational forms and practices, diverging from the national-level "rules of the game" (DiMaggio and Powell, 1983, 1991). In this context, institutions represent established ways of acting and transacting rooted in shared "regulative, cognitive, and normative frames" (Morgan and Kristensen, 2006, p. 1470). The dissemination of common rules, traditions, and norms among organizations leads to the institutionalization of organizational forms, primarily driven by the associated rewards. Conformity, termed "institutional isomorphism" (DiMaggio and Powell, 1983), enhances institutional legitimacy, securing benefits from resources and transactions that ultimately contribute to institutional survival (Meyer and Rowan, 1977). This perspective takes a deterministic stance, prompting increased interest in understanding how "institutional entrepreneurs" manipulate and influence institutional forms, challenging isomorphic influences (Garud et al., 2007).

New organisational institutionalism posits that any divergence between home and host institutional environments compels multinational enterprises (MNEs) to uphold institutional legitimacy (Kostova and Zaheer, 1999). The pressures to maintain internal and external legitimacy offer insights into entry mode decisions (Vora and Kostova, 2007) and location strategies of MNEs (Xu and Shenkar, 2002). Scott's (1995) regulative, normative, and (cultural-) cognitive dimensions serve as the basis for constructing institutional country profiles, frequently employed in quantitative research within the framework of new organisational institutionalism-based IB studies (Urbano and Alvarez, 2014).

3.3 Comparative Capitalism and International Business

The third institutional approach, Comparative Capitalism (CC), emerging from socioeconomics and political economy, provides a distinctive perspective on understanding the diversity in the socioeconomic architecture of countries (Allen, 2004). Unlike NIE, which may view countries like Germany, the UK, and Norway as similar based on institutional effectiveness convergence, CC emphasizes significant differences in their political-economic structures, resource provision, and organizational control. CC aims to unveil intrinsic diversity among capitalist countries, elucidating how institutions matter for IB by providing unique resources, competencies, and practice norms to firms. The specificity of the host institutional environment influences challenges faced by firms during internationalization, transactions, and local linkages.

CC has been instrumental in studying institutional systems and their impact on IB-related outcomes like innovation, comparative advantage (Witt and Jackson, 2016), and corporate governance (Aguilera and Jackson, 2003). The concept of institutional drift within the CC framework has framed studies on multinational firms' institutional entrepreneurship, cross-national transfer of employment practices, and business group performance under state capitalism (e.g. Streeck and Thelen, 2005).

Despite being underrepresented in IB research, CC is argued to offer a fruitful institutional approach, focusing on the structures, forms, and functions of production regimes within political economies (Woodhouse & Johnston, 2023). It shifts the IB-institution nexus towards "institutional configurations," allowing IB to distil interdependent institutions into a cohesive framework. CC considers bundles of attributes in institutional domains, moving beyond one-dimensional variables and offering a nuanced understanding of institutional complexities and their diverse impact on specific business activities and decisions (Woodhouse & Johnston, 2023). This approach contrasts with the prevalent operationalization of institutions in empirical IB studies, often relying on indices measuring the "strength" or "quality" of institutional dimensions through sources like the World Economic Forum, World Bank, and Heritage Foundation.

4.0 Summary

This chapter reviewed key approaches to institutional theory. It began by defining and outlining the ontology of the term ‘institutions’, in a bid to then understand the broader role of institutions. From this perspective, the section has defined and illustrated why ‘understanding institutional theory’ is imperative when considering the impact of institutions within a particular domain. From here, the chapter then provided an overview of the topography of institutional approaches, for what defines a ‘menu’ of institutional theory. How one approaches institutions defines how ‘institutions matter’. This is then extended to the role of institutions and institutional theory in the domain of international business. This facilitates a contextual approach to international business in that economic action does not happen in isolation but indeed within the institutional setup. How one sees the institutional context depends on one’s definition and approach of institutions.

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