2

Theorizing Organizations

Learning Objectives

This chapter will:

- **Review the central concepts and arguments of organizational economics, institutional theory, and evolutionary theory**
- **Highlight the differences and commonalities between these theoretical frameworks**
- **Discuss the linkages in these frameworks to the relational perspective**

1. Introduction

The broad reach of theorizing organizations is not surprising, given the complexity of the subject matter, which encompasses structures and processes, actions and contexts, and relationships cutting across levels of analysis, from cognition at the individual level to inter-organizational relations at the level of communities. Scholars study identities, hierarchies, decisions, rules, and so on as **ontological** matters, on the assumption that such entities have a consistent existence and can be unambiguously specified. They are also interested in **epistemological** questions regarding, for example, the degree of certainty in conclusions drawn from the analysis of the same ontological matters in different settings.

Some researchers use a single perspective to investigate a narrow question, such as whether employees on long-term contracts are more or less likely than temporary employees to share information with colleagues. Others draw on several perspectives in the same study to explore the interconnections between different problem areas, such as the processes by which managers' perceptions of external **stakeholder** demands translate into organizational change programs. Investigators often take analytical concepts from adjacent disciplines, where they are already well tested, to be methodologically efficient, or they use them as "bridging concepts" to avoid seeing phenomena in isolation. Resource dependence theorists, for example, who study the uncertainties that organizations face when they require resources controlled by other organizations, draw on reasoning from political science to explore the contestability of organizational design (Pfeffer and Salancik, 1978). Researchers working from the knowledge-based perspective draw on identity theory in social psychology to explain the conditions under which individuals share knowledge (Kogut and Zander, 1996). Organizational demographers use arguments from cognitive science and social exchange theory to investigate the impact of management team diversity on the competitive strategy of organizations (Hambrick et al., 1996). And learning theory is used by social network theorists to investigate the diffusion of information across organizational boundaries (Kraatz, 1998). Such cross-disciplinary work requires much diligence in the use of concepts developed for different contexts, but it increases the likelihood of new theoretical insights for understanding complex situations.

Organizational scholars sometimes borrow ideas from different areas of inquiry to create a more encompassing explanatory scheme which sorts the empirical observations and guides the collection of data. Their goal is to identify competing and complementary arguments in the search for logically adequate and empirically grounded explanations for organizational phenomena. In doing so, they may draw on perspectives that employ similar streams of argumentation and build upon each other. Social identity theorists, for example, use ideas from the interpretive approach to explain the construction of organizational identity, and motivation theorists use interpretivist arguments to study how individuals select cues from their social situation to make sense of task requirements. Resource dependence theorists draw on interpretivism as well to explain how actors perceive demands from the organization's environment. And institutional theorists employ interpretive arguments to explain how actors create the organizational rules to which they then respond. Interpretation is central to human agency and to the relational aspects of organizational structure and action, explaining how choices are developed, evaluated, and renegotiated by individuals in an ongoing dialog with unfolding situations (Emirbayer and Mische, 1998; Meyer and Jepperson, 2000; Powell and Colyvas, 2008).

Although it is unlikely that there will ever be a "grand theory" (Merton, 1967) in organization science, synthesizing everything to be known about organizations, there are certain strands which can be usefully drawn together. Perspectives with the same epistemological roots, for example, may be subsumed under schools of thought, theory groups, or frames of reference. As theoretical frameworks, they provide orientation by sorting ideas and concepts into consistent categories, integrating related streams of research, and permitting comparison across different research contexts. In areas of inquiry as diverse as organization studies it is often useful to search for possibilities of integration across different perspectives. Without at least some concern for integration, scholars risk propagating a highly fractionated view of organizational phenomena. A lack of appreciation of links between perspectives can also lead to a certain degree of research inefficiency, if scholars fail to consider ideas produced in areas other than their own and then simply "rediscover" what is known already.

The aim of this chapter is to review three theoretical frameworks that, over the last few decades, have become central points of reference in organizational analysis: organizational economics (regarding costs and benefits), institutionalism (regarding norms and values), and organizational evolution (regarding adaptation and change). Taken together, these frameworks are sufficiently broad to capture the central elements of organizations as continually evolving activity systems, oriented towards collective goals, and struggling to maintain a distinct identity in an uncertain environment from which they draw vital resources. They also share common links to the relational view on organizations. The central ideas in these frameworks are summarized in Table 2.1.

Table 2.1 Key ideas in organizational economics, institutionalism, and evolution

	Economics	Institutions	Evolution
Key concepts	Governance	Meaning	Change
Assumptions about humans	Self-interested, opportunistic, intendedly rational	Sociable, socially biased, conforming	Mindful, future- and past-oriented
Units of action and interpretation	Exchange, transaction	Ideas, norms, symbols, values	Rules, routines, competencies
Goals of organizational design	Administrative efficiency	Accountability, predictability, social legitimacy	Adaptability, external and internal fitness
Key causal mechanism	Instrumental rationality	Meaning construction, negotiation	Contribution to fitness

2. Organizational economics

Organizational economics has its origins in debates that economists have had since the 1970s – with precursors in Barnard's (1938) **inducements–contributions** calculus and March and Simon's (1958) writings about the rationality of self-interested individuals – about whether firms are homogeneous organizational entities and whether they operate in markets that are sufficiently competitive to weed out inefficient firms (Barney and Ouchi, 1986). Organizational economists differ from the standard neo-classical view in that they do not take the firm – or more broadly, the organization – as given and do not treat it as a "black box," with structures and practices that are irrelevant to the firm's position in markets. In contrast to the standard neo-classical economic approach, which presumes that individual actors are perfectly rational and firms are driven solely by profit maximization goals, organizational economists propose a rather weak model of optimality. Individuals, so their argument goes, are constrained in their **instrumental rationality** because they do not have access to complete information and are not fully capable of processing the information available to them. Akin to **rational choice theory**, individuals are considered intendedly rational; given the constraints of information and time, they simplify the decision problem rather than seek the best possible solution (March and Simon, 1958).

The perspectives falling within the framework of organizational economics are oriented to the guiding question: "Why are there *any* organizations?" The answer to this question employs the concepts of exchange, cost, efficiency, and governance. Any production system involves the exchange of entities such as labor, commodities, services, and information. Exchange implies costs (e.g., searching for information, negotiating deals, evaluating outcomes), motivating the actors to select an efficient form of governance for coordination and control. Organizational economists have developed several approaches to the question of what kinds of governance forms help to reduce the uncertainty associated with exchange, each addressing a specific aspect of this question: property rights, principal–agent relations, and transaction costs (Barney and Hesterly, 1996).

2.1 Property rights

The standard economic approach views markets as the most efficient solution to the problem of coordinating economic exchange. The "invisible hand" of the price mechanism in markets that are competitively structured and populated by calculatively rational economic actors is thought to ensure that exchange is swift and equitable in the sense that the least efficient actors are weeded out – at least in the long run. Organizational economics emerged out of a critique of this view, asking why there are any firms at all. If markets are the most efficient way to manage exchange, why would there be complex organizational systems, like corporations? These are costly to maintain because one cannot assume that individuals always cooperate voluntarily and contribute equitably to collective efforts (Coase, 1937), not even in organizations pursuing non-economic goals, like schools and social clubs.

According to Alchian and Demsetz (1972), the concept of **property right** offers an explanation for the existence of organizations by providing an institutional framework for defining the conditions of ownership and control of productive assets and for evaluating the costs of control in an organization relative to the costs of governance in the open market. Producers will establish an organization only if they expect the benefits of "internalization" to exceed the costs. Creating an organizational system for allocating scarce resources and monitoring their uses involves various costs. For example, individuals may pretend to possess valuable skills or they may claim to be committed to a work team, thus creating a "**moral hazard**" for the principal. If they have an incentive to exaggerate claims about their performance, they cannot be trusted and need to be monitored closely. In this case, the rational principal will assign monitoring functions to select individuals, acting as supervisors or managers, to observe, evaluate, and sanction the efforts of each producer. Creating such roles is efficient up to a point beyond which the marginal costs of monitoring exceed the marginal benefits from reduced shirking. However, this solution to governance introduces the problem of creating efficient incentives for the monitor to expend effort on monitoring. The person assigned a monitoring role may want to shirk as well, by distorting information about the details of his or her monitoring activities. A solution is to reward monitors by giving them "property rights," that is, the right to exclusive usage of resources (e.g., money, labor, equipment, information), including the right to negotiate contracts, determine payment for their contributions, and extract the residual income from the value created by those they monitor (Alchian and Demsetz, 1972). The assignment of such rights leads to the creation of an organizational hierarchy, stretching from lower-level supervisors and project leaders, to department heads and top managers.

Based on the assumption that individuals are motivated to maximize the returns from the rights given to them, the question is, how are these rights distributed in an organization and how do the actors put them to use? What is the structure of property rights that maximize the efficient use of resources? The distribution of property rights among the members of an organization determines the structure of behavioral opportunities. One might hypothesize, for example, that publicly owned organizations are less efficient than privately owned organizations if the former lack transfer rights and incur higher control costs. Changes in the economic environment, such as the intensity of market competition, or in the institutional environment, such as foreign trade regulation or antitrust legislation, can lead to efficiency gains or losses for organizations, depending on their effects on the incentive structure for owners and controllers (Bishop and Thompson, 1992).

2.2 Principal–agent relations

In large-scale organizations, it is unlikely that those who own property are in full control of the use to which their property is put. To the extent that principals lack time or expertise to exercise control, they may delegate managerial control to others, the agents. This leads to a principal–agent relationship in which the agents may be able to exploit or circumvent the principals' control attempts. To protect themselves from exploitation by agents, who may be opportunistically inclined, principals may want to specify contractually all expectations they have of agents managing their assets (Aoki et al., 1990). In practice, however, it is rarely possible to write complete contracts, covering all contingencies that might arise. There may be uncertainty about the future, and it may be too costly to enforce contract specifications that are open to interpretation in changing environments and when there are many agents involved. Contracts cannot effectively compensate for the stochastic elements one finds in many organizational settings (Holmstrom, 1982).

The agency problem is the possibility of an opportunistic agent acting against the interests of principals who are then motivated to act *as if* the agent will indeed behave opportunistically. Principals will want to create organizational structures to protect themselves from exploitation, while minimizing the agency costs (i.e., monitoring and sanctioning agent behavior) associated with such structures. If they cannot exercise "process control" by verifying agent behavior directly, they may attempt to monitor the *results* of behavior, by exercising "output control." However, this does not solve the agency problem if performance outcomes are difficult to measure, or there are disputable definitions of "good" performance. In this case, the labor market in which managerial competencies are traded may be the only mechanism to discipline managers, but the efficiency of this mechanism depends on the availability of appropriate metrics and reliable information about managerial skills. In cases where such information is absent, principals may rely on social indicators, such as the reputation of agents. For example, company shareholders may appoint to the governing board directors considered experts in a particular field (Singh and Harianto, 1989), and the stakeholders of universities may resort to university ranking schemes as indicators of quality management (Gioia and Corley, 2002). Reputational indicators, however, are subject to their own limitations, as argued by institutional theorists.

2.3 Transaction cost economics

The transaction cost economic perspective complements property rights and agency theory with a concern for the costs of exchange taking place in organizations relative to the costs of exchange in markets (Williamson, 1994). The basic unit of analysis is the individual transaction implicated in the exchange of goods, services, or information. Transaction costs arise from the preparation of an exchange relationship, leading to an informal agreement or a formal contract. They include the costs of identifying appropriate partners, assessing their trustworthiness and likely contributions, and negotiating the terms of the exchange. Other costs arise after an agreement has been forged, such as the costs of monitoring the partner's compliance with the terms of the agreement, enforcing compliance, and adjusting the terms of the exchange, if necessary.

While property rights and agency theories are more concerned with the distribution and use of authority, the transaction cost approach focuses specifically on the organizational boundary question, asking about the conditions under which transaction costs in the open market are so high that it is more efficient to bring exchanges into the organization, where they become subject to hierarchical control (Eisenhardt, 1989). From the transaction cost perspective, markets are only efficient to the extent that the actors have full information about each other's competencies and commitments, and are able to assess the value of the exchange. Transaction costs are higher in situations of uncertainty if, for example, the actors cannot rely on prices as a source of information about the value of the exchange or if they cannot assess the trustworthiness of the exchange partner. Uncertainty forces them to expend more resources on coordinating exchanges than they otherwise would. Hence, they have an incentive to design governance forms that minimize transaction costs. One option is to internalize those exchange relations that entail the greatest degree of uncertainty and to externalize the more routine activities, thus either expanding or constricting the organization's boundary for different activities.

Given the assumption of bounded rationality and opportunism, actors will always be under pressure to devise governance structures that economize on transaction costs. The general answer to the question "Why do organizations exist?" is that organizational authority systems emerge to resolve the problems of market-based governance under conditions of uncertainty. Two conditions are particularly relevant as sources of uncertainty: transaction frequency and transaction-specific investments (Williamson, 1985). Regarding *transaction frequency*, the more often an exchange takes place between two partners, the greater is the incentive to find an economical way to manage the relationship. One-time exchange is not worth worrying about; it can be handled through "spot" contracts specifying inducements and contributions, as when a tourist purchases a snack at a hot dog stand. However, if there is a high probability that the exchange will occur again, there is an incentive for the actors to enter into a long-term relational agreement. For example, two lawyers specializing in different fields, who expect to be working together on the same type of projects again in the future and who know that their collaboration will require much time investment, may decide to create a formal partnership because this saves on transaction costs from not having to renegotiate the terms of the relationship for every project.

Transaction-specific investments refer to the resources the partners invest to maintain the relationship. For example, the actors may contribute special skills that are of value only in that relationship, for example because the skills are tied to the specific needs of a joint customer. Asset-specific skills, which cannot be transferred readily to other people or organizations, increase the degree of informational and behavioral interdependence between the actors, which in turn increases uncertainty if the actors behave opportunistically. Organizations provide a solution to this problem to the extent that they can impose formal rules and hierarchical controls or can rely on informal controls, as will be discussed in Chapter 6. When transactions involve high asset-specificity and recur frequently, the partners have an incentive to create long-term organizational arrangements providing reliability and information transparency, rather than relying on short-term contracts mediated through the price mechanism of markets. Robust organizational forms would be expected, for example, in the surgical department of a hospital, where it is critically important that staff coordinate their specialized skills flexibly and equitably in line with evolving patient needs, task requirements, and technological possibilities. Organizational structures that provide clear rules and support collegial behavior and consensual decision-making among the medical staff tend to be more efficient in this case than short-term, arm's-length market relations (Witman et al., 2010). Once the actors work under common ownership and the same organizational roof, they have less incentive to seek personal advantages over each other.

2.4 Summary

Organizational economists have made significant contributions to our understanding of organizations. Compared to the standard economic approach, which treats organizations mostly as a "black box" or assumes that organizations are singular and coherent entities, the perspectives dealing with property rights, principal–agent relations, and transaction costs come much closer to organizational reality, taking into account the bounded rationality of actors and the problem of uncertainty. They discuss organizations not as monolithic entities but as aggregates of individuals with different capabilities and utility functions. Their specific contribution to organizational analysis is the concern for costs and benefits, the separation of ownership and control, and the conditions under which exchange relations are better coordinated hierarchically in organizations than through the market price mechanism. The organizational economics framework, however, is often criticized for its axiomatic approach to economic criteria (e.g., efficiency, utility maximization), at the expense of viewing organizations and markets as "social constructions" replete with cultural meanings, social biases, and flawed interpretations. Organizational economics is most useful for studying organizational settings with actors who are motivated mostly by material concerns. These are primarily economic enterprises, but may also include organizations offering their members social or cultural returns, to the extent that the members evaluate these returns in terms of "more" or "less" and are willing to pay a "price" for goal achievement. Still, any economic approach to organizations is limited if the individual and organizational actors are abstracted out of their social and institutional context (Granovetter, 1985). In organizational economics, questions concerning, for instance, the political enforcement of contracts or the social definition of property are either not problematized at all or are addressed only indirectly, with recourse to other theories, such as institutional theory. Institutionalist thinking has gained some currency in economics but has largely remained within the economic tradition of viewing actors as basically self-interested and competitive (Hodgson, 2004). Institutional theory has much stronger grounding in sociology, political science, and history, where it is used to contemplate how "things came to be what they are" and how actors quarrel over how "things should be."

3. Organizational institutionalism

Broadly defined, institutions are relatively persistent rule systems, allowing people to act collectively on the basis of common understandings. Distinct rule systems can be found in areas like government, business, family, education, health, and religion. Each of these areas consists of a web of meanings and values which specify how its participants should act and relate to one another. Social and economic processes are considered institutional if they have a rule-like quality providing coherence and stability. Institutions penetrate organizations in the form of cultural ideas, social conventions, and cognitive frames with which problems are evaluated and solutions are devised, based on understandings of what is socially acceptable in a given instance (Scott, 2008). Hospitals, for example, admit patients on the basis of socially defined rules classifying different categories of patients for specialized treatment; universities handle student grievances using rules distinguishing a legitimate from an illegitimate grievance; and sports clubs use rules specifying acceptable forms of fundraising. Institutional rules are often infused with values and ideologies, which individuals or groups may use to **rationalize** their vested interests, as when funeral undertakers argue that selecting a "bottom-price" funeral arrangement would indicate a lack of respect for the departed.

Institutional theory has a long and rich history in the social sciences, with broad applications in organizational analysis at both the micro-level of cognition and interpretation (Powell and Colyvas, 2008) and the macro-level of society (Zucker, 1987). Institutional theory extends into every corner of society, drawing on broad-sweeping ideas of such thinkers as Marx, Weber, Durkheim, Mead, Simmel, Tönnies, and Veblen regarding the functioning of markets, the role of laws, and the nature of social organization. Institutional theorists study the non-economic aspects of organizations as well as those things that are hidden from view if one thinks of organizations as merely instrumental entities. While there is no single unitary perspective in institutional theory, there is general agreement on the view of organizations as entities existing in social, political, and symbolic realms, subject to demands that are not always consistent with the material and technical requirements of production. It makes a difference for understanding organizations if one views them as tools for powerful elites to promote their interests or as entities following a logic of their own. Organizational economists take the former view, when they argue that the principals devise governance systems to protect their investments. Many institutional theorists take the latter view, suggesting that organizations often develop on their own terms, to the point where they may be able to escape economic requirements because they are taken for granted by their main constituents. When this happens, organizations have the quality of a "**social fact**" (Durkheim, 1982) in the sense that they are accepted independently of people's specific preferences.

3.1 Organizations as rationalized systems

The distinct insight of institutional theory is the view of organizational environments as a web of cultural elements providing meaning and legitimacy. Organizations are considered legitimate if there are undisputed explanations for their existence, roles, and jurisdictions. They gain the status of "rationalized systems" by absorbing, interpreting, and enforcing cultural values so that they can act as coherent entities (Meyer and Rowan, 1977). Institutional theory thus offers an antidote to the calculative rationality that economists normally impute to organizational actors. It suggests that models of rationality are themselves cultural notions, emerging out of the values and norms prevailing in a given social setting. In the educational sector, for instance, the key values revolve around the meaning of education in its various manifestations of training, schooling, and special needs instruction (Meyer, Boli and Thomas, 1994a). The specific meanings of education may be subject to contestation regarding the social value of particular ideas, or the pedagogical value of certain kinds of examinations, but there is general consensus on the social significance of education *per se*. In other fields, the key values may be more precarious, as in the mental health sector in many countries, where institutional rules are too weak to confer undisputed legitimacy on a given organizational form of detecting mental disorders and restoring mental health (Shorter, 1997). The result of ambiguity regarding the definition of mental health and the value of different therapeutic techniques is an organizationally fragmented sector that includes different professions with distinct interests and ideologies, competing therapeutic technologies, and different funding arrangements, as well as diverse populations of organizations (e.g., specialized clinics, counseling centers, self-help groups) with structures and goals that often have little to do with what goes on in everyday patient care (Meyer, 1994).

Some organizations may survive on the basis of "rationalized myths" (Meyer and Rowan, 1977). For example, when medical specialists promulgate the belief that standards of health in society will decline if tighter government regulations on fee structures are introduced, they may be creating a myth that rationalizes their vested interest in professional self-control. "Rationalized myths" are most likely to arise in settings where it is difficult to measure performance and cause–effect relations. In such settings, organizations often use rituals (e.g., award ceremonies, retirement parties) or engage in actions with symbolic value (e.g., architectural building designs suggesting progressiveness, product names indicating innovativeness) to save face or to promote confidence in what they are doing. Mental health clinics employ "admission suites," and youth summer camps use initiation rites, to create an illusion of consensus around the legitimacy of the organizational form they employ. Myth-like statements such as "Quality first" or "We care about people" obtain their force not from their truth value but from the fact that people think that everyone else believes in them. "Rationalized myths" are examples of institutions that have an impact not necessarily because they provide the "correct answer" regarding how best to solve certain problems, but because they carry values that people accept (Stinchcombe, 1997). Organizations reproducing themselves through myths may have forms that are far removed from efficiency-based evaluation. Mental health organizations, for example, may claim that they are effective because they follow government-mandated admission procedures or because they protect the idea of sovereignty of the individual, without having to prove that patient health is indeed improved through the therapeutic methods applied (Scheid and Greenley, 1997).

Organizations can enhance their survival chances by demonstrating that they act as legitimate participants in society. If they enjoy the status of institutionalized organizations, they can expect continued support from customers, government regulators, and investors even if there is no agreement on how to measure their economic contributions. If, on the basis of "rationalized myths," they can convince their institutional constituents that they take social expectations seriously, they may be able to conduct their operational affairs without having to document that they do in fact meet these expectations. This is not to say that compliance with institutions is incompatible with economic performance. Organizations may adopt product quality standards, customer complaint procedures, policies to curb sexual harassment, and so forth not only because this promotes the *image* of caring about quality or equity but also because it may in fact confer economic advantages (Beck and Walgenbach, 2005). Even organizations for which values (e.g., justice, political correctness) are at the center of their *raison d'être* (e.g., planned parenthood clinics, labor unions) can derive economic utility from value conformity. Social movement organizations and business interest associations may offer their members meaningful participation rights, while also providing material incentives to remain in the organization (Aldrich et al., 1994). And corporations may adopt human resource management techniques not only to present the image of a "modern organization" but also to improve their social standing in the hope that this helps to attract qualified managers and employees (Staw and Epstein, 2000).

3.2 Institutionalization processes

In contrast to the static approach of organizational economists who study the appropriateness of particular governance structures under existing conditions, institutional theorists take a more dynamic view, examining the processes by which organizations adopt particular structures. They ask about the origins and diffusion of institutional rules, and the strategies by which organizations adapt to them or alter them to suit their specific purposes (Scott, 2008). Institutionalization describes a process of constructing reality based on rules and standards that both enable and constrain human action. At the point where a particular reality is no longer questioned, it becomes objectified and internalized as being "true" (See Berger and Luckmann, 1966). Institutionalization may occur in a variety of ways. Organizational members may internalize standards through the acceptance of rewards or through peer pressure, or they may imitate the strategies and structures of other organizations. The outcomes of institutionalization are organizational forms that are independent of the preferences of particular actors and that no longer need to be maintained through explicit acts of social control (Zucker, 1977).

Institutional theory predicts that organizations that are subject to the same institutional forces will over time adopt similar forms. For example, the central role that family and village play in East Asia is taken as an explanation for the particular way businesses are structured and organizational authority is distributed in that part of the world (Wilkinson, 1996). In the typical Korean or Japanese enterprise, authority is based on moral superiority, in addition to technical competence. Employees in East Asian organizations are expected to participate in collective events, such as company-endorsed recreation or award ceremonies, to a far greater extent than is the norm in Western organizations. Institutional pressures rooted in tradition and custom are evident in the way East Asian corporations discourage employees from forging strong social ties with employees from other companies (Chai and Rhee, 2010). In Western companies, by contrast, it is far more acceptable that employees develop social ties with people outside the employer's domain. In industries that place a premium on innovation, such as the higher-education or the multimedia sector, employees may even be *encouraged* to maintain ties with outsiders in order to gain access to valuable knowledge (Benner, 2003).

Guided by the fundamental question, "Why are organizations so similar?," institutional theorists have identified three mechanisms by which organizations adopt forms in line with institutional expectations: coercive, normative, and mimetic (DiMaggio and Powell, 1983). *Coercive* forces typically emanate from the state via regulation, public ownership, or legislation. In the educational sector, for example, coercive pressures are evident in government regulations on standards for curriculum development, student evaluation, and teacher promotion. In the airline industry, safety standards are attached to landing rights granted by governments and airports. *Normative* forces operate through shared interpretations of values, attitudes, and identities. In contrast to coerced compliance, normative forces require no externally imposed motivation for conformity. Rather, the actors are internally motivated to do what is expected, or they rely on intermediary organizations, such as professional associations and labor unions, to aggregate and promote normative standards. In the educational sector, it is often through informal contacts between teachers and local employers that curriculum needs are interpreted. Lastly, *mimetic* processes are driven by organizations emulating other organizations. Many universities, for example, have introduced professional programs that mimic those of private educational institutes, and fashion shows are organized worldwide along presentation standards that are copied across events. Imitation of other organizations, particularly those that are perceived to be successful, is a common low-cost strategy for organizations in situations of uncertainty.

Coercive, normative, and mimetic processes may occur in the absence of evidence that they help organizations improve their economic performance. Organizations may be rewarded more for their similarity to other organizations than for their operational efficiency. Similarity may help them attract employees with particular competencies or may enhance their reputation as reliable social systems. Organizations may staff teams on the rotation principle to minimize bribery, but this practice can have severe efficiency costs. Managers may seek the advice of professional consultants and external coaches not because they can furnish indisputable evidence that their advice will bring economic success to the organization, but because the act of seeking advice allows them to say to the organization's stakeholders that they are doing *something* to improve their situation (Kieser, 1997). Organizations may develop expensive procedures (e.g., for performance evaluation) to signal to the public that they are serious about meeting social expectations through mechanisms such as "optimization" and "lifelong learning." Similarity in organizational form does not imply that organizations never diverge in the way they handle problems specific to their local environment. Schools, for example, will often deviate somewhat from institutional standards in order to maximize the flexibility required by the uncertainties of daily life in the classroom (Meyer, Scott, and Strang, 1994b). Medical clinics may maneuver between competing institutional logics, where health restoration is practiced with reference to technical, social, and economic criteria (Reay and Hinings, 2009). Institutionalization is best viewed as a fluid process that helps reduce uncertainty, without eliminating it, not least because organizations compete with others as they struggle to shape the very institutions that impact on their condition.

3.3 Constructing institutions

There is no singular and uniform approach within the institutionalist framework. Theorists differ foremost in their view of institutions as a set of relatively stable constraints or as a contested terrain. A common distinction is that between an older and a newer version of institutional theory (DiMaggio and Powell, 1991; Stinchcombe, 1997), although in research practice these two versions are often difficult to separate. Theorists working with the older version of institutionalism tend to take a view of institutionalization as essentially a political struggle between actors with competing interests. Organizational adaptation to environmental change is seen as a process driven by conflicts of interest between individuals and coalitions who use the organization as a strategic device to further their goals. Political struggles often have unintended consequences, which may say more about institution-building than the purposive actions themselves. Professional architects, for example, may engage in activities – in the name of “artistic freedom” or “professional rigor” – that are intended to produce innovations, but they may end up creating “silent hierarchies” and “invisible walls” (Brown et al., 2010). In the newer version of institutional theory (neo-institutionalism), the emphasis is less on conflict and change, and more on the persistence of institutional structures and their enduring impact on organizations. Institutions are seen as involving powerful forces at the macro-level of society, embedded in ideologies and state structures, and heavily constraining organizational options. In some cases, institutional forces are so strong that individuals are not even aware of any alternative actions they *could* take. Mental asylums (Goffman, 1961), spiritualist consulting (Zaidman et al., 2009), and religious sects (Bennett, 2006) are examples of organizations trying to create a “totalizing” experience for their participants.

In recent years, institutional theorists have paid more attention to the micro-level and cognitive elements of institutions, emphasizing human agency and choice within institutional constraints (Ingram and Clay, 2000). The immense growth of the global economy, it is argued, has softened institutional controls over the flow of goods, money, and labor, leading to more fragmentation and less predictability in the organizational world (Sennett, 2006). In line with these changes, many scholars are turning away from the assumption that institutions are mostly self-reproducing. They are paying more attention to the mechanisms by which institutions are maintained and extended into the future, or are adjusted to fit changing circumstances. Their argument is that institutions must be actively maintained, or they risk disintegration. To this end, many organizations employ expensive rituals to reinforce rules and expectations. Organizations may also attempt to create new institutions to reduce uncertainty in a hostile environment, as in the cultural sector where there is intense competition for limited resources and where organizations juggle economic goals with symbolic and aesthetic considerations (Amin and Thrift, 2007). Institutions play a central role in the cultural economy, by providing orientation through regulations, technological infrastructures, and social conventions. In a music cluster in northern Italy, for example, music academies, music events, and collective interest associations are constructed to achieve some degree of order for freelance musicians in an otherwise intensely competitive market (Sedita, 2008). The anecdote below (2.1) describes the problems an artist experiences who works in an industry that lacks the kind of institutional support that professionals in fields like law and medicine normally enjoy.

ANECDOTE 2.1

Sam had just moved from Toronto back to his small hometown in the Canadian Prairies to be closer to his family and friends from school. His friends back home had told him that as an artist with his kind of talent he could be innovative anywhere, but in his hometown he would also have emotional support of the kind he would not get in the "big city." Soon Sam realized that his move to this small rural town was a big mistake. He had many close friends there, but he missed the formal recognition as an *artist*. Not only was "this place just too straight to be different," as he called it, but it also lacked the kind of organizations that would give his work the legitimacy that people in other professions normally enjoy.

Sam thought that his identity as a professional artist was on shaky ground in a place that had none of the diverse arts organizations he was used to in Toronto. Being close to such organizations was important to him. Unlike lawyers, doctors, and engineers, who obtain formal training, licenses, reputation, and income in a well-established sector of organizations, he had only recourse to arts organizations that led an extremely precarious life in the economy. He felt that art was not given the social respect that professionals in other fields received. There were no socially accepted criteria for distinguishing the professional artist from the art hobbyist. He had been told by many people that artistic talent was a gift, not a skill that could be taught. He hated it when he met people who remarked that he was "just an artist."

All that Sam could do to gain respectability was to create his own reputation as a professional. To make his identity as a professional credible he had to confidently assert himself by making himself as visible as possible. His small, rural hometown was not the place to achieve this goal. This town did not offer him the opportunities he had in Toronto where he interacted with many other artists, people from the media, and organizers of workshops and special events. Being around old friends was nice and comforting, but he missed Toronto where he had access to art dealers, art critics, art collectors, art historians, and art schools.

A micro-level perspective on the construction of institutions forces attention to the motivations and capabilities of individual actors who work within existing institutional constraints but are not blind prisoners of institutions. Sam, in the above anecdote, prefers to be in Toronto where he can choose between a multitude of organizations relevant to his particular interests. Institutional environments are a dynamic complex of individuals, roles, rules, and meanings, producing variations in structures and enactments (Meyer and Jepperson, 2000). Many recent studies, designed from an institutionalist perspective, have taken an interpretive and **constructivist** stance to examine how exactly people create rituals, negotiate rules, or save face when confronted with failure (Powell and Colyvas, 2008). Such studies contribute to a more balanced approach to the tension between stability and change, and between structure and action in institutions. Research on institutions conceived at the micro-level of individual cognition and action, such as the study reported in the research brief below (2.1), views organizations as social constructions that acquire some stability only through the active engagement of organizational participants. This study shows how individuals contribute to the reproduction of a society's social class system by participating in a traditional organizational ritual in a leading university (Dacin et al., 2010). The findings suggest that institutional outcomes like legitimacy and reputation are not automatic but the result of people actively communicating ideas and negotiating over resources. Research on the micro-foundations of institutions and on the agentic aspects of institution building returns attention to power and politics as the issues that are at the center of the older version of institutional theory (Zald and Lounsbury, 2010).

RESEARCH BRIEF 2.1

Many studies of organizational phenomena conducted from an institutional perspective have either ignored the question of maintaining institutions or have assumed that the reproduction of institutional rules and routines is largely automatic, given the definition of institutions as taken-for-granted elements and entities. To show how institutions are linked to the actions of concrete individuals, Dacin et al. (2010) examined how micro-level interactions between people in organizational rituals contribute to the maintenance of larger societal institutions.

The authors studied how the ritual of college dining (the "Formal Hall") at the University of Cambridge contributes to the maintenance of the British social class system. Rituals are highly structured and dramatic episodes of repeated interaction and communication in which the participants develop shared understandings of some reality. This study shows how the dining ritual socializes the participants into particular values and teaches them the roles they are expected to play. By hiding disagreement and conflict, this ritual also motivates participants to maintain order and build a common identity, and to refrain from resistance to established social class values and the entitlements that go with social class. The dining ritual carries symbolic and cultural material that individuals draw on in their daily interactions also outside the university setting. This organizational ritual thus has wider societal implications, supporting the maintenance of social class distinctions across time and space.

While insightful in the specific instance of one particular organizational mechanism of institutional reproduction, it is not self-evident that the findings of this study can be generalized beyond the context under investigation. As the authors themselves note, this context is unique in many ways. The University of Cambridge is one of two universities in the United Kingdom that are most closely associated with social class. It is one of the two oldest universities in the English-speaking world and has, until quite recently, been overwhelmingly dominated by white, male students from privileged social backgrounds. The basic function of this university – to prepare students for life in the upper echelons of British society – has essentially remained unchanged. Uniqueness of context speaks to the limitations of a single case study, especially since, as in this empirical instance, longitudinal data are not available to explore the long-term dynamics of institution building. It is, therefore, not possible to test alternative explanations for the institutional outcomes investigated here. Nevertheless, this study highlights the details of an important institutional mechanism – organizational rituals – that occurs in many other organizational contexts as well (e.g., company birthday parties and initiation ceremonies) and that contributes to the reproduction of macro-level institutions, such as ideologies and social class beliefs.

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3.4 Summary

The central insights of all variants of institutional theory lie in the departure from the standard economic view of organizations as activity systems driven by the economic calculus of self-interested individuals. For institutional theorists, organizations do not exist only for instrumental reasons. Although their professed goal may be to maximize profits, they normally do not create forms oriented solely to the needs of efficient production. Rather, they are social systems held together by shared interpretations of acceptable norms of collective conduct. On the other hand, institutional theorizing is problematic to the extent that organizational actions are treated as *purely* social and it is assumed that social interaction has benevolent outcomes simply because the actors are familiar with each other or share the same experience. Although institutions impose powerful constraints, through the "rule of law" or through ideologies, organizational responses are often sub-optimal, haphazard, and contested. Recent studies have contributed additional insights into our understanding of the role of institutions in organizational life by exploring the micro-level actions by which institutions are constructed, reproduced, or transformed. By attending to the agentic aspects of institution building, one can move beyond the more reactive elements of institutional imitation and conformity. The idea that organizations may succeed or fail in their relationship with institutions is taken up explicitly by the evolutionary approach to organizational analysis.

4. Organizational evolution

Organizations always operate with some degree of uncertainty, no matter how well designed their structures are or how clearly their goals are specified (Aldrich and Ruef, 2006). In environments that are constantly shifting, organizations work with incomplete information, new problems arise, and old solutions are no longer effective. Much of organizational decision-making occurs by way of trial and error and improvisation, with results that are normally not the best ones possible. On the other hand, there may be outcomes of flawed actions that actually *improve* an organization's fate, depending on the state of the environment. From the evolutionary perspective, the relationship between organizational actions and outcomes is largely indeterminate. The more skilled or motivated individuals do not necessarily outperform the less "fit" individuals, and the more efficient organizations do not necessarily outcompete the less efficient organizations, an insight shared with institutional theory. Organizational evolution is a probabilistic process, not a deterministic one. What sometimes appears to be a sequence of decisions leading to a particular outcome may simply be something that individuals discover in retrospect. Evolutionary theory explains organizational developments without the assumption that individuals are economically rational or that they assign socially "correct" meanings to their actions.

Evolutionary theorizing in organization studies has its origins in nineteenth-century explanations of social change as a process driven by the gradual replacement of old entities with new ones that are better adapted to the new conditions (Tylor, 1871). The evolutionary idea is that the replacement of outdated entities with new ones can be explained by features of the relevant environment, without having to take recourse to notions like special creation, purposive design, or moral imposition (Dennett, 1995). Applied to organizations, this means that the success of entities like rules, routines, technologies, and work groups does not depend on the intelligence of organizational designers, strategy leaders, or governing board members, but on properties of the relevant environment which favor particular combinations of the elements constituting an organization. Scholars working in sociology (Runciman, 2009), anthropology (Richerson and Boyd, 2005), psychology (Campbell, 1969), and economics (Nelson, 2006) have extended Darwin's theory of biological evolution (as a natural selection process of descent with modification) to the study of change in the cultural realm of ideas and beliefs, and the social realm of action and interaction. Evolutionary processes are considered sufficiently general to apply to all systems (biological, cultural, and social), although the details of these processes vary across particular instances (Hodgson and Knudsen, 2006). Human behavior is subject to genetic *and* cultural influences. Inventions like the preferential hiring of women for certain kinds of jobs are of a social and cultural nature, and are not the result of changes in the human genetic code. It is well known that men and women can perform equally well in a variety of work roles, but it is also known that the different strategies that men and women may adopt for accommodating their work behavior to their unique psychologies is partly the result of evolved psychology (Nicholson, 2010).

Organizational evolution is not the same reproductive process as it occurs in biology, given the human capacity for learning and transmitting new knowledge to members of the same and subsequent generations. Still, there are certain principles of variation and inheritance that allow the conceptualization of organizational change by the same evolutionary algorithm that has unified our understanding of biology. We know that organizational evolution has taken place when changes in the frequency distribution of units (e.g., beliefs, skills, practices) in a population of such units – bounded in such entities as routines, groups, organizations, or industries – have occurred such that the population as a whole is better adapted to current conditions in the relevant environment. When evolutionary theorists speak of evolutionary change, they merely mean that an adaptive change has taken place; they do not mean that this change is an improvement, in a value-laden sense, in some behavior, attitude, or structure. The aim is to explain the evolution of organizational forms with a view to their adaptive complexity, innovativeness, coherence, or some other feature, rather than to evaluate this feature as “good” or “progressive,” which would require criteria that themselves have meaning only within a specific environment. Characterizing the emergence of a particular organizational form as “inevitable” or “bound to happen” requires knowledge of the form’s previous history and the ongoing constraints, with reference to the relevant comparisons and possibilities, but such complete knowledge is rarely available.

4.1 Generic processes of evolution

Darwinian evolution is essentially about replicating populations of slightly different combinations of units in changing resource environments, rather than changes of singular self-organizing systems. Evolutionary processes, thus conceived, are generic and applicable to any unit and environment. The units may be decisions or competencies, and the environments may be labor or capital markets, or the capacity and willingness of individuals to attend to the information contained in units, such as rules and skills. The Darwinian paradigm characterizes evolution as a movement away from a previous state of a system towards a new and different state, driven by four generic processes: variation, selection, retention, and the competitive struggle for resources. Evolution in a social system, like an organization, work group, or business cluster, is possible if there is sufficient variation in the population of units constituting the system, if selection can operate because there is competitive pressure, and if the selected units can be passed on to subsequent generations (Aldrich and Ruef, 2006).

4.1.1 Variation

The processes generating differences between the units in a population are central to any evolutionary explanation. Without variation, there can be no selection and, therefore, no possibility of improving the adaptive fit between the population and its environment. If all units in a population were exactly identical, simple random selection would determine which units were replicated and which were not. If there is variation and some of the units are better able to acquire resources than others, then those variations with the adaptive advantages will be more likely to be replicated. For example, a skill that is easy to learn is more likely to be passed on to newcomers in an organization, if learning new skills produces a selective advantage in the relevant environment. If variation is to enable evolution, it has to create new opportunities for the organization to adapt to changing environments. Variations must also be able to fail. In an evolutionarily “fit” organization, outdated ideas are given up, inappropriate rules are discarded, and old skills are forgotten if they are no longer useful in a new environment.

Variations exist within organizations and between organizations. At the organizational population level, such as an industry or business cluster, there may be significant differences in control structures, strategies, and practices. The Catholic Church, for example, has more strictly hierarchical decision-making structures than worker cooperatives, and Islamic mosques translate "salvation" into different organizational practices than the routines used by Protestant churches or Buddhist temples (Dyck and Wiebe, 2012). Within organizations, variations may exist between individuals in their personalities, interests, and competencies, and between departments in **task technologies**, work cultures, and evaluation systems. Variations are created through deliberate actions, as when organizations develop new quality control techniques to outcompete rival organizations. Variations also result from chance events and faulty decisions. The organizational equivalents of mutation in the biological domain are improvisations and trial-and-error experiments stemming from opportunistic behavior, interpersonal conflicts, or simple curiosity. Much of the variation generated in organizations is "blind" in the evolutionary sense of individuals not anticipating correctly the outcomes of their actions (Campbell, 1969). Organizational strategists and planners may act intentionally, contemplating constraints and options, but they cannot know the consequences of their own or other people's discoveries and subsequent decisions until they have made them. The selection of variations follows from the consequences of actions rather than from intentions.

4.1.2 Selection

Variations that improve a unit's survival chances are positively selected so that, over time, the advantageous variations become more prevalent in the population. Selection criteria vary depending on the type of environment in which a population exists. For example, schools are subject to institutional expectations with respect to social needs and cultural values, whereas video stores are exposed to competitive pressures driven by consumer tastes regarding the meaning and cost of entertainment. If selection criteria favor, say, production flexibility, as in the hypercompetitive fashion industry, then adaptive organizations will develop structures and processes that deliver flexibility, and organizations with rigid structures will eventually be weeded out by market competition, holding everything else (e.g., government wage subsidies, trade protection) constant. At the organizational population level, the results of market selection are evident in the different failure rates of organizations. At the level of individual organizations, political selection criteria may lead to different dismissal rates for different categories of employees, while selection criteria based on technology may generate different disbanding rates of jobs with different skill requirements.

In contrast to predictions from organizational economics, but in line with institutional theory, selection criteria do not always reward the most efficient organizational forms. In some cases, for example in environments with clientelist political traditions, powerful individuals may use coercive measures to maximize their own returns or to extend "personal favors." In other environments, social norms may prevail over economic efficiency criteria, as in the area of international relations (e.g., ASEAN, European Union) where justice and diplomacy are important considerations. Evolutionary theorists distinguish between selection criteria that are internal and those that are external to the organization, but they may be empirically related in a given instance. Internal and external criteria may co-evolve in the sense that the entities in which they apply have a causal impact on each other's ability to survive. The development of the German dye industry up to World War I is an example of such co-evolution, as firms' selection decisions on research affected, and were reinforced, by curricular developments in the German university system (Murmann, 2003). Internal and external criteria are not always consistently or functionally related. For example, internal selection may be driven by organizational leaders' desire to hire people similar to themselves. This practice may create **organizational inertia** by producing a homogeneous and closed **organizational culture**, preventing the organization from adapting quickly to deep changes in the environment. From an evolutionary perspective, selection processes may not create the best of all possible worlds. Evolution always produces winners and losers, and stories of success normally provoke anti-stories of alternative explanations, all of which keep the system in motion.

4.1.3 Retention

Selected variants can only be used on future occasions if there are mechanisms to preserve and reproduce them. Without the ability to retain what has been discovered, any gains would dissipate quickly. Retention mechanisms in organizations include files, job descriptions, and records of meetings. Learning theorists suggest that retention mechanisms help the organization economize on information processing in situations that require significant cognitive investments (Miner and Mezias, 1996). At the level of organizational population, retention mechanisms are embedded in linkages between organizations through which knowledge is diffused and resources are shared, such as formal production cooperations (e.g., joint ventures) and informal social ties (e.g., social networks between former work colleagues). Resource dependence theorists postulate that organizations which are mutually dependent, because they draw on the same environmental resource pool, tend to enter into alliances to soften the impact of competitive selection (Pfeffer and Salancik, 1978).

4.1.4 Competition

Resource scarcity leads to a competitive struggle between the units in a population. Different types of resources are relevant at different levels of action. At the cognitive level, ideas may compete for human attention in brainstorming meetings; at the organizational level, work groups may compete for financial support; and at the level of organizational populations, industries may compete for government subsidies. Competition ensures that there is a continuous push for change and innovation, producing winners and losers, thus contributing to new variations. The survival of a single unit in a population may not be consequential to the survival of the population as a whole, depending on how tightly coupled the units in the population are – the closer the linkages, the stronger the population-level implications of changes in any one unit. Variations across units contribute to the pool of competencies in the population, but they do not determine the population's collective fate. The survival of a chain organization in fast-food, banking, or maid services is not normally jeopardized by the closure of a single outlet (Winter and Szulanski, 2001).

In sum, the processes of variation, selection, and retention do not occur in sequence but function simultaneously and via feedback effects. Retention processes enable the replication of selected variations, for instance by improving imitability. They can also constrain the emergence of new variations, for example by reinforcing routines that make it difficult to absorb inconsistent information. In a changing environment, selection criteria are themselves subject to evolution, altering the conditions for variation and retention. Organizational evolution proceeds through the diffusion of units available for selection. Institutional mechanisms of diffusion include imitation, instruction, and strength of habit, subject to actors' opportunism and bounded rationality. Similar to organizational economists, evolutionary theorists focus on the competitive constraints in diffusion, noting mechanisms such as bankrupty and takeovers, but they also emphasize that competition is not the only selection force. Organizations often collaborate either out of a sense of social obligation, as in communities of cooperatives (Staber, 1992), or for economic reasons, as when firms collude to increase market power (Pfeffer and Salancik, 1978). Impediments to efficient evolution arise when the actors disagree on goals, protect their vested interests, or misinterpret new opportunities. Organizational evolution is not a mechanistic sequence of actions and responses, but is affected by the perceptions and interpretations of individuals acting alone or in unison with others. Evolutionary mechanisms always contain a significant element of uncertainty, leading to indeterminacy of outcomes.

4.2 Evolutionary indeterminacy

From an evolutionary perspective, any "improvement" in organizational form is relative and differs from optimization by some absolute standard. Evolution denotes changes that may or may not be *intended* by the actors, and the direction, magnitude, or speed of changes cannot be specified in advance. Organizational evolution is best understood as the result of the actions and interactions of "intendedly rational people making what sense they can of their various situations, pursuing their various aims, and often acting in ways that they have difficulty explaining, even to themselves" (Weeks and Galunic, 2003: 1320). Evolution is driven by the interplay of actors, who are differentially endowed with resources and motivations, and variable conditions in the economic and institutional environment. Evolution is not an efficient optimization process, but a context-dependent and, in many ways, deeply flawed process of adaptation, with uncertain outcomes (Carroll and Harrison, 1994).

The evolutionary process rules out the kind of determinism familiar in standard economic theory, which presumes a moving equilibrium in the variables of interest. It is also inconsistent with the determinism inherent in standard **contingency analysis**, which views situational factors as an imperative force in organizational development and argues that the suitability of a given organizational form is determined by the goodness of fit between itself and the current environment (Lawrence and Lorsch, 1967). And it opposes those neo-institutional theorists who argue that institutions are powerful and persistent to the point where they leave no meaningful choices to organizations. Evolutionary change occurs neither fully randomly nor fully predictably. On the one hand, much of what happens in organizational evolution involves errors, surprises, and chance events, although organizational planners and strategic managers often adopt a rhetoric of deliberate intervention (e.g., in press releases, on websites, on television talk shows), presenting themselves as individuals making decisions with foresight and strength of will. Organizations contain significant elements of randomness stemming from interest conflicts between individuals and units, flawed decision-making structures, and fragmented organizational cultures. On the other hand, organizations also contain elements of order, in the form of authority hierarchies, formal rules, and standard operating procedures, that help keep the organization on a directed path. The normally espoused *raison d'être* of organizing is to create selection and retention structures that enhance predictability and accountability, but the appropriateness of particular structures can be known only retrospectively. Evolution is an emergent process, in the sense that units at higher levels of action depend on units at a lower level without being reducible to, or predictable from, lower-level units (Blitz, 1992). For example, personal dispositions like ambition and creative talent may contribute to an organization's innovativeness but they do not determine whether the organization is indeed innovative and whether innovativeness enhances organizational survival. The outcomes of organizing are not independent of the interests and capabilities of individual actors, but neither are they fully determined by them.

4.3 Summary

According to evolutionary theory, as used in organization science, organizations are not like organic systems, but they share the variation–selection retention algorithm common to all evolutionary systems (Campbell, 1969). To be useful for an understanding of organizational life, evolutionary theory must achieve at least three objectives. First, it must explain the dynamics of how organizational forms change over time. In doing so, it must recognize the underlying variability of the components making up organizations and populations of organizations. In particular, it must appreciate the impact of human agency, leaving room for cognitive diversity, discretionary possibilities, and changes in actors' capabilities and preferences. Second, it must address the mechanisms that generate persistence as well as change, rather than merely describing statistical regularities of the "if–then" sort. And third, it must consider the ever-present possibility that organizations evolve in ways that do not improve their performance and do not serve the interests of all their members equally well. Most organizations fail eventually, and many others produce outcomes that are not in the best interest of everyone. An organization exists not necessarily because it serves the interests of its designers, although the designers may *think* that it should. And an organization does not exist because it constitutes an effective solution for some kind of social problem, although planners may *propose* that it does.

The inclusion in the analysis of dysfunctional elements in organizations helps to avoid the **functionalist** reasoning evident in studies that attempt to explain the occurrence of an entity in terms of its beneficial outcomes. An organizational rule may not achieve what it is supposed to achieve; an individual may not contribute to the work group as specified in the employment contract; and a hierarchical system of control may not be efficient even if it is endorsed by everyone in the organization. If one defines the structure of an organization by its purported functions, there is the need to explain the non-occurrence of functions as well. One would also need to suggest functional alternatives, as well as the mechanisms by which evolutionary processes produce different outcomes, both adaptive and non-adaptive. A distinct contribution of evolutionary theorizing is that it takes into account the entire range of possibilities, leaving open what the actors in organizations make of these possibilities in a given instance.

5. Common relational elements in organizational economics, institutions, and evolution

Scholars working within an economic, institutionalist, and evolutionary framework address specific questions about organizations and employ a distinct set of analytical concepts, but they also share commonalities that offer a possibility of integration. One of these commonalities is the concern – albeit not always stated explicitly – for relations between units, as opposed to the attributes of units. The growing interest in organization studies in relations has gone hand in hand with the "cultural turn" in the social sciences (Emirbayer, 1997), with scholars attending to the meanings of social action and to the ways in which individuals construct meaning (Pachucki and Breiger, 2010). The conventional – and, in managerial practice, also the most popular – approach to organizations and organizational design and governance emphasizes the structural architecture of relationships between actors differing in relevant attributes (e.g., age, education), and proposes that this configuration (e.g., who in a group occupies what position, who has what kinds of decision-making rights) shapes individual and collective action in predictable ways. The relational approach, by contrast, attends to the mutual constitution of structural relations and the meanings of relations, with a view to what people do when they discover contradictions or obstacles, renegotiate the content of ties, or change partners (White, 1992). From a relational perspective, the structure of relations affects their meaning, while at the same time being shaped by the meanings that the actors ascribe to relations. Structure and meaning are co-constitutive of one another.

Consider, for example, the assembly of individuals shown in Exhibit 2.1. This assembly is a social collectivity in the sense that the members have a common goal, in this case gaining admission to a tourist site. While waiting, some of them converse with others, including people they have never met before. They exchange ideas, tell stories, and some of them might make plans to meet again in the future. A conventional **structuralist** study of, say, group diversity would focus on the group's configuration in terms of individual differences, such as nationality or occupational background, and would *infer* from these differences something about collective behavior, such as whether the individuals will likely stage an organized protest if this tourist site remains closed for the rest of the day. By contrast, a study conceived in relational terms would also investigate the meanings the individuals assign to their membership in this group, with a view to how they construct these meanings out of their social relations. Some of the individuals who share the same ethnic background might assign a new meaning to the concept of ethnicity, depending on what they hear in their discussions with others. For some of them, interaction with different people might open new opportunities for viewing

Exhibit 2.1

themselves as something other than tourists. Others might move closer to people they perceive as similar to themselves, to survive in a setting where they feel like "strangers in a strange land." The mutual constitution of meanings and relations will likely differ depending on the situation (Godart and White, 2010). In a different context, the same individuals might exhibit very different behaviors. If they were to meet in, say, an organizational project team, they may define their interaction primarily with a view to technical requirements (Kilduff et al., 2000).

The point is that individuals are always embedded in a context-dependent web of structures and meanings from which they derive their identity in relation to the identity of others in the web (White, 1992). Simply knowing that individuals in a group differ in some attribute says nothing about the group's collective orientation. From a relational perspective, one also needs to study how they make sense of that attribute in light of how it relates to the distribution of other attributes in the group, such as whether the discourse among the participants reveals any overlaps in the meanings of the same and different attributes. A relational perspective suggests that social entities evolve through the dynamic interplay between meanings and structures. Relational structures emerge out of the meanings the individuals assign to them, while in turn shaping the meanings connected to the structures in which the individuals are embedded. As individuals switch between the various social, cultural, and economic domains in which they are active, opportunities arise for constructing new meanings and relational structures (Mische and Pattison, 2000). For example, when students move between places of study, home, and work, they adjust the meanings of the situations in which they are located as well as the identities that are invoked by the movements (Burke and Franzoi, 1988). Research on work groups has shown that racial similarity increases cooperative behavior to the extent that group members interpret such similarity as confirming their work-related identity (Milton and Westphal, 2005). In a different context, racial similarity may lead to different outcomes, although the actors are the same. In complex organizations, one should not be surprised that people's interpretations of their condition change in line with co-evolving relational structures.

The concern for relations is reflected in many of the ways in which organizational scholars draw on arguments from evolutionary theory, institutionalism, and organizational economics. For example, evolutionary theory draws attention to the temporality of organizational relations by asking about the origins of variations and the dynamics of selection processes. Selection criteria are not immutable but are the result of struggles between individuals over the "correct" meaning of the criteria. The competitive struggle for meanings is embedded in, and made possible by, existing relational structures, while the structures evolve through the replication and transformation of people's mutual orientations and actions. If a consistent pattern of collective behavior emerges, it might be the result of convergent evolution under common selective pressures in a tightly bounded environment. Alternatively, it might be the outcome of different retention patterns, such as lateral transmission (e.g., through the importation of new ideas from outside a group) or vertical transmission (e.g., mentors passing ideas on to the next generation of organizational members).

Institutional theory adds to this understanding by exploring the rules and conventions that channel human attention, and the mechanisms for enforcing expectations. Institutional thinking provides a framework for explaining the conditions under which change is evoked, imposed, or acquired. When change is evoked, individuals respond automatically to a change in environmental circumstances. When change is imposed, individuals comply with the expectations set by powerful institutions. And when change is acquired, individuals observe, imitate, or learn from salient others. In each case, individuals assign meaning to relations, based on the existing structure of relations. Thus, the acquisition and use of meaning systems always involve social structures plus institutional rules for defining what kinds of relations are appropriate in a given context. Individual choices are impossible without such relational rules. For example, some of the people shown in Exhibit 2.1 may prefer the "first-come-first-serve" queuing rule, while others may refer to the "I paid for it" domination rule, expecting the organizational leadership of the tourist site to impose a system of orderly admission. A problem arises in settings where the actors differ in their understanding of institutional rules ("What is order?") or where they refuse to submit to institutional forms of domination ("I was here first!").

Similarly, but with a view more to the material utility value of orientations, organizational economists note that individuals' preference functions are not exogenously given. Instead, they emerge out of the transactions through which individuals procure scarce resources, evaluate contractual obligations, and define property relations. For example, when the partners to an exchange relationship perceive a risk that the other actor will behave opportunistically, they have an incentive to restructure the relationship by adding institutional safeguards, such as contractual clauses or third-party dispute resolution arrangements. Situations that are so complex that they cannot be interpreted unambiguously may motivate the actors to invest in long-term relationships to develop common understandings, whereas unfulfilled **reciprocity** claims may cause them to look for new partners outside the industry. Regarding the group of people waiting for admission to the tourist site (Exhibit 2.1), organizational economists would predict the pure market to fail as a coordination mechanism, if the individuals have distinct identities, there is no shared history of cooperation, and some of the individuals are inclined to behave opportunistically by cutting in line or pretending physical disability. When information ambiguity is extreme, it may overwhelm all rational control attempts, leading to collective behavior dominated by chance events. From an evolutionary perspective, these are situations that provide fertile ground for mutation through the reinterpretation of norms and the renegotiation of roles. Organizations in the creative sector (e.g., advertising, architecture) illustrate settings where the possibility of such mutations is actively pursued. In other industries, organizations try to prevent such mutations by imposing tight formal structures, although such structures may provoke unplanned behavioral deviations with potential adaptive value.

6. Conclusion

Each of the three theory camps discussed in this chapter constitutes an overarching framework, combining related streams of research and providing a platform for integrating arguments from diverse perspectives. The arguments qualify as theory in that they propose causal schemes linking concepts, specify boundary conditions, and permit falsifiable hypotheses (Bacharach, 1989). While these frameworks all view organizations as social entities adapting to changing requirements in relevant environments, they differ in their approach to the details of how organizations respond to these requirements. Whereas organizational economists focus on the demands for more efficient structures and practices, institutional and evolutionary theorists argue that many of the most fateful forces in the organizational world are the result of socio-cultural pressures in the form of traditions, norms, and ideologies.

All three frameworks emphasize external forces, but they are also mindful of the fundamental fact that organizations are composed of individuals who construct – through cognitions, actions, and interactions – organizational forms as locally shared systems of meaning from the ground up. Meaning systems involve various types of perceptual choices: people discount the future, rationalize the past, and reframe current situations. The concern for human agency also turns on the question of evidence in the development of explanations for observed organizational phenomena. All social science researchers struggle with problems related to the interpretation of empirical observations. If one accepts the psychologist's characterization of people as individuals who are often mistaken about the causes of their own behavior (Wilson and Brekke, 1994), then one should not be surprised that even the methodologically most diligent organizational researchers refrain from claiming that they know what their study subjects are *really* thinking and are *therefore* doing. Any theoretical statement can only be an approximation of the "truth," and all evidence in favor of one or the other explanation must be considered tentative (Popper, 1959). Given available data, one may not be able to conclude, for example, that someone behaves cooperatively in a work group because the existing incentive system guards against shirking (the property rights explanation of economists), because the person imitates high-status individuals in the group (the institutional explanation), or because such behavior brings adaptive advantages to both the person and the collectivity (the evolutionary explanation). Motive-based explanations of behavior are problematic because they are fairly immune to direct empirical verification (Reskin, 2003), as individuals are often not aware of the reasons for their behavior (Tilly, 2006).

Although organizational researchers risk making interpretive mistakes of a kind that may not arise in the study of material matters in fields like physics or chemistry, it should not prevent them from developing alternative explanatory hypotheses and to subject these to the best empirical tests they can muster. The goal should be to construct theoretical arguments that are open to refutation through an appeal to logic and evidence. This is what has been happening in organization studies for the last few decades and what has made this field such a lively area of research and debate. The discussions in the following chapters will show how theorizing from an economic, institutional, and evolutionary perspective advances our understanding of a range of substantive organizational problem areas. They indicate the usefulness of these perspectives for understanding phenomena in all types of organizations, including economic enterprises, cultural organizations, interest associations, ideological organizations, and organizations where it is difficult to disentangle the material and social motives of their members.

Recommended further reading

Burrell, G. and Morgan, G. (1979) *Sociological Paradigms and Organisational Analysis*. London: Heinemann.

Similar to social analysis in general, organizational analysis can be organized along two dimensions: philosophical assumptions about the nature of society and the nature of social science. This classification system has proven useful for organizing many of the theoretical perspectives in use in organization studies.

Hofstede, G. (1996) An American in Paris: The influence of nationality on organization theories, *Organization Studies*, 17: 525–537.

The author proposes that organizational researchers from different countries and cultural regions of the world work with different theories. It is, therefore, difficult to achieve consensus on any theory of organizations.

Pfeffer, J. (1993) Barriers to the advance of organizational science: Paradigm development as a dependent variable, *Academy of Management Review*, 18: 599–620.

Compared to the natural sciences, the study of organizations is paradigmatically not well developed, lacking consensus about concepts and methodologies. The author views this as a barrier to the development of a successful organizational science.

Stern, R. and Barley, S. (1996) Organizations and social systems: Organization theory's neglected mandate, *Administrative Science Quarterly*, 41: 146–162.

The authors link the study of organizations to the social context in which it has developed, arguing that the location of organizational scholarship in a business school environment has led to reduced attention to organizations' role in the broader society.

Practice questions for Anecdote 2.1

1. **What could Sam do to build for himself an institutional setting that would give him the recognition he seeks as a professional artist?**
2. **How would you build a social network in a small rural town to increase your economic opportunities as an artist?**
3. **Identify some of the transaction costs Sam faces when setting up an arts show in his home town.**