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Institutional theory and isomorphism: limitations in multinational companies

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ABSTRACT

Today's popular thinking is that every organization is unique and, in their processes and organizational behavior, specific. However, we witness how organizations, particularly those operating within the same industry, are becoming similar and the same as each other. The explanation for this occurrence is the institutional theory of organization that was created primarily as a critique to contingency theory that supports idiosyncratic of organizations. Institutional theory of organization explains how organizations operating within the same industry or organizational fields tend to adapt to the same structures, behaviors and activities. In the foreground of the institutional theory of organization is the institutional isomorphism that explains the similarity of the companies in an organizational field. In this paper, the author will present the current knowledge regarding this approach in management and will emphasize the lacks of this theory when it is applied with multinational companies and its subsidiaries; the multinational companies are interesting to researchers because of the complexity of operations and the complexity of the external environment and intra-organizational environment.

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1. INSTITUTIONAL THEORY OF ORGANIZATION: ASSUMPTIONS, IDEAS AND MOST IMPORTANT CONCEPTS

The main objective of this paper is to gather some of the relevant literature and crucial concepts regarding institutional theory and institutional isomorphism. The author will use the collected knowledge for further research of institutional theory and the impact it has on multinational companies in the Republic of Croatia.

Popular thinking is that every organization is unique and, in their processes and organizational behavior, specific. However, we witness how organizations, particularly those operating within the same industry, are becoming similar to each other. The explanation for this occurrence is the institutional theory of organization that was created primarily as a critique to contingency theory that supports idiosyncratic of organizations. Institutional theory assumes that the organizational action is limited by the normative regulations (Donaldson, L. 1995), and the room for maneuver of individuals has been narrowed due to the presence of institutions that impose the modus operandi (Scott, W. R. 2005). As the most powerful argument of institutional theory is that the behavior and functioning of the organization in the same industry is imposed by the institution, not the market itself (Meyer, Rowan 1997). For better understanding of this approach it is necessary to define what the institution represents. Barley and Tolbert define the institution as a set of common rules and relationships that define the categories of social actors: their related activities and relationships. Institutional theory of organization is based on the fact that organizations operating within the same industry or organizational field tend to adapt the same structures, behaviors and activities (Shonk and Bravo 2010). Authors of this idea and concept are DiMaggio and Powell. In their research they focused on finding the answer to a question why similar organizations operate by nearly same principles, how organizations respond to the pressures of the environment and, finally, what impact institutions have on the development of organizational strategy and structure (DiMaggio and Powell, 1983). Organizational field (Kostova, Kendall, Roth, 2008) is defined as a socially acceptable pattern of behavior and organizational structure. DiMaggio and Powell define the organizational field as "those organizations that, in general, participate in the creation of institutional area: key suppliers, resources, consumers, regulatory agencies and other organizations that produce similar services or products." (DiMaggio and Powell, 1983).

The organization is required to prove its legitimacy in order to gain right to use and to deploy resources. Legitimacy is perceived as desirable action of one entity within the framework of social values, norms, beliefs and definitions (Scott, 2001). Since the patterns of socially acceptable behavior is defined by the environment (Tipurić 2004 from Meyer and Rowan 1977) managers make decisions that are socially acceptable (not necessarily rational) and are strongly influenced by social pressures and are actually an imitation of previous decisions, in most cases, market leaders (Robbins, Barnwell, 2006).

The process of institutionalization results in three types of institutions (Scott, 2011):

• *regulatory institutions* rely on rules that have an obligatory dimension; they consist of laws and policies that create an obligation to a certain behavior, and failure to comply with the same is being sanctioned

• *normative institutions* are based on the standards of behavior, social values and professional standards

• *cognitive institutions* define social reality through common values and concepts; most often socially acceptable behavior is "taken for granted" and as such, the only right one.

The institutions propose guidelines for an organizational behavior that is considered proper and desirable (Barley and Tolbert, 1997), and which will ultimately be legitimate: therefore, will eliminate the potentially undesirable behavior. The environment in which the power of the institution is emphasized give impetus to those organizations that operate in accordance with the set of norms and standards, and on the other hand, it is easier to sanction those who do not adapt their behavior to isomorphic. Factors such as the conditions of insecurity, lack of prestige and / or reputation condition certain organizations to identify themselves with what is considered traditional and socially acceptable (Phelps and Dickson, 2009).

Although the process of institutionalization is placed at the level of economic activity, its impact depends on the activity of organization. Logically, some activities such as the banking industry are more exposed to institutional pressures than for example in the music industry. The degree of exposure to the process of institutionalization depends on two factors (Janićijević 2014):

1. degree to which the output of organizations in the same organizational field can be measured, evaluated and standardized

2. degree to which organizations can control the flow of resources in the same organizational field

The higher degree of output standardization, the less will the organization be exposed to the pressures of institutionalization and vice versa. Consequently, the less possibility of influencing social resources and their use, will increase the exposure of institutional isomorphism and conformity with the aim of achieving legitimacy.

Institutional theory is characterized by the conditions in the environment in which organization operates and the impact of the environment on the organization itself. Limitations that are imposed affect contextual shaping of desirable behavior and it is different depending on organizational field. When composing its behavior isomorphic within organizational fields, organizations achieve legitimacy, enhance and ensure its chance of survival. Doing business in an environment characterized by uncertainty proved to be a fertile ground for isomorphism among organizations. In time when organizations are faced with a strategic decision-making supported by incomplete information regarding the changes in the environment, often look to competitors trying to find answers to their questions and closely monitor behaviors and reactions of competitors. Previously mentioned limitation of human activity can be seen just in terms of uncertainty, when the organization are set to make strategic decisions based on the decisions of competitors, but they are not always in line with the initially set targets (DiMaggio and Powell, 1983; Galaskiewicz and Wasserman, 1989). Often this behavior under uncertainty leads to a vicious circle where "the blind leads the blind" (O'Brien and Slack, 2004). When there is a gap between institutional expectations and efficiency, the company decouples formal structure from current business practices and conformity tends to have ceremonial character (Tipurić, 2014 from Meyer and Rowan, 1997).

2. INSTITUTIONAL ISOMORPHISM

The main focus of institutional organization theory is on the institutional isomorphism which explains the similarity among organizations in an organizational field (Tipurić, 2014) and how organizations become similar to their competitors (DiMaggio and Powell, 1983). Isomorphism explains the degree of conformity of organization to norms and practices that have been established in a given organizational field (Johnston, 2013). This process leads to homogeneity of organizations and it is called isomorphism. In the background of institutional isomorphism lays the fact that organizations tend to find indications in the environment for the formation of appropriate actions and practices for business. Theorists support this concept indicating that over time organization operating within the same field adopt similar organizational structures and patterns that will ultimately appear isomorphic (Deephouse and Carter, 2005; Washington and Patterson, 2001).

There can be identified 3 types of isomorphism (DiMaggio, Powell 1983):

• coercive isomorphism

• normative isomorphism

• mimetic isomorphism

Coercive isomorphism
Coercive isomorphism results in institutional pressures by the organization forcing those organizations that depend on them (DiMaggio and Powell 1983). In the background of coercive isomorphism are formal and informal pressures by the state legislatures, regulatory agencies but also the cultural expectations that society has from organizations (Tipurić, 2014). Coercive isomorphism is emphasized in situations where leading organizations affect other followers in such way that imposes desired behavior in order to achieve legitimacy and additional benefits (Edwards et al. 2009), primarily related to increasing the availability of social resources and avoiding sanctions (Johnston, 2013).

Mimetic isomorphism
Organizations tend to form their practices and policies mimicking those organizations which are considered to be successful and legitimate. This phenomenon is called mimetic isomorphism. Mimetic isomorphism is a consequence of the uncertainty in the environment and unclear organizational

objectives. Benefits of mimetic isomorphism are numerous: low cost of human capital, decisions arising from mimetic isomorphism are based on finding a viable solution with minimal cost since the problems occur in unclear and uncertain environment (DiMaggio and Powell, 1983). The uncertain environment can be seen as a force that encourages organizations to imitate each other within the same organizational field. Furthermore, mimetic isomorphism can serve as a practical solution for those organizations that are not able to solve their problems by themselves (Lee, Penings, 2002) Organizations apply almost identical structures of those successful ones, believing that will achieve the same level of success, but at the same time do not take into account the context in which these structures are applied (Janićijević, 2014). For those organizations whose core business is closely related (operating in the same organizational field) is more likely that over time will appear isomorphic (Edwards et al, 2009).

Normative isomorphism

Normative isomorphism is the result of professionalization within a specific organizational field (Tipurić, 2014; Johnston, 2013). Professionalization is defined as the collective effort of members in the same profession in order to establish rules and restrictions for governing business performance in that profession by setting the cognitive basis of their autonomy (Ashworth et al, 2007). As a consequence, individuals that are connected through the same profession will develop skills and homogeneous characteristics over time and gain legitimacy (Johnston, 2013). The normative pressures on an organization can potentially have a significant impact; experiences and beliefs of individuals within the organization can lead to a fact whether the organization will be considered legitimate or not. Qualification and individual characteristics of individuals are helping the organization to achieve conformity within the organizational field (Johnston, 2013); For example, the accounting service will not be perceived as legitimate if its employees are not qualified and certified accountants.

3. CHALLENGES AND LIMITATIONS OF INSTITUTIONAL THEORY AND INSTITUTIONAL ISOMORPHISM IN MULTINATIONAL COMPANIES

The research work of scientists in the field of institutional theory and multinational companies offers a theoretical background for a better understanding of this theory. Multinational companies are in their characteristics and practices considerably different from domestic companies mostly due to a combination of multidimensionality and heterogeneity (Doz and Prahalad, 1991).

Organizational field

Institutional theory defines the organizational field as an environment in which the organization operates. Field defines socially acceptable structures and practices. Kostova, Roth and Dacin suggest that organizational field is nonexistent in the context of multinational companies: multinational companies create their own "metaorganizational field".

Institutional isomorphism

Kostova, Roth and Dacin state how "classical" institutional isomorphism in multinational companies cannot be identified. They propose the concept of limited institutional isomorphism because it occurs within the organizational field (which in the business of these organizations is again specific) and a definition of the organizational field in this case does not exist. Furthermore, considering that multinational companies operate in a host country and are introducing something new are less likely to adopt the established domestic business practices and routines (Kostova, Roth, Dacin 2008). These organizations are seen as an unique class since they are "foreigners", therefore, taking into account this fact, local presence of isomorphism on them will be less pronounced. Furthermore, given that the boundaries of an organizational field are shifted host country faces difficulties in the systematization to which organizational field multinational company or its subsidiaries belong to. Also, the scarcity of resources in the local environment is superseded by alternative sources. In "institutional freedom" multinationals will enjoy as long as they comply to the law and legislation of host country.

Legitimacy

Achieving and maintaining the legitimacy of multinational companies is a critical factor because of the complexity of the environment in which they operate and intra-organizational processes. Kostova and others criticize the traditional thinking of achieving legitimacy especially because of the specific context in which the multinational companies operate. Customizing to the myriad of regulatory, cognitive and normative expectations deriving from conflicting sources that create pressures and complicate the process of achieving legitimacy (Kostova, Roth, Dacin, 2008). The authors propose an alternative approach; negotiating access with key groups. Legitimacy is therefore more a social construct rather than a function of isomorphism. Multinational companies often use their corporate reputation (especially if it is stable and strong) as a source of achieving legitimacy in the host country.

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