

Institutional Theory the Logic of Institutions

Sandeep Bhasin
Amity University Uttar Pradesh, Uttar Pradesh, India

Abstract: Institutional theory focuses on the resilient aspects of social structure. According to Richard Scott, to understand the theory of institutions, one has to consider the factors that shape formal organizational structures, including formal and informal schemes, rules, norms and routines which become established as authoritative guidelines for social behavior. This report research paper looks at the history of institutional research, macro and micro factors that impact the constitution of the institute and different approaches of institutional economics. The study looks at the three mechanisms of institutional isomorphic change. The study also covers the legitimacy of organizational institutionalism.

Key words: Constitution, organizationa institutionalism, structure, schemes, India

INTRODUCTION

One fundamental difficulty involved in the study of institutions is that there is no widely accepted definition of institutions (Chang, 2002). David and Mark (2008) was one of the first theorists to elaborate on institutionalization as a process which value is infused beyond technical requirements. He proposed institutionalization as a variable, so organizations could be more or less institutionalized. However, at a broad level, institutions are the working rules of a society. They can be defined as a set of formal and/ or informal procedures, routines and norms in the organizational structure. It also includes perceptual learnings and moral rules which reside at Micro, Meso and Meta levels within the firm. Institutional Theory can be understood as “policy-making that emphasizes the formal and legal aspects of government structures”. Institutional theory focuses on the resilient aspects of social structure. To understand the theory of institutions, one has to consider the factors that shape formal organizational structures including formal and informal schemes, rules, norms and routines which become established as authoritative guidelines for social behavior (Scott, 2008A, B). Another popular definition of institutional theory is it considers the processes by which structures, including schemas, rules, norms and routines, become established as authoritative guidelines for social behavior. It inquires into how these elements are created, diffused, adopted and adapted over space and time and how they fall into decline and disuse “Institutional theory” P408-14 in Encyclopedia of Social Theory, George Ritzer, ed. Thousand Oaks, CA: Sage). Institutional theory emphasizes that organizations are open systems strongly

influenced by their environments but that it is not only competitive and efficiency-based forces that are at work. Socially constructed belief and rule systems exercise enormous control over organizations both how they are structured and how they carry out their work.

What helps in sustaining the business in the long run is achieving optimization of resources at Meso-to-Meta levels. As an institution, the management has to ensure creation of value for all the stakeholders, especially the investors and employees which adds to sustainable strategic choices available with the firm. Value creation by the firm gets impacted by internal and external environment (Fig. 1). The firm deserves a better understanding of impact factors at: meta level, macro level and meso level and micro level to help build scenarios which lead in building sustainable businesses. Social, cultural, political, technological and economic factors impact the firm’s working at the Meta-level (Institutional Theorists have not considered technological and economic contexts as separate area of study but have covered its impact in the New Institutional Theory). These factors shape the Macro-environment of a firm to operate in. A better understanding and analysis these factors lead the firm to deduce the environment in which industry operates. This would include a deep study of role of the government in shaping the policies, openness of the markets specifically to the industry in which the firm operates, financial market efficiency that allows the firm to raise funds, development of related infrastructure, overall management of the national and state governments, labor market conditions and the rule of law pertaining to the business of the industry (Fig. 1).

Understanding these factors lead the firm to build a sustainable strategy. To build this, the firm has to

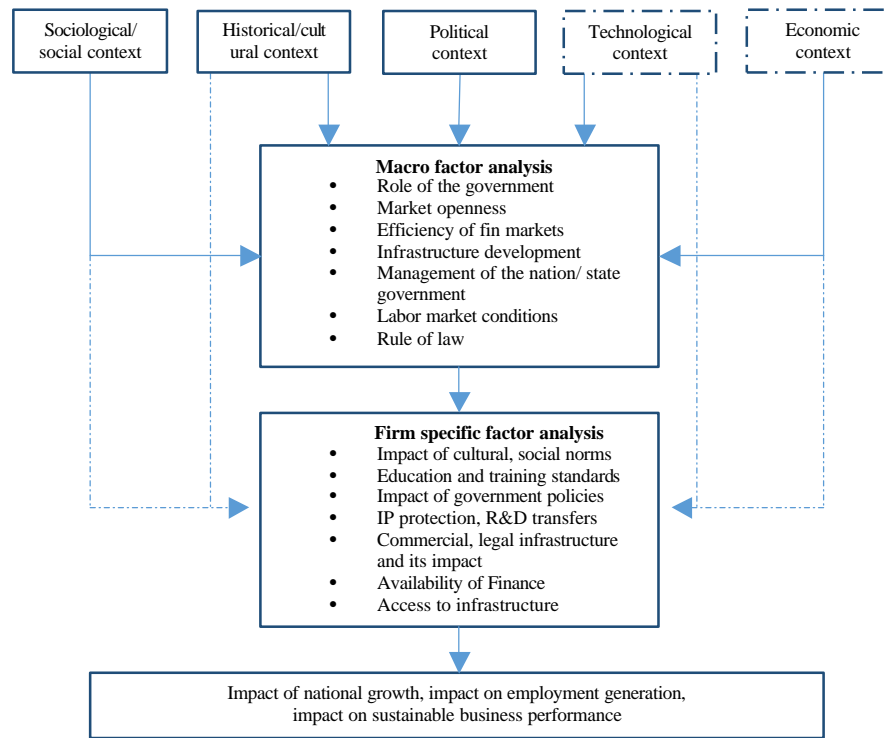


Fig. 1: Micro, macro factor analysis and impact on country growth

understand these independent and related factors with an inside-out approach where it analyzes the impact on the working of the firm at a Micro-level. This impact analyses builds the foundation for institutional theory.

History: Most reviewers credit Weber with introducing legitimacy into sociological theory and thus into organization studies. Weber’s analysis of the legitimacy of different authoritytypes is well known to many organizationtheorists. Weber’s writings also cover the importance of social practice being oriented to ‘maxims’ or rules and suggest that legitimacy can result from conformity with both general social norms and formal laws. The sociological study of institutions dates back to Spencer’s work in the 19th century. Since him, many sociologists such as Durkheim, Marx, Parsons, Weber and more recently Berger and Luckmann, have studied the subject. However, when organization theory began, researchers paid little attention to institutions (Scott, 2008). According to Scott (2008a, b) the three major strings of institutionalism were conducted by Merton and Selznick, Talcott Parsons and Hebert Simon. At Columbia University, Merton and Selznick were stimulated by the

English translation of Weber’s work on bureaucracy. Merton’s research showed how forces within bureaucracy produced a normative order that actors would follow. However, it was Selznick that transformed organizations into institutions. Selznick suggested that organizations became institutionalized when achieved an established status .

However, it was David Selznick that transformed organizations into institutions. Selznick suggested that organizations became institutionalized when achieved an established status. He proposed institutionalization as a variable, so organizations could be more or less institutionalized. Those who follow Selznick’s theoriesfollow the view of”organizations as the rational creatures they pretend to be but vehicle for embodying values” (Scott, 2008a, b). In the TVA study case, Selznick approached analysis politically, studying group conflicts and alliances in organizations.

Talcott Parsons studied how a company is legitimized by having its values aligned with relevant institutional patterns related to the company’s sector. Also, different sector of society have different values which are stratified in society. The company that serves more highly values is expected to be more legitimized and have more resources.

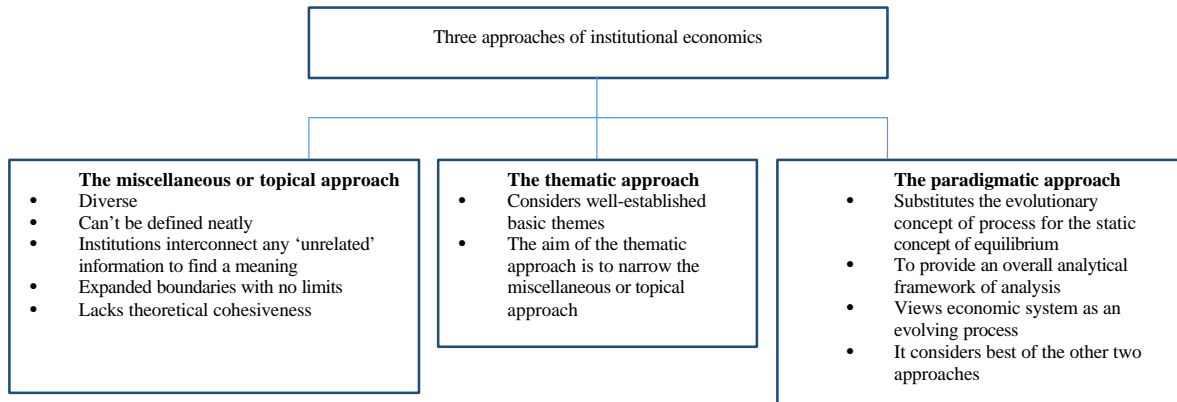


Fig. 2: Approaches of institutional economics (Adapted from Gruchy Allan G., three different approaches to institutional economics: An Evaluation, Journal of Economic Issues Voi. XXIV No. 2 June 1990)

Simon studied how the possible paths and outcomes created mentally by an actor are limited by the environment and organizational features. He and March showed “the ways in which organizations shape the behavior of participants by developing “performance programs” to guide routine behavior and “search programs” to follow when confronting unusual tasks”. The earlier institutional theorists were concerned with actors inside organization, the role of values and norms in the institutionalization process, the focus on micro or local environments, the elements constraining organization being political tradeoffs and alliances (Scott, 2008a, b).

Meyer and Rowan (1977) published two seminal articles “The Effects of Education as an Institution” and “Institutionalized Organizations: Formal Structure as Myth and Ceremony” which is widely considered as the beginning of New Institutional Theorists. The new institutionalists draw on cognitive and cultural theory to focus on different elements in institutional theory. They “recognized that individuals actively participate in perceiving, interpreting and making sense of their world” (Scott, 2008a, b). We now look at different institutional theories propagated over the years.

Three different approaches of institutional economics:

Over the years, multiple approaches of Institutional theory have converged into two broad categories, viz., classic institutional theories and new institutional theory (New institutional theory started developing in 1977 with the articles by Meyer and Rowan (1977). We can understand this further by considering yet another version of three different approaches through the spectrum of institutional economics (Fig. 2):

- Miscellaneous or topical approach
- Thematic approach
- Pragmatic approach

The Miscellaneous or Topical approach is so diverse in nature that it is extremely difficult to put in generally accepted framework of analysis. According to this first approach, the interests of institutionalists are so widespread and diverse that these heterodox economists feel they are entitled to analyze any topic that is of interest to them. They abandon the narrow boundaries set up by orthodox economists and feel free to inquire into any matter that throws light upon the topic under consideration (Gruchy, 1990). The approach is so diverse that it can't be defined neatly with almost all the factors, even those without any direct impact on the theory are considered. The institutions following this approach interconnect any 'unrelated' information to find a meaning which may or may not exist, thus resulting into expanded boundaries with no limits. All this may lead to lack of theoretical cohesiveness.

The Thematic approach considers well-established basic themes including (these 6 sub-approaches in thematic approach is covered in Fig. 1. Figure 1 is a graphical representation of all the theories converging into one theory of institutionalization which will be referred throughout the article) the role of government, the importance of technology, value concept, the theory of social control, the impact of culture and the role of institutions. The aim of the thematic approach is to narrow the miscellaneous or topical approach.

The third approach is the paradigmatic approach substitutes the evolutionary concept of process for the static concept of equilibrium. This is used with the sole purpose to provide an overall analytical framework of analysis. The theory views economic system as an

evolving process by considering the best of the other two approaches. The paradigmatic approach goes one step further than the thematic approach by seeking to provide an overall analytical framework of analysis.

Sociological institutionalism: Sociological institutionalism (researchers and economists have been using social institutionalism as a subset of sociological institutionalism. I have used these two terms alternatively assuming social institutionalism and sociological institutionalism both are concerned with the impact of society in general) of the firm works around resource dependence model (Resource Dependence Theory (RDT) is the study of how the external resources of the firms impact the behavior and actions of the firms operating within an industry. Resource dependence theory has implications on the (divisional) structure of firms, specific duties of the board members, roles and responsibilities of temporary and permanent workforce, the firm's production strategies as compared to industry, vertical and horizontal integration and contract structure, firm's relationships with stakeholders among others), considering world systems analysis which avoids cultural structures and processes in its explanations. In the study of policy, sociological institutionalism focuses on quests for legitimation in political organizations and tends to focus on processes of policy imitation and diffusion and especially on surprising convergences in forms of institutions and policies. In sociological institutionalist theory, organizational structures constitute the hypothesized infrastructures through which normative, cognitive and dependence mechanisms exert their influence. Sociological institutional explanations is considered to be working optimally in situations where the policy makers (Fig. 1) requires specific guidance from institutions, formally or informally and sees no cost (latent or specific) in adopting the characteristics or structures of other organizations. Sociological institutional explanations for policy stability also overlap with historical institutionalist accounts of "policy lock-in" or "path dependence" (Clemens and Cook, 1999). The theorists who follow sociological institutionalism emphasize on convergence in political processes (Amenta and Kelly, 2010).

MATERIALS AND METHODS

Historical institutionalism: Historical institutionalism differs from sociological institutionalism in its lack of endorsement of a specific theoretical program and as a school of thought has only a moderately high level of self-identity (Hall and Taylor, 1996). Followers of this theory see the institutions as structures created following

path dependence (Time matters. The impact of strategies surface after a medium-to-long time lapse), i.e., new (Macro and Micro level) policies reshape political actions with an unset patten of probability of actions and results. The theorists who follow the theory of path-dependence also tend to focus on the persistence of political processes and outcomes (Amenta and Kelly, 2010). Under this theory, the most common institutions discussed are those at the state or country level, notably the polity or the political economy (Hall and Taylor, 1996). Many of the historical institutionalists refer themselves as "state centered" thus, forming a boundary to work within. Historical institutionalists focus on Macro level analysis addressing big questions and issues of wide interest but surround them within specific places and times, thus not allowing it to get influenced with 'long-range extremism impacts' (the term 'long-range extremism impact' can be considered as an avoidance of meta-level impact that gets created with factors beyond the scope of historical institutional theory). Predominantly, historical institutionalists address the issue of institutional change, hence the impact of path-dependence become a prime factor for the study. Historical institutionalism is not tied to any one method of analysis and some of the work specified by historical institutionalists as exemplars combine a wide variety of methodological techniques (Amenta and Kelly, 2010; Pierson and Skocpol, 2002).

Political institutionalism: Political institutionalism addresses power explicitly and emphasizes the causal role of political institutions on political outcomes and processes. This theory started as 'state-centered' theory in the early 1980s. This initial state-centered theoretical program has evolved into a political-institutional one over the last decade or so (Amenta, 2005). This theory focuses more on the 'systemic' and 'structural' aspects of states and political party systems and the manner of their organization in constructing arguments notably that these political institutions shape the political identities, interests and strategies of politically mobilized groups (Amenta and Kelly, 2010).

The institutional isomorphism: Organizational structure which used to arise from the rules of efficiency in the marketplace, now arise from the institutional constraints imposed by the state and the professions. The efforts to achieve rationality with uncertainty and constraint lead to homogeneity of structure also referred as Institutional Isomorphism. As an innovation spreads, a threshold is reached beyond which adoption provides legitimacy rather than improves performance. The impact of innovation on formation of Institutions can be referred in Fig. 3 and 4. Isomorphism is constraining process that

Theory Element	Regulative	Normative	Cognitive
Basis of compliance	Expedience	Social Obligation	Taken for granted
Mechanisms	Coercive	Normative	Mimetic
Logic	Instrumentality	Appropriateness	Orthodoxy
Indicators	Rules, laws, sanctions	Certification, accreditation	Prevalence, isomorphism
Basis of legitimacy	Legally sanctioned	Morally governed	Culturally supported, conceptually correct
Inter-firm	Employment contract protocols, procedures	Communities of Practice	'Constitutive' Scripts
Corporate	Property relations governance structure	Corporate identity career	Frames and recipes
Sector or field	Association Network	Corporate reputation occupation	Strategic set
Nation State	Licensor Monopoly of violence	Families, occupations, nationalism	National institutions
Global Regional	International agencies transactional corporation	Emulative nationalism corporate citizenship	Centre/ periphery developmentalism

Fig. 3: Basis of institutionalization

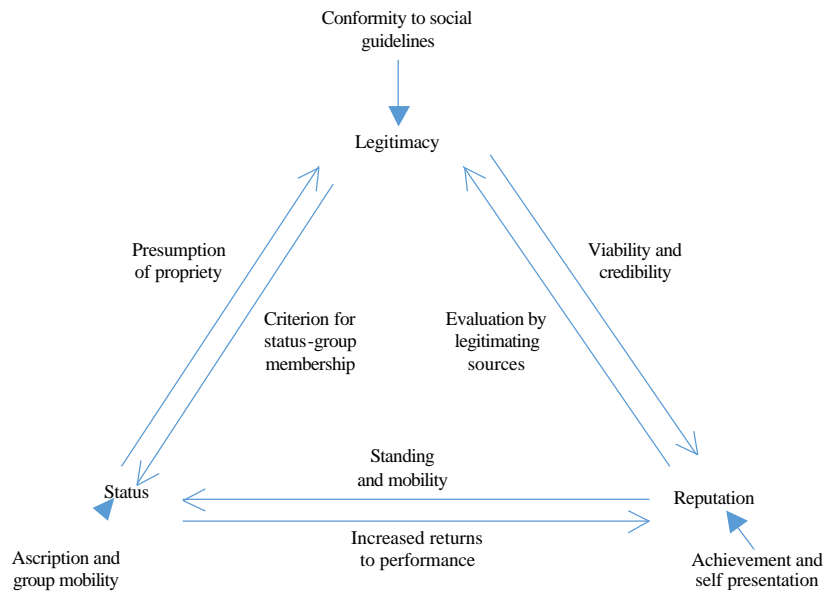


Fig. 4: The interrelation of legitimacy, reputation and status

forces one unit in a population to resemble other units that face the same set of environmental conditions. Organizations compete not just for resources and customers but for political power and institutional legitimacy for social as well as economic fitness (Dutton *et al.*, 1983; Field *et al.*, 1983).

Basis of institutionalization: Three mechanisms of institutional isomorphic change as proposed by DiMaggio and Powell are:

- Coercive isomorphism
- Mimetic processes
- Normative pressures

Coercive Isomorphism refers to the condition where pressures from other organizations within the same industry is increased to force the firm to initiate a process of change. This could have a dependence upon cultural expectations from the society as well. Other factors that play an impact are government policies and mandates, contract law and financial reporting requirements. According to DiMaggio and Powell, “organizations tend to be increasingly homogeneous within given domains and increasingly organized around rituals of conformity to wider institutions”. It may be worthwhile to note that large organizations can have similar impact on their subsidiaries.

Mimetic Processes generally have an impact when there is a suspense of uncertainty within the industry. This uncertainty encourages imitation (of policies, strategies and behavior). DiMaggio and Powell observe that organizational models can be diffused through employee migration or by consulting firms.

Normative pressures are brought about by professions according to DiMaggio and Powell. They observed that certain norms get developed during formal and informal education get an entry into the organizations. Job changes and inter-hiring between existing organizations also encourages isomorphism. People from the same educational backgrounds will approach problems in similar ways.

The similarities caused by these three processes allow firms to interact with each other more easily and to build legitimacy among organizations.

The new institutionalists

Legitimacy in organizational institutionalism:

Legitimacy is a central concept in organizational institutionalism, although most of it has been theoretical in its skewness rather than empirical in its approach. New institutional theory started developing in 1977 with the articles by Meyer and Rowan (1977). Although, Zucker only mentioned legitimacy once in passing, Meyer and Rowan made it a central focus of their analysis, invoking the term at least 43 times in some form. Their theory placed 'legitimacy' and 'resources' together and suggested that both of these outcomes may result from being efficient with in the organizational environment.

Meyer and Scott (1983) defined organizational legitimacy as the degree of cultural support for an organization. It mainly refers to the adequacy of an organization as theory. A completely legitimate organization would be one about which no question could be raised. Perfect legitimation is perfect theory, complete (i.e., without uncertainty) and confronted by no alternatives.

The new institutional theorists now started critically evaluating the concept of legitimacy in organizations, especially what factors would lead to gaining or losing legitimacy. Galaskiewicz (1985) in his study published in annual review of sociology titled 'Interorganizational relations' published in 1985, found that "organizations often sought to enhance their legitimacy by donating to charities, forming director interlocks and obtaining external endorsements." Ashforth and Gibbs highlighted three purposes for legitimation efforts: gaining, maintaining or defending legitimacy which was taken forward by other institutional theorists including Elsbach and Sutton and Suchman. The study of Legitimacy of organizational institutionalism covers:

- Subjects of legitimacy (those social entities, structures, actions and ideas whose acceptability is being assessed)
- Sources of legitimacy (internal and external audiences who observe organizations and make legitimacy assessments)

The consequences of legitimacy is that it "enhances organizational survival (Meyer and Rowan in their study Institutionalized organizations: formal structure as myth and ceremony, published in 1977 in American Journal of Sociology argued that legitimacy measured by endorsements and inter-organizational increased survival rate among organization. This aspect was further researched upon by Baum and Oliver and other leading institutional theorists). More recently as an interest in legitimacy has spread into the strategic management literature, researchers have developed and tested hypotheses predicting how various types of legitimacy would affect other performance measures such as the value of initial public offerings, stock prices, stock market risk and stakeholder support.

Deephouse and Suchman further simplify the concept of legitimacy (Fig. 5) in institutions with a simple equation: $Prestige = Legitimacy + Legitimacy \times X$ ($Status + Reputation + [Status \times Reputation]$) where Prestige is an organization's capacity to achieve objectives by virtue of enjoying a favorable social evaluation.

Process of institutionalization: (This study is an adaptation of an article The Institutionalization of Institutional Theory, authored by Pamela S. Tolbert Cornell University and Lynn G. Zucker University of California, available at DigitalCommons@ILR).

Every successful organization that has managed to sustain itself for a longer period of time has built on innovation. The process of institutionalization involves tracking the three stages of pre-institutionalization, semi-institutionalization and full-institutionalization (Table 1).

Three major factors that impact the innovation drive (Fig. 6) within an organization are technological change, legislation and market forces (a detailed analysis of other factors impacting the sustainability of the organization can be referred to in Fig. 1 above where we have analyzed many more factors impacting the performance of an organization's sustainability drive).

In an organizational context, the process of habitualization involves the generation of new structural arrangements in response to a specific organizational problem or set of problems and the formalization of such arrangements in the policies and procedures of a given

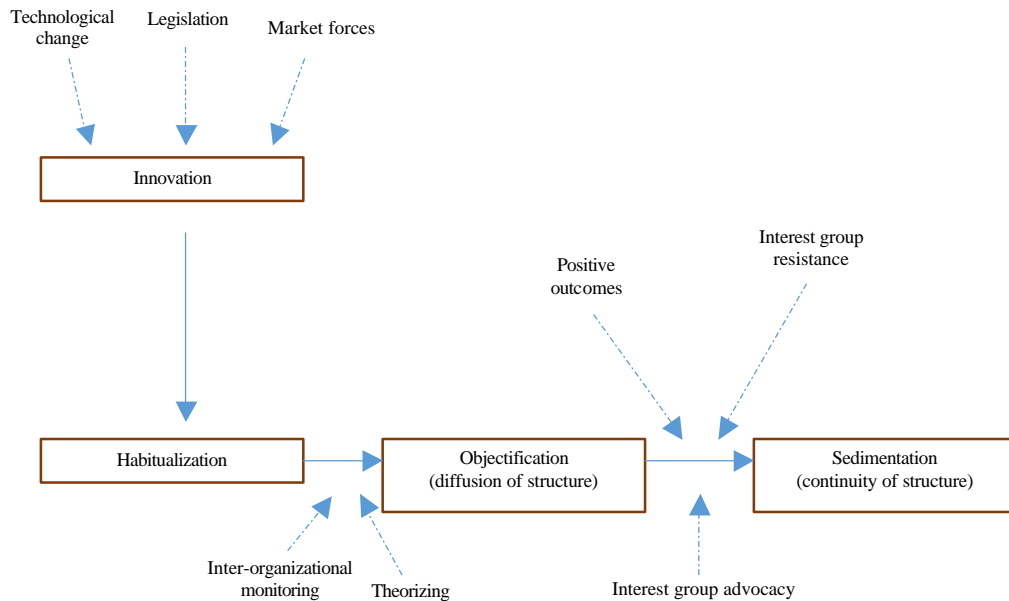


Fig. 5: Factors impacting innovation drive

Table 1: Stages of institutionalization and comparative dimensions (The institutionalization of Institutional Theory, authored by Pamela S. Tolbert Cornell University and Lynn G. Zucker University of California, available at DigitalCommons@ILR)

Dimension	Pre-institutionalization stage	Semi-institutionalization stage	Full institutionalization stage
Processes	Habitualization	Objectification	Sedimentation
Characteristics of adopters	Homogeneous	Heterogeneous	Heterogeneous
Impetus for diffusion	Imitation	Imitative/normative	Normative
Theorization activity	None	High	Low
Variance in implementation	High	Moderate	Low
Structure failure rate	High	Moderate	Low

organization or a set of organizations that confront the same or similar problems (Tolbert and Zucker, 1996). Habitualization leads to diffusion of structure known as Objectification. It may be noted here that organization tries to theorize the experience considering the imitation/replication done by other players. Objectification involves the development of some degree of social consensus among organizational decision-makers concerning the value of a structure and the increasing adoption by organizations on the basis of that consensus. Such consensus can emerge through two different though not necessarily unrelated mechanisms (Tolbert and Zucker, 1996). Objectification of theory leads to Sedimentation with forces including positive outcomes and interest group resistance and advocacy (replication and adaptation of certain theories already proven to be successful lead to sedimentation which rests on continuity of proven institutional structure).

Identification of factors that affect the extent of diffusion and the long-term retention of a structure is thus key to understanding the process of sedimentation (Tolbert and Zucker, 1996). Sedimentation stage creates its impact even if there is opposition with demonstrable

results. What creates the difference in acceptance of theory is its diffusion and its positive results under different conditions.

RESULTS AND DISCUSSION

Comparing the new with the old: The idea of institutionalism presented by Tolbert and Zucker discussed above considers diffusion of ideas which was avoided by most of old institutionalists. For them, the concept of institutionalism was an inside-out approach (Fig. 6) (Sociology 6/1:18 (1972)).

Institutionalism was more of operational efficiency and organizational receptivity which got impacted by the market efficiency, defined by market forces and the environment strategies. Environment strategies created environmental conditions which defined strategies for an organization. Nowhere did we speak of the adaptability of best practices as practiced by other players in the industry. Tolbert and Zucker, in their model discussed previously, clearly defined the influence of other players operating in the market place which has over the last

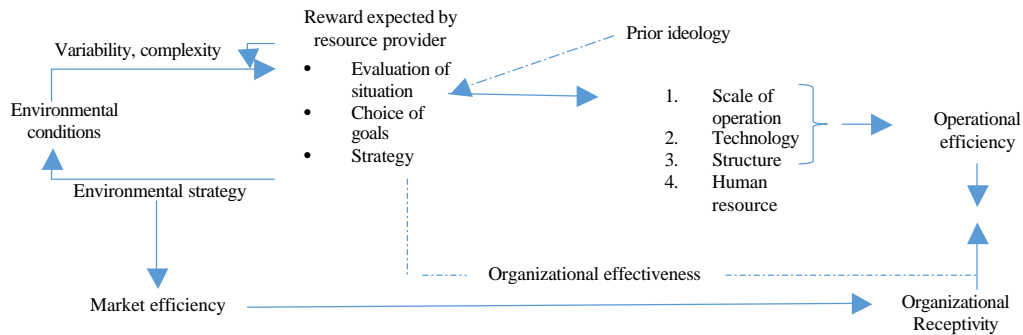


Fig. 6: Organizational receptivity

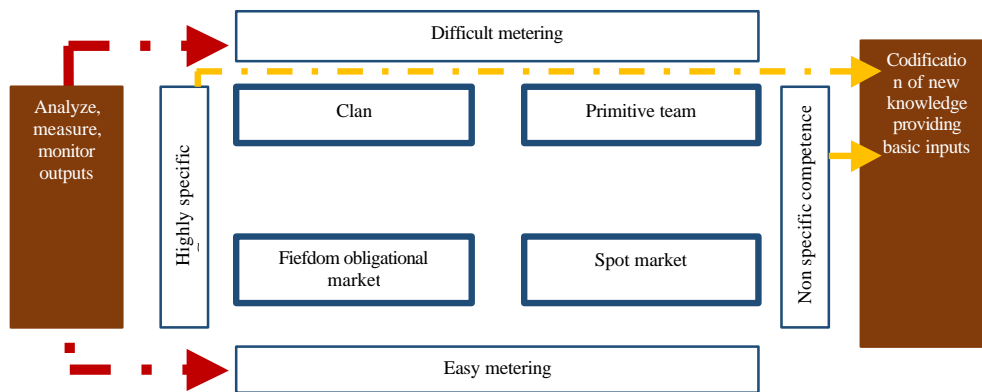


Fig. 7: Execution of replication plan

decade become one of the major source of innovation in the industry. This innovation by some and replication by many creates a new institutional working. However, the major issue with the new theorists has been implementation of institutional practices or execution of replication plans. This issue is broadly covered by Ray and Mok (1979) (Fig. 7) by attempting to define the competence of an organization. Where exactly the firm operates depends upon two factors, ease of measurement of competency and clarity of defining the competence. The firm is said to be operating with primitive teams or non-involved teams if they have non-specified competence which is difficult to codify and if analyzing, measuring and monitoring outputs has higher difficulty.

The organization, on the other hand works in a niche, referred to as a Clan by the Ray and Mok of the competence is highly specific and clearly defined but have difficulty in analyzing, measuring and monitoring the output of the activities undertaken. Loveridge and Mok (1979) managed to address the issues related to competence and its direct impact on market segmentation which helped the new institutional theorists in understanding the dynamism of institutionalization. Ha-Joon Chang, Peter Evans, in their article The Role of Institutions in Economic Change published in 2000 raised

some interesting issues on the presence of twolines of ideologically and politically distinct research: New Institutional Economics (NIE) (The NIE is a research project that applies the tools of neo-classical economics to transaction costs, property rights, and public choice) and Institutional Political Economy (IPE) (The IPE traces its roots to the intellectual legacy of Karl Marx, Thorstein Veblen, Joseph Schumpeter, Karl Polanyi and Herbert Simon). While the NIE connects to neoclassical economics, the IPE follows the tradition of the “old institutional economics” (Lopez and Quero, 2012).

NIE theorists categorize institutions as those that follow a set pattern of rules that may include certain restrictions imposed on workings of human interactions that define the transaction costs and define economic development. The IPE, on the other hand, emphasizes the importance of political realities in the selection of public policies and highlights the role of institutions in setting the terms of human interaction (Chang, 2002; Lopez and Quero, 2012). Chang refers NIE as “superficial” and IPE as “explicitly institutionalist”. The NIE links development to two key institutions: those safeguarding the rights of ownership, on one hand and those enforcing contract compliance, on the other (Lopez and Quero, 2012). The IPE for its part, asserts that attempts to explain the origins of institutions are futile and highly misleading. Moreover,

all societies, irrespective of time and place, achieve cooperation, cohesion and order under the influence of a complex set of behavioral codes inherited from the past. Individuals are born into a preexisting institutional environment that is they are already institutional individuals in “the state of nature” (Hodgson, 2006, Lopez and Quero, 2012). This discussion between NIE and IPE is still going on.

CONCLUSION

Globalization, also referred to as Global Village has forced organizations across the world to discover themselves. Some organizations have managed to create their own identity and others prefer to mimic or replicate the best practices through the process popularly known as Isomorphism among Institutional theorist. Contribution of universities in helping organizations follow classical or new institutional theories has been extremely high. One aspect that deserves attention is the development of theoretical models by theorists and educationalists but what really matters is the execution of these practices. Executions by different actors at different times generating desirable and failed results help formulation of theories. For Institutional theorist, institutional economics becomes one such base theory. Miscellaneous or topical approach, thematic approach and pragmatic approach offers the starting point to understand the development and impact of institutional theory.

The development of institutional theory can be understood with the three aspects of isomorphism within organizations. Coercive Isomorphism, Mimetic Processes and Normative pressures help us understand different stages of institutional development. With different approaches covering varied theoretical aspects, classic and new institutional theorists helped us understand how organizations get their characters. Institutionalists investigate the assumptions that forma connection between policies and practices. The incredible changes ineffectively perceived by realist social sciences happen substantially all the more through waves of accommodating non-choice than through systems of completely structured and self-sufficient legitimized perform (Adopted from the study Reflections on Institutional Theories of Organizations authored by John W. Meyer, published in The Sage Handbook Of Organizational Institutionalism, 2008 The IPE traces its roots to the intellectual legacy of Karl Marx, Thorstein Veblen, Joseph Schumpeter, Karl Polanyi and Herbert Simon).

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