



Towards an Institution-Based View of Business Strategy

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Abstract. This article focuses on a key question: Why do strategies of firms from different countries differ? Drawing from recent research on business strategies in Asian organizations, this article outlines the emergence of an institution-based view of business strategy which sheds light on why firms differ, reviews four streams of research in a broad range of countries, and critiques and extends some of the current work by suggesting a number of future research directions.

Keywords: institution, business strategy, Asia

This article focuses on a key question: Why do strategies of firms from different countries and regions differ? This is the very first question among the five most fundamental questions in strategic management raised by Rumelt, Schendel and Teece (1994:564).¹ Since the diversity of firm strategies around the world can arise as the result of many possible forces internal or external to the organization, this question engenders a wide variety of disparate answers from economists (Nelson, 1991) and sociologists (Carroll, 1993). Thus far, strategy researchers have primarily focused on industry conditions (Porter, 1980) and firm resources (Barney, 1991) as drivers of firm differences, leading to competition- and resource-based perspectives, respectively.

Drawing from recent research on Asian organizations, I argue that in addition to these existing theories, a new, institution-based view has emerged to account for differences in business strategy. A number of scholars suggested that in addition to industry and firm level conditions, a firm also needs to take into account wider influences from sources such as the state and society when crafting and implementing its strategies (DiMaggio and Powell, 1991; Oliver, 1997). These influences are broadly considered as institutional frameworks (North, 1990; Scott, 1995). When applied to strategy research, this new perspective, consequently, can be called an *institution-based* view of business strategy (Peng, 2000a, 2002; Peng and Heath, 1996).

Since no firm can be immune from institutional frameworks in which it is embedded, there is hardly any dispute that institutions matter. In order to make further theoretical progress, researchers must “tackle the harder and more interesting issues of how they matter, under what circumstances, to what extent, and in what ways” (Powell, 1996:297). This article, consequently, has three objectives. First, extending earlier theoretical work (Peng, 2000a, 2002; Peng and Heath, 1996), this article outlines the broad contour of the new, institution-based view of business strategy. Second, I review the recent Asian management literature to assess the progress made in the direction Powell (1996) calls for. Given that most existing

research takes place in the West, a focus on Asia allows us “to vary institutional contexts;” otherwise, “it is difficult if not impossible to discern the effects of institutions on social structures and behaviors if all our cases are embedded in the same or very similar ones” (Scott, 1995:146). Informed by research on a number of Asian countries, the four substantive areas reviewed are (1) supplier strategies, (2) entrepreneurial strategies, (3) diversification strategies, and (4) growth strategies. While this is not an exhaustive list of research areas, I believe that they represent a broad spectrum of research interests through which the institution-based view of business strategy can be illustrated. Finally, current research is critiqued and future research directions are suggested.

Understanding institutions

According to North (1990:3), institutions are “the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction.” Similarly, Scott (1995:33) defines institutions as “cognitive, normative, and regulative structures and activities that provide stability and meaning to social behavior.” Consequently, an “institutional framework” is defined by Davis and North (1971:6) as “the set of fundamental political, social, and legal ground rules that establishes the basis for production, exchange, and distribution.”

Under the label of “new institutionalism,” there are differences between the economic version (North, 1990; Williamson, 1985), which focuses more on efficiency, and the sociological version (DiMaggio and Powell, 1991; Scott, 1995), which concentrates more on legitimacy. Delineating the theoretical boundaries of these perspectives is beyond the scope of the present article. In the spirit of previous institutional work in strategy (e.g., Oliver, 1997; Peng and Heath, 1996), this article takes an *integrative* approach, drawing from the broad institutional literature to examine how institutions bear on the strategy problem.

Institutional frameworks interact with organizations by signaling which choices are acceptable and supportable. As a result, institutions help reduce uncertainty for organizations. Institutional frameworks are made up of both formal and informal constraints (North, 1990). *Formal* constraints include political rules, judicial decisions, and economic contracts. *Informal* constraints, on the other hand, include socially sanctioned norms of behavior, which are embedded in culture and ideology (Scott, 1995). North (1990) suggests that in situations where formal constraints fail, informal constraints will come into play to reduce uncertainty and provide constancy to organizations. These insights have important implications for the development of an institution-based view of business strategy (Peng, 2000a).

An institution-based view of business strategy

Strategies are about choices. Therefore, an analysis of business strategy needs to “recognize the exercise of choice by organizational decision makers” (Child, 1972:10). Given the influence of institutional frameworks on firm behavior, any strategic choice that firms make is inherently affected by the formal and informal constraints of a given institutional framework (North, 1990; Oliver, 1997). Viewed from such a perspective, much of the strategy literature,

which largely focuses on Western firms, does not discuss the specific relationship between strategic choices and institutional frameworks. To be sure, the influence of the “environment” has long been featured in the literature (Lawrence and Lorsch, 1969). However, what has dominated this research is a “task environment” view, which focuses on economic variables such as market demand and technological change. Until recently, scholars had rarely looked beyond the task environment to explore the interaction among institutions, organizations, and strategic choices. Instead, a market-based institutional framework has been taken for granted.

Such an omission is unfortunate, because it is precisely the institutional frameworks in developed economies that prompt Western firms to choose certain strategies and constrain them from choosing others (Peng and Heath, 1996). Today, we are much more conscious of the importance of the relationships between organizations and institutions. Treating institutions as independent variables, an institution-based view on business strategy, therefore, focuses on the dynamic interaction between institutions and organizations, and considers strategic choices as the outcome of such an interaction (figure 1). Specifically, strategic choices are not only driven by industry conditions and firm-specific resources that traditional strategy research emphasizes (Barney, 1991; Porter, 1980), but are also a reflection of the formal and informal constraints of a particular institutional framework that decision makers confront (Oliver, 1997; Scott, 1995).

Since the 1990s, more and more scholars have come to realize that institutions matter (Powell and DiMaggio, 1991; Scott, 1995), and that strategy research cannot just focus on industry conditions and firm resources (Khanna and Palepu, 1997; Peng, 2000a). As argued by Hoskisson et al. (2000), institutional theory appears to be a highly insightful approach when probing into organizational strategies in Asia. While taking institutions seriously is only a first step, working out the analytic logic of their influence is the second, and explicating the underlying mechanisms comes next. This article can be considered as a part

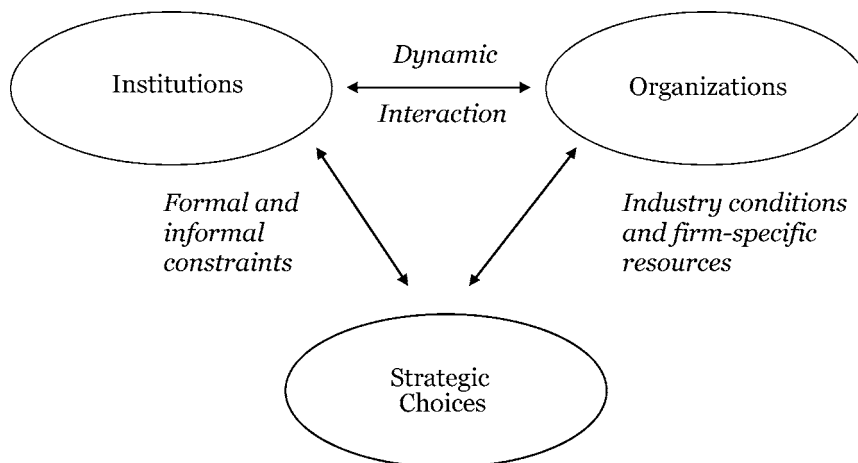


Figure 1. Institutions, organizations, and strategic choices.

Source: Peng, M.W. (2000). *Business Strategies in Transition Economies*: p. 45. Thousand Oaks, CA: Sage.

of this broad intellectual movement in search of a better understanding of the relationship among institutions, organizations, and strategic choices (Peng, 2002). Next, I turn to four substantive areas of recent research in a variety of Asian economies to illustrate how the institution-based view has evolved.

Supplier strategies

While most strategy research focuses on Western firms, recently, it has become virtually “impossible to discuss the matter of business strategy long without the issue of Japanese economic organization surfacing” (Williamson, 1991:87). Of particular concern to strategy researchers is the *keiretsu* networks, the webs of interfirm relations that envelop many Japanese firms (Gerlach, 1992) and now increasingly involve other Asian firms (Peng, Lee and Tan, 2001). Specifically, within such a network, independent suppliers seem to be willing to site their factories close to major manufacturers such as Toyota and Honda, in the absence of a long-term contract. Such a high degree of asset specificity creates economic value by reducing delivery time and costs and increasing the efficiency of more just-in-time deliveries (Dyer, 1997). However, according to research in the West (Williamson, 1985), such a high degree of asset specificity is likely to result in high transaction costs, because the value of suppliers’ location-specific assets will depreciate considerably when they no longer have a contract with manufacturers and/or when suppliers want to deliver to other manufacturers located elsewhere. Consequently, suppliers are predicted to be unwilling to site their factories in a vulnerable location, and manufacturers often need to engage in costly vertical integration. In contrast to such thinking, some Japanese firms seem to have an unlikely combination, namely, high asset specificity and low transaction costs, thus presenting a puzzle to researchers (Dyer and Nobeoka, 2000). More recently, as *keiretsu* networks are extended throughout Asia, how indigenous Asian firms “buy in” becomes an interesting new issue (Peng, Lee and Tan, 2001).

One answer to solve the puzzle is to invoke the difference in national cultures between Japan and Western countries such as the United States (Dore, 1987). A high propensity to cooperate is believed to be rooted in the Japanese culture, and, consequently, a high degree of interfirm cooperation is more likely. Beyond this simplistic culturalist perspective, more recent work has increasingly focused on the institutional frameworks in which Japanese firms are embedded (Hill, 1995). Specifically, while Japan has developed a set of formal legal frameworks based on the American model in the postwar decades, they are not used extensively. Instead, Japanese firms tend to place a greater emphasis on informal constraints, such as consensus- and trust-building, instead of formal contracts. In other words, “the informal constraints of Japanese society do a *relatively* better job of holding opportunism in check than those of many Western societies,” resulting in both a high degree of specialization and low transaction costs (Hill, 1995:129, original emphasis). The upshot is that major manufacturers such as Toyota and Honda can avoid costly vertical integration typically found in Western automobile companies, while still benefiting from close cooperation with suppliers (Dyer and Nobeoka, 2000).

Although research on Japanese supplier strategies has demonstrated that interfirm strategies can be organized differently and still generate competitive advantage (Peng, Lee and

Tan, 2001), this work is a *weak* test of the institutional perspective. This is because the national cultures between Japan and Western countries are so different that it is difficult to partition out the impact of institutional influences independent of national cultural influences. The next section reviews some recent work that takes on such a challenge.

Entrepreneurial strategies

A strong test of the institutional perspective needs to demonstrate that institutions matter independent of national cultures (Lau and Ngo, 2001). Such work has only begun recently. Most research in this area starts with a cross-cultural perspective, that is, comparing and contrasting the impact of different national cultures on firm behavior. For example, the dramatic contrasts between Chinese and American cultures have attracted a number of cross-cultural studies which report significant differences. However, critics argue that many *cross-cultural* studies do not accomplish their objective; rather, they end up being *cross-national* studies that reflect the impact of environmental factors such as different formal and informal institutional frameworks in various countries (Farh, Earley and Lin, 1997:441; Kelley and Worthley, 1981:164). Therefore, it is difficult to conclude whether the observed differences between subjects in two different countries are due to cross-cultural or cross-national differences (Lau and Ngo, 2001).

One solution is to introduce a third sample from Hong Kong or Taiwan (McGrath et al., 1992). Subjects in Taiwan and Hong Kong are assumed to share the cultural roots with their counterparts in mainland China, and operate in a different, market economy. However, since Taiwan and Hong Kong represent a third national environment, employing these samples, although representing substantial progress, is still unable to allow researchers to isolate the role of national institutions that is independent of the cultural effect, or vice versa (Mitchell et al., 2000).

Attempting to fill such a gap, Tan and Peng (2002) recently employ a rigorous, quasi-experimental design to better isolate the role of cultural and national differences. It is widely known that the Chinese are an entrepreneurial people, as evidenced by the wealth they generate throughout Southeast Asia and now increasingly in North America and Western Europe (Fukuyama, 1996). However, entrepreneurial activities in mainland China were kept at a minimum during the Maoist period until the 1970s. Since then, the emergence of entrepreneurship in mainland China seems to indicate that it is the development of market-supporting institutions, both formal and informal, that gives birth to a new wave of entrepreneurship (Peng, 2001a). Similar to Lau and Buenitz (2001), Tan and Peng (2002) test this proposition by focusing on entrepreneurs who have founded new businesses. Specifically, we draw on three samples, namely, mainland Chinese, Chinese Americans, and Caucasian Americans. These samples represent two distinctive national environments (the People's Republic of China versus the United States) and two different cultures (Chinese versus American). We measure the differences in entrepreneurs' perception of the environment and their strategic orientations. Two competing hypotheses are generated. First, if the *national* institutional effect predominates, then Chinese American and Caucasian American entrepreneurs would show relatively similar patterns of response compared with those of mainland Chinese entrepreneurs. Conversely, if the *cultural* effect predominates,

then mainland Chinese and Chinese American entrepreneurs would show relatively similar patterns of response when compared with those of their Caucasian American counterparts (Tan and Peng, 2002).

The introduction of the Chinese American sample thus “bridges” the two national samples. On one hand, these entrepreneurs compete with their Caucasian American counterparts in the same national environment. On the other hand, Chinese American entrepreneurs, despite their immigration experience, have been found to maintain significant cultural similarities with counterparts in their former homeland. For example, while other immigrant groups may try to “blend in,” Chinese Americans often emphasize their cultural uniqueness, as evidenced, for example, by the distinctive decorations for Chinatowns in major American cities (Fukuyama, 1996). Under the joint impact of cultural and environmental influence, the response of Chinese American entrepreneurs, therefore, cannot be predicted *a priori* in a single direction, and has to be entertained in two competing hypotheses.

Our empirical results lend strong support for the institutional perspective (Tan and Peng, 2002). Specifically, Chinese American and Caucasian American entrepreneurs tend to share more similarities in terms of their environmental perceptions and strategic orientations when compared with their counterparts in mainland China. Despite a presumed cultural link between mainland Chinese and Chinese American samples, these two groups differ significantly on many dimensions. These results, therefore, provide some preliminary evidence suggesting that it is institutional frameworks, rather than national cultures, that drive entrepreneurship. Given that the institutional environments between mainland China and the United States are radically different, our findings are hardly surprising. More work may need to concentrate on “partially similar” cases (Lau and Ngo, 2001; Shenkar and von Glinow, 1994), such as by comparing and contrasting firm strategies in different Asian economies, which we turn to next.

Diversification strategies

Since the 1970s, research in the West suggests that, on average, firms with a higher level of diversification are less profitable than firms with a lower level of diversification (Hoskisson and Hitt, 1994). What seems to hurt performance the most is a strategy of conglomerate (or unrelated) diversification. Consequently, unrelated conglomerates have largely become a thing of the past in major developed economies since the 1980s and 1990s. In contrast, highly diversified conglomerates, often called “business groups,” have often been found extensively in Asian countries, such as China (Keister, 2000; Peng, 1997), Hong Kong (Au, Peng and Wang, 2000; Wan, 1998), India (Khanna and Palepu, 2000), South Korea (Chang and Hong, 2000), and Taiwan (Chung, 2001; Hamilton and Feenstra, 1995).

Seen through a Western lens, the persistence and emergence of these diversified conglomerates throughout Asia seems puzzling (Granovetter, 1994). A culturalist perspective would suggest that the national cultures of these emerging economies may foster these culturally important practices. The validity of this view, however, is questionable in light of significant cultural differences among this diverse group of countries. Another perspective suggests that as a highly institutionalized organizational form due to historical reasons, these conglomerates persist in these “backward” countries with little performance benefits.

A stronger proposition, often embraced by Western media, consultants, and advisors to Asian governments, is that these conglomerates actually destroy value and therefore should be dismantled. Rigorous evidence supporting this proposition, however, is rare. Preliminary findings actually suggest that in contrast to the conventional wisdom in the West, there seems to be discernible performance *benefits* associated with conglomerates in emerging economies, as Khanna and Palepu (2000) and Khanna and Rivkin (2001) find in India and Indonesia. Other scholars report similar findings in Hong Kong (Wan, 1998), Singapore (Lim and Teck, 1995), and Taiwan (Chung, 2001). These findings thus confront researchers: How to reconcile the striking differences in diversification strategies from developed and emerging economies?

The answer seems to lie in the institutional perspective with a focus on the underlying formal and informal institutional frameworks permeating these countries. While emerging economies in Asia are hardly uniform, their formal institutions tend to fall short to varying degrees in providing support for low transaction-cost business operations in three critical areas: (1) a credible legal framework, (2) a stable political structure, and (3) functioning strategic factor markets (Khanna and Palepu, 1997; Peng and Heath, 1996).

Throughout Asia, because of the weaknesses of formal institutions, “informal constraints rise to play a *larger* role in regulating economic exchanges in these countries during the transition” (Peng and Heath, 1996:504, added emphasis). The main informal constraints come from three sources. First, the *interpersonal* relations among executives serve as a focal point for valuable managerial networking. Although managers all over the world devote a considerable amount of time and energy to cultivate interpersonal ties, managers in Asia, due to a lack of publicly available, reliable information about market opportunities, perhaps “rely more heavily on the cultivation of personal relationships to cope with the exigencies of their situation” (Child, 1994:150). By engaging in reciprocal, preferential, and mutually supportive networking, managers in diversified conglomerates, who often share the same family, clan, and/or educational background, are able to reduce uncertainty in their decision making.

Second, *external* connections linking these executives and key stakeholders, especially government officials, are also a crucial part of the informal institutional constraints (Boddeyn and Brewer, 1994; Oliver, 1997). Given the need to combat environmental uncertainty, it is not surprising that managers maintain a “disproportionately greater contact” with government officials (Child, 1994:154). For example, in China, Peng and Luo (2000) find that connections with officials appear to be more important than ties with other managers in terms of their impact on firm performance. In Thailand, Peng, Au and Wang (2001:171) document that 42 of the top 200 listed firms have *active-duty* military officers serving as directors on the board, who may provide important “political resources” (Boddeyn and Brewer, 1994) and “institutional capital” (Oliver, 1997) for firms in such an unstable environment. Bribes, gifts, cronyism, and other corrupt practices may be part of working with the bureaucracy. But that is not the whole story. In many cases, educating officials is more important than exchanging favors (Khanna and Palepu, 1997). Conglomerates can leverage their government contacts, and present to officials a united front of the interests of diverse industries and businesses represented by a single group, thus minimizing the risk of overloading the bureaucracy.

Finally, the *reputation* of conglomerates serves as an informal but strong signaling device to reduce uncertainty for customers and investors. In consumer markets throughout Asia, independent consumer protection organizations are rare, and government watchdog agencies are often ineffective (Khanna and Palepu, 1997). As a result, consumers are reluctant to trust new brands. Conversely, since established brands wield tremendous power, conglomerates with a quality reputation can leverage their names to enter new industries, including unrelated ones.

When attracting financial investors, the reputation of conglomerates also becomes a valuable, unique, and hard-to-imitate competitive advantage (Barney, 1991). It is interesting to note that in contrast to the United States, where Internet business is dominated by start-ups which have raised significant capital, Internet services in Asia are predominately provided by established conglomerates, which can more easily raise external financing and provide internal funding. Such an ability to raise capital, as well as to internally allocate capital, compensates for a crucial void in the underdeveloped financial markets. In addition to financial investors, foreign direct investors are also more likely to be attracted to established conglomerates than to unknown independent firms in emerging economies. Again, the reputation and prestige of established business groups saves on search costs for foreign investors, which can be tremendous given the lack of information and the steep learning curve in these countries (Luo and Peng, 1999).

Overall, informal constraints offer some constancy and predictability in the absence of well-developed formal market-supporting institutions. Specifically, diversified conglomerates are able to compensate for the lack of formal institutional constraints by performing basic functions by themselves, such as allocating capital, obtaining market information, and enforcing contracts. In contrast, in developed economies, specialized organizations (e.g., stock exchanges, market research firms, law firms, and the courts) as part of the formal institutions will handle these responsibilities, thus nullifying the needs to support these costly activities within the firm.

Taken together, research on diversification strategies in Asia not only highlights the explanatory power of the institutional perspective, but also reminds us of the institutional embeddedness of the recent findings of diversification research in developed economies. It is important to note that the negative relationship between conglomerate diversification and performance was actually not found during an earlier era in the West (Matsusaka, 1993). Instead, financial markets' response to unrelated acquisitions was *positive* in the 1960s. These findings thus document "a dramatic reversal in [U.S.] investor sentiment toward diversification—positive in the 1960s, neutral in the 1970s, and negative in the 1980s" (Matsusaka, 1993:358). In the 1960s, external capital markets in the United States were less developed in terms of firm-specific information disclosure than in later decades. For example, relative to the current period, there was less access by the public to databases, analyst reports, and other sources of information that could reduce transaction costs between external investors and firms. As a result, conglomerates in the United States at that time were perceived *ex ante* by external capital markets to have an advantage in their abilities to allocate capital internally, a logic very similar to the favorable reaction of external markets to conglomerates in some Asian economies now. In short, the institutional perspective highlights the historical specificity of a particular relationship

between diversification and performance, which may not necessarily hold longitudinally and spatially.

Growth strategies

Before the current economic transition, firms in China were not interested in growth (Tan and Litschert, 1994). A fascinating aspect of the transition process is that firms there are now compelled to grow to be more competitive in the emerging ocean of market competition, thus presenting strategy researchers with a previously unencountered question first raised by Peng and Heath (1996): How do firms in transition economies such as China achieve growth?

Existing research on the growth of the firm suggests that there are typically three strategies for growth, namely, generic expansion, mergers and acquisitions, and/or networks and alliances (Penrose, 1959; Williamson, 1985). Work on firm growth in transition economies highlights the institutional prerequisites that support each of these three growth strategies. Specifically, generic expansion calls for a staff of capable managers. Mergers and acquisitions require functioning strategic factor markets. Developing networks and alliances needs to build trust and mutual understanding. While the institutional frameworks supporting the first two growth strategies are primarily formal ones, those for the last strategy are of an informal nature based on interpersonal relationships (Peng, 2000a).

Empirical work has been initiated in China, first through a qualitative phase building on three longitudinal case studies conducted over a seven-year period (Peng, 1997). This work has recently moved to a quantitative phase (Peng and Luo, 2000). Several interesting findings emerge. First, generic expansion, based on firms' own resources, is typically infeasible initially, because of the lack of certain critical resources at most firms (e.g., technology). In fact, some of these firms may need to "shrink" by turning around from persistent performance problems (Bruton, Ahlstrom and Wan, 2001). Second, handicapped by both a lack of capital and a lack of formal strategic factor markets, nor can most firms hope, at least initially, to acquire necessary resources through mergers and acquisitions. Many so-called mergers have been mandated by the government in an effort to bail out ailing state-owned firms (Peng, Luo and Sun, 1999). Third, an informal, network-based growth strategy is typically favored by a variety of firms (Peng and Heath, 1996). They usually rely on developing inter-organizational networks by tapping into the complementary resources at partner firms in order to jointly pursue growth opportunities (Peng, 1997; White, 2000). Specifically, state-owned firms like to team up with foreign firms and private firms in order to access financial capital, advanced technology, and entrepreneurial energy (Peng, 2000b; Shenkar and Li, 1999). Non-state firms are interested in obtaining some political support from the government by collaborating with state-owned firms (Lau and Busenitz, 2001; Peng, 2001a). Foreign firms tap into the capabilities of domestic partners in order to navigate the uncertain waters of economic transition (Beamish, 1993; Luo and Peng, 1999; Peng, 2000b; Yan and Gray, 1994). Finally, micro, interpersonal ties among managers at multiple firms are translated into macro, interorganizational relations leading to better firm performance—in short, a *micro-macro* link (Peng and Luo, 2000). Further, another extension of such micro-macro link can be found in Lau and Busenitz (2001), in which they link the

micro, entrepreneurial cognition with the macro, entrepreneurial strategies and performance in China.

Given that strategic choices are inherently affected by managers' national cultures (Hofstede, 1991), it is not surprising that Chinese managers, who have a widely noted cultural propensity to rely on informal ties, resort to personal connections to achieve organizational goals (Chen, 2001). However, Boisot and Child (1996), Peng (1997, 2000a), Peng and Heath (1996), and Xin and Pearce (1996) argue that, in addition to cultural influences, institutional imperatives during the transition may further necessitate the extensive reliance on personalized exchange relationships. Such an institutional interpretation is borne out by similar findings from transition economies throughout Central and Eastern Europe (Grabher and Stark, 1997). These countries include the Czech Republic (Spicer, McDermott and Kogut, 2000), Hungary (Stark, 1996), and Russia (Linz and Krueger, 1998; Puffer, 1994). Note that in these countries there is little influence of the Chinese (or Asian) culture which puts a premium on interpersonal ties. Nevertheless, the emergence of a network-based strategy, which "blurs" existing organizational boundaries and creates "recombinant property" (Stark, 1996), has been widely reported. It is evident that despite the cultural differences, similar institutional imperatives during the transition must have played an important role in leading to similar growth strategies throughout transition economies (Peng, 2000a).

While initial research finds that growth strategies in transition economies such as China converge on networks and alliances, it is important to caution that this is a *dominant* strategy, which should not be confused as the *only* strategy (Peng and Heath, 1996:517). A network-based strategy is not without its problems. The first is the lack of codification of information, routines, and capabilities. The second is the lack of a formal governance basis; often, members do not operate as unified groups. Decision making in these networks tends to be case by case, with extensive negotiations and bargaining among members. These loosely structured, largely informal networks are based on trust, reputation, and mutual understanding, which, unfortunately, can be exploited if there are divergent economic interests and/or when the enforcement mechanism is weak (Peng, 2000a:64). As a result, there is a recent move throughout China to establish large, fully incorporated enterprises and business groups with a unified command-and-control structure and subsidiaries, as opposed to loosely connected network members (Keister, 2000). Some of these groups, such as the "red chips" listed in Hong Kong and New York, have ventured abroad with some success (Au, Peng and Wang, 2000).

Consequently, these activities increasingly call for a strategy of mergers and acquisitions to achieve growth (Peng, Luo and Sun, 1999). Such a need, in turn, has fueled the urgency to strengthen the formal institutional constraints, namely, to establish an adequate legal framework to allow for such market-based transactions (Zhang and Peng, 2000). In other words, the failure of formal institutional frameworks has led to the reliance on informal constraints, which results in a network-based strategy. Further more, the problems of such a strategy call for strengthening formal institutions, and therefore, the dynamic interaction between institutions and organizations comes full circle (figure 1). Specifically, it evolves precisely in a manner described by North (1990:5) in that strategic choices made by organizations are influenced by the institutional framework, and "in turn, they influence how the institutional framework evolves."

Contributions, critiques, and extensions

Contributions

While a short article such as the present one is certainly unable to do justice to such a vast and expanding literature,² it is evident that significant progress has been made in the past decade or so. At least two major contributions emerge. First, research on Asian organizations has addressed head-on the very first fundamental question in strategic management on “why firm strategies differ” identified by Rumelt and colleagues (1994), through developing and extending an institution-based view of business strategy. Note that this new perspective does not imply a rejection of existing work based on competition- and resource-based views. Elsewhere (Peng, 2001b:821), I have argued that there is substantial room to integrate the more established resource-based view with the emerging institution-based view of business strategy. It is important to note that these perspectives are not mutually exclusive. The institution-based view supplements and enriches mainstream strategy research by drawing attention to the often overlooked importance of institutions, both formal and informal, which are broader than the traditional notion of national cultural differences (Hoskisson et al., 2000).

The recent rise of interest in institutional research is probably a reaction to its “back-burner” status in the strategy research agenda for a long time. Moreover, not only existing strategy research focuses largely on the West, so does most institutional work. As a result, the importance of institutions fades into the background, which is generally ignored by most strategy researchers. A focus on Asian economies is, therefore, theoretically important because it allows us to highlight the importance of institutional forces (Scott, 1995:146). In other words, Asian economies have become “viable research laboratories” (Shenkar and von Glinow, 1994:56). Such work, I believe, has provided the *strongest* support to the institution-based view, because research in developed economies, where the “rules of the game” are taken for granted, has had a difficult time separating the institutional effect on firm strategy and performance that is independent of economic and cultural effects. Research on non-Western economies, on the other hand, has not only clearly demonstrated that institutions matter, but has also made significant progress to take on the challenge suggested by Powell (1996:297) to specify the *nature* of such a link in terms of “how they matter, under what circumstances, to what extent, and in what ways.”

Second, in addition to advancing strategy research, institution-based research on business strategies in Asian economies also contributes to institutional theory by demonstrating the benefits of integrating with efficiency-oriented research. Some institutional theorists suggest that the “new institutionalism . . . comprises a *rejection* of rational-actor models” often found in efficiency-based research (DiMaggio and Powell, 1991:8, added emphasis). While such a perspective may be insightful when studying educational institutions and public bureaucracies, where institutional research initially rose, recent work argues against pitting “strategic and institutional,” “substantive and symbolic,” and “economic and social” factors against each other (Powell, 1996:295). When institutional theory moves away from schools and bureaucracies to assert its influence in the arena of efficiency-driven business organizations, a focus on efficiency outcomes becomes necessary (Oliver, 1997; Scott,

1995). Otherwise, the usefulness of institutional theory in explaining performance-driven organizational phenomena such as business strategy is limited.

In our particular case, traditional institutional analysis would suggest that certain strategies (e.g., supplier relations in Japan, conglomerate diversification in India and Korea) persist simply because such a practice is widely adopted (or institutionalized), independent of evidence that it “works.” Such a perspective, however, is difficult to accommodate the emerging evidence documenting concrete performance benefits associated with these strategies (Khanna and Palepu, 2000; Khanna and Rivkin, 2001). At this juncture, an integrative approach incorporating both the institutional and efficiency perspectives would be sensible. The challenge for researchers is to uncover the underlying mechanisms that relate institutions to organizational strategies, and then to link them with firm performance (Peng and Luo, 2000).

Critiques and extensions

Originating in the 1970s, the new institutionalism in the social sciences was still in its adolescence by the 1980s (Scott, 1995), and its application to strategic management is a more recent development (Oliver, 1997)—note that virtually all key references reviewed in the four substantive sections are published in the 1990s and beyond. As a result, there are a number of important problems that existing research has yet to address.

Perhaps foremost is the need for more theoretical development in order to answer the question first raised by Coase (1937): “What is the nature of the firm?” A lot of existing work on “firm” strategies does not agree on what exactly a firm is. A firm in the West has relatively clear legal boundaries characterized by hierarchical control by top management (Williamson, 1985). A firm, especially the large conglomerate, in many Asian economies tends to have “blurring” boundaries permeated by personal connections, partial ownerships, and board interlocks. Such a loosely defined organization is often called a “business group” (Granovetter, 1994). The difficulty in defining firm (or group) boundaries has not only led to empirical problems when measuring their size, strategy, and performance (Khanna and Rivkin, 2001), but also resulted in a conceptual debate on whether these organizations qualify as “firms.”

Specifically, Hamilton and Feenstra (1995:58) argue that the narrowly defined Coasian firm with clear boundaries “does not have the same empirical and conceptual significance throughout the world but, rather, is a prominent feature . . . only in modern Western societies.” While research on *keiretsu* networks in Japan has forced strategy researchers to examine the validity of our conceptualization of the firm based on the Western model, more recent work finds that similar networks dominate the organizational landscape in many Asian countries. A traditional answer is to suggest that these organizations are “outliers” operating under a different set of logic, and that the field can afford to ignore them and develop “grand” theories (mostly focusing on Western economies). However, in light of the growing importance of Asian economies and their increased integration with the rest of the world, such an answer becomes indefensible, if we as a field ever endeavor to approach a *global* science of organizations (Peng, Lee and Tan, 2001). While delineating the essence of this debate is beyond the scope of this article, future conceptual progress on what constitutes a “firm”

is clearly needed when carrying out strategy research in both Western and non-Western economies.

Second, most existing research is of a static nature, that is, scholars propose and test *linear* directions, such as close supplier relations and conglomerate diversification lead to better performance. The *dynamic* aspects of the complex relationships have been rarely explored. For example, supplier relations that are too close may introduce rigidities in product designs, resulting in a loss of much-needed flexibility. It is not known, however, how close the relationship with suppliers is “too close.” In terms of conglomerates in Asian economies, after all, they confront the same problems that plague those in the West: The more activities a firm engages in, the harder it is for the head office to coordinate, control, and invest properly in different member units. Therefore, “how much scope is too much” remains to be explored, because it is evident that beyond a point of inflection, further diversification will only backfire (Chang and Hong, 2000; Lee, Peng and Lee, 2002). In future research, how to identify such a point of inflection in highly dynamic and uncertain institutional environments remains a major challenge.

Finally, how national cultures, interacting with institutional frameworks, affect strategic choices needs to be explored in more depth. Will strategies in Asian economies converge on Western models? Given that individual managers making strategic decisions are influenced by their own national cultures (Hofstede, 1991), convergence is not likely to be the case, at least in the short run (Chen, 2001). On the other hand, complete divergence is also not feasible in today’s increasingly integrated global economy. By implication, what seems more likely is “crossvergence,” in that strategies in non-Western economies will continue to be different from those observed in the West, while, beyond some point of inflection discussed above, gradually moving toward more similar (but not the same) strategies, as more market-supporting institutions are developed (Young et al., 2002). Currently, we know very little about how these cultural processes manifest themselves in strategic choices, and therefore, need to pay attention to these processes in future research.

Conclusions

This article has focused on why firm strategies differ, by exploring the underlying institutional frameworks that drive strategic choices. Since “frame-breaking experiences only come from examining and comprehending organizations operating in other places and other times” (Scott, 1995:151), business strategies in Asian organizations have attracted significant attention recently. Overall, research in this area has increasingly appeared in leading journals, thus starting to disseminate this knowledge and assert its influence in the mainstream literature (Peng, 2001b; Peng et al., 2001). To be sure, the studies reviewed in this article, mostly published in the 1990s, are just the entering wedges into the complex and dynamic relationships among institutions, organizations, and strategic choices, and certainly not the final words on them. Companies’ strategic moves and our learning about them are not likely to stop soon. One thing for sure is that the importance of institutional influences on business strategies will be increasingly appreciated in the new millennium, thus necessitating more attention from researchers, practitioners, as well as policy makers not only in Asia but also around the world.

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Notes

1. The other four most fundamental questions are (1) How do firms behave? (2) How are strategy outcomes affected by strategy processes? (3) What determines the scope of the firm? and (4) What determines the international success and failure of firms? While other questions can be raised, according to Rumelt and colleagues (1994:570), they "all relate in one way or another" to these five questions.
2. For a detailed review of management and organizational research on Greater China, see Peng et al. (2001).

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