Engaging with the Plurality of Economics for Integrated Strategic Thinking

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Responsible Strategic Thinking for Business and Society: A Practical Guide

Engaging with the Plurality of Economics for Integrated Strategic Thinking

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Abstract

Strategy-making can be influenced by insights from economics. Economics as a subject is plural, and this chapter identifies two economic perspectives: Neoclassical Economics (the mainstream) and Institutional Theory. Neoclassical Economics' key concepts include Individualism, Instrumentalism, Equilibrium, Utility Maximisation, Rationality, Marginalism, and Profit Maximisation. Conversely, Institutional Theory highlights the role of institutions (society's norms, rules, regulations, and cultural expectations) in shaping economic behaviour and organisational outcomes. Each offer something unique for the Strategic Thinker.

Strategy-making, when guided by Neoclassical Economics, focuses on resource management, production optimisation, operational efficiency, and competitiveness to result in profit maximization. However, this short-term focus can lead to ethical dilemmas, environmental neglect, and a disregard for broader societal goals, necessitating the incorporation of more comprehensive considerations. Institutional Theory broadens strategic decision-making contexts by emphasising the role of institutions in shaping organisational behaviour, helping businesses to align with regulatory changes, cultural shifts, and societal expectations.

By integrating Institutional Theory, organisations become more adaptable, able to foster innovation and resilience in dynamic environments, and navigate long-term sustainability challenges. Aligning strategies with institutional expectations enhances organisational legitimacy, fostering trust and ensuring that businesses are more ethically and socially responsible. A case study explaining the effective application of Institutional Theory is included in this chapter.

In conclusion, integrating both Neoclassical Economics and Institutional Theory into strategy-making enhances both short-term performance and long-term sustainability. Strategic thinkers who leverage both frameworks can balance operational efficiency with ethical considerations, allowing for more comprehensive and robust decision-making. Understanding that economics encompasses more than just the mainstream offers novel insights for strategic thinking.

Key Points

- Neoclassical Economics rests upon several key foundational concepts: Individualism, Instrumentalism, Equilibrium, Utility Maximisation, Rationality, Marginalism and Profit Maximisation that shape its theoretical framework and analytical methods, offering several implications for strategy-making

- Institutional Theory counters neoclassical assumptions of perfect information and rationality, emphasising the constraints of incomplete information and transaction costs in economic behaviour.
- Varied institutional contexts, shaped by regulatory, cultural, and historical factors, significantly influence strategic decisions and economic outcomes, necessitating thorough institutional analysis for effective strategic thinking.
- Integrating Neoclassical Economics and Institutional Theory results in a strategy-making approach more aligned to the expectations of the Strategic Thinker.
- Integrating Neoclassical and Institutional approaches helps optimise short-term profitability while ensuring long-term sustainability.
- Institutional Theory helps anticipate social, cultural, and regulatory shifts, fostering more adaptable and resilient organizations.
- Integrating both frameworks encourages strategies that align financial success with ethical and social responsibility.
- Neoclassical models provide performance metrics, while Institutional Theory offers context through social and cultural understanding.

The Development and Key Meanings of Neoclassical Economics

When you hear "economics", we are really referring to a mainstream 'type' of economics called "Neoclassical Economics". Neoclassical Economics arose from a response to the shortcomings of classical economics and the marginal (more of this later, in 'Marginalism') revolution of the 19^{th} century (Neck, 2022). Neoclassical Economics represented a shift in economic thinking towards a more rigorous and systematic analysis of individual behaviour, market interactions, and resource allocation that laid the groundwork for modern mainstream economics.

In the late twentieth century, a small group of self-identified neoclassical economists (namely, George Stigler, Paul Samuelson, Milton Friedman, etc) actively shaped the discipline (Morgan, 2015; 2016). Neoclassical Economics rose to prominence by presenting itself as a scientific and objective discipline. Through the adoption of mathematical modelling and formal analysis, neoclassical economists established their work as the standard approach within the field of economics. This emphasis on rigour and precision lent credibility to their theories, allowing them to dominate both academic disclosure and policy discussions (Henry, 2012; Morgan, 2015; Neck, 2022). This is the 'core' of economics we know today.

It is important to note that 'Neoclassical Economics' continues to evolve and there are diverse interpretations within the field. It has meant different things to different authors, including:

(1) the subjective marginal utility theory of the 1870s onwards;

(2) the economic theories of Alfred Marshall;

(3) the works of the twentieth-century scholars, established by Marshall, Leon Walras and others;

(4) A combination of the above;

(5) The Samuelsonian neoclassical synthesis, merging microeconomic price and resource allocation theory with Keynesian macroeconomics, among others (Samuels, 1990; Henry, 2012; Neck, 2022).

The next section outlines the core principles of Neoclassical Economics to enable the strategic thinker to navigate its impact on society/life.

The Core Principles of Neoclassical Economics

Neoclassical Economics rests upon several key foundational concepts that shape its theoretical framework and analytical methods. Understanding these can offer a fuller understanding of how economics informs strategy-making.

Figure 1 demonstrates the fundamental pillars of neoclassical economics:

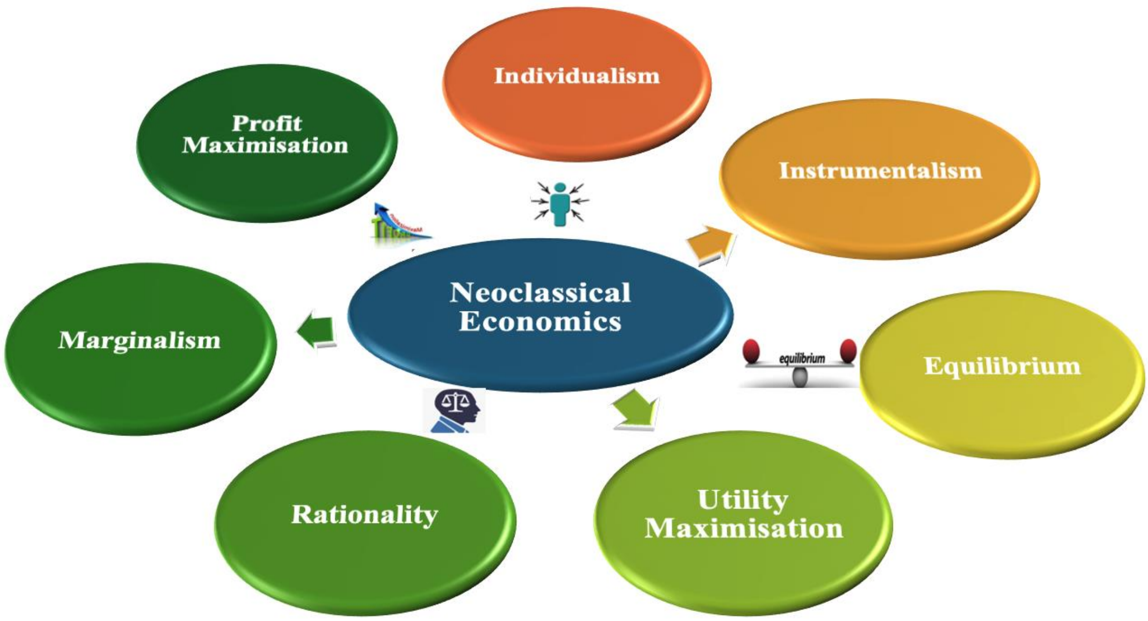

Figure 1: The Fundamental Pillars of Neoclassical Economics

Individualism

Neoclassical economists base their explanations on the behaviour and decisions of individual agents, such as consumers and firms, as a basis for understanding economic phenomena (Gueldry, 2015). This school of thought asserts that individuals act rationally, seeking to maximise utility (for consumers) or profits (for firms), and that markets operate efficiently when left to the forces of supply and demand.

Margaret Thatcher (Prime Minister of the United Kingdom from 1979 to 1990) was a proponent of individualism and in 1987, she contended that:

> “There is no such thing [as society]! There are individual men and women and there are families, and no government can do anything except through people and people look to themselves first” (Thatcher, 1987).

Moreover, both neoclassical economics and Thatcher’s individualist ideology emphasise the central role of individual agents as the primary drivers of economic behaviour, while minimising the role of collective action or government intervention in shaping economic outcomes (Klees, 2008).

Instrumentalism

Instrumentalism is also known as Preferentialism and Preference Theory. It assumes that all behaviour is preference-driven, or more precisely, it is understood as the means of maximising preference or satisfaction. Every action and utterance are instrumental to satisfaction to such an extent that there is no philosophical space left for questioning whether the agent will act on her preferences.

Essentially, neoclassical theory represents a narrow form of consequentialism (Holbrook, 1991; Tanyi and Bruder, 2014) in which the sole consequential concern is the degree to which a uniform index of preference satisfaction is maximised (Arnsperger and Varoufakis, 2006; 2018).

Equilibrium

First introduced by Cournot in 1983 ‘equilibrium’ is often referred to as the third axiom of neoclassical economics (Arnsperger and Varoufakis, 2018). The imposition of equilibrium is simple: “it could not be otherwise!”. In other words, neoclassicism cannot demonstrate that equilibrium would naturally arise from agents’ instrumentally rational choices (Arnsperger and Varoufakis, 2006; 2018). If equilibrium cannot naturally arise, the second-best alternative for the neoclassical theorist is to assume that behaviour fluctuates around a theoretically determined equilibrium and then explore the likelihood that, once at equilibrium, the system will tend to remain there or drift away. This exploration is known as ‘stability analysis’ (Arnsperger and Varoufakis, 2006; 2018).

This idea can be traced back to the two great success stories that emerged from neoclassical economics since WW2: General Equilibrium Theory and Game Theory. In neither case does the equilibrium solution naturally arise from the assumptions of the models (Arnsperger and Varoufakis, 2006; 2018).

In General Equilibrium Theory, its leading practitioners assert that convergence to a general equilibrium can only be demonstrated in highly restrictive special cases. More broadly, it is not just challenging to prove that a theoretical system of markets will reach equilibrium in each market based on the rational actions of buyers and sellers; it is impossible (See Mantel, 1973; Sonnenschein, 1973:1974).

Similarly, in Game Theory, the same outcome is observed: in the most intriguing socio-economic interactions (or games), the common knowledge that all players are instrumentally rational rarely leads to one of the interaction's Nash equilibria. Nash equilibrium refers to a scenario in a strategic game where no player can achieve a better outcome by independently altering their strategy, provided that the strategies of the other players remain the same (Kreps, 1989; Holt and Roth, 2004). Moreover, something additional is needed to achieve equilibrium. This additional element manifests in the form of an axiom stating that the beliefs of all players are consistently aligned at every stage of every game (see Hargreaves-Heap and Varoufakis, 2004).

This assumption introduces another type of methodological balancing: by assuming that agents' beliefs are consistently aligned, we treat them as if they are already in Nash equilibrium. Once again, equilibrium is assumed from the start, even before analysing how stable the system is or how vulnerable it might be to disruptions. In this, Cournot's influence continues to shape economic thought (Arnsperger and Varoufakis, 2006; 2018).

Utility Maximisation

The concept of utility maximisation in economics is as old as the field of economics itself and it is the source for the neoclassical theory of consumption (Gilad, 1987). Neoclassical economists argue that *homo economicus* (or a rational person) aims to maximise their utility or satisfaction, subject to their budget constraints (Gueldry, 2015; Maialeh, 2019). Consequently, neoclassical theory of utility maximisation assumes that irrational behaviour is unsystematic and, consequently, impossible to model (Gilad, 1987). Utility Maximisation (choice) model is also called the individual choice model (Aleskerov et al., 2006).

Rationality

The neoclassical economist views humans as *homo economicus* (or a rational, self-interested individual who maximises their own utility or welfare) (Bernoulli, 1738).

Consequently, Neoclassical Economics assumes that individuals are rational beings that make decisions that maximise their utility. This forms the basis of consumer and producer behaviour models (Gueldry, 2015; Soukup et al., 2015; Neck 2022). For neoclassical economists, the concept of rationality is associated with maximising net revenue or total gain (Soukup et al., 2015). However, a downside to the rational choice theory is that it is aimed solely at maximising utility which often neglects ethical considerations (Marckmann, 2009).

Marginalism

Neoclassical Economics is commonly referred to as "marginalism" because it revolves around marginal concepts like marginal utility, marginal cost and marginal revenue. In essence Marginalism views the capitalist economy as fundamentally efficient, sees production as a cooperative effort between the contributions and sacrifices of suppliers of productive services and considers income distribution to follow the principle of "to each according to his/her contribution to social welfare.” While this principle may require adjustments, it is rarely deemed fundamentally unfair.

Marginalism argues that in a market economy, prices, quantities produced, and the distribution of the social product among wages, rents, and interest are determined by the interaction between supply and demand, which are functions of prices. This interaction, it is argued, causes the economy to gravitate toward a state of equilibrium, where supply and demand for all goods and services of production factors are balanced (Petri, 2021). Furthermore, Marginalism refers to production inputs – labour, land and capital – as “factors of production.” It argues that, similar to produced goods, these factors also have supply and demand functions and a tendency toward equilibrium between supply and demand. Consequently, the marginal approach focuses on the analysis of marginal changes in economic variables in which the key concepts of marginal utility, marginal cost, marginal revenue, marginal productivity, profit maximisation, consumer equilibrium, marginal rate of substitution (MRS), marginal rate of technical substitution (MRTS), equilibrium, efficiency and distribution of income were birthed.

By focusing on these marginal adjustments, the marginal approach offers a precise framework for understanding complex economic behaviours. It helps clarify how small changes at the margin influence broader resource allocation decisions, pricing strategies, and the interactions between consumers and producers in competitive markets. The approach also plays a key role in addressing how equilibrium is achieved and maintained, providing insight into both short-term adjustments and long-term market stability.

Furthermore, the marginal approach is essential for evaluating efficiency in an economy. It examines whether resources are being used to maximise output without wasting inputs and ensures that consumer preferences are being met as effectively as possible. As a result, this approach has wide applications across microeconomics, welfare economics, and policy-making, influencing discussions about income distribution and market dynamics (Royer, 2014; Petri, 2021).

Profit Maximisation

Profit maximisation is one of the core assumptions within economic theory and is seen as a necessary condition for achieving efficient market outcomes. It maximises the benefits for individual suppliers and buyers, as well as society as a whole (Brueckner, 2013). As previously noted, economic theory assumes that humans pursue self-interest, maximising it through rational decision-making by economic agents striving to satisfy their unlimited needs and wants with limited resources (i.e., time, capital, labour). Firms are assumed to act in ways that maximise their profits. This occurs through decisions about the quantities of goods to sell at given prices. Suppliers aim to sell more goods at higher prices because selling quantities at higher prices increases revenue and maximises profits. Contrarily, the law of demand states that the higher the price of a good, the fewer buyers will demand it. Essentially, the higher the price, the lower the quantity demanded. The interplay of demand and supply affects the price of goods supplied and demanded. When supply meets demand, the economy is said to be at equilibrium, achieving economic efficiency as the amount of goods supplied equals the amount of goods demanded (Brueckner, 2013; Keen and Standish, 2006).

Implications of Neoclassical Economics for Strategy-Making

The approach of Neoclassical Economics has several implications for strategy-making within organisations.

Limited Consideration of Non-Economic Factors

Social - Neoclassical Economics often overlooks the impact of social norms, cultural values, and institutional frameworks on economic behaviour (Casson, 1997; Ntibagirirwa, 2009). However, strategic thinking should account for these factors to ensure strategies are culturally sensitive, socially responsible and that institutional frameworks, including formal regulations and informal societal norms, which shape organisational behaviour and influence business outcomes are integrated. Neoclassical Economics assumes rational behaviour, but real-world decisions are often influenced by cognitive biases and emotions (Abhyankar, 2019; Reisch, 2017). Strategic thinking could incorporate insights from behavioural economics and consumer psychology to better understand and predict consumer behaviour. Furthermore, the focus on profit maximisation in neoclassical economics can lead to ethical dilemmas, such as exploitation, unfair labour practices, and neglect of corporate social responsibility (Robin, 1988; Hosmer 2007). Strategic thinking needs to incorporate ethical considerations to build trust and a positive image. Institutions play a key role in setting the rules and norms that influence ethical business behaviour, ensuring that corporations are held accountable to both societal and governmental standards (North, 1990).

Neoclassical Economics fails to address the issues of income inequality and social welfare (Wade 2011; Chibba 2019, Wadw 2018). However, strategic thinking considers the social impact of business decisions to foster inclusive growth and equity (Kaplan, 2019). Institutional structures, such as welfare systems, labour laws, and social safety nets, are critical in shaping equitable economic outcomes. Businesses that align their strategies with these institutional frameworks are more likely to contribute to inclusive and sustainable economic development. It is evident that Neoclassical Economics considers labour as a key factor of production, however it often underestimates the importance of long-term human capital development (Sodirjonov, 2020). Strategic thinking should prioritise employee development, education, and well-being (Grigorescu, 2016). Institutions, such as educational systems and vocational training programmes, play a crucial role in fostering this human capital development, and businesses that collaborate with these institutions can gain a competitive advantage through a more skilled and motivated workforce.

Environmental - Traditional neoclassical models typically do not incorporate environmental externalities (Halkos, 2016). Strategic thinking should integrate environmental considerations to promote sustainability and comply with regulatory requirements (Gustafsson, 2018). Institutional frameworks, such as environmental regulations, international treaties, and societal expectations for corporate responsibility, are increasingly shaping how businesses must operate to remain sustainable. Companies that anticipate and align with these institutional demands can not only avoid legal risks but also build a reputation for environmental stewardship, enhancing their long-term viability and market position.

Change - Finally, Neoclassical models are often seen as static, thus assuming conditions of equilibrium. However, strategic thinking must be dynamic and adaptive, considering the rapid technological advancements and evolving market conditions (Mufudza, 2018) as already discussed in Chapter 1. Institutions provide stability through rules and norms, but they must also evolve to keep pace with changing environments. Strategic thinkers who understand the institutional landscape can better anticipate regulatory changes and societal shifts, enabling organizations to adapt proactively and remain competitive.

Focus on Profit **Maximization**

Neoclassical Economics assumes that the aim of a firm is to maximise profits by optimising production and minimising costs. The more traditional vocabulary around strategy-making does aim to maximise profits, prioritising initiatives that improve operational efficiency, manage resource allocation to optimise efficiency, and reduce waste (Mazzarol et al., 2009) and traditionally, strategies have been evaluated based on their potential to enhance profitability and competitive positioning (Harrison and Kennedy, 1997; Mazzarol et al., 2009). Consequently, the traditional concept of strategy making represented by **strategic management** and neoclassical economics' core concept of profit maximisation are closely related because both are seen as fundamental to the successful management and growth of a firm.

Strategic management establishes long-term goals and short-term objectives that guide the organisation's effort and profit maximisation is often a prerequisite within this framework (Steiner, 2010). Moreover, strategic management provides integration by ensuring that all strategic initiatives are aligned with the goal of increasing profitability, thus making profit maximisation a central tenet of strategic plans (Monye and Ibegbulem, 2018).

Strategic management involves analysing market conditions, competitor strategies, and customer needs to position the company effectively in the market. By understanding these factors, companies can better position themselves effectively in the market, which enhances profitability. Furthermore, profit maximisation is essentially achieved by gaining a competitive advantage, which strategic management facilitates through targeted strategies that enhance market position and profitability (Monye and Ibegbulem, 2018).

Strategic management also involves a culture of innovation and growth to remain competitive and meet evolving consumer needs results. Innovation, in turn leads to new products, services, and processes that promote the growth in revenues and reduce costs, thus directly impacting profitability (AlQershi, 2021).

Strategic management also encourages continuous monitoring of the external environment and internal performance, allowing for agile adjustments to strategies. Profit maximisation requires flexibility to adapt to market changes, competitive pressures, and emerging opportunities, which strategic management facilitates (Ghobadian et al.,2008).

However, as has been discussed previously, the focus on profit maximisation, or competitive advantage or relative value is insufficient to meet the wider expectations of sustainability (where it is not just about growth) and wider stakeholder expectations.

Assumption of Rationality

There are benefits to rationality in strategy-making and these have already been reflected on in Chapters 1 and 2, with the recognition of the importance of strategic management activities, and the use of planning tools as a foundation for systematic analysis. Rationality ensures decisions are based on comprehensive analysis and objective data, potentially enhancing strategic initiatives. Rationality involves careful cost-benefit analysis to optimise resource allocation and minimise waste (Celik, 2019).

Rationality involves using predictive models and data analysis to foresee and manage risks effectively. Rationality uses scientific data and models to create effective environmental regulations and policies (Celik, 2019; Alhosseiny, 2023). In terms of long-term sustainability, rationality ensures sustainability initiatives are economically viable and based on solid evidence (Celik, 2019). In essence, rationality should contribute to a more efficient market where resources are optimally allocated. It should also foster an environment that is conducive to innovation and economic growth. Rationality serves to enhance a firm’s competitiveness and provide frameworks for effectively responding to economic crises (Celik, 2019; Alhosseiny, 2023).

In other words, the integration of rationality can lead to more informed, efficient, and effective decision-making, thereby driving success and resilience in businesses, although considered alone, rationality is surely insufficient, given its potential inability to consider human behaviour.

Neoclassical Economics relies on marginal analysis to guide decision-making, focusing on small, incremental changes. In economics, marginal analysis serves as a decision-making tool that assesses the additional benefits and costs of a small (or marginal) change in the production of goods or services. This process helps businesses and individuals evaluate whether the added cost of a specific action or decision is outweighed by the additional benefit, ensuring resources are allocated efficiently and decisions are economically sound (Palmer et al, 1999).

In contrast, strategic thinking provides the vision and innovation, i.e., a comprehensive framework for decision-making that incorporates various tools and analysis, including marginal analysis (Kehbila, 2021). In other words, strategic thinking provides the overall direction, and marginal analysis helps optimise specific decisions with that strategy (Lowder, 2009). Or, strategic management (planning) focuses on assessing each strategic decision based on its incremental benefits, costs and optimisations, such as reducing marginal cost reductions or increasing marginal revenue, rather than transformative or disruptive innovations (Barney, 2000).

Consequently, strategic planning employs insights from marginal analysis to ensure optimal allocation of resources or the allocation of resources where they will have the most significant impact, thus ensuring strategic initiatives are both efficient and effective (Bağdigen, 2013; Flach and Mendes, 2013). Strategic planning ensures that firms operate in an optimal and efficient manner by incorporating marginal analysis to ensure that strategies are designed to maximise efficiency and effectiveness, thereby achieving the best possible outcomes (Swicegood, 1987). Moreover, strategic planning also employs marginal analysis to refine strategies, focusing on initiatives that offer the highest incremental returns relative to their costs.

In terms of managing organisation risks, strategic planning uses marginal analysis to refine management strategies, thus ensuring that the additional risks taken are justified by the incremental benefits gained.

One of the primary goals of strategic planning is to foster innovation and growth by identifying opportunities that align with the organisation's long-term vision and goals. This process requires a careful balance of creativity and analysis, as organisations seek to pursue new initiatives and improvements while ensuring the efficient allocation of resources (Nadikattu, 2020; Gutterman, 2023). Consequently, strategic planning incorporates marginal analysis as an essential tool to assess and rank innovations based on their potential to deliver the greatest incremental growth compared to their associated costs (López and Oliver, 2023).

Effectively, marginal analysis and strategic planning are closely linked because marginal analysis offers detailed, incremental insights that help optimise resource allocation and optimise value. On the other hand, strategic planning provides the broader framework for making these decisions. Therefore, by integrating marginal analysis into strategic planning, firms can carefully evaluate each step for its incremental impact, resulting in more efficient, effective, and adaptable strategies. It is this combination of broad vision and detailed analysis that enables firms to achieve their long-term objectives while maintaining optimal operational efficiency.

It would be fair to say at this stage that the discipline of Neoclassical Economics is more suited to the concept of strategic management/planning with its foundations in rational thought and approaches. There are overlaps and complements between Neoclassical economics and certain intentions of businesses and organisations, however the core principles of neoclassical economics are also out of touch with the sustainable strategic thinking argued for in Chapter 1. Hence, we turn to alternative ways of thinking.

Plurality – An Alternative Approach to Neoclassical Economics: Institutional Theory

While Neoclassical Economics remains the dominant school of thought in the field, providing foundational theories on supply, demand, and market equilibrium, we argue that there are valuable insights to be gained from perspectives that extend beyond this framework. Neoclassical thought primarily focuses on individual rationality, utility maximization, and equilibrium states, often overlooking the complexities of human behaviour, social institutions, and the impact of historical and cultural contexts on economic outcomes.

In this chapter, we explore the diversity and plurality within the broader field of economics. This section investigates the concept, scope, and definitions of 'institutions' as discussed in the competing school of thought known as Institutional Theory. The goal is to enhance our understanding of 'institutions' and examine their role in economic actions while contrasting this viewpoint with the mainstream perspective of Neoclassical Economics. Different institutional approaches offer unique theoretical frameworks for understanding the institutional environment and evaluating their potential impact on strategic decision-making. This chapter will delve into these institutional approaches and their implications for strategic thinking.

The Development and Key Meanings of Institutional Theory

Without a shared understanding of how others will respond and the effectiveness of sanctions in addressing potential opportunistic behaviour, interpersonal and business interaction becomes impossible (North, 1987; 1991). Economic entities like firms engage in transactions based primarily on trust and the assurance that their expectations will be met. The nature of exchanges between entities, which are often repetitive and frequent, requires 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. These rules and regulations, fundamental to Institutional Theory, are collectively referred to as 'institutions.'

LINK: The idea of the need for trust in exchanges is discussed further in Chapter 9 as the basis for ethical behaviour in business.

Institutional Theory has become a significant field within the social sciences, offering new analytical perspectives that have enriched various disciplines including business management, economics, sociology, and political science. The theory primarily aims to explore and explain the impact of the broader economic, social, and cultural environments on behavioural and economic outcomes, as noted by scholars such as Scott (2008), Kenworthy (2006), Jackson & Deeg (2008), and Hodgson (1998; 2001). Institutional Theory challenges traditional paradigms like Neoclassical Economics and strategic management, which often view equilibrium as a persistent state. Authors such as North (1991) and Hodgson (2001) have critiqued these established views, advocating for a broader understanding that incorporates the complexity and dynamism of the economy. This approach has progressively shifted how social sciences understand and study various phenomena, moving away from static models to embrace more fluid and evolving interpretations. For this reason, Institutional Theory provides valuable insights into strategic thinking and the broader study of organisations.

This shift towards institutional theory aligns us with the transition from traditional strategic management, which is supported by neoclassic economics, toward more flexible, iterative forms of strategic thinking. Institutional Theory offers valuable insights into this evolving landscape by emphasising the importance of rules, norms, and structures that guide organizational and economic behaviour. Unlike Neoclassical Economics, which focuses on equilibrium and optimal outcomes, Institutional Theory recognizes that organizations operate within complex, evolving environments, where change is constant, and outcomes are not easily predictable.

In this context, the term 'institutions' takes on a variety of meanings, often shaped by the disciplinary lens through which it is viewed. As Jackson and Deeg (2019) and Redding (2005) highlight, the lack of a universally accepted definition of 'institutions' can lead to ambiguity in its application. Despite this, the dual role of institutions—as both enablers and constraints on the actions of firms, individuals, and states—is a consistent theme across the literature. Institutions not only set up the frameworks that shape incentives but also influence decision-making processes and drive change within and between businesses. This capacity to influence behaviour underscores the importance of understanding institutional dynamics in the context of strategic thinking, as they have the potential to underpin critical decisions in business, economics, and beyond.

Although definitions of institutions vary widely, they consistently highlight the role of institutions in both enabling and constraining the actions of entities such as firms, individuals, or nation-states. Institutions set up overarching frameworks that influence incentives, thereby shaping business, economic, social, and political interactions across various spheres and levels. By establishing these frameworks, institutions not only dictate certain behaviours but also act as drivers of change within and between business. These have potential to underpin decisions of business.

What Does Institutional Theory Offer Differently to Conventional Economics?

Institutional theory can be divided into three distinct approaches: new institutional economics, new organizational institutionalism, and comparative institutionalism (Woodhouse & Johnston, 2023) (see Figure 2). Institutional approaches differ extensively by way of their conceptualisation of institutions, their level of analysis and subsequently, their explanation of how institutions matter for strategic thinking (see Table x for a summarised discussion). We introduce each approach in turn, then extend the discussion to the overall implications for strategic thinking.

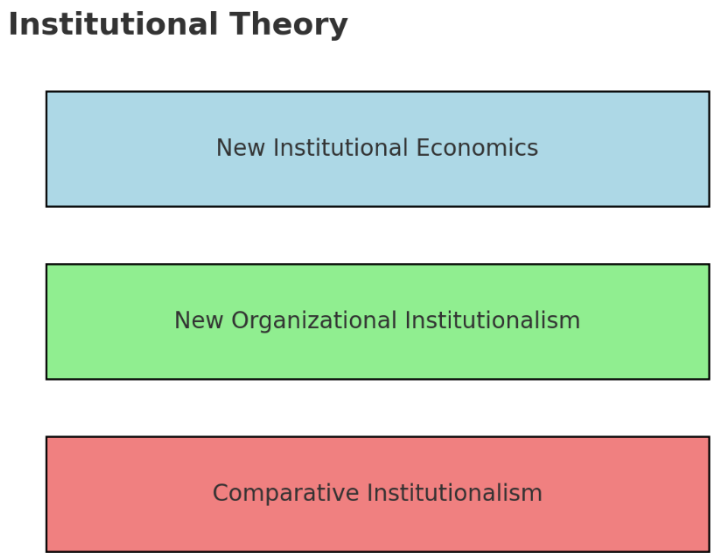

Figure 2

New Institutional Economics

By challenging the conventional neoclassical economics assumptions of perfect information, unbounded rationality, and immediate market transactions, institutional economics provides a significant departure from mainstream economic analysis of economic systems and actors like firms. This perspective asserts that individuals operate under constraints of incomplete information and limited cognitive capacity, relying on the 'bounded' information available to them. Consequently, market participants face uncertainty about future outcomes, leading to the occurrence of 'transaction costs' to gather information. To mitigate these risks and expenses, individuals establish institutions, which include formal entities like regulations, laws, and contracts, as well as informal elements such as belief patterns, thought habits, and cultural norms. In essence, institutions play a crucial role in determining economic performance and define the decisions made my firms. This integration of institutional analysis into economic thought has led to the development of new methodological approaches within economics, now known as 'New Institutional Economics' (NIE).

To provide a more nuanced approach than traditional mainstream economics, NIE focuses on the concept of transaction costs. These costs create frictions in economic exchanges, which are crucial in shaping production, transactions, and ultimately, economic outcomes (Coase, 1937; North, 1991). The focus on the frictions inherent in economic and business exchanges, central to NIE, has shed light on the concept of asset specificities in transactions. Asset specificities refer to the unique characteristics and qualities of assets that make them particularly valuable in specific transactions or contexts, but less so in others. In the context of New Institutional Economics (NIE), asset specificities create frictions in economic exchanges by increasing transaction costs. These specificities can arise from various factors, including physical attributes, human skills, or investments made for a particular transaction, which limit the asset's value in alternative uses or transactions. As a result, when asset specificities are high, firms may opt for non-market transactions or hierarchical exchanges to mitigate risks and reduce transaction costs. This focus on asset specificities helps explain why firms exist and expand, as they seek to manage and optimize the use of specialized assets in a way that enhances efficiency and economic outcomes.

NIE examines the role of institutions and their interactions with organisational structures. In this analysis, institutions are seen as both formal and informal norms, rules, and constraints established by humans to manage uncertainty and exert control over their environments (Menard & Shirley, 2005). These institutions are often referred to as the "rules of the game in a society" (North, 1991, p. 3), which coordinate and influence societal actions.

NIE argues that the dynamics of market exchanges and related frictions are shaped by the institutional context. This context, also known as the 'institutional framework,' 'institutional regime,' or 'institutional environment,' includes specific sub-institutions that govern economic behaviours and the strategic alignment of organizations. It encompasses both informal conventions and routines as well as formal regulatory mechanisms that guide and restrict socio-economic behaviours. Crucially, factors like the efficacy of property rights and contract enforcement within this framework significantly impact transaction costs (Williamson, 1975; Coase, 1937). According to North (1991, p. 110), the institutional context "dictates the margins at which organizations operate," providing a critical lens through which the behaviour of economic agents, especially businesses, can be understood. This perspective views the institutional environment as a foundational framework that underpins all economic exchange and production activities.

In the field of NIE, institutions are recognized to include both formal and informal components (North, 1991):

- **Formal** institutions are comprised of constitutions, laws, regulations, and contracts
- **Informal** institutions consist of societal norms, values, and customs that are often shaped by longstanding cultural and religious influences.

While NIE acknowledges the importance of both types of institutions, its practical application has predominantly focused on formal aspects. This emphasis has led to a substantial interest in studying how various rules and regulations influence the selection and effectiveness of governance structures used to manage economic activities.

Institutions in a country shape the viability of engaging in certain economic activities, like foreign direct investment, by affecting the costs associated with transactions and production (Coase, 1998). 'Effective' institutional regimes are crucial because they help reduce transaction costs by eliminating the need for upfront expenditures, particularly when there is a lack of 'transactional trust.' High transaction costs can negatively impact economic productivity and subsequently inhibit economic growth (North, 1991). Therefore, the study of transaction costs underscores the fundamental role of institutions in minimizing these costs. Viewing transaction costs as the "cost of running the economic system" (Williamson, 1975), this analysis provides a unique perspective on how institutions influence the behaviour and decisions of economic agents, endorsing a pragmatic 'best way' approach (Rodrik, 2008).

As such, and for strategic thinking, understanding the interplay between institutions and transaction costs is vital for both policymakers and businesses. By analysing how institutional frameworks can be optimized to minimize transaction costs, stakeholders can create an environment conducive to economic activity, attracting foreign direct investment and fostering entrepreneurship. Policymakers must recognize that enhancing institutional quality—such as improving legal frameworks, enforcing contracts, and fostering transparency—can significantly lower the barriers to entry for new businesses and stimulate existing ones. Similarly, businesses can leverage this understanding to strategize their market entry and operational decisions, ensuring they align with the institutional context to minimize costs and maximize efficiency. This insight is particularly relevant in a globalized economy, where the competitive landscape often hinges on the ability to navigate diverse institutional environments effectively. Thus, the relationship between institutions and transaction costs not only shapes economic outcomes but also guides strategic decision-making, emphasizing the necessity for adaptive approaches in both public and private sectors.

New Organisational Institutionalism

Grounded in sociology and organizational theory, organizational institutionalism views institutions as intra-organizational forms, practices, and activities shaped by coercive, mimetic, and normative mechanisms (DiMaggio & Powell, 1983; Scott, 1995). Unlike New Institutional Economics, which focuses primarily on national-level institutions, organizational institutionalism provides a more granular, organization-level analysis by emphasizing how institutional pressures influence organizational structures and behaviours. This framework has proven especially useful for examining the diffusion of organizational patterns and the similarities and differences in practices across organizations.

Organizational institutionalism has sparked a rich body of literature focused on the internal and external legitimacies of firms (e.g., Kostova & Zaheer, 1999; Kostova & Roth, 2002), extending its applicability to various domains. The distinction between 'old' and 'new' organizational institutionalism further clarifies its evolution. Early institutionalists such as Selznick (1949, 1996) and Clark (1960, 1972) are regarded as the pioneers of old organizational institutionalism, which highlighted how organizations develop unique practices and competencies through institutionalization. Selznick (1996) argued that institutionalization results from the interplay between an organization’s internal dynamics and external environment, which shapes the 'character' of the organization. This process creates enduring patterns of behaviour, allowing organizations to resist external pressures for change and maintain internal legitimacy.

In contrast, new organizational institutionalism, led by scholars like DiMaggio & Powell (1991) and Scott (1995), shifts the focus to understanding how organizations conform to external institutional pressures. These pressures drive isomorphism—where organizations become like each other—as they seek legitimacy in their broader environments. While old organizational institutionalism emphasized institutionalization as an adaptive process for internal stability and legitimacy, the new approach focuses on how organizations respond to institutional pressures for external legitimacy, offering a more dynamic view of organizational change and conformity.

Comparative Institutionalism

In contrast to other branches of institutional theory, the core idea behind comparative institutionalism is that diverse socioeconomic models are not simply variations of a singular 'market capitalist economy' nor a random assembly of economic institutions. This perspective challenges the dominant belief that there is one universally optimal growth model for maximizing economic performance, as often pursued by contemporary governments. It also rejects the notion that structural reforms should aim for uniform liberalization and deregulation across economies. Instead, comparative institutionalism views capitalism as a political economy characterized by institutionally diverse production regimes, where different institutional configurations and forms lead to distinct economic outcomes. Replicating identical institutional frameworks, such as sub-spheres or domains, across political economies does not guarantee similar growth trajectories, as each system is shaped by unique path dependencies and institutional complementarities (Amable et al., 2011).

A key tenet of comparative institutionalism is that societal institutions fundamentally shape the organization of economic activities, which in turn affects organizational, business, and country-level outcomes (Jackson & Deeg, 2008; Hall & Soskice, 2001; Hotho, 2014). Unlike New Institutional Economics and New Organizational Institutionalism, which often emphasize convergence toward similar institutional forms or practices, comparative institutionalism highlights divergence and diversity as essential features of institutional development (Woodhouse & Johnston, 2023). This divergence is crucial to understanding the variety of capitalist systems and the distinct pathways economies take based on their institutional arrangements.

Within this framework, national political economies are understood to follow specific 'logics' of economic agency, developed through distinct typologies of institutional configurations. Comparative institutionalism suggests that the character and interests of economic actors are shaped by these arrangements, which in turn condition the development of their resources, strategies, and capabilities. Thus, institutions do not just set the rules of the game; they actively shape the 'supply-side' of the economy by determining how key inputs—land, labour, capital, and products—are organized and accessed by businesses (Hancke, 2009). This perspective underscores the role of institutional complementarity, where different institutional elements interact in ways that reinforce and enhance each other, contributing to the unique outcomes observed in various capitalist economies.

Comparative institutionalism also emphasizes that institutional configurations are deeply embedded in historical and social contexts, resulting in path dependency. Path dependency refers to the tendency for economic and institutional development to follow historical trajectories, making radical shifts or transformations difficult. This helps explain why attempts to impose identical institutional reforms in different contexts often fail—different political economies have distinct institutional histories and interdependencies that shape their present and future trajectories. Therefore, instead of striving for convergence towards a uniform model of liberal capitalism, comparative institutionalism argues for the recognition of institutional variety and the importance of tailoring economic reforms to the specific institutional contexts of each country.

This perspective has significant implications for policymaking, as it cautions against one-size-fits-all approaches to economic reform. Comparative institutionalism suggests that successful growth and development depend not on replicating a single ideal model but on recognizing and working within the unique institutional configurations of each political economy. This diversity in institutional structures and practices creates the varied forms of capitalism observed across different countries, each with its own strengths, weaknesses, and growth potential.

The three approaches to institutional theory are summarised in Table 1.

Institutional Theory and its Three Approaches			
Institutional Approach	New Institutional Economics (NIE)	New Organizational Institutionalism	Comparative Institutionalism
Focus	Formal and informal institutions that mitigate the costs of transacting in a market setting, focusing on property rights, governance structures, and contract enforcement.	Analysing the dissemination and adoption of organizational patterns and explaining variations in organizational practices through isomorphism and legitimacy.	Comparative analysis of institutional configurations, their complementarities, and how they shape the diversity of capitalist systems and economic performance.
Theoretical Perspectives	Rooted in economic theory, NIE emphasizes transaction cost economics, bounded rationality, and the role of institutions in reducing uncertainty and enabling cooperation between economic agents.	Social constructivist approach, focusing on how organizations conform to cultural norms, rules, and structures to gain legitimacy and how institutional logics shape organizational behaviour.	Focuses on varieties of capitalism, institutional complementarities, and the interplay of political, social, and economic institutions that explain different capitalist outcomes.
Key Concepts	Transaction costs, property rights, bounded rationality, opportunism, and agency theory. Institutions are seen as the rules of the game that reduce uncertainty and facilitate market transactions.	Institutional isomorphism (coercive, mimetic, normative), legitimacy, decoupling, and institutional logics. Emphasizes how organizations adapt to their environments to gain legitimacy and survive.	Institutional complementarity, path dependency, comparative advantage, and varieties of capitalism. Analyses how different institutional frameworks (e.g., labour market, financial systems) interact to shape the performance of national economies.

Implications for Strategy-Making	NIE informs strategies focused on reducing transaction costs, designing efficient governance structures, and ensuring property rights and contract enforcement. Strategy-making is viewed through the lens of optimizing firm performance by aligning internal governance with external institutional frameworks.	Organizations must navigate institutional environments by adhering to social norms, rules, and expectations to gain legitimacy. Strategy making involves balancing efficiency with conformity to institutional expectations, often leading to practices of decoupling or ceremonial adoption of formal structures.	Comparative institutionalism suggests that firms' strategies must align with the specific institutional configurations of their home country or region. This approach emphasizes that "one-size-fits-all" strategies do not work, as different institutional contexts lead to different forms of competitive advantage.
Examples of Application	Analysing how firms in emerging markets navigate weak institutional frameworks to reduce transaction costs and improve market efficiency. Examining the impact of legal reforms on property rights and investment.	Explaining how multinational corporations (MNCs) adopt local organizational practices to gain legitimacy in foreign markets. Analysing how firms engage in isomorphism to resemble successful competitors.	Understanding why firms in coordinated market economies (e.g., Germany) pursue different strategies than those in liberal market economies (e.g., the U.S.). Investigating how institutional complementarities support specific industries in different capitalist systems.
Key Literature	North (1987; 1991), Williamson (1975), Coase (1937; 1998)	DiMaggio & Powell (1983), Scott (2008), Meyer & Rowan (1977)	Hall & Soskice (2001); Whitley (1999); Amable (2003); Woodhouse & Johnston (2023)

Table 1: Summarises the three approaches to Institutional theory

Institutional Theory and Insights for Strategic Thinking

Institutional Theory offers significant insights for strategic thinking and decision-making in several critical ways. At a top level, by incorporating insight from Institutional Theory into strategic thinking and decision-making, organisations can more effectively navigate their complex business and economic environments, making choices that are not only strategically sound but also institutionally informed. This enhances their ability to achieve long-term sustainability and success. There are four key ways in which Institutional Theory can offer insights for strategic thinking:

1. Understanding of Institutional Context

Understanding the broader institutional contexts in which organizations operate is a fundamental aspect of strategic thinking and decision-making (Woodhouse & Johnston, 2023). This scopes how various norms, regulations, and cultural expectations collectively shape the business environments, offering valuable insights that can be pivotal for organisational strategy.

The core idea behind (comparative) institutional perspectives are that diverse economies do not represent nearly identical versions of the same 'market capitalist economy' nor a random assembly of institutions. Capitalism, 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). In the business world, strategic decisions such as expansion and defining subsidiary roles may not yield the same results in two countries, even if both countries appear similar, such as being categorised as 'Western and capitalist'. The work of Woodhouse & Johnston (2023) for example finds a variety of country clusters. In this view, Germany is as different to the United Kingdom as is the UK to Mexico. Preconceptions of country similarity that underpin strategic thinking and decisions can be dangerous, and more recognised insights of the formal and informal institutions that define countries is always required.

Moreover, the nuances of institutional contexts extend beyond superficial categorisations like 'Western and capitalist'. Even within supposedly similar regions, such as Europe or North America, significant variations exist in terms of regulatory frameworks, cultural norms, and historical legacies. For example, while both France and the United States may be considered Western capitalist economies, their institutional landscapes differ vastly due to factors such as legal traditions, labour market regulations, and attitudes toward foreign investment.

These institutional differences can profoundly impact the success of strategic decisions. For instance, a strategy that proved effective in one country may falter in another due to contrasting regulatory environments or divergent cultural expectations. Ignoring these institutional nuances can lead to costly missteps and missed opportunities for organisations seeking to expand internationally. To navigate this complexity, organisations must conduct thorough institutional analysis before making strategic decisions. This involves examining not only formal institutions like laws and regulations but also informal institutions such as social norms, trust networks, and cultural practices. By understanding how these institutions interact and shape behaviour within a given context, organisations can develop strategies that are better aligned with the realities of their operating environments.

Furthermore, institutional analysis enables organisations to identify potential synergies and conflicts between different institutional spheres. For example, a strategy that aligns with regulatory requirements in one area may clash with cultural norms in another, highlighting the need for careful consideration and possibly adaptation of the strategy.

In conclusion, understanding the different environments where organisations operate is key to making smart strategic decisions. By including institutional analysis in their planning, organisations can reduce risks, seize opportunities, and improve their chances of success in a complex global market.

2. Ability to Understand and Adapt to Institutional Change

Understanding the broader institutional contexts in which organisations operate is fundamental, but this offers a *static* perspective. It is a snapshot in time. Institutions of economies are seen to change through time and are thus *dynamic*. While national institutions typically change at a slow rate, research has shown that institutional change does occur (Gingrich, 2015). Institutional change reflects political and business coalitions that emerge and provide a critical mass of actioned change.

LINK: Chapter 3 includes insight on a strategic thinker's role in politics and policy-making.

Managing institutional change is a critical aspect of strategic decision-making, especially in environments characterised by rapid regulatory changes or cultural shifts. Organisations must be prepared to adapt their strategies in response to these evolving institutional landscapes to remain competitive and resilient.

One key aspect of managing institutional change is anticipating shifts in the institutional environment. By closely monitoring political developments, regulatory trends, and societal movements, leaders can identify emerging changes and proactively adjust their strategies accordingly. This proactive approach allows organisations to stay ahead of the curve and capitalise on new opportunities while mitigating potential risks associated with evolving institutional dynamics.

Additionally, organisations must be agile and responsive in their strategic decision-making processes to effectively navigate institutional change. This requires a willingness to embrace innovation and experimentation, as well as the ability to quickly pivot strategies in response to shifting institutional pressures. By fostering a culture of adaptability and change readiness, organisations can position themselves to thrive in dynamic institutional environments.

Furthermore, managing institutional change requires effective communication and stakeholder engagement. Leaders must communicate the rationale behind strategic shifts and actively involve stakeholders in the decision-making process to garner support and facilitate buy-in. Engaging with key stakeholders, including government agencies, industry associations, and community groups, can also help organisations navigate regulatory changes and build collaborative partnerships that enhance their resilience to institutional change.

LINK: Stakeholders are discussed further in Chapter 5.

Institutional Theory offers unique insights into the potential trajectory of institutional change. It suggests that institutional changes may be predictable, allowing insight into how much economies/institutions can change. The business environment is made up of several institutions (referred to as institutional sub-spheres) that define an economy's (1) labour markets, (2) the financial system and (3) education system, for example. These institutions are non-random and compatible with each other. They are jigsaw pieces that fit together. More formally, the business environment has the presence of "institutional complementarities" (Amable, 2016).

The notion of 'institutional complementarity' is widely used in comparative institutional analysis to express the idea that certain institutional forms, when jointly combined, continue to reinforce each other, and contribute to improving the functioning, stability, and coherence of specific institutional configurations or 'models of capitalism' (Amable, 2016). The existence of institutional complementarities explains how differentiated economies may exist based on complements between institutional forms. For example, flexible labour markets (regulations that make it easy to 'hire and fire') complement a financial system that allows short-term capital provision, allowing organisations to control costs easier and yield profits. This 'combination' is typical of liberal economies like the UK and US (Hall & Gingerich, 2009; Woodhouse & Johnston, 2023). The consensus on institutional complementarities on market/liberal economies (e.g. UK, USA, Canada) and coordinated based economies (e.g. Germany, Netherlands, Sweden etc) is set out in the work of Amable (2016). We provide a simplified schematic of the types of interactions/complementarities between institutional sub spheres in Table 2 (table 2 at present).

Institutional Sub-sphere	**Key Features**	**Complementarities & Interactions**
Education System	- Quality-based competition for skill development. - Focus on long-term skill formation. - Strong vocational training.	- Links to Labour Markets through skill development. - Supports Financial Systems by providing skilled human capital.
Financial System	- Focus on long-term capital investment. - Encourages innovation and stability.	- Requires employment stability from Labour Markets. - Supports Product Markets by providing capital for innovation.
Labour Markets	- Employment protection enhances workforce stability. - Strong emphasis on specific skills development.	- Linked to Education System through skill formation. - Stability supports long-term investments from Financial System. - Influences demand in Product Markets.
Product Markets	- Structured to encourage competition and innovation. - Regulation to control monopolistic behaviour.	- Connected to Financial System through capital needs for innovation. - Requires skilled labour from Labour Markets.

Table 2: Showing the types of interactions/complementarities between institutional sub-spheres.

Institutional complementarity provides important insight into institutional change. Change, triggered by political will, aimed at altering the composition of given institution(s) may cause incoherence or disequilibria that result in the weakening of the stability of the overall institutional system. For example, the impact of the European

Union ‘Lisbon Agenda’ has been called into question in reference to its impact on the coherence of non-liberal capitalist models (Amable, 2016). In this view, complete change of all institutions is impossible, and any institutional change is likely to reinforce the status quo of the institutional context. Simply, the UK economy will never be like the German economy (a more coordinated economy), even if there was political and business will in the UK to be so. Any longer-term change is likely to be predictable.

3. Enhancing Organisational Legitimacy

Strategic decisions frequently extend beyond economic ramifications and encompass considerations of organisational legitimacy. According to Institutional Theory, legitimacy holds paramount significance for the success of organisations. Strategies that align with the expectations of institutional stakeholders, including governmental bodies, trade associations, and cultural communities, stand a greater chance of garnering support and recognition.

Organisations operate within a broader institutional environment that dictates norms, regulations, and cultural expectations. Conforming to these institutional norms bolsters an organisation's legitimacy, enhancing its standing within the societal framework. Conversely, strategies that diverge from institutional expectations risk facing resistance and scrutiny, potentially undermining the organisation's credibility and long-term viability.

Therefore, strategic decision-makers must evaluate the institutional context in which their organisation operates. By aligning strategic initiatives with institutional expectations, organisations can cultivate trust and goodwill among key stakeholders, fostering a supportive environment conducive to growth and sustainability. This emphasis on organisational legitimacy underscores the interconnectedness between strategic decision-making and the broader institutional landscape, highlighting the need for strategic alignment with institutional norms and values.

For instance, let's consider a multinational corporation planning to expand its operations into a new market. Before entering the market, the corporation conducts thorough research on the local regulatory environment, cultural norms, and societal expectations. It identifies that the government in the target market has stringent environmental regulations and a strong emphasis on sustainability practices. Additionally, there is a prevalent cultural sentiment favouring businesses that demonstrate a commitment to environmental stewardship.

Considering these institutional factors, the organisation devises a strategic plan that not only focuses on profitability but also emphasises environmental sustainability. It invests in green technologies, implements eco-friendly manufacturing processes, and initiates community outreach programmes to support environmental causes. By aligning its strategy with the institutional expectations of the government and the local community, the organisation not only enhances its legitimacy but also gains the support and trust of key stakeholders.

4. Influence on Organisational Behaviour

Institutional Theory offers valuable insights into how institutions shape organisational behaviours and processes (North, 1991). By examining these influences, organisations can better understand the underlying reasons behind their (and others) strategic decisions. For instance, let us consider a retail company operating in the United Kingdom's fashion industry.

In this example, Institutional Theory reveals how the company's strategic choices are influenced by various external factors. Firstly, the company must comply with regulatory standards set by government agencies, such as those pertaining to labour laws, consumer rights, and environmental regulations. These regulations not only dictate the company's operational practices but also influence its strategic decisions, such as sourcing materials from ethical suppliers and implementing sustainable business practices to mitigate environmental impact.

Furthermore, Institutional Theory highlights the importance of adhering to cultural norms within the fashion industry. In the UK, there is a growing awareness and demand for sustainable and ethically sourced fashion products. Therefore, the company's strategic decisions, such as investing in eco-friendly manufacturing processes and promoting ethical fashion initiatives, are influenced by societal expectations and industry standards.

Additionally, institutional pressures from industry peers, trade associations, and consumer advocacy groups can influence the company's behaviour and strategic choices. For example, the company may face pressure to align with industry-wide initiatives aimed at promoting diversity and inclusion in the workforce or reducing carbon emissions throughout the supply chain.

By recognising these institutional pressures and influences, the company can make informed strategic decisions that not only ensure compliance with regulatory standards but also enhance its reputation, brand image, and long-term sustainability. In essence, Institutional Theory helps explain how external factors influence organizational behaviour, enabling companies to adapt to their environments effectively. This understanding is at the heart of strategic thinking.

A summary of implications for strategic thinking is given in Table 3.

Insight from Institutional Theory	**Description**	**Implications for Strategic Thinking**
1. Understanding of Institutional Context	- Organizations must comprehend their broader institutional environments, including norms, regulations, and cultural expectations, to navigate strategic decisions effectively (Woodhouse & Johnston, 2023). - Different institutional configurations influence economic outcomes, meaning similar strategies may yield different results across countries. - Organizations should conduct thorough institutional analyses to identify nuances that may affect their strategies and success.	- Develop context-specific strategies by conducting comprehensive institutional analyses. - Avoid assumptions of similarity across markets and tailor strategies to local conditions.
2. Ability to Understand and Adapt to Institutional Change	- Institutions are dynamic, changing over time; organizations must manage these changes effectively to remain competitive (Gingrich, 2015). - Organizations should monitor political and	- Foster a culture of adaptability within the organization to respond swiftly to institutional changes.

	regulatory developments to anticipate changes and adapt strategies accordingly. - A culture of adaptability and effective stakeholder engagement is crucial for managing institutional change and building resilience.	- Implement continuous monitoring of the political and regulatory landscape.
3. Enhancing Organisational Legitimacy	- Legitimacy is vital for organizational success; aligning strategies with institutional expectations fosters support and trust among stakeholders. - Organizations that conform to norms and regulations can enhance their credibility and long-term viability. - For example, multinational corporations must consider local regulatory and cultural factors when entering new markets to build legitimacy.	- Prioritize stakeholder engagement to build trust and enhance legitimacy. - Align strategic initiatives with institutional expectations to secure support.
4. Influence on Organisational Behaviour	- Institutional Theory explains how external factors influence organisational behaviour and strategic decisions (North, 1991). - Compliance with regulations and adherence to cultural norms shape operational practices and strategic choices, such as ethical sourcing and sustainable practices in the fashion industry. - Understanding these influences allows organizations to adapt their strategies effectively.	- Recognize and analyse external pressures influencing organizational behaviour. - Adapt strategies to meet regulatory requirements and societal expectations.

Table 3: A Summary of Implications for Strategic Thinking.

Case Study: Strategic Decision-Making at Marks & Spencer (M&S)

Introduction:

Marks & Spencer (M&S), a renowned British multinational retailer, faces the challenge of expanding its operations into new international markets while maintaining its position as a leader in the retail industry. Incorporating insights from Institutional Theory into its strategic decision-making processes can provide valuable guidance for navigating the complex institutional contexts of various countries.

1. Understanding of Institutional Context:

M&S recognises the importance of understanding the diverse institutional contexts in which it operates. The company conducts thorough analyses of the regulatory frameworks, cultural norms, and historical legacies of potential new markets before making strategic decisions. For example, when considering expansion into European markets, M&S acknowledges the significant variations in institutional landscapes among countries, such as differences in legal traditions and labour market regulations.

Case Study Example: M&S conducted extensive research before entering the French market, recognising that despite being a Western capitalist economy like the UK, France has distinct institutional differences, particularly in terms of labour laws and consumer preferences. By understanding these institutional nuances, M&S tailored its market entry strategy to align with French regulatory requirements and cultural expectations, thereby mitigating risks and enhancing its chances of success.

2. Ability to Understand and Adapt to Institutional Change:

M&S acknowledges that institutional environments are dynamic and subject to change over time. The company actively monitors political developments, regulatory trends, and societal movements to anticipate shifts in institutional landscapes. By embracing innovation and fostering a culture of adaptability, M&S remains responsive to evolving institutional pressures, ensuring its continued competitiveness and resilience.

Case Study Example: In response to growing consumer demand for sustainable and ethically sourced products, M&S underwent a strategic shift to incorporate eco-friendly manufacturing processes and promote ethical fashion initiatives. By aligning its strategy with evolving institutional expectations regarding environmental sustainability, M&S not only enhanced its legitimacy but also gained the support and trust of key stakeholders, including consumers and advocacy groups.

3. Enhancing Organisational Legitimacy:

M&S recognises the importance of aligning its strategic decisions with institutional expectations to enhance its legitimacy within the broader societal framework. By conforming to regulatory requirements and cultural norms, M&S cultivates trust and goodwill among key stakeholders, fostering a supportive environment conducive to growth and sustainability.

Case Study Example: When expanding into markets with stringent environmental regulations and a strong emphasis on sustainability, such as Scandinavia, M&S proactively adjusted its strategy to prioritise environmental stewardship. By investing in green technologies and community outreach programmes, M&S not only complied with institutional expectations but also bolstered its legitimacy and garnered support from governmental bodies and local communities.

4. Influence on Organisational Behaviour:

Institutional theory sheds light on how external institutional factors influence M&S's strategic decisions and organisational behaviour. By recognising these influences, M&S can make informed decisions that ensure compliance with regulatory standards, enhance its reputation, and promote long-term sustainability.

Case Study Example: In response to institutional pressures to promote diversity and inclusion in the workforce, M&S implemented initiatives aimed at fostering a more inclusive workplace environment. By aligning its behaviour with industry-wide standards and societal expectations, M&S not only enhanced its brand image but also strengthened its position as a socially responsible retailer.

Conclusion:

By incorporating insights from Institutional Theory into its strategic decision-making processes, Marks & Spencer effectively navigates the complex institutional contexts of international markets, ensuring its long-term sustainability and success in an ever-changing business landscape.

What Can a Strategic Thinker Do?

The integration of Neoclassical Economics and Institutional Theory into strategy-making offers a comprehensive approach to navigating the complexities of modern business environments. We summarise the pros and cons of each theoretical approach, with their implications for strategic thinking in Table 4. By combining these frameworks, organizations can develop more robust, ethical, and sustainable strategic plans that are well-aligned with both economic objectives and institutional contexts.

1. **Balancing Short-term and Long-term Goals:** Neoclassical Economics emphasizes short-term profit maximization and operational efficiency, while Institutional Theory encourages a long-term focus on sustainability, social responsibility, and regulatory adaptation. Strategic thinkers can harness this duality by creating a balance between optimizing short-term profitability and ensuring long-term viability. This approach allows firms to remain competitive while also addressing evolving societal and institutional demands, such as environmental sustainability and corporate ethics.
2. **Adaptive Strategy in Dynamic Markets:** Neoclassical models provide tools for responding to market fluctuations and making data-driven decisions. However, Institutional Theory adds a layer of adaptability by equipping

businesses with insights into how institutions and regulatory environments change over time. Strategic thinkers can leverage this to create flexible strategies that not only respond to immediate market conditions but also anticipate institutional shifts and evolving social expectations.

3. **Enhancing Organizational Resilience:** By integrating institutional insights, organizations can build resilience against external shocks, such as regulatory changes, societal pressure, or cultural shifts. Strategic thinkers who incorporate Institutional Theory into their planning can anticipate these changes and develop proactive measures, such as improving stakeholder relations or aligning business practices with emerging social norms. This leads to stronger, more adaptable organizations capable of thriving in unpredictable environments.
4. **Ethical and Inclusive Decision-Making:** Neoclassical Economics tends to focus on profit maximization, often sidelining ethical considerations, while Institutional Theory promotes a deeper engagement with social norms, ethical issues, and stakeholder expectations. Strategic thinkers can use this combined perspective to craft strategies that are not only financially sound but also socially responsible. This ethical dimension enhances corporate reputation, stakeholder trust, and long-term sustainability.
5. **Leveraging Quantitative and Qualitative Insights:** Neoclassical Economics offers powerful quantitative tools for evaluating performance, costs, and market dynamics, while Institutional Theory brings a qualitative understanding of how culture, values, and institutions influence behaviour. A strategic thinker who draws on both frameworks can apply quantitative analysis to measure business performance while using qualitative insights to ensure that strategies are aligned with broader social and institutional contexts.
6. **Innovation and Collaboration:** Institutional Theory emphasizes the importance of collaboration, networks, and partnerships, encouraging organizations to work with stakeholders and external institutions. By fostering such collaborations, businesses can drive innovation, share knowledge, and stay ahead of industry trends. Neoclassical insights, meanwhile, provide the analytical framework to ensure these collaborations remain efficient and value-driven.

This integrated approach not only enhances organizational success but also contributes to the broader goal of creating more inclusive, equitable, and sustainable economic systems. Strategic thinkers who understand that economics extends beyond mainstream Neoclassical thought are better equipped to generate novel insights and devise strategies that are multidimensional. By incorporating both individualistic and institutional perspectives, businesses can remain competitive while also contributing to a more sustainable and equitable global economy.

The Plurality of Economics and the Implications for Strategic Thinking			
Neoclassical Economics		**Institutional Theory**	
The Good (Pros)	***The Not So Good (Cons)***	***The Good (Pros)***	***The Not So Good (Cons)***
Individualism Focus: It prioritises individual decision-making and personal responsibility, aligning with liberal democratic principles. Moreover, this framework assumes that individuals, acting in their self-interest, make rational decisions that contribute to overall economic efficiency. Consequently, by focusing on personal responsibility, individuals are expected to bear the outcome of their decisions, whether positive or negative.	**Overlooks social institutions**: It overlooks the importance of social institutional, and collective dynamics that shape economic behaviour and outcomes. This is because it primarily focuses on individual decision-making and assumes that each person acts independently to maximise personal utility or profit. In reality, economic actions are deeply influenced by factors such as social norms, cultural values, institutions, and historical contexts, all which guide how individuals behave in markets.	**Recognising the Role of Institutions**: Institutional Theory emphasizes how institutions (formal and informal rules, norms, and practices) shape economic behaviour and organizational outcomes. This understanding helps organizations navigate complex environments influenced by societal expectations and cultural norms.	**Analysing Operational Efficiency**: Institutional Theory tends to focus more on the social and cultural contexts that shape behaviour rather than on the specific mechanisms that drive operational efficiency. It may not provide the quantitative tools or models needed to evaluate performance metrics effectively. It emphasises longer-term issues over short-term ones.
Rationality Assumption: Neoclassical economics assumes individuals behave rationally, seeking to maximise utility or profit, which ensure that scarce resources are allocated to their most valuable uses. This rational behaviour assumption provides a clear and structures framework for understanding and predicting economic decision-making. Furthermore, it assumes that all economic agents – whether individuals, firms, or governments – have access to perfect information,	**Irrational Nature of Humans**: The assumption that individuals always act rationally in neoclassical economics is often criticised as overly simplistic. However, people frequently make decisions that are not purely logical or self-serving. Instead, individuals often act irrationally, driven by a variety of factors such as emotions, cognitive biases, or incomplete information, all of which can impact strategic decision-making in organisations.	**Understanding Organizational Behaviour**: It provides insights into how organizations adapt to their institutional contexts. By analysing the pressures and expectations from various stakeholders, organizations can better align their strategies with the realities of their environments that extend beyond markets.	**Quantitative Evaluation of Initiatives**: While Institutional Theory emphasises qualitative aspects of decision-making influenced by institutional norms and values; it often lacks rigorous quantitative analysis. This can make it challenging for organizations to evaluate the financial impact of specific strategic initiatives systematically.

allowing them to weigh the costs and benefits of every decision they make.			
Focus on Profit Maximisation: By focusing on profit maximisation, firms can contribute to overall economic efficiency by ensuring that scarce resources are allocated to their most valuable uses. This can lead to an increase in both producer and consumer surplus within competitive markets. Moreover, profit maximisation also fosters investment and economic growth, as successful firms reinvest profits into expanding operations, creating jobs, and improving productivity.	**Ignores border societal goals:** Profit Maximisation ignores broader societal gaols, such as equitable wealth distribution, environmental sustainability, which often requires sacrificing immediate profit for the greater good. As such, it often leads to short-term thinking by prioritising immediate profit over long-term sustainability or ethical considerations. This approach can also lead to the prioritisation of profit at the expense of employee well-being and corporate ethics.	**Navigating Regulatory Changes:** Institutional Theory equips organizations with frameworks to understand and adapt to regulatory changes effectively. It emphasises compliance and the role of regulations in shaping business practices, helping organizations avoid legal pitfalls and align with government expectations.	**Focusing on Profitability:** Institutional Theory can sometimes prioritize social and ethical considerations at the expense of profitability. While this perspective is crucial for sustainable practices, it may lead to suboptimal financial outcomes for organizations that need to balance profit with social responsibility.
Marginalism: Uses marginal analysis to guide decisions, focusing on incremental changes that maximise utility or profit, which is useful in business and resource allocation. This approach assumes that individuals and businesses make rational decisions by comparing the marginal cost (the cost of producing one additional unit of a good or service) with the marginal benefit (the additional satisfaction a person or business gains from consuming or producing one more unit of a good or service.	**Overlooks Systemic issues**: Marginalism often overlooks larger systemic issues, focusing more on short-term or small-scale optimisation while ignoring broader social impacts. This narrow focus also means that marginalism may not be well-equipped to deal with long-term systemic challenges such as climate change, inequality, or financial crises.	**Facilitating Change Management**: By understanding institutional pressures, organizations can develop strategies for managing change more effectively. Institutional Theory helps identify the forces driving change and the resistance that may arise, allowing for more informed and strategic responses.	**Adaptability in Dynamic Markets:** Although Institutional Theory recognizes the importance of institutions in shaping behaviour, it may struggle to keep pace with rapid changes in market conditions. Organizations might find it challenging to adapt quickly to new trends or disruptions when relying heavily on institutional frameworks.

Focus on Equilibrium: Neoclassical economics provides insight in how economies move toward equilibrium, a state where supply and demand in the market naturally balance each other. This equilibrium is achieved through market forces: when there is excess supply (a surplus), prices tend to fall, and when there is excess demand (a shortage), price rise. These adjustments help guide the market back to a balance state.	**Market Equilibrium - a rare condition**: The assumption of equilibrium is often criticised because real-world markets are highly dynamic and rarely, if ever, reach a state of perfect equilibrium as described in traditional neoclassical economic models. In practice, markets are constantly evolving and influenced by various factors that lead to fluctuation, imbalances, and inefficiencies.	**Enhancing Collaboration and Networks:** Institutional Theory highlights the importance of collaboration and relationships among organizations, stakeholders, and institutions. This perspective encourages companies to build networks and partnerships that can enhance innovation and knowledge sharing.	**Adaptability in Dynamic Markets:** Although Institutional Theory recognizes the importance of institutions in shaping behaviour, it may struggle to keep pace with rapid changes in market conditions. Organizations might find it challenging to adapt quickly to new trends or disruptions when relying heavily on institutional frameworks. It promotes longer term strategic thinking over short term decision making.
Short term focus: Neoclassical economics is well suited for guiding firms and markets in short-term optimisation. It prioritises immediate resource allocation, enhance operational efficiency and competitive positioning. It Focuses on maximising short-term profits, minimising cost, systematically evaluate the incremental benefits and costs of strategic initiatives and ensures that every strategic decision is evaluated for its potential to enhance profitability, thereby supporting the organisation's long-term success.	**Lack of long-term focus**: Neoclassical economics often overlooks long-term strategies like innovation, sustainability and investment in research and development, which are crucial for future growth and resilience. As a result, it tends to neglect non-economic factors, such as ethical considerations, dynamic market conditions, social inequality, and environmental impacts. This focus can lead to myopic behaviour, where firms prioritise short-run profit gains at the expense of long-term viability. Moreover, by emphasising competition and profit maximisation, Neoclassical economics relies heavily on simplistic assumptions.	**Fostering Long-Term Strategic Thinking:** Institutional Theory promotes a long-term view of strategy by encouraging organisations to consider the impact of their actions on institutions and society as a whole. This perspective helps businesses make more informed decisions that align with long-term goals, ensuring sustainability and resilience in changing environments.	**Underestimating Competitive Forces:** Institutional Theory can sometimes underplay the role of competition and market forces. While it acknowledges the impact of institutions, it may not adequately address how competitive dynamics can influence organizational behaviour and strategic decision-making. It involves itself more with ‘meta’ market issues.

Table 4: The Pros and Cons of Neoclassical Economics and Institutional Theory.

Recommended Reading

Exploring Further the Plurality of Economics:

1. Harvey, J., 2015. Contending Perspectives in Economics: A Guide to Contemporary Schools of Thought. 1st Edition. Edward Elgar.

Institutional Theory:

1. Woodhouse, D. & Johnston, A., 2023. Comparative capitalism and the empirical taxonomy of context: enhancing the institutionalist blueprint. Critical Perspectives on International Business, 19(5), pp. 661-698.

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