

A Comparison of Institutional Theory and Contingency Theory

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ABSTRACT

Contingency and institutional theory represents two popular theories in the area of organizational studies. However, institutional theory questions the practicability and rationality of contingency theory. This paper compares the two theories from four aspects: the core argument, the change mechanism, the application of academic research and the methodology of the application of the two theories. Both theories can take into account internal and external factors when describing organizational change, so they have been widely recognized in organizational research. Contingency theory is a functional interpretation, which emphasizes achieving high performance by maintaining the adaptability and consistency of organizational structure and situational variables, while institutional theory is a cognitive and cultural interpretation.

INTRODUCTION

Contingency and institutional theory represents two popular theories in the area of organizational studies and both claim that organizational change is a response to both internal and external factors. Contingency theory was widely used from the 1950s to the 1970s, challenging the classical universalistic organizational theory that there is one best way to manage the organizations (Donaldson 2001). It argues that the characteristics of the organization are influenced by both external and internal factors, which are the situational contingencies (Donaldson 2001). The characteristics of the organization include the structure, leadership, decision-making process, and human resource management (Donaldson 2001), but this paper focuses on the organizational structures.

Institutional theory challenges the functionalism and rationalism of contingency theory (Donaldson 2001) and provides a rich and multifaceted view of organizations (Zucker 1987). It points out that though the strategic decisions made by shareholders heavily influence organizational change, authorities outside the organization also exert great influence on such changes (Selznick 1996; Zucker 1987). In an institutional context, organizations are pressured to become increasingly similar and that this is not voluntary (Zucker 1987). There is a shift in

institutional theory that denies the model of the rational actor and shifts towards a cognitive and cultural explanation. This contrasts with the old institutional theory that emphasizes the relationship between organization and governance rather than the interaction between culture and organization (Selznick 1996). The bounded rationality, which is considered to be the socially constructed mind, helps organizations cope with uncertainty (Selznick 1996).

This paper identifies the differences between these theories and then compares their strengths and weaknesses to present a better understanding of these theories. In doing so, this paper compares the central arguments, mechanisms towards change, applications in academic studies and methodologies applied to both theories.

The central argument of structural contingency theory focuses on the alignment of the organizational structure and situational contingencies (Donaldson 2001). It stresses the "fit" state of this alignment and assumes that the highest organizational effectiveness can be achieved when the alignment reaches fit state. There are three primary contingencies in the literature, including environment (Burns & Stalker 1961), organizational size (Child 1975), and strategy (Donaldson 2001). The change of each of these contingencies will change certain levels of the organizational structure. In terms of environment, organizations are suggested to

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adopt a mechanical structure, which is routine-based, when the environment is stable, while the organization adopts organic structure, which advocates participatory management way, when the environment is unstable (Burns & Stalker 1961). Regarding organizational size, large companies are suggested to take a bureaucratic structure, while smaller companies should take a simple, centralized, unbureaucratic structure (Child 1975). With regard to strategy, companies with an undiversified strategy are capable of achieving a higher performance when they take a functional structure, such as a department of marketing, human resource management, accounting, and so on. With a diversified strategy, organizations are suggested to adopt a divisional structure, in which the department is based on its different services and products. In contingency theory, organizations are assumed to be performance-oriented and fully capable of attaining high performance. It is also the dominant view of corporations that the shareholders in voluntary association are the only members that matter (Selznick 1996). However, this dominant view may not be true when scholars regard the corporation as an institution. They consider all the relevant stakeholders rather than only the shareholders and the sensitivity of the organization to outside authorities (Selznick 1996).

A change of the organizational structure happens in the institutional field where those organizations that create a recognized area of institutional life and tend to generate similar products and services, which finally results in the phenomena of isomorphism (DiMaggio & Powell 1983). Institutional theory is "a widely accepted theoretical posture that emphasizes rational myths, isomorphism, and legitimacy" (Scott 2008), in which, legitimacy is the core and imperative of institutional theory and justifies that organizations adopt certain kinds of structures because they want to gain a high degree of resilience rather than effectiveness (Selznick 1996; Zucker 1987). Maintaining a "stable" state is the objective of the organization (Zucker 1987). Especially when the goal of organization is ambiguous and the environment is uncertain, it is more likely for the organizations to adopt some rules passively and take on a successful structure to avoid the uncertainty and risks (DiMaggio & Powell 1983). As a result, contingency theory stresses an individual organization's rationality toward the structural change of the organization, which is a functional explanation, whereas institutional

theory emphasizes the collective and social rationality, based on cognitive and cultural explanation. Comparatively, institutional theory takes more account of the organization's long-term interest (Meyer & Rowan 1977; Selznick 1996).

Originally, the mechanism governing how the organizations adapt themselves to the different contingencies was understood as a causal or deterministic relationship between contingency and structure. For example, the size of the organization determines whether the organization takes on a bureaucratic structure or not. However, some scholars challenged this static mechanism and proposed a more dynamic way to understand this, resulting in the SARFIT model (Donaldson 2001). The organization is initially situated in a fit status, having a structure that fits its existing level of contingency variables, in which its structure is positively related with its performance. When this contingency changes, the performance becomes unsatisfactory because the organization retains a misfit structure. Therefore, the organization makes an adaptive change to regain fit status (Donaldson 2001). Based on the dynamic model, Donaldson (2001) proposed a theory of performance-driven change. Integrated with risk concept and portfolio theory, Donaldson (2001) argued that the business cycle, competition, debt, and divisional risk all increase organizational change, where the organization finally reaches the quasi-fit status. This view makes the contingency mechanism a more realistic guide for managers to implement.

The mechanism of institutional theory is realized through mimetic, normative, and coercive processes that can influence organizational structure, climate, and behavioural focus (DiMaggio & Powell 1983). A mimetic process refers to adopting or imitating others' successful responses to uncertainty. Normative pressure stems primarily from professionalism, which owns the authority to explain the uncertainty and provide guidelines to shape an organization's behaviour. The third pressure is coercion, which is generally central to state legitimation, such as government mandate, laws, and regulations (DiMaggio & Powell 1983; Zucker 1987). Once the elements of organizations is institutionalized, they will maintain over long periods of time without further justification or elaboration, becoming highly resistant to change (Zucker 1983). However, since the source of the institutional elements are uniformly generated

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externally, the creation of a new social order seems problematic, which is in an infinite regression to god rather than addressing the organizational problems (Zucker 1987). Therefore, the role of the individual as an “institutional entrepreneur” has been recognized and such entrepreneurs change the game and bring in the new games through their entrepreneurship (DiMaggio 1988; Meyer & Rowan 1977). As a consequence, both theories argue that internal needs are the source of organizational change. However, the force strengthening the change in contingency theory is driven by performance, while the force strengthening the change in institutional theory is driven by powerful agents outside the organization.

The research questions that contingency theory can resolve are indicated as the influence of fit on performance, contingency adaption process, contingency elements in theory-creation and relationship between contingency factors and aspects of the organization they affect (Donaldson, 2001). On the other hand, the research focus of institutional theory includes the institutional environment, the degree of institutionalization, the cause of institutionalization, and the consequences of institutionalization (Zucker 1983). Furthermore, institutional theory has been generally shaped with various studies in sociology, social psychology, economics, and political science, largely focusing on the constant structure of social systems at various levels (i.e. organization, society, and the world) and the effect of institutional processes in conflict (Donaldson 2001).

The methodology used in contingency theory is quantitative research, which empirically tests the relationship between different variables of contingency and the organizational structure. For example, there is a few empirical study validating the relationship that contingency fits positively affect organizational performance (Donaldson 2001). For some exploratory studies based on contingency theory perspective, case studies are applied to gain insight about the organization and the environment (McAdam, Miller & McSorley 2016; McGrandle 2017). Institutional theory, however, uses deductive methods (DiMaggio & Powell 1983; Meyer & Rowan 1977) to generate hypotheses about the relationships among legitimacy forces, degree of institutionalization, and organizational survival. Both quantitative (Badewi & Shehab 2016; Li, Li & Cai 2014) and interpretive (Marie Doherty,

Chen & Alexander 2014) methods have been used in research based on the institutional theory perspectives.

Contingency theory challenges the classical organizational theory argument that “maximum organizational performance results from maximum formalization and specialization” (Donaldson 2001). Furthermore, variables of contingency have been empirically tested, which lays a foundation for theoretical advancement (Donaldson 2001). Despite these strengths, contingency theory can’t explain why some organizations adopt the discipline structure passively. Additionally, the variables of contingency are so diversified and difficult to unify into the theory (Donaldson 2001). Moreover, the empirical estimation of the effect of fit on performance is challenged by unreliability, range restriction, and confounds, which makes some empirical outcome less pervasive (Donaldson 2001).

For institutional theory, most studies use degree of control by the state, via law, regulation, or resource flow as the measure of the degree of institutionalization. This is global and invariant across organization, comparative studies is recommended to be conducted to see their influences on organizations. Furthermore, it is difficult to distinguish institutional from resource dependent explanations (Zucker 1987). In addition, the old and new institutionalism encourage an undesirable priority in discussing polarities and polemics, which interferes with the advancement of understanding and hinders the quest for a more effective and cooperative systems in managing organization (Selznick 1996).

CONCLUSION

In conclusion, this article sheds light on the differences between contingency theory and institutional theory by comparing their central arguments, mechanisms, research applications, and methodologies. Both theories are popular in organizational studies for their success in explaining organizational change towards internal and external elements. Contingency theory is a functional-based explanation that tries to maintain the fit alignment between organizational structure and situational variables to attain high performance, while institutional theory is a cognitive and cultural explanation. The increasingly invariant mix of organizational structure, climate, and behavior result from external authorities, which contributes to the long-term survival of the organization. Mixed

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methods are applied in the study of both theories.

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