

# **IMP and the two traditions of institutionalism**

Catherine Welch<sup>1</sup>

University of New South Wales

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<sup>1</sup> Catherine Welch, School of International Business, University of New South Wales, Sydney 2052, AUSTRALIA. Fax: +61 2 9313 6775, phone: +61 2 9385 5882, email: c.welch@unsw.edu.au.

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### **ABSTRACT**

This paper makes a theoretical contribution to the IMP tradition by revisiting the relationship between institutionalism and the “markets-as-networks” approach. In particular, the diversity of institutional thought is reviewed and different strands of institutional thought identified. It is argued that an engagement with these broader institutional traditions has the potential to contribute to theory development in IMP.

## Introduction

A dialogue with, and critique of, the new institutional economics has been a key element of theory development in the Industrial Marketing and Purchasing (IMP) approach. Håkansson et al. (1982) acknowledged Williamson (1975) as one of the theoretical antecedents to the “interaction model”. This paper makes a theoretical contribution to the IMP tradition by revisiting the relationship between institutionalism and the “markets-as-networks” approach. An examination of this aspect of IMP’s conceptual history has the potential, it will be argued, to enrich future theory development.

While the IMP dialogue has mainly been with Williamson, institutionalism is a very complex intellectual tradition that spans a number of disciplines and approaches (for a review, see Hall & Taylor 1996). Two main schools of institutional thought will be contrasted in this paper – rationalist and sociological – although, as will be discussed, the two institutional approaches themselves encompass a range of perspectives. Rationalist institutionalism is most often associated with Oliver Williamson, but a “modified” alternative can be found in the later writings of Douglass North. Rationalist institutionalism is most often associated with the discipline of economics, although rationalist explanations have been adopted in other disciplines such as political science. Sociological institutionalism, as the term suggests, has been more influential in other disciplines such as sociology, political science and organizational theory. Sociological institutionalism operates on some very different assumptions to those of its rationalist variant, and has developed alternative explanations for the development and maintenance of institutions. As in the case of rationalist institutionalism, sociological institutionalism is not a single tradition and two closely related but distinct variants – normative and cognitive – will be discussed.

The purpose of this paper, then, is to explore the differences between these two institutional traditions and the little acknowledged contribution of sociological institutionalism to IMP thought. The discussion is divided into four parts. The first section provides an overview of rationalist institutionalism, the second contrasts it with sociological institutionalism, and the third explores the contribution of sociological institutionalism to the “markets as networks” paradigm.

In the fourth and concluding section, the implications for IMP theorising of a closer engagement with sociological institutional thought are reviewed.

### **Rationalist institutionalism**

The first IMP study (IMP1), reported in Håkansson et al. (1982), acknowledged its intellectual debt to the new institutional economics, notably Williamson's (1975) transaction cost approach. The 1982 study set the scene for IMP engagement with Williamson's work: while TCE was seen to be an improvement on neoclassical economics, it was also regarded as having limitations and the "interaction model" was quite distinct from TCE. In a thorough critique of TCE that highlighted its contrasts with the IMP "markets as networks" tradition, Johanson and Mattsson (1987) argue that the two theories differ in their theoretical assumptions and "problem orientations".

Williamson's version of TCE – or versions, for his theory has been evolving over a twenty-five year period – is well known and will not be discussed at length here. Briefly, Williamson (1991), in taking the transaction as his unit of analysis, argues that transactions vary in terms of their frequency, uncertainty and asset specificity. Depending on the attributes of transactions, transaction costs can be minimized through the use of different organizational forms or governance structures (Williamson 1975), the market or hierarchy (to which he later added the intermediate form of hybrid). In more recent formulations, Williamson (1991, 1996) has described TCE as a three-layered schema consisting of the individual, the governance structure and the institutional environment. While Williamson (1975) placed himself squarely in the tradition of new institutional economics, he later conceded that TCE was just one version of new institutional economics (1985).

Notable distinctions between TCE and IMP are that the latter posits trust rather than opportunism, mutual adaptation between firms as an alternative to vertical adaptation, network interdependence rather than aggregates of single transactions, and an alternative view of markets as comprised of long-term relationships (Johanson & Mattsson 1987). As Johanson and Mattsson (1987)

recognize, they are not the only ones critical of Williamson. Some of the harshest critics can be found in the ranks of institutional economists (some of whom declare themselves to be “old” institutionalists in the sense that they claim to be the true successors to John Commons and Thorstein Veblen), whose scepticism towards TCE centres on the observation that Williamson remains, at heart, a neoclassicist (eg. Dugger 1990). They argue that Williamson is not true to the spirit of institutionalism in each of his three levels of theory: behavioral attributes, governance structures and institutional environment. With reference to the first level, behavioral attributes, Williamson is criticized for retaining a view of the individual as rational, opportunistic and maximizing. He assumes optimizing behavior, in that individuals are driven to economize on transaction costs (Hodgson 1993). Transaction cost minimization is another form of utility maximization, with other human traits marginalized. Williamson’s conceptualization of the second level, governance structures, assumes that efficiency accounts for organizational forms: economic activity will be organized in such a way that a transaction type will be aligned to its most appropriate governance structure. Other explanatory variables for understanding markets and firms, such as power (Bauer & Cohen 1983), are not considered. Williamson’s analysis is static, assuming equilibrium conditions for each governance structure, and he does not consider the drivers of institutional evolution (Dugger 1990). Williamson’s third level, the institutional environment, is an attempt to recognize that legal and political institutions and norms can affect the costs of particular governance forms, but has been criticized as under-developed (Groenewegen 1996).

Douglass North is one institutional theorist who in his more recent writings has addressed some of these criticisms. In an earlier collaborative work (North & Thomas 1973), North takes a rationalist approach to economic history, arguing that economic efficiency explains the rise of the Western world. An efficient economy is one whose system of property rights encourages individual incentive, by ensuring that the “private” rate of return from individual economic activity is equivalent to the “social” rate of return. However, North (1990) later repudiated this efficiency explanation. North’s central insight was that efficiency explanations could not account for the persistently poor performance of some economic institutions. He therefore sought to

construct a theory which would also explain the way in which institutions constrain behavior and alter incentive structures in such ways that sub-optimal outcomes may be the result.

North's (1990) "modified" rationalism presents a contrast to his earlier model of "efficient" history, and to Williamson's TCE, in several ways. Firstly, he argues that in order to understand institutional change and economic performance it is necessary to go beyond rational actor models and acknowledge the range of human motivations and limitations of information processing. For various reasons, individuals may surrender wealth maximization goals for other values and ideologies. In addition, not only do they act on incomplete information, but they interpret what knowledge they have through "mental constructs that can result in persistently inefficient paths" (North 1990, p. 8). These "mental constructs" are institutionally based, with individuals internalizing the norms and standards of behavior that are part of an institution's informal constraints.

Secondly, institutions, which alter the opportunity set and incentive structure of individuals, are not "necessarily or even usually" (North 1990, p. 16) designed for efficiency; rather, they are constructed and maintained to further the interests of individuals and groups with superior bargaining power. Moreover, state power is usually harnessed to the interests of those who run it, increasing the costs of third-party enforcement. As well as the variables of efficiency and power, an explanation for institutions has to be sought in culture. Institutions operate as "cultural filters" as well as structures of power, affecting individual beliefs and behavior. North completes his expansive concept of institutions by trying to link economic transactions to wider socio-political structures. The "rules of the game" for individual contracts reflect a country's property rights, which in turn reflect the hierarchy and power structure of that country's polity.

In a third contrast to TCE, North (1990) is concerned to address the conundrum of institutional change. He argues that "entrepreneurs" are motivated to seek new institutional frameworks due to changes in incentives brought about by, first of all, changes to relative prices and, second, changes to preferences. However, although individual parties may believe that their own interests may best be served by institutional change, such change is difficult to achieve. Even if they are

able to alter the formal rules of the institution, the latter's underlying informal constraints and behavioral norms are harder to eradicate. Given "the host of changes in a variety of constraints" (North 1990, p. 68) that is required, it is likely that institutional change will be incremental. North therefore sets up a two-way explanation of change: institutions shape organizations, in that organizations are founded to take advantage of the opportunities provided by the prevailing institutional structure, and they develop according to knowledge acquired within institutional constraints. At the same time, organizations shape institutions, in that entrepreneurial action by individual organizations to achieve improved bargaining outcomes will produce changes, however incremental, in institutional structures.

Despite these significant modifications to Williamson's institutionalism, North remains a rationalist to the extent that he sees culture, tastes, ideologies, subjective perceptions and preferences as a supplement to rather than an alternative to efficiency explanations. Changes to individual incentive structures remain the driving force of institutional evolution. Moreover, North is unable to explain the sources of cultural change, even though he acknowledges its importance, simply stating that "we know very little" on the subject (North 1990, p. 84). However, as shall be seen, his modified variant of rationalism converges with that of sociological institutionalism in many respects – in particular, his incorporation of culture (ideologies, preferences and tastes) and path-dependent evolution.

### **Sociological institutionalism**

Old and new institutional economics do not have a monopoly on institutional theory: so-called "new" institutionalism has also become an important influence on contemporary organizational theory, sociology and political science. Sociological institutionalism has also informed IMP theories, although not in a sustained or "explicit" way (Salmi 1995). Moreover, it has had an influence on "old" institutional economic and modified rationalism. While new institutionalism in economics is often regarded as the successor to Veblen and Commons, sociological institutionalism traces its heritage to "greats" such as Emile Durkheim, as well as, more directly, to Philip Selznick's post-war work on the Tennessee Valley Authority.

Sociological institutionalism has developed different assumptions and propositions to those forwarded by TCE and other “rationalist” forms of institutionalism. There are many versions of sociological institutionalism, but all are concerned with institutions as social systems that regularize social interactions. Institutions are comprised of “patterns of activity” according to which actors conduct their material lives (rules, routines, habits, scripts, roles etc) and “symbolic” or meaning systems (beliefs, values, principles, paradigms, frames, ideologies, theories, schemas etc) through which they make sense of the world (Friedland & Alford 1991, p. 232). Unlike rationalist institutionalism, which interprets institutions as a series of sanctions or regulations that constrain behaviour and alter individual incentive structures, sociological institutionalism tends to regard institutions as social constructions that shape the understandings and preferences of actors (Scott 1995).

There is, however, some diversity in sociological institutional thought, as in the case of “rationalist” institutionalism. Scott (1995) distinguishes between normative and cognitive explanations of institutions (see also DiMaggio & Powell 1991). Normative institutionalists conceptualize institutions as values and norms that are internalized by social actors. Cognitive institutionalists regard institutions as the cognitive frames through which we understand social reality. Just as institutions are defined in different ways, they are also analysed at various levels, ranging from organizational sub-systems to the world system of states and global capitalism. Each of these institutional levels is seen to provide the environment for a lower level of institution (Scott 1983).

Sociological institutionalism is a distinct body of theory in four ways. Firstly, it provides a model of “practical” rather than rational action (DiMaggio & Powell 1991). In a rationalist account of human action, such as in TCE, actors seek to realise a fixed hierarchy of preferences through bargains and resource exchanges with each other. They make decisions on the basis of abstract rationality – a “logic of consequences” (March & Olsen 1996) – to which they select the course of action most likely to maximize their interests. The outcome of these exchanges is dependent on relative capabilities, defined as the control over scarce resources. A practical model of action does

not dispute that actors can and do make choices in a systematic and purposeful manner. However, in interacting with others they follow a “logic of appropriateness” (March & Olsen 1996) which is institutionally defined. In this view, actors select courses of action according to their perceptions of “what is feasible, legitimate, possible and desirable” in particular institutional environments (Hay & Wincott 1998, p. 956). Acting “appropriately” consists of conforming to the expectations of others, following established routines (or “scripts”) and conventions, and adjusting behaviour as a result of learning from previous experiences. Interaction is therefore a process of identity formation, role enactment and the internalization of social norms (March & Olsen 1996). Actor interests, resources, beliefs, goals and choices are in this normative view socially constituted. Institutions operate at a more fundamental level than in the rationalist account: rather than simply being constraints to which actors must adapt their strategic choices in order to optimize individual gains, institutions “define the ends and shape the means by which interests are determined and pursued” (Scott 1987, p. 508). This is a sharp contrast to rationalist institutionalism, which assumes exogenous preferences: institutions alter the cost-benefit calculus but not preferences themselves.

A second contribution of sociological institutionalism is its conceptualisation of the organisation-environment interface. As Hodgson (1988) observes, TCE adheres to methodological individualism; in other words, explaining social phenomena, including organizations, in individual terms. Institutional theory instead takes a “holistic” approach to organizational development. The institutional environment inscribes itself into the structures and practices of organisations. Over time, organizations are likely to become isomorphic with – conform to – their institutional environments (Meyer & Rowan 1977; DiMaggio & Powell 1983). Through this process of adaptation organizations acquire external legitimacy, thus increasing their chances of stability and survival. Isomorphism is partly a product of the deliberate strategy of organizations, partly the result of socialization. At the same time as they adapt to their institutional environments, organizations “often play active roles in shaping those contexts” by managing to “institutionalise their [own] goals and structures” (Meyer & Rowan 1977, p. 348). Institutional theories therefore propose a “complex duality” between actors and their environments (Hay & Wincott 1998, p. 956): actors alter and respond to their environment by taking calculated action,

but they do so according to beliefs and practices which have been formed by these very environments. This is even the case for organizations, such as firms, which are traditionally considered to operate uniformly on the basis of rational efficiency. As Orru et al. (1991) report in their comparison of the national environments of East Asian firms, “[s]ocially constructed, accepted models of correct market behavior shape interfirm relations, prompting firms to behave with and against each other in characteristically homogeneous ways.” (p. 363) Efficiency is in itself a socially constructed, institutionalized principle.

The third facet of sociological institutionalism to note is its “interpretivist” or “social constructionist” approach. While rationalist institutionalism takes a social realist perspective, in assuming a reality outside of human perceptions of it, this is challenged by cognitive institutionalism. The “interpretive turn” or “cognitive revolution” in the social sciences was sparked by new theories of social cognition in ethnomethodology, phenomenological sociology and cognitive psychology. The central concern of such theories is how individuals and groups make sense of the social world of which they are a part. Reality is not seen as external to human interpretation, or *verstehen*, but is constructed by our understanding of it; by interpreting the reality around them, actors change and structure it. Human action is based on existing preconceptions derived in part from an individual’s social world; at the same time, in the course of acting according to their preconceptions, individuals induce changes to the world around them. Individual cognition and the social world therefore constitute each other. “Cognitive” institutionalists have taken an interpretivist approach to the study of organizations, seeking to understand how collective cognitions develop. In doing so, they turn their attention to the ways in which shared meaning systems develop and are regularized in social interaction. Organizations are viewed as “socially constructed systems of shared meaning” (Smircich & Stubbart 1985, p. 724), not just formalized patterns of behaviour. Meaning is institutionalized when it develops a “taken-for-granted” nature in organisational life. In this way, cognitive institutionalists attempt to address the issue of changing “cultures”, the issue that so perplexes North (1990).

The fourth and final insight of sociological institutionalism is its analysis of change and evolution. As already noted, Williamson’s comparative statics approach is representative of a

rationalist perspective that does not problematize institutional change. If institutional change is discussed at all, it is assumed that efficient institutions eventually prevail. Sociological institutionalists differ in that they make institutional dynamics central to their explanations. Institutions are process as well as structure in this view. The evolution of organisational structures and interorganizational relationships can, according to this approach, be analyzed in terms of the institutionalization processes which take place: in other words, the persistence over time of social patterns of thought and behavior. Cognitive and normative institutionalists have alternative accounts of institutionalization processes (Zucker 1977). Normative institutionalists regard the internalization of social norms as constituting the mechanism for institutionalization. Cognitive institutionalists, on the other hand, regard institutionalization as occurring when social meaning is objectified and reified, gaining its “taken for granted” status. These institutionalization processes, whether cognitive or normative, are – as North (1990) suggests – “path-dependent”; in other words, present choices and actions are conditioned and constrained by past ones (Hay & Wincott 1998). As this conceptualization of change might seem to lead to an “over-socialized” view of human behavior, Oliver (1991) attempts to incorporate the role of actors bringing about change through their strategic actions.

<b>Rationalist institutionalism</b>	<b>Sociological institutionalism</b>
regulative role of institutions	normative/cognitive role of institutions
rational action	practical action
methodological individualism	holism
social realism	social constructionism
equilibrium	path dependence

**Table 1: Rationalist and sociological institutionalism compared**

The contrast between rationalist and sociological institutionalism is summarized in Table 1. To use Scott’s (1995) terminology, rationalist institutionalism is “regulative” in focus, portraying

institutions as a system of informal and formal rules and sanctions that regularize and constrain behavior. Sociological institutionalism, by contrast, focuses on the normative and cognitive aspects of institutions: human behavior is regularized through internalization of norms and the social construction of meaning. A contrast between the two traditions can also be found in their explanations for human action, with sociological institutionalists substituting practical for rational action. At the organizational level, sociological institutionalists also take a holistic approach, proposing a “complex duality” between organizations and their environments rather than the methodological individualism of a rationalist approach. Cognitive institutionalism takes a constructionist approach to social reality, in contrast to the realism assumed by rationalist institutionalism. The final contrast is that between the dynamic explanations of path dependence proposed by sociological institutionalism, as opposed to the equilibrium assumptions of rationalist institutionalism. While the contrast between the two institutional traditions has now been clarified, the question now remains as to how the alternative, sociological form of institutionalism relates to IMP theories. What is the relationship between IMP and sociological-institutionalist theories, and how can the latter contribute to a richer understanding of industrial networks?

### **Sociological institutionalism and industrial networks**

A sociological-institutional view of networks is consistent with many aspects of IMP thinking, and in fact IMP theories have drawn extensively on this stream of literature. In industrial network literature – in both the interaction and “actors-activities-resources” models – firms are portrayed as institutionalized actors. Actors construct their identity by interacting with others in the network and conforming to their expectations. They are socialized into the network by taking on roles in relation to others and acting in accordance with rules of behaviour. Over time, the network develops shared understandings or “theories” (Johanson & Mattsson 1992) – a “kind of network logic” (Håkansson & Snehota 1995). From this perspective, networks can be viewed as “webs of signification” (Kallinikos 1989); that is to say, collective cognitive frames. The network becomes “locked in” to certain processes through “path-dependent dynamics” (Lundgren 1995, p. 66). All these examples serve to show that IMP theories have certainly been informed and influenced by

sociological-institutional concepts. The two theoretical perspectives therefore have more in common than just their criticism of TCE.

However, a more sustained dialogue with sociological institutionalism has not yet emerged. Yet such a dialogue would, it seems, have a number of benefits. Once networks are analyzed as institutions, a range of questions, clarifications and issues surfaces. The first broad issue area concerns network processes. The interaction model of IMP1 analyzes the institutionalization of relationships in “normative” terms (Håkansson et al. 1982): the routinization of behavior over time leads to mutual expectations of the roles and responsibilities of each party to the relationship. These expectations become internalized and are not questioned by either party, taking on a rationality of their own. While normative processes in relationships were therefore integrated into the interaction model, there has been less recognition of the cognitive dimension of networks. One exception is the theory of networks that emerged from IMP2, which discusses the importance of the identity formation of actors and their construction of network “theories” (Håkansson & Snehota 1995). However this does not amount to an analysis of networks as shared meaning systems. The findings of cognitive institutionalists would suggest that the institutionalization of shared cognition should be added to Håkansson and Snehota’s (1995) list of the “process characteristics” of networks.

The second broad issue area concerns the relationship between network and environment. In the “markets as networks” approach the firm’s environment is constituted by its network relationships, both direct and indirect, and a focal network’s relationship with other networks and institutions is often not specified. While Johanson and Mattsson (1991) incorporate the “institutional setting” as one of their levels of analysis, IMP2 does not, regarding all wider institutional influences as being mediated through more immediate network relationships (Håkansson & Snehota 1995). A sociological institutional approach would, however, suggest that the use of multiple levels of analysis may be appropriate, at least for some research questions: for example, Salmi’s (1995) analysis of the network effects of wider institutional changes in the former Soviet Union. Certainly, the conceptualization of the network-environment relationship remains an area of some contention in the IMP literature (Halinen & Törnroos 1998).

Sociological institutionalism and the IMP approach already share a range of assumptions, as their respective critiques of TCE suggest. They both reject the neo-classical arguments retained by Williamson: rationality assumptions, utility maximization, equilibrium states, over-reliance on efficiency explanations, and exogenous preferences. However, there are also differences. Sociological institutionalism has perhaps placed more emphasis on institutionalization processes, particularly of a cognitive nature, and suggests the possibility of multiple levels of institutional analysis. As a result, insights from sociological institutionalism have the potential to contribute to theory development in IMP.

### **Conclusion**

Theory development in the social sciences involves a creative dialogue with alternative theoretical perspectives. While the IMP “markets as networks” approach has benefited from its critical engagement with new institutional economics in general, and TCE in particular, it has been argued in this paper that alternative institutional traditions would be worth examining. The institutional literature is considerably more diverse than the rationalist version popularized by Williamson. Sociological institutionalism has already made a contribution to IMP theorizing about networks, and its core assumptions are closer to network approaches than those of TCE. An understanding of the sociological institutionalist literature could produce new research questions about the evolution and functioning of networks, as well as assist in the development of richer explanations of network behavior. It is hoped that future research will explore the relationship between the two theories in more detail, generating new theoretical insights and research propositions.

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