ARTICLE

The Institution-Based View as a Third Leg for a Strategy Tripod

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Executive Overview

This article identifies the emergence of the institution-based view as a third leading perspective in strategic management (the first two being the industry-based and resource-based views). We (a) review the roots of the institution-based view, (b) articulate its two core propositions, and (c) outline how this view contributes to the four fundamental questions in strategy. Overall, we suggest that the institution-based view represents the third leg of a strategy tripod, overcomes the long-standing criticisms of the industry-based and resource-based views' lack of attention to contexts, and contributes significant new insights as part of the broader intellectual movement centered on new institutionalism.

As part of a broader intellectual movement centered on new institutionalism throughout the social sciences in recent decades (DiMaggio & Powell, 1983, 1991; North, 1990, 2005; Scott, 1987, 1995, 2008b; Williamson, 1975, 1985), strategic management researchers have increasingly realized that institutions are more than background conditions (Oliver, 1997; Peng & Heath, 1996). Instead, "institutions *directly* determine what arrows a firm has in its quiver as it struggles to formulate and implement strategy" (Ingram & Silverman, 2002, p. 20, emphasis added). Consequently, an institution-based view of strategic management has emerged (Peng, 2002, 2003). More important, this view has been argued to be one of the three leading perspectives in strategic management—the other two being the industry-based and resource-based views (Peng, 2006, 2009).

With an age of approximately 30 years, strategic management ("strategy" in short) is a relatively young discipline that is constantly in search of new perspectives (Hambrick & Chen, 2008). Its first period of growth was in the 1980s, when Porter (1980) introduced what we now call the industry-based view. The second period of growth took off in the 1990s, propelled by the resource-based view advocated by Barney (1991). We argue that the third period of growth, largely in the last decade or so, has been underpinned by the rise of the institution-based view. Since it takes three legs to sustain a platform, we believe that the institution-based view has significantly enriched the strategy discipline by adding a third leg, leading to a strategy tripod shown in Figure 1.

What are the origins of the institution-based

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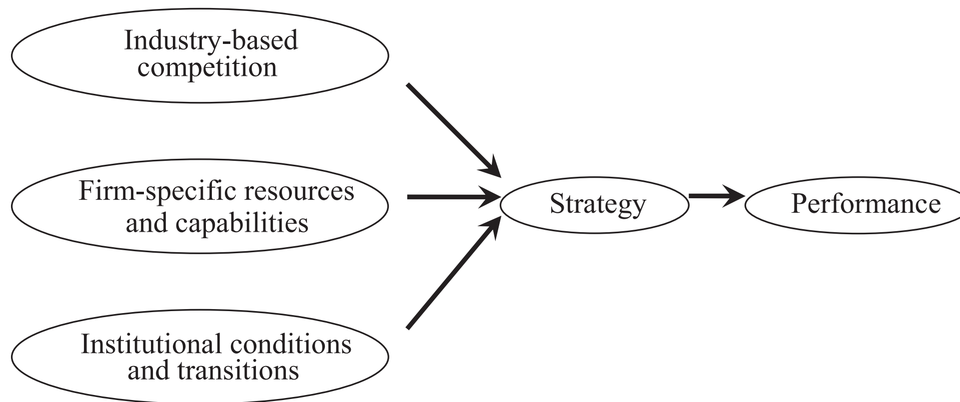
Figure 1
The Institution-Based View: A Third Leg of the Strategy Tripod



Source: Peng (2009, p. 15).

view in strategy? How does the institution-based view add to our understanding of strategy above and beyond what we already know based on the industry-based and resource-based views? This article addresses these crucial questions by (a) reviewing the roots of the institution-based view, (b) articulating its two core propositions, and (c) outlining how the institution-based view contributes to the four fundamental questions in strategy. While this article draws on a series of earlier work, its most recent and most direct companion paper is Peng, Wang, and Jiang (2008), which emphasized the institution-based view in international business strategy with a focus on emerging economies. Differentiating from Peng et al. (2008), the current article is positioned to directly speak to the core literature in strategic management and does not deliberately emphasize the international aspects. While we discuss research on emerging economies, we also point out the equally important ramifications of the institution-based view for research on developed economies. Combining the articulation of the two core propositions and the efforts to address the four fundamental questions will be the first-time contribution this article makes to enrich the strategic management literature.

The Roots of the Institution-Based View in Strategy

Two sets of forces underpin the rise of the institution-based view in strategy: external and internal. The first is the broader new institutionalism movement throughout the social sciences in the last three decades pioneered by economists (North, 1990; Williamson, 1975, 1985) and sociologists (DiMaggio & Powell, 1983; Meyer & Rowan, 1977; Scott, 1987, 1995, 2008b). Institutions are commonly known as the "rules of the game." More formally, institutions are defined by economist Douglass North (1990, p. 3) as "the humanly devised constraints that structure human interaction," and by sociologist W. Richard Scott (1995, p. 33) as "regulative, normative, and cognitive structures and activities that provide stability and meaning to social behavior." While terms and labels differ on the surface, North's (1990) scheme of broadly dividing institutions into formal and informal camps is complementary to Scott's (1995) idea of three supportive pillars: regulative, normative, and cognitive (see Table 1). Following Peng (2006, 2009), this article will use an integrative approach, drawing on the best insights from both economics and sociology as well as other allied disciplines, instead of sticking

Table 1
Dimensions of Institutions

Degree of Formality (North, 1990)	*Examples*	*Supportive Pillars (Scott, 1995)*
Formal institutions	• Laws	• Regulative (coercive)
	• Regulations	
	• Rules	
Informal institutions	• Norms	• Normative
	• Cultures	• Cognitive
	• Ethics	

with terms and labels from one side of the literature.

Regardless of disciplinary roots, there is a remarkable consensus on a core proposition: Institutions matter. As a next step, scholars must "tackle the harder and more interesting issues of how they matter, under what circumstances, to what extent, and in what ways" (Powell, 1996, p. 297). It is this quest to enhance our understanding of *how* institutions matter that leads to the proliferation of new institutionalism research throughout the social sciences, which now includes strategic management.

In addition to external forces that spill over to strategy, the institution-based view has also grown in response to the internal forces within strategy—specifically, the long-standing criticisms of the industry-based and resource-based views' lack of attention to contexts. The industry-based view, derived largely from the patterns of competition in the United States in the 1970s (and before), has been criticized for ignoring histories and institutions (Narayanan & Fahey, 2005). Take the very first of Porter's five forces, interfirm rivalry, and its prescription for a cost leadership strategy. The industry-based view seldom questions what is behind such rivalry. In truth, formal government policies and informal media and consumer sentiments regarding the "dos and don'ts" play a significant role in shaping competition (Dobbin & Dowd, 1997; Fligstein, 1990). Under certain institutional conditions, a cost leadership strategy can be accused of being *unethical*—think of the trouble Wal-Mart faced by pursuing the "everyday low price" strategy. Under other conditions, a cost leadership strategy may become *illegal*—in the Japanese bookselling industry, price fixing is legal while price competition is banned (Stevenson, 2009). In international trade, the single-minded pursuit of a cost leadership strategy that ignores host country trade laws and regulations can easily attract legal action centered on antidumping (Schuler, Rehbein, & Cramer, 2002). In short, the industry-based view has not paid adequate attention to contexts.

Likewise, the resource-based view has been criticized for its "little effort to establish appropriate contexts" (Priem & Butler, 2001, p. 32). Valuable, rare, and hard-to-imitate resources and capabilities in one context may become nonvaluable, plentiful, and easy to imitate in other contexts (Brouthers, Brouthers, & Werner, 2008; Oliver, 1997). Barney (2001, p. 52) himself acknowledged the validity of this criticism, noting that "the value of a firm's resources must be understood in the specific market context within which a firm is operating. . . . [T]oo many authors have simply assumed away this question, and, thus, have failed to help develop a more complete theory of firm advantages."[1] For example, Dell's capabilities in "flexible manufacturing" of PCs added value when competition was moderately dynamic. However, in the new context of high-velocity, dynamic competition, Dell's "flexible manufacturing" capabilities turned out to be not flexible enough. Dell ended up approaching contract computer manufacturers with offers to sell most—and possibly all—of its PC factories (*Wall Street Journal*, 2008a).

In summary, externally, the rise of new institutionalism throughout the social sciences has energized scholarly attention in strategy to focus on how institutions matter. Internally, the frustration associated with the industry-based and resource-based views' lack of adequate attention to contexts has called for new theoretical perspectives that can overcome these drawbacks. The result is the emergence of the institution-based view (Peng, 2002, 2006; Peng et al., 2008).

Developing the Third Leg of Strategy

To be sure, the influence of the "environment" (Lawrence & Lorsch, 1969) has long been featured in the literature. However, strategy research has typically favored a "task environment" view, which focuses primarily on economic variables such as market demand and technological change (Dess & Beard, 1984). Until about the mid-1990s, researchers rarely looked beyond the task environment to explore the interactions

[1] Barney (2001) was a response to the critique of the resource-based view made by Priem and Butler (2001). Overall, Barney (2001, p. 52) argued that Priem and Butler's primary criticisms were "unfounded." Consequently, Barney's acknowledgment of the validity of this specific criticism on context speaks volumes about this point.

among institutions, organizations, and strategic choices (as critiqued by Narayanan & Fahey, 2005). Instead, a market-based institutional framework has been taken for granted, and formal institutions (such as laws and regulations) and informal institutions (such as cultures and norms) have been assumed away as "background." While some argue that this treatment of institutions as background conditions is insufficient to gain a deeper understanding of strategic behavior in developed economies (Clougherty, 2005; Oliver & Holzinger, 2008; Scott, 2008b), its deficiency becomes more striking when the strategy research radar starts to probe into the corporate landscape of emerging economies (Lau & Bruton, 2008).

In other words, when markets work smoothly in developed economies, "the market-supporting institutions are almost invisible," according to McMillan (2007), who went on to argue that when markets work poorly in emerging economies, "the absence of [strong market-supporting] institutions is conspicuous." Coinciding with the rise of emerging economies in the global economy since the 1990s, more strategy researchers become interested in these countries (Hitt et al., 2004; Lyles & Salk, 1996; Tong, Reuer, & Peng, 2008). Possessing a number of theoretical tools in their research repertoire, these scholars often choose to deploy an institutional perspective, which is believed to give them the best mileage—relative to other theories—in advancing strategy research on emerging economies (Wright, Filatotchev, Hoskisson, & Peng, 2005). The fact that an institutional perspective is the most frequently drawn upon theoretical tool speaks volumes about the particular usefulness of this perspective when seeking to better understand the unfolding competition in emerging economies (Peng et al., 2008).

It is very clear that treating institutions as "background" (or at best "control variables") will not advance strategy research on emerging economies very far. The profound differences in institutional frameworks between emerging economies and developed economies force scholars to pay more attention to these differences in addition to considering industry-based and resource-based factors (Khanna & Yafeh, 2007; Li & Peng, 2008; Zacharakis, McMullen, & Shepherd, 2007). For example, recent research on the determinants of multinational subsidiary performance documents that (a) in developed economies, corporate (firm-specific) effects are more critical in explaining the variation in foreign subsidiary performance (consistent with the resource-based view), and (b) in emerging economies, country effects, which are proxies for institutional differences, are more salient (supportive of the institution-based view) (Makino, Isobe, & Chan, 2004, p. 1028). Overall, such research articulates the emergence of a third leg of the strategy tripod. Next, we outline two core propositions derived from the institution-based view.

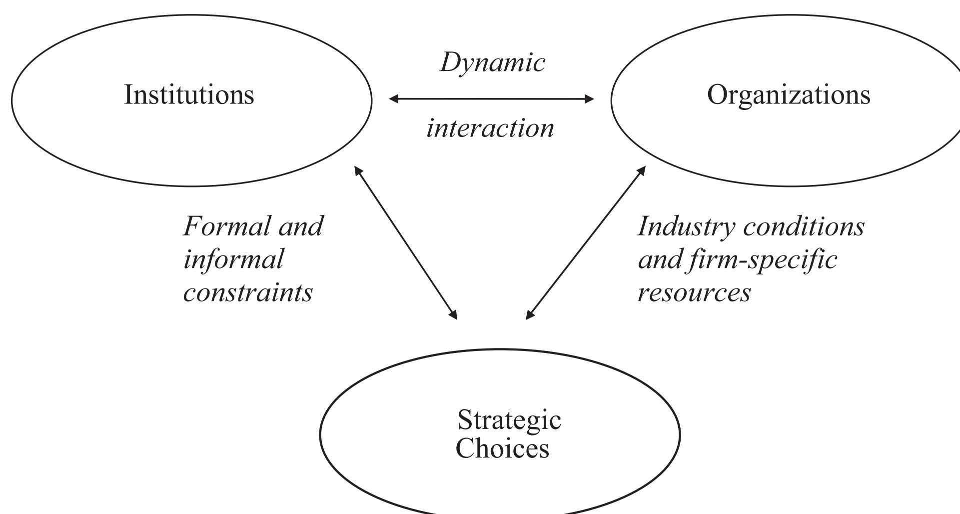
Two Core Propositions

Treating institutions as independent variables, the institution-based view of strategy focuses on the dynamic interaction between institutions and organizations and considers strategic choices as the outcome of such an interaction (Peng, 2002). As shown in Figure 2, strategic choices are not only driven by industry conditions and firm capabilities, but are also a reflection of the formal and informal constraints of a particular institutional framework that managers confront (Jarzabkowski, 2008). As a start, this section outlines the two core propositions emerging out of the institution-based view (Peng & Khoury, 2008).

(Boundedly) Rational Choices

While institutions serve many functions, their most fundamental role is to reduce uncertainty and provide meaning (Peng, 2006; Scott, 2008b). Broadly speaking, institutions reduce uncertainty for different actors by conditioning the ruling norms of behaviors and defining the boundaries of what is legitimate. Actors, in turn, rationally pursue their interests and make choices within a given institutional framework (Lee, Peng, & Barney, 2007). Uncertainty clouds the judgment of actors, and the cues that inform decisions and actions emerge from the relevant institutions, giving purpose and meaning for decision-makers such as strategists (Jarzabkowski, 2008). Referring to Scott's (1995, p. 35) three pillars, compliance or legitimacy occurs through "(1) expedience (regulative pillar), (2) social obligation (normative pil-

Figure 2
Institutions, Organizations, and Strategic Choices



Source: Peng (2002, p. 253).

lar), or (3) on a taken-for-granted basis (cognitive pillar)." Overall, from a rational choice perspective, we suggest:

> ***Proposition 1: Managers and firms rationally pursue their interests and make strategic choices within the formal and informal constraints in a given institutional framework.***

In theoretical terms, the rationality discussed here is bounded (but not perfect) rationality (Williamson, 1985). As economic players, managers and firms are assumed to be "*intendedly* rational, but only *limitedly* so" (Simon, 1961, xxiv, italics original)—note the "simultaneous reference to both intended and limited rationality" (Williamson, 1985, p. 45). One example is the determination of executive compensation. In the United States, the (formal) competitive market for executive talents and the general (informal) tolerance for larger income inequality have fueled rising CEO compensation (Kaplan, 2008). In 1980, the average U.S. CEO made approximately 42 times the average worker's salary; in 2006, 364 times (Walsh, 2008, p. 26). In January 2009, news broke that Wall Street executives paid themselves $18 billion in bonuses in 2008, during which many financial services firms were being bailed out by hundreds of billions of taxpayer dollars (*New York Times*, 2009). While labeled by President Obama as "shameful," the executive compensation decisions were understandable based on Proposition 1. When these firms received bailout funds in late 2008, there were very few strings attached regarding limits on executive bonuses. Therefore, there was no evidence that any of the firms handing out large bonuses violated formal law. In the absence of formal checks and balances, the executives' decisions were thus rational: They pursued their interest first (Jensen & Meckling, 1976). *Bounded* rationality was also clearly at play: These executives failed to appreciate the informal (but powerful) norms concerning what was fair (Walsh, 2008), and thus attracted outcries from the media and the new president.

Formal and Informal Institutions as Compensatory Structures

Within the institutional literature, economists have mostly focused on formal laws, rules, and regulations (La Porta, Lopez-de-Silanes, & Shleifer, 2008), and sociologists have paid more attention to informal cultures, norms, and values (DiMaggio & Powell, 1983; Meyer & Rowan, 1977). North (1990) and Scott (1995) supported a complementary view where research on the impact of institutions investigates both formal and informal components. Extending these insights to strategy research, we argue:

Proposition 2: While formal and informal institutions combine to govern firm behavior, in situations where formal constraints are unclear or fail, informal constraints will play a larger role in reducing uncertainty, providing guidance, and conferring legitimacy and rewards to managers and firms.

For example, in the wake of political collapse in the former Soviet Union, numerous Russian entrepreneurs attempted to launch and survive by relying on social ties and connections (known as *blat*) within their local networks (Puffer & McCarthy, 2007). Informal social ties facilitate economic exchanges providing continuity for firms weathering formal institutional transitions (Peng & Heath, 1996). Further, research on informal activities such as corruption also shows the importance of informal institutions in the recognition and exploitation of opportunities (Webb, Tihanyi, Ireland, & Sirmon, 2009). The common condition in these comparatively unique environments is the convergence toward informal institutions in lieu of deficient or absent formal institutions. Specifically, there is a predominant reliance on network-based strategies drawing on informal relationships (Peng, 2003). In other words, individuals and firms "often find ways of altering the terms of their formal and informal contracts to avoid the adverse effects of weak [formal] contracting institutions" (Acemoglu & Johnson, 2005, p. 949).

Many observers have the impression that relying on informal connections is a strategy relevant only to firms in emerging economies, and that firms in developed economies pursue only "market-based" strategies. This is far from the truth. Even in developed economies, formal rules make up only a small (though important) part of institutional constraints, and informal connections are pervasive (North, 1990).[2] Just as firms compete in product markets, firms also fiercely compete in political markets characterized by informal relationships (Oliver & Holzinger, 2008). The best connected firms are able to reap huge benefits. *Business Week* (2007) reported that for every dollar U.S. defense firms spend on lobbying, they reap $28, on average, in earmarks from Uncle Sam, and more than 20 firms grab $100 or more. Such an enviable return on investment (ROI) compares favorably to capital expenditure (where $1 brings in $17 in revenues) or direct marketing (where $1 spent fetches barely $5 in sales). Basically, the institution-based view suggests that when a firm cannot be a cost, differentiation, or focus leader in product markets, it can still beat the competition on other grounds—namely, the nonmarket political arena where informal relationships hold great sway (Oliver & Holzinger, 2008).

Addressing Four Fundamental Questions

Every discipline is unified by a set of fundamental questions, which act to define a field and to orient the attention of scholars, students, and practitioners in a certain direction. In strategic management, Rumelt, Schendel, and Teece (1994) suggested four fundamental questions: (a) Why do firms differ? (b) How do firms behave? (c) What determines the scope of the firm? (d) What determines the success and failure of firms around the globe? The industry-based and resource-based views have addressed these important questions. Ultimately, the influence of a new perspective boils down to the new insights it brings on top of what is already known. What are the new insights brought by the institution-based view beyond the answers provided by the industry-based and resource-based views for these four fundamental questions?[3] We will look at each individually.

Why Do Firms Differ?

A fundamental assumption in strategy research, especially from the resource-based view, is firm

[2] In contrast to the "(formal) law and economics" tradition in new institutionalism research, Dixit (2004) proposed a new subfield provocatively named "lawlessness and economics" to leverage the abundance of informal institutions not specified by formal laws and to explore their impact on economic behavior. Dixit (2004, p. 9) suggested that "'law and economics' and 'lawlessness and economics' can be regarded as two mutually exclusive and jointly exhaustive subfields of the larger field of economic governance."

[3] Ingram and Silverman (2002) also organized chapters in their edited volume, *The New Institutionalism in Strategic Management*, according to these four fundamental questions.

heterogeneity (Barney, 1991; Rumelt et al., 1994). In every modern economy, firms, like individuals, differ. This question of "Why do firms differ?" thus seems obvious and hardly generates debate. However, one of the most influential institutionalism papers, DiMaggio and Powell (1983, p. 147), started by asking: "What makes organizations so similar?" Interestingly, institutional insights on why firms are so similar can help us address one of the most fundamental questions in strategy: why firms differ.

Much of our knowledge about "the firm" is from research on firms in the United States and to a lesser extent the United Kingdom, which are embedded in what is known as Anglo-American capitalism (Carney, Gedajlovic, & Yang, 2009; Peng & Jiang, 2009). A smaller literature deals with other Western countries such as Germany, France, and Italy, collectively known as continental European capitalism. While some differences between Anglo-American and continental European firms have been reported (Carr, 2005), the contrast between these Western firms and their Japanese counterparts is more striking (Kotha, Dunbar, & Bird, 1995; McGuire & Dow, 2009; Yoshikawa & McGuire, 2008). For example, instead of using costly acquisitions typically found in the West, Japanese firms extensively employ a network form of supplier management, giving rise to the term *keiretsu* (network). It turns out that when viewed as a "big picture," firms within one institutional environment tend to be similar (DiMaggio & Powell, 1983), but firms differ across institutional frameworks (Lin, Peng, Yang, & Sun, 2009).

As strategy scholars venture into emerging economies, more puzzles emerge (Ahlstrom, Bruton, & Yeh, 2007; Bruton, Dess, & Janney, 2007; Bruton & Lau, 2008; Lau & Bruton, 2008; Li & Peng, 2008; Young et al., 2008). For example, it is long established that economic growth can hardly occur in poorly regulated economies. Yet, given China's strong economic growth and its underdeveloped formal institutional structures (such as ineffective courts), "how can China be achieving rapid rates of growth, while retaining such an institutional order?" (Boisot & Child, 1996, p. 607; see also North, 2009, p. 110). Since aggregate firm growth leads to the growth of the economy, strategy researchers have endeavored to provide firm-level answers to address this intriguing puzzle. A partial answer suggests that interpersonal networks (known as *guanxi*) cultivated by managers may serve as informal substitutes for formal institutional support (Peng & Heath, 1996). In other words, interpersonal relationships among managers are translated into an interfirm strategy of relying on networks and alliances to grow the firm, which, in the aggregate, contributes to the growth of the economy (Peng & Luo, 2000; Ren, Au, & Birtch, 2009).

There is a widespread belief that *guanxi* and the related network-based strategies are products of the unique Chinese (or Asian) culture that favors collectivism. The institution-based view refutes such reasoning by pointing out that every culture has a word or two describing what the Chinese call *guanxi* (Singh, 2007). The intensification of informal networks during institutional transitions is predicted by our Proposition 2, which stresses the heavier reliance on informal constraints to combat potential opportunism and facilitate transactions when formal market-supporting institutions are underdeveloped. Outside China, the intensification of informal networks as a driver for firm strategies has been reported in Argentina (Guillen, 2000), Indonesia (Dieleman & Sachs, 2006), India (Kedia, Mukherjee, & Lahiri, 2006), and Russia (Puffer & McCarthy, 2007). Per Proposition 1, managers and firms behave rationally under these circumstances. Given the prevalence of institutional nuance in these settings, industry-based and resource-based views alone will not foster a sufficiently deep or adequate understanding of the differences between firms (Khanna & Yafeh, 2007).

Further, the institution-based view predicts that the more formal market-supporting institutions develop in emerging economies, the more we can expect a reduced reliance on informal network-based strategies and a heavier reliance on arm's-length market-based strategies (Peng, 2003). The history of modern economic development throughout the Western world corroborates this view (Greif, 2006). Preliminary evidence from China's recent institutional transitions

(Guthrie, 1998; Li, Poppo, & Zhou, 2008; Zhou, Poppo, & Yang, 2008) is also supportive of this view.

How Do Firms Behave?

Each of the three legs of the strategy tripod (as shown in Figure 1) sheds light on this question. The industry-based view suggests that the strategic task is mainly to stake out a position that is less vulnerable relative to the five forces within an industry. The resource-based view posits that firm-specific capabilities differentiate successful firms from failing ones.

The institution-based view adds by arguing that in addition to industry- and firm-level conditions, firms also need to take into account the influences of formal and informal rules of the game. For example, consider the Japanese pharmaceutical industry. The success of innovative Japanese automobile and electronics products around the world has led many to naively believe that all Japanese firms are "innovative." The institution-based view refutes this thinking, by pointing out that world-class innovative pharmaceutical firms are all Western. Why is there not a single Japanese pharmaceutical firm that is world-class? The reason is institutional. The health care system in Japan does not reward innovative new drugs (Mahlich, 2009). The Ministry of Health negotiates drug prices with firms. However, once fixed, prices are not allowed to rise during drugs' prespecified shelf life. If prices remain the same but manufacturing costs decrease because of economies of scale, then the *oldest* drugs, not the newest, command the highest margins in Japan (Peng, 2009, p. 101). Thus, given these rules of the game (Proposition 1), Japanese pharmaceutical managers and firms, being rational, find little incentive to aggressively invest in R&D. In contrast, Western firms face an institutional environment that rewards "wonder drugs" with the highest margins, thus fueling their R&D-intensive strategy (Lu, Tsang, & Peng, 2008).

In summary, the example of Japanese pharmaceutical firms suggests that institutions are not just "background" conditions and that not all major pharmaceutical firms should pursue an R&D-intensive strategy. Within the same industry, tremendous diversity exists due to institutional differences.

What Determines the Scope of the Firm?[4]

The scope of the firm refers to the product and/or geographic scope of the firm (Peng & Delios, 2006). Strategy researchers have mostly focused on the product scope, and international business scholars have paid more attention to the geographic scope (Collinson & Rugman, 2007; Lu & Beamish, 2004; Rugman, 2005). Given our focus on strategy in this article, this section outlines work that deals with product scope.

In the United States, the product scope of the largest Fortune 500 firms has experienced significant changes in the postwar era (Davis, Diekmann, & Tinsley, 1994). From the 1950s to the 1970s, a broad scope based on a large number of unrelated product markets was deemed valuable. However, the consensus since the 1980s favors product-related diversification and discredits conglomeration. This change has been documented by the dramatic reversal in investor sentiments toward conglomerate mergers and acquisitions—"positive in the 1960s, neutral in the 1970s, and negative in the 1980s" (Matsusaka, 1993, p. 358). The dominant trend since the 1980s has brought U.S. firms to focus more on core competencies. In many respects, the postwar decades were "a round-trip for corporate America" (Shleifer & Vishny, 1991, p. 51).

How to make sense of this round-trip? Both the industry-based and resource-based views focus on product relatedness. The industry-based view deals primarily with the risks associated with a single-industry strategy and calls for some moderate diversification for risk reduction purposes. The resource-based view emphasizes synergy in related industries and products. Both views converge to an argument in favor of product-related diversification, as opposed to conglomeration. However, both views have a hard time explaining why conglomeration took place in the first place and then

[4] This section focuses on the determinants of the scope of the firm in *developed* economies, specifically the United States. See Khanna and Yafeh (2007), Lee, Peng, and Lee (2008), Peng and Delios (2006), and Peng, Lee, and Wang (2005) for explications on how the institution-based view sheds light on what is behind diversification strategies in *emerging* economies.

why the round-trip was undertaken. There are two rival interpretations. The first is that the conglomeration strategy of the 1960s was a good idea back then, but was no longer a good idea more recently. The second is that conglomeration, whose overall performance was dismal, was a mistake from the start, and was corrected more recently—in other words, "corporate America took a 30-year detour away from efficiency" (Shleifer & Vishny, 1991, p. 54).

The institution-based view suggests a plausible explanation tapping into both formal and informal aspects of the institutional environment (Peng, Lee, & Wang, 2005; Wan & Hoskisson, 2003). Between the 1950s and the 1970s, the federal government, through a set of formal constraints, inadvertently promoted conglomeration (Fligstein, 1990). The post-1950 antitrust policies eliminated horizontal and vertical mergers within the same industry as viable growth strategies because they were viewed as "anticompetitive." Reluctant to pay out the high cash flows as dividends, managers and firms seeking growth were forced to look beyond their primary industry by engaging in unrelated acquisitions, which would not be challenged by antitrust authorities. In other words, our Proposition 1 suggests that managers and firms in an earlier era behaved rationally given the formal institutional constraints. In terms of the influence of the informal institutions, the 1950s was the first decade during which MBA education took off in the United States. As more MBAs, trained to be multi-industry general management specialists, entered corporate America, they led to an informal but powerful norm that viewed a firm as an economic entity—regardless of its industry membership—in search of profits, as opposed to a producer dedicated to a particular industry (Fligstein, 1990). In short, conglomeration was in vogue (Abrahamson, 1996), and most large corporations deviant from this norm were forced to conform (Davis et al., 1994).

However, by the early 1980s, the formal constraints that favored conglomeration changed substantially. Intraindustry mergers were no longer critically scrutinized by the Reagan administration, thus allowing for acquisitions of rivals within the same industry.[5] In contrast with the way conglomeration was facilitated by heightened antitrust policy, the movement for more related diversification, typically within the same industry, has been enabled by more relaxed antitrust enforcement since the 1980s (Shleifer & Vishny, 1991). Moreover, we saw a new generation of MBAs influenced by the newly coined idea of "shareholder capitalism" (Jensen & Meckling, 1976). The rise of "shareholder capitalism" directly correlated with the demise of the previous legitimacy-enhancing informal norms in favor of conglomeration (Davis et al., 1994). Consequently, the new norm—or "fashion" (Abrahamson, 1996)—is to focus on core product areas.

Overall, the curious round-trip of the product scope of the firm over time in the United States cannot be adequately explained by the industry-based and resource-based views only. The institution-based view adds a significant piece to the puzzle by drawing on both formal and informal aspects of the institutional framework during post-war decades (Peng et al., 2005). It is the combined impact and change of these institutional constraints that is behind the evolution of the scope of the firm (Lee, Peng, & Lee, 2008).

What Determines the Success and Failure of Firms Around the Globe?

This focus on performance, more than anything else, defines the strategy field (Hambrick & Chen, 2008; Peng, 2006, 2009; Rumelt et al., 1994). All three major perspectives that form the strategy tripod ultimately seek to answer this question. The industry-based view posits that the degree of competitiveness in an industry largely determines firm performance (Porter, 1980). The resource-based view suggests that firm-specific ca-

[5] This change was not because the U.S. government suddenly changed its mind. It was in part because of efforts made by new institutionalism scholars, who promoted "a growing appreciation for transaction costs" (Williamson, 1985, p. 365). These scholars argued for the efficiency benefits of vertical mergers. If antitrust authorities do not allow a supplier and a buyer to merge and thus force them to constantly negotiate with each other, the additional transaction costs are likely to translate into higher prices for consumers, who will ultimately suffer. Internalization through mergers and integration may reduce some of these transaction costs and benefit consumers (Williamson, 1975).

pabilities drive performance differences (Barney, 1991).

The institution-based view argues that institutional forces also provide an answer to differences in firm performance. As firms increasingly venture abroad, it is difficult to imagine firms that fail to do their "homework" by getting to know the various formal and informal rules of the game in overseas markets will emerge as winners (Globerman & Shapiro, 2009; Hitt et al., 2004; Luo & Peng, 1999). This point is obviously crucial for firms doing business internationally. However, firms doing business *domestically* also need to exercise significant due diligence regarding the rules of the game to ensure good performance; otherwise, firms can be burned in their own home country. In October 2008, India's Tata Group, developer of the critically acclaimed Tata Nano automobile that would retail for just $2,500 (the cheapest car in the world), painfully scratched its plans to manufacture the Nano in West Bengal (*Economist*, 2008). Evidently Tata's plans, which would generate thousands of jobs in West Bengal, failed to take into account the hostile state government and farmers who resented the loss of farmland for the Nano factory.

Overall, although different schools of thought often debate with each other, the true determinants of firm performance probably involve a *combination* of these three-pronged forces, thus calling for a strategy tripod perspective (Brouthers et al., 2008; Gao, Murray, Kotabe, & Lu, 2009; Meyer, Estrin, Bhaumik, & Peng, 2009; Yamakawa, Peng, & Deeds, 2008; Yang, Jiang, Kang, & Ke, 2009). In a first comprehensive quantitative test measuring the impact of industry-based, resource-based, and institution-based variables on firm strategy and performance, Gao et al. (2009) found that institution-based variables assert significant effects on exporters' strategy and performance "above and beyond the impact of firm competencies and industry factors." Overall, the institution-based view complements the existing industry-based and resource-based views to collectively sustain a strategy tripod.

In summary, these four questions represent some of the most fundamental puzzles in strategy. While other questions can be raised, they all relate in one way or another to these four (Rumelt et al., 1994). The institution-based view adds significantly new insights to these questions by bringing institutions to the forefront of the research agenda (Ingram & Silverman, 2002; Peng et al., 2008).

Discussion

Contributions

By arguing that the institution-based view has emerged as the third leg for a strategy tripod, this article makes three contributions: (a) We identify the roots of the institution-based view, (b) we outline the two core propositions that go beyond the relatively simplistic "institutions matter" assertion, and (c) we illustrate how the institution-based view adds significant insights to the four fundamental questions in strategy above and beyond what we already know based on the industry-based and resource-based views.

McKinley, Mone, and Moon (1999) argued that whether a particular theory gains widespread acceptance depends on its continuity, novelty, and scope. We believe that the institution-based view excels in these three attributes, thereby propelling its recent rise as the third leading perspective in strategy. First, by extending new institutionalism into strategy research, the institution-based view exemplifies a great deal of *continuity* from the larger social sciences literature (Ingram & Silverman, 2002). Strategy researchers are familiar with certain elements of new institutionalism, such as transaction cost economics (TCE). Further, the institution-based view exhibits strong continuity with existing research by being able to address strategy's four fundamental questions head on.

Second, by emphasizing the path-dependent nature of the evolution of institutions and its impact on strategy, the institution-based view brings significant *novelty* to strategy research. Examples include the puzzling growth of economic development in China, the curious lack of world-class innovative pharmaceutical firms in Japan, and the mind-boggling round-trip of the product scope of the firm over time in the United States. New institutionalism research outside strategic

management often examines economic and organizational outcomes from the deep past (Greif, 2006; North, 1990, 2005).[6] This approach contrasts sharply with the usual "best practice" in strategy research coming from the industry-based and resource-based traditions that ignore histories and contexts (Narayanan & Fahey, 2005). According to Ingram and Silverman (2002, p. 6):

> *The treatment of history in the new institutionalism stands in sharp contrast to the normal practice in research on business strategy. Strategy often suffers from a tyranny of the here and now, a desire to celebrate contemporary phenomena and slight historical ones. This ahistoricism is one reason why research in strategy struggles for social-scientific legitimacy. By reveling in current affairs and de-emphasizing their underpinnings in the past, strategy scholarship often undermines its own claims to develop explanations that transcend their contemporary context. In other words, the field of strategy struggles to develop good theory, because it downplays temporal transitivity and generalizability.*

It is not surprising that scholars who focus on strategic choices during institutional transitions in emerging economies are among the first groups of strategy researchers to pay attention to the importance of contexts (Luo & Peng, 1999; Peng & Heath, 1996). Simply focusing on traditional industry-based and resource-based variables will not paint a complete picture (Meyer et al., 2009), thus triggering the quest to probe deeper into institution-based insights. Of course, scholars interested in developed economies have long argued for more attention to institutions (Dobbin & Dowd, 1997; Fligstein, 1990; Oliver, 1997). Both streams of work have now converged to lead to the institution-based view.

The institution-based view also excels in its *scope*. The many possible institution-based factors that may influence firm strategy and performance allow for numerous ways of theorizing and testing, resulting in an expanding and cumulative body of knowledge. As examples, we use three diverse areas to illustrate the broad scope of the institution-based view. First, the institution-based view can add significant insights to the industry-based and resource-based views by specifying in what contexts and under what circumstances certain capabilities in certain industries add value (Brouthers et al., 2008; Dacin et al., 2007). Second, the institution-based view can also benefit from cross-fertilization with the evolutionary perspective, whose leading question is "How do firms coevolve with their environment?" (Lewin & Volberda, 1999, p. 520). Third, research on multinational enterprises (MNEs) can be further propelled by the institution-based view (Dunning & Lundan, 2008; Kostova, Roth, & Dacin, 2008).

While the institution-based view adds to the strategy literature, it also contributes to the larger new institutionalism literature. Focusing on firm-level strategy, the institution-based view contributes to institutional economics by connecting its micro and macro branches. The micro TCE branch has taken the macro institutional environment as a given "background" and focused more on microanalytical aspects such as opportunism (Williamson, 1975, 1985). The macro branch of institutional economics (Greif, 2006; La Porta et al., 2008; North, 1990) has reminded us that such "background" needs to be brought to the forefront. Yet institutional economics tends to talk about rulers and interest groups on the one hand and economic outcomes on the other hand—leaving the intermediate, firm-level strategy-making processes largely unexplored. In other words, institutional economics has not focused on how individual firms respond to institutional frameworks from a strategy perspective. The institution-based view of strategy, therefore, directly connects the firm-level strategy-making processes with both the micro and macro branches of institutional economics.

The institution-based view of strategy also adds to the sociologically oriented institutional theory by demonstrating the benefits of integrating with efficiency-oriented research. DiMaggio and Powell (1991, p. 8) suggested that the "new institutionalism . . . comprises a *rejection* of rational-actor models" often found in efficiency-based research (italics added). While such a perspective may make sense when studying educational institutions and public bureau-

[6] For example, North, Wallis, and Weingast (2006) recently developed a conceptual framework for interpreting "recorded human history."

cracies, where sociologically driven new institutionalism research initially arose (Meyer & Rowan, 1977), more recent work has advised us not to pit "strategic and institutional," "substantive and symbolic," and "economic and social" factors against each other (Powell, 1996, p. 295). In other words, initial work may have "overstated" organizations' urge to adopt superficial conformity at the expense of their quest for efficiency (Scott, 2008a, p. 431). As institutional theory moves away from schools and bureaucracies to assert its influence in strategy, a focus on efficiency outcomes, which is a hallmark of strategy research, becomes necessary and enriches institutional theory (Oliver, 1997; Scott, 1987, 2008a).

Finally, the institution-based view of strategy also holds potential to push the boundaries of the emerging literature on the varieties of capitalism (VOC) (Hall & Soskice, 2001) as well as corporate social responsibility (CSR) (Husted & Allen, 2006). The VOC literature seeks to understand the diverse topography of institutional landscapes (Carney et al., 2009; Jackson & Deeg, 2008). On the other hand, the CSR literature posits that the relationship between basic economic conditions and corporate behavior is mediated by institutional constraints (Campbell, 2007). For example, the recent recall of certain toys made in China reminds us that firms face the possibility of losing their legitimacy (and business) if they ignore their basic CSR concerning product safety (Peng & Chen, 2009). Both VOC and CSR can be enhanced by integrating with the institution-based view of strategy.

Why the "Institution-Based" View Label for Strategy?

One interesting point to discuss is why we use the particular label "institution-based view." Is it the same as an "institutional view"? Is it the same as "institutional economics"? Or "institutional theory"? What is the value of a new label for strategy?

The adoption of the term "institution-based view," coined by Peng (2002), stems from the confusion in the literature and the decision to avoid an interdisciplinary turf battle.[7] First, the proliferation of "institutional" research has produced some confusion. In our (impartial scholarly) view, broadly speaking, any theory that invokes a new institutionalism framing can be legitimately labeled "institutional theory." However, in the literature the term "institutional theory" increasingly refers to the *sociological* version of the institutional literature (DiMaggio & Powell, 1983). The economic version, represented by North (1990), is often labeled simply "institutional economics." Because of the interdisciplinary nature of strategy research, using either label ("institutional theory" or "institutional economics") would cause confusion. Furthermore, there has been significant interpenetration between economics and sociology. For example, Scott (1995) has long acknowledged North's (1990) influence in economic sociology. North's (2005) more recent work has explicitly discussed "stickiness" (resistance to change) as part of cognition, which notably bears reciprocal correspondence to Scott's (1995) third (cognitive) pillar. Some economists have now worked on typically "sociological" constructs such as culture and social capital (Guiso, Sapienza, & Zingales, 2006) and drawn extensively on the sociological literature. Therefore, in response to reviewer pressures from both sides, Peng (2003, p. 276) clarified:

> *Although the economic (e.g., North, 1990) and sociological (e.g., Scott, 1995) versions of institutional theory have some differences, they are broadly complementary (Scott, 1995). Following Peng and Heath (1996, p. 499), who suggest that "a combination of the two is natural" for management research, here I draw on the best available insights from the institutional literature, regardless of the disciplinary background.*

[7] During the review process, Peng and Heath (1996), Peng (2003), and Peng et al. (2005) were pushed by some economically oriented reviewers to declare that our theoretical background was "institutional economics," which should have nothing to do with (the sociological) "institutional theory." At the same time, we were pushed by some sociologically oriented reviewers to declare our "party line" by following the sociological version of "institutional theory." As part of management scholarship, our work was indeed inspired by *both* the economic and sociological versions of the institutional literature. To remain intellectually honest, we felt uncomfortable declaring allegiance to any disciplinary "party line" at the expense of another discipline. Of course, other strategy scholars may choose not to blend these lines of reasoning in order to strive for greater consistency—at least in relation to the literature in one discipline (Estrin, Baghdasaryan, & Meyer, 2009).

Innovation is often forced by necessity. The innovative "institution-based view" label is forced by the necessity to get the papers accepted by reviewers while advancing strategy research, and is the fruit of an interdisciplinary dialogue or "trade" (Peng, 2004). The value of the new label is that this is a progeny the strategy field can lay claim to as its own (Peng & Khoury, 2008). We need to have the self-confidence to declare that we are doing neither second-class economics nor second-class sociology, but first-class strategy research. Advocated by Peng (2002, 2006, 2009; Peng et al., 2008), the "institution-based view" label has helped us differentiate from existing work in economics and sociology, and has attracted a series of additional papers that carry this research forward (Gao et al., 2009; Lee et al., 2008; Lu et al., 2008; Mahlich, 2009; Meyer et al., 2009; Peng & Jiang, 2009; Peng & Pleggenkuhle-Miles, 2009; Yamakawa et al., 2008; Yang et al., 2009).

Future Directions

Institution-based research in strategy is likely to develop in at least three directions. First, the institution-based view, for the first time, enables strategy scholars to confront important public policy issues. Because institutional frameworks have typically been assumed to be "background," strategy researchers have largely shied away from important public policy issues (Barney, 2005). Despite the popularity of TCE in strategy research, we as a field have almost totally failed to pay attention to Williamson's (1975) subtitle: *Antitrust Implications*.[8] The upshot? Microsoft, an otherwise brilliant firm, the poster child for the industry-based and resource-based views, ended up in court for alleged antitrust violations. Its alleged crime? Not voluntarily helping its competitors (!). It is clear that Microsoft strategists trained by the industry-based and resource-based views failed to appreciate the rules of the game that—rightly or wrongly—govern a leading firm differently than nonleading firms. While Microsoft, its accusers, and its defenders could vehemently argue (Liebowitz & Margolis, 1999; Schmalensee, 2000), Microsoft's failure to include antitrust issues on its strategy radar screen, until it was sued, was an evident failure in strategic due diligence. In the long run, strategy's tendency to eschew engagement with major public policy issues may keep the field on the sidelines in debates about issues in which it can potentially contribute (Peng, 2003, p. 275). We hope the institution-based view will help overcome this tendency.

A second direction is to study how firms adapt to institutional changes and regulatory shifts (Peng, 2003; Walker, Madson, & Carini 2002). The ongoing global economic crisis and firms' strategic responses will prove to be fertile ground for such research. For example, some U.S. politicians blame the current financial crisis on Congress' 1999 deregulatory decision to repeal part of the Glass-Steagall Act of 1933 and a 2004 SEC rule that allows more leverage, and now call for more regulation. Strategy scholars need to answer why five leading investment banks folded while most hedge funds and private-equity companies have had fewer problems under the same deregulation policy. Why have GM and Ford sold large numbers of their desirably fuel-efficient cars in Europe but not in the United States? Clearly, it is not because they do not possess capabilities in fuel-efficient technologies. Their lack of incentive to market such cars in the United States is underpinned by an institutional framework characterized by lower taxes on gasoline. Conversely, their aggressive marketing of such cars in Europe is fueled by another institutional framework centered on heavier taxes on gasoline and stronger discouragement of consumption and pollution (*Wall Street Journal*, 2008b).

A third direction is to develop stronger measures of institutions, probably first arising out of descriptive, qualitative, and historical research but ultimately quantifying their dimensions (La Porta et al., 2008). Criticizing the literature, Gomez-Mejia, Wiseman, and Dykes (2005, p. 1512) argued:

[8] A complete search of all *Strategic Management Journal* publications since its first volume in 1980 yielded only a grand total of one (!) article with "antitrust" in its title (Clougherty, 2005) and one more article with "antitrust" in its abstract (Shleifer & Vishny, 1991).

> *The danger of extending institutional theory too broadly, however, such that each institutional context is different, is that our application of the theory becomes atheoretical, leading us down a path toward highly stylized idiosyncratic examples that prevent the development of a generalizable theory of the firm. In our view, there must be a balance between recognizing unique contextual factors and the theory.*

We agree. We are not advocating "dense descriptions" and "case studies" for every paper. The ultimate aim for proponents of the institution-based view will be to demonstrate *how* institution-based variables matter. The potential institutional variables include institution relatedness (Peng et al., 2005), institutional distance (Chan, Isobe, & Makino, 2008; Estrin, Baghdasaryan, & Meyer, 2009; Xu & Shenkar, 2002), legal origins (La Porta et al., 2008), and corruption indexes (Cuervo-Cazurra & Genc, 2008; Lee & Oh, 2007). However, institution-based variables tend to be coarse-grained and universal—at least within one context. In other words, since the rules of the game within one institutional framework, in theory, apply to all firms within its jurisdiction, how can certain firms better use these rules to outperform the rest? For example, intellectual property regimes centered on patents as a specific rule of the game are generally argued to facilitate more innovation and better performance. However, empirical links among R&D, patenting, and performance of *specific* firms are tenuous (Khoury & Peng, 2008).

It is here we need to reemphasize that the institution-based view is one of the three legs of the strategy tripod—but not the only leg. It is in *combination* with the industry-based and resource-based views that the institution-based view can add its value (Gao et al., 2009; Meyer et al., 2009; Oliver, 1997). In the case of patenting, the industry-based view suggests that patents contribute more to leading firms in certain industries (such as pharmaceuticals) than in other industries (such as electronics) (Bessen & Meurer, 2008, p. 18). The resource-based view argues that it is not capabilities in R&D per se that drive performance (Gittelman, 2008). It may be the firm-specific, in-house patent law expertise, in combination with R&D prowess, that leads to superior firm performance (Somaya, Williamson, & Zhang, 2007).

Finally, in terms of teaching and learning, we believe that incorporating the institution-based view will make the strategy teaching and learning experience more insightful, realistic, and balanced. Table 2 outlines a series of important institution-based topics and debates that are typically missed or ignored in strategy teaching at the undergraduate and MBA levels. We recommend that they be added. Otherwise, we are doing the practitioner community a disservice by training

Table 2
Institution-Based Topics Recommended for Strategic Management Teaching

Areas in Strategy Teaching	*Recommended Institution-Based Topics and Debates*
Industry-based view (five forces)	• Formal: Competition policy (e.g., Microsoft's antitrust issues)
	• Informal: Norms governing a cost leadership strategy (e.g., the Wal-Mart effect)
Resource-based view	• Government intervention in the determination of value (e.g., bailouts in 2008–2009)
Market entry	• Antidumping laws in host countries
Competitive dynamics	• Collusion versus competition
Strategic alliances	• Antitrust considerations (especially when collaborating with competitors)
Mergers and acquisitions	• Antitrust scrutiny, which may come from abroad (e.g., the proposed merger of two U.S.-based firms, GE and Honeywell, was torpedoed by the EU)
Product diversification	• Persistence of business groups (conglomerates) in emerging economies
Organization structure	• Location of key units (such as R&D)—do they have to be in the home country?
Corporate governance	• Formal laws and informal norms governing executive compensation (e.g., Wall Street bonuses in 2008–2009)
Corporate social responsibility	• Formal: Environmental regulations ("race to the bottom" versus "race to the top")
	• Informal: Norms governing domestic and overseas social responsibility

Source: Adapted from text in Peng (2009).

would-be strategists solely in the tradition of industry-based and resource-based views. Imagine the shock that Microsoft's strategists experienced when informed that they were being sued by antitrust authorities, after these strategists had done everything "right" by the playbooks of the industry-based and resource-based views.

Teaching of the industry-based view and related topics such as competitive dynamics, strategic alliances, product diversification, and acquisitions needs to take into account the role of formal competition (antitrust) policies (Clougherty, 2005). Teaching topics such as five forces, corporate governance, and CSR will be significantly enriched if we engage students with debates on the informal (but powerful) norms regarding a variety of issues. For example, how low can a Wal-Mart-type low-cost strategy go without attracting public criticism? How high can executive compensation be set without provoking media outcries (Kaplan, 2008; Walsh, 2008)? How much investment can be made overseas without endangering firms' social responsibility toward domestic employees, communities, and governments (Peng & Pleggenkuhle-Miles, 2009)? As a dynamic, fast-moving field, strategy will have no shortage of new institution-based topics and debates that can be brought into the classroom.

Conclusion

Thirty years is a tender age for the relatively new discipline of strategic management (Hambrick & Chen, 2008). The latest leading theoretical perspective in strategy—the institution-based view—has an even younger age of approximately ten years within the strategy literature. Overall, the rise of the institution-based view can be viewed from a simple SWOT analysis. In terms of O and T, externally, the rise of new institutionalism throughout the social sciences has created an *opportunity*. Internally, further development of the strategy field has been *threatened* by a lack of attention to crucial contexts exhibited by the existing literature. Strategy as a field needs to embrace the proposition that "institutions matter" and to push forward to shed light on how institutions matter. In terms of S and W, the institution-based view excels in its continuity, novelty, and scope as its leading *strengths*. Researchers also need to be aware of its *weaknesses* (such as being too broad and too encompassing) and endeavor to overcome them.

In short, it is the emergence of the third leg that sustains a strategy tripod. If strategy is truly a discipline about the "big picture" (as many of us like to say in our teaching), then the institution-based view, based on its explicit link between broad institutional issues and firm strategy and performance, will help substantiate strategy's "big picture" claim.

More than 20 years ago, Scott (1987) labeled the institutional theory literature to be in its adolescence.[9] Within the field of strategic management, we can make the case that the institution-based view is currently in its adolescence as the third leading perspective. In conclusion, it is useful to quote Scott's (1987, p. 510) conclusion:

> *Adolescents have their awkwardness and their acne, but they also embody energy and promise. They require encouragement as well as criticism if they are to channel their energies in productive directions and achieve their promise.*

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[9] Scott (2008a) recently labeled the institutional theory literature in sociology as "approaching adulthood."

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