Beyond Management and the Worker: The Institutional Function of Management

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Management's role in negotiating the organization's relationships with the environment has been neglected in theory and research. Strategies for managing interorganizational interdependence include: merger, joint ventures, cooptation, movement of personnel among organizations, regulation, and political activity. Institutional management activities can be explained using variables measuring dimensions of the organization's context.

Theory, research, and education in the field of organizational behavior and management have been dominated by a concern for the management of people *within* organizations. The question of how to make workers more productive has stood as the foundation for management theory and practice since the time of Frederick Taylor. Such an emphasis neglects the institutional function of management. While managing people within organizations is critical, managing the organization's relationships with other organizations such as competitors, creditors, suppliers, and governmental agencies is frequently as critical to the firm's success.

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Parsons (15) noted that there were three levels in organizations: (a) the technical level, where the technology of the organization was used to produce some product or service; (b) the administrative level, which coordinated and supervised the technical level; and (c) the institutional level, which was concerned with the organization's legitimacy and with organization-environment relations. Organization and management theory has primarily concentrated on administrative level problems, frequently at very low hierarchical levels in organizations.

Practicing managers and some researchers do recognize the importance of the institutional context in which the firm operates. There is increasing use of institutional advertising, and executives from the oil industry, among others, have been active in projecting their organizations' views in a variety of contexts. Mintzberg (14) has identified the liaison role as one of ten roles managers fill. Other authors explicitly have noted the importance of relating the organization to other organizations (23, 32).

Saying that the institutional function is important is different from developing a theory of the organization's relationships with other organizations, a theory which can potentially guide the manager's strategic actions in performing the function of institutional management. Such a theory is needed, and data are accumulating to construct such a theory.

The purposes of this article are: (a) to present evidence of the importance of the institutional function of management, and (b) to review data consistent with a model of institutional management. This model argues that managers behave as if they were seeking to manage and reduce uncertainty and interdependence arising from the firm's relationships with other organizations. Several strategic responses to interorganizational exchange, including their advantages and disadvantages, are considered.

Institutional Problems of Organizations

Organizations are open social systems, engaged in constant and important transactions with other organizations in their environments. Business firms transact with customer and supplier organizations, and with sources of credit; they interact on the federal and local level with regulatory and legal authorities which are concerned with pollution, taxes, antitrust, equal employment, and myriad other issues. Because firms do interact with these other organizations, two consequences follow. First, organizations face uncertainty. If an organization were a closed system so that it could completely control and predict all the variables that affected its operation, the organization could make technically rational, maximizing decisions and anticipate the consequences of its actions. As an open system, transacting with important external organizations, the firm does not have control over many of the important factors that affect its operations. Because organizations are open, they are affected by events outside their boundaries.

Second, organizations are interdependent with other organizations with which they exchange resources, information or personnel, and thus open to influence by them. The extent of this influence is likely to be a function of the importance of the resource obtained, and inversely related to the ease with which the resource can be procured from alternative sources (9, 31). Interdependence is problematic and troublesome. Managers do not like to be dependent on factors outside their control. Interdependence is especially troublesome if there are few alternative sources, so the external organization is particularly important to the firm.

Interdependence and uncertainty interact in their effects on organizations. One of the principal functions of the institutional level of the firm is the management of this interdependence and uncertainty.

The Importance of Institutional Management

Katz and Kahn (12) noted that organizations may pursue two complementary paths to effectiveness. The first is to be as efficient as possible, and thereby obtain a competitive advantage with respect to other firms. Under this strategy, the firm succeeds because it operates so efficiently that it achieves a competitive advantage in the market. The second strategy, termed "political," involves the establishment of favorable exchange relationships based on considerations that do not relate strictly to price, quality, service, or efficiency. Winning an order because of the firm's product and cost characteristics would be an example of the strategy of efficiency; winning the order because of interlocks in the directorates of the organizations involved, or because of family connections between executives in the two organizations, would illustrate political strategies.

The uses and consequences of political strategies for achieving organizational success have infrequently been empirically examined. Hirsch (7) has recently compared the ethical drug and record industries, noting great similarities between them. Both sell their products through gatekeepers or intermediaries — in the case of pharmaceuticals, through doctors who must write the prescriptions, and in the case of records, through disc jockeys who determine air time and, consequently, exposure. Both sell products with relatively short life cycles, and both industries place great emphasis on new products and product innovation. Both depend on the legal environment of patents, copyrights, and trademarks for market protection.

Hirsch noted that the rate of return for the average pharmaceutical firm during the period 1956-1966 was more than double the rate of return for the average firm in the record industry. Finding no evidence that would enable him to attribute the striking differences in profitability to factors associated with internal structural arrangements, Hirsch concluded that at least one factor affecting the relative profitability of the two industries is the ability to manage their institutional environments, and more specifically, the control over distribution, patent and copyright protection, and the prediction of adoption by the independent gatekeepers.

In a review of the history of both industries, Hirsch indicated that in pharmaceuticals, control over entry was achieved by (a) amending the patent laws to permit the patenting of naturally occurring substances, antibiotics, and (b) instituting a long and expensive licensing procedure required before drugs could be manufactured and marketed, administered by the Food and Drug Administration (FDA). In contrast, record firms have much less protection under the copyright laws; as a consequence, entry is less controlled, leading to more competition and lower profits. While there are other differences between the industries, including size and expenditures on research and development, Hirsch argued that at least some of the success of drug firms derives from their ability to control entry and their ability to control information channels relating to their product through the use of detail personnel and advertising in the American Medical Association Journals. Retail price maintenance, tariff protection, and licensing to restrict entry are other examples of practices that are part of the organization's institutional environment and may profoundly affect its success.

Managing Uncertainty and Interdependence

The organization, requiring transactions with other organizations and uncertain about their future performance, has available a variety of strategies that can be used to manage uncertainty and interdependence. Firms face two problems in their institutional relationships: (a) managing the uncertainty caused by the unpredictable actions of competitors; and (b) managing the uncertainty resulting from non-competitive interdependence with suppliers, creditors, government agencies, and customers. In both instances, the same set of strategic responses is available: merger, to completely absorb the interdependence and resulting uncertainty; joint ventures; interlocking directorates, to partially absorb the interdependence; the movement and selective recruiting of executives and other personnel, to develop interorganizational linkages; regulation, to provide government enforced stability; and other political activity to reduce competition, protect markets and sources of supply, and otherwise manage the organization's environment.

Because organizations are open systems, each strategy is limited in its effect. While merger or some other interorganizational linkage may manage one source of organizational dependence, it probably at the same time makes the organizations dependent on yet other organizations. For example, while regulation may eliminate effective price competition and restrict entry into the industry (11, 19, 25), the regulated organizations then face the uncertainties involved in dealing with the regulatory agency. Moreover, in reducing uncertainty for itself, the organization must bargain away some of its own discretion (31). One can view institutional management as an exchange process — the organization assures itself of needed resources, but at the same time, must promise certain predictable behaviors in return. Keeping these qualifications in mind, evidence on use of the various strategies of institutional management is reviewed.

Merger

There are three reasons an organization may seek to merge — first, to reduce competition by absorbing an important competitior organization; second, to manage interdependence with either sources of input or purchasers of output by absorbing them; and third, to diversify operations and thereby lessen dependence on the present organizations with which it exchanges (17). While merger among competing organizations is presumably proscribed by the antitrust laws, enforcement resources are limited, and major consolidations do take place.

In analyzing patterns of interorganizational behavior, one can either ask executives in the organizations involved the reasons for the action, or alternatively, one can develop a hypothetical model of behavior which is then tested with the available data. Talking with organizational executives may not provide the real reasons behind interorganizational activity since (a) different persons may see and interpret the same action in different ways, (b) persons may infer after the fact the motives for the action or decision, and (c) persons may not be motivated to tell the complete truth about the reasons for the behavior. Much of the existing literature on interorganizational linkage activity, therefore, uses the method of empirically testing the deductions from a hypothetical model of interorganizational behavior.

The classic expressed rationale for merger has been to increase the profits or the value of the shares of the firm. In a series of studies beginning as early as 1921, researchers have been unable to demonstrate that merger active firms are more profitable or have higher stock prices following the merger activity. This literature has been summarized by Reid (27), who asserts that mergers are made for growth, and that growth is sought because of the relationship between firm size and managerial salaries.

Growth, however, does not provide information concerning the desired characteristics of the acquired firm. Under a growth objective, any merger is equivalent to any other of the same size. Pfeffer (17) has argued that mergers are undertaken to manage organizational interdependence. Examining the proportion of merger activity occurring within the same 2-digit SIC industry category, he found that the highest proportion of within-industry mergers occurred in industries of intermediate concentration. The theoretical argument was that in industries with many competitors, the absorption of a single one did little to reduce competitive uncertainty. At the other extreme, with only a few competitors, merger would more likely be scrutinized by the antitrust authorities and coordination could instead be achieved through more informal arrangements, such as price leadership.

The same study investigated the second reason to merge: to absorb the uncertainty among organizations vertically related to each other, as in a buyer-seller relationship. He found that it was possible to explain 40 percent of the variation in the distribution of merger activity over industries on the basis of resource interdependence, measured by estimates of the transactions flows between sectors of the economy. On an individual industry basis, in two-thirds of the cases a measure of transactions interdependence accounted for 65 percent or more of the variation in the pattern of merger activity. The study indicated that it was possible to account for the industry of the likely merger partner firm by considering the extent to which firms in the two industries exchanged resources.

While absorption of suppliers or customers will reduce the firm's uncertainty by bringing critical contingencies within the boundaries of the organization, this strategy has some distinct costs. One danger is that the process of vertical integration creates a larger organization which is increasingly tied to a single industry.

The third reason for merger is diversification. Occasionally, the organization is confronted by interdependence it cannot absorb, either because of resource or legal limitations. Through diversifying its activities, the organization does not reduce the uncertainty, but makes the particular contingency less critical for its success and well-being. Diversification provides the organization with a way of avoiding, rather than absorbing, problematic interdependence.

Merger represents the most complete solution to situations of organizational interdependence, as it involves the total absorption of either a competitor or a vertically related organization, or the acquisition of an organization operating in another area. Because it does involve total absorption, merger requires more resources and is a more visible and substantial form of interorganizational linkage.

Joint Ventures

Closely related to merger is the joint venture: the creation of a jointly owned, but independent organization by two or more separate parent firms. Merger involves the total pooling of assets by two or more organizations. In a joint venture, some assets of each of several parent organizations are used, and thus only a partial pooling of resources is involved (4). For a variety of reasons, joint ventures have been prosecuted less frequently and less successfully than mergers, making joint ventures particularly appropriate as a way of coping with competitive interdependence.

The joint subsidiary can have several effects on competitive interdependence and uncertainty. First, it can reduce the extent of new competition. Instead of both firms entering a market, they can combine some of their assets and create a joint subsidiary to enter the market. Second, since joint subsidiaries are typically staffed, particularly at the higher executive levels, with personnel drawn from the parent firms, the joint subsidiary becomes another location for the management of competing firms to meet. Most importantly, the joint subsidiary must set price and output levels, make new product development and marketing decisions and decisions about its advertising policies. Consequently, the parent organizations are brought into association in a setting in which exactly those aspects of the competitive relationship must be jointly determined.

In a study of joint ventures among manufacturing and oil and gas companies during the period 1960-71, Pfeffer and Nowak (22, 24) found that 56 percent involved parent firms operating in the same two-digit industry. Further, in 36 percent of the 166 joint ventures studied, the joint subsidiary operated in the same industry as *both* parent organizations. As in the case of mergers, the proportion of joint venture activities undertaken with other firms in the same industry was related to the concentration of the firm's industry being intermediate. The relationship between concentration and the proportion of joint ventures undertaken within the same industry accounted for some 25 percent of the variation in the pattern of joint venture activities.

In addition to considering the use of joint ventures in coping with competitive interdependence, the Pfeffer and Nowak study of joint ventures examined the extent to which the creation of joint subsidiaries was related to patterns of transaction interdependence across industries. While the correlations between the proportion of transactions and the proportion of joint ventures undertaken between industry pairs were lower than in the case of mergers, statistically significant relationships between this form of interorganizational linkage activity and patterns of resource exchange were observed. The difference between mergers and joint ventures appears to be that mergers are used relatively more to cope with buyer-seller interdependence, and joint ventures are more highly related to considerations of coping with competitive uncertainty.

Cooptation and Interlocking Directorates

Cooptation is a venerable strategy for managing interdependence between organizations. Cooptation involves the partial absorption of another organization through the placing of a representative of that organization on the board of the focal organization. Corporations frequently place bankers on their boards; hospitals and universities offer trustee positions to prominent business leaders; and community action agencies develop advisory boards populated with active and strong community political figures.

As a strategy for coping with interdependence, cooptation involves some particular problems and considerations. For example, a representative of the external organization is brought into the focal organization, while still retaining his or her original organizational membership. Cooptation is based on creating a conflict of interest within the coopted person. To what extent should one pursue the goals and interests of one's organization of principal affiliation, and to what extent should one favor the interests of the coopting organization? From the point of view of the coopting organization, the individual should favor its interests, but not to the point where he or she loses credibility in the parent organization, because at that point, the individual ceases to be useful in ensuring that organization's support. Thus, cooptation requires striking a balance between the pressures to identify with either the parent or coopting institution.

Furthermore, since cooptation involves less than total absorption of the other organization, there is the risk that the coopted representative will not have enough influence or control in the principal organization to ensure the desired decisions. Of course, it is possible to coopt more than a single representative. This is frequently done when relationships with the coopted organization are particularly uncertain and critical. Cooptation may be the most feasible strategy when total absorption is impossible due to financial or legal constraints.

Interlocks in the boards of directors of competing organizations provide a possible strategy for coping with competitive interdependence and the resulting uncertainty. The underlying argument is that in order to manage interorganizational relationships, information must be exchanged, usually through a joint subsidiary or interlocking directorate. While interlocks among competitors are ostensibly illegal, until very recently there was practically no prosecution of this practice. In a 1965 study, a subcommittee of the House Judiciary Committee found more than 300 cases in which direct competitors had interlocking boards of directors (8). In a study of the extent of interlocking among competing organizations in a sample of 109 manufacturing organizations, Pfeffer and Nowak (23) found that the proportion of directors on the board from direct competitors was higher for firms operating in industries in which concentration was intermediate. This result is consistent with the result found for joint ventures and mergers as well. In all three instances, linkages among competing organizations occurred more frequently when concentration was in an intermediate range.

Analyses of cooptation through the use of boards of directors have not been confined to business firms. Price (26) argued that the principal function of the boards of the Oregon Fish and Game Commissions was to link the organizations to their environments. Zald (33) found that the composition of YMCA boards in Chicago matched the demography of their operating areas, and affected the organizations' effectiveness, particularly in raising money. Pfeffer (18) examined the size, composition, and function of hospital boards of directors, finding that variables of organizational context, such as ownership, source of funds, and location, were important explanatory factors. He also found a relationship between cooptation and organizational effectiveness. In 1972, he (16) found that regulated firms, firms with a higher proportion of debt in their capital structures, and larger firms tended to have more outside directors. Allen (1) also found that size of the board and the use of coöptation was predicted by the size of the firm, but did not replicate Pfeffer's earlier finding of a relationship between the organization's capital structure and the proportion of directors from financial institutions. In a study of utility boards, Pfeffer (20) noted that the composition of the board tended to correlate with the demographics of the area in which the utility was regulated.

The evidence is consistent with the strategy of organizations using their boards of directors to coopt external organizations and manage problematic interdependence. The role of the board of directors is seen not as the provision of management expertise or control, but more generally as a means of managing problematic aspects of an organization's institutional environment.

Executive Recruitment

Information also is transferred among organizations through the movement of personnel. The difference between movement of executives between organizations and cooptation is that in the latter case, the person linking the two organizations retains membership in both organizations. In the case of personnel movement, dual organizational membership is not maintained. When people change jobs, they take with themselves information about the operations, policies, and values of their previous employers, as well as contacts in the organization. In a study of the movement of faculty among schools of business, Baty, et al. (2) found that similar orientations and curricula developed among schools exchanging personnel. The movement of personnel is one method by which new techniques of management and new marketing and product ideas are diffused through a set of organizations.

Occasionally, the movement of executives between organizations has been viewed as intensifying, rather than reducing, competition. Companies have been distressed by the raiding of trade secrets and managerial expertise by other organizations. While this perspective must be recognized, the exchange of personnel among organizations is a revered method of conflict *reduction* between organizations (29). Personnel movement inevitably involves sharing information among a set of organizations.

If executive movement is a form of interfirm linkage designed to manage competitive relationships, the proportion of executives recruited from within the same industry should be highest at intermediate levels of industrial concentration. Examing the three top executive positions in twenty different manufacturing industries, the evidence on executive backgrounds was found to be consistent with this argument (21). The proportion of high level executives with previous jobs in the same industry but in a different company was found to be negatively related to the number of firms in the industry. The larger the number of firms, the less likely that a single link among competitors will substantially reduce uncertainty, but the larger the available supply of external executive talent. The data indicated no support for a supply argument, but supported the premise that interorganizational linkages are used to manage interdependence and uncertainty.

The use of executive movement to manage non-competitive interorganizational relationships is quite prevalent. The often-cited movement of personnel between the Defense Department and major defense contractors is only one example, because there is extensive movement of personnel between many government departments and industries interested in the agencies' decisions. The explanation is frequently proposed that organizations are acquiring these personnel because of their expertise. The expertise explanation is frequently difficult to separate from the alternative that personnel are being exchanged to enhance interorganizational relationships. Regardless of the motivation, exchanging personnel inevitably involves the transfer of information and access to the other organization. It is conceptually possible to control for the effect of expertise — in other words, taking expertise into account, is there evidence that recruiting patterns reflect the influence of factors related to institutional management?

Regulation

Occasionally, institutional relationships are managed through recourse to political intervention. The reduction of competition and its associated uncertainty may be accomplished through regulation. Regulation, however, is a risky strategy for organizations to pursue. While regulation most frequently benefits the regulated industry (11, 19), the industry and firms have no assurance that regulatory authority will not be used against their interests. Regulation is very hard to repeal. Successful use of regulation requires that the firm and industry face little or no powerful political opposition, and that the political future can be accurately forecast.

The benefits of regulation to those being regulated have been extensively reviewed (25, 30). Regulation frequently has been sought by the regulated industry. Currently, trucking firms are among the biggest supporters of continued regulation of trucking. Since the Civil Aeronautics Board was created in 1938, no new trunk carriers have been started. Jordan (10) found that air rates on intrastate (hence not regulated by the CAB) airlines within California are frequently 25 percent or more lower than fares on comparable routes of regulated carriers. Estimates of the effects of regulation on prices in electric utilities, airlines, trucking, and natural gas have indicated that regulation either increases price or has no effect.

The theory behind these outcomes is still unclear. One approach suggests that regulation is created for the public benefit, but after the initial legislative attention, the regulatory process is captured by the firms subject to regulation. Another approach proposes that regulation, like other goods, is acquired subject to supply and demand considerations (25). Political scientists, focusing on the operation of interest groups, argue that regulatory agencies are "captured" by organized and well-financed interests. Government intervention in the market can solve many of the interdependence problems faced by firms. Regulation is most often accompanied by restriction of entry and the fixing of prices, which tend to reduce market uncertainties. Markets may be actually allocated to firms, and with the reduction of risk, regulation may make access to capital easier. Regulation may alter the organization's relationships with suppliers and customers. One theory of why the railroads were interested in the creation of the Interstate Commerce Commission (ICC) in 1887 was that large users were continually demanding and winning discriminatory rate reductions, disturbing the price stability of railroad price fixing cartels. By forbidding price discrimination and enforcing this regulation, the ICC strengthened the railroads' position with respect to large customers (13).

Political Activity

Regulation is only one specific form of organizational activity in governmental processes. Business attempts to affect competition through the operation of the tariff laws date back to the 1700's (3). Epstein (6) provided one of the more complete summaries of the history of corporate involvement in politics and the inevitability of such action. The government has the power of coercion, possessed legally by no other social institution. Furthermore, legislation and regulation affect most of our economic institutions and markets, either indirectly through taxation, or more directly through purchasing, market protection or market creation. For example, taxes on margarine only recently came to an end. Federal taxes, imposed in 1886 as a protectionist measure for dairy interests, were removed in 1950, but a law outlawing the sale of oleo in its colored form lasted until 1967 in Wisconsin.

As with regulation, political activities carry both benefits and risks. The risk arises because once government intervention in an issue on behalf of a firm or industry is sought, then political

TABLE 1. Advantages and Disadvantages of Strategies of Institutional Management

Strategy	Advantages	Disadvantages
Merger	Completely absorbs interdependence	Requires resources sufficient to acquire another organization May be proscribed by antitrust laws, or infeasible for other reasons (e.g., a governmental unit cannot be absorbed by a firm)
Joint ventures	Can be used for sharing risks and costs associated with large, or technologically advanced activities Can be used to partially pool resources and coordinate activities	Is available only for certain types of organizations, though less restricted than merger (COMSAT, for instance, brings together government and business)
Cooptation	Relatively inexpensive	May not provide enough coordination or linkage between organizations to ensure performance Coopted person may loose credibility in original organization
Personnel movement	Relatively inexpensive Almost universally possible	Person loses identification with original organization, lessening influence there Linkage is based on knowledge and familiarity, and on a few persons at most, not on basic structural relationships
Regulation	Enables organization to benefit from the coercive power of the government	Regulation may be used to harm the organization's interests
Political activity	Enables organization to use government to modify and enhance environment	Government intervention, once legitimated, may be used against the organization as well as for its benefit

intervention becomes legitimated, regardless of whose interests are helped or hurt. The firm that seeks favorable tax legislation runs the risk of creating a setting in which it is equally legitimate to be exposed to very unfavorable legislation. After an issue is opened to government intervention, neither side will find it easy to claim that further government action is illegitimate.

In learning to cope with a particular institutional environment, the firm may be unprepared for new uncertainities caused by the change of fundamental institutional relationships, including the opening of price competition, new entry and the lack of protection from overseas competition.

Conclusion

The institutional function of management involves managing the organization's relationships with other organizations. Table 1 presents strategies of institutional management with their principal advantages and disadvantages. From observation of organizational activities, the most common response to interdependence with external organizations seems to be the attempt to develop some form of interorganizational linkage to ensure the continuation of favorable relationships with important organizations in the environment.

All such interfirm linkages have costs, with the most fundamental being the loss of the organization's autonomy. In return for the certainty that one's competitors will not engage in predatory price cutting, one must provide assurances about one's own behavior. For example, cooptation involves the possibility of acquiring the support of an external organization, but at the same time the firm gives up some degree of privacy over its internal information and some control over its operations and decisions.

Variables affecting responses to the organization's environment can be specified. Actions taken to manage interdependencies are related to the extent of the interdependence and its importance to the organization. The response to competitive interdependence is related to measures of industry structure, and particularly to the necessity and feasibility of developing informal, interorganizational structures. Two important issues remain. First, is effective institutional management associated with favorable outcomes to the organization? Second, given the importance of institutional management, why are some organizations more successful than others at this task?

The effect of institutional management on firm performance is difficult to measure, and seldom has been examined. To examine the effect of successful institutional management, an outcome measure is needed. Profit is only one possibility, because there is evidence that the reduction of uncertainty may be sought regardless of its effect on profit (5). Whatever criterion is chosen is affected by many factors. To attribute a result to institutional management, other causes must be controlled. Nevertheless, institutional management receives a great deal of management attention in some firms and a firm's interorganizational relationships may be important to its success and survival.

Of even more fundamental interest is the question of why some firms are able to develop more effective strategic responses to their institutional environments. It is possible that effective institutional management requires fundamentally different structures of top management, or the development of excess managerial capacity, or the development of particular types of information systems. It is easier to find successful institutional management than to identify critical variables enabling it to develop in the first place. For example, some universities have better relationships with their state legislatures than do others. It is possible to retrospectively infer explanations as to why this is so. What remains to be done is to explain those factors that could be designed into an organization initially to ensure effective institutional management in the future.

Considering its probable importance to the firm, the institutional function of management has received much less concern than it warrants. It is time that this aspect of management receives the systematic attention long reserved for motivational and productivity problems associated with relationships between management and workers.

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