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# Institutions and dynamic capabilities: Theoretical insights and research agenda for strategic entrepreneurship

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## 1. Introduction

Institutional approach (IA) and dynamic capabilities approach (DCA) have become popular lines of theorizing in management research (Peng et al., 2009; Teece, 2014), each offering valuable insights. Each approach discretely offers rather solid explanations to firm structure, behavior, and performance (Peng et al., 2009; Teece, 2007). However, they fall short of fully reflecting the multifaceted nature of management and strategy phenomena. For example, DCA views competitive advantage as a function of dynamic capabilities (DCs) especially in dynamic environments (Teece, 2007), but often overlooks the circumstances that DCs are conditioned and bounded (Barreto, 2010). Conventional theorization in IA that are often followed by mainstream empirical research posits that institutions provide meaning, structure, and template to social behavior and shape how firms behave (DiMaggio & Powell, 1983; Hasselbladh & Kallinikos, 2000; Meyer & Rowan, 1977; Peng & Khoury, 2008). However, it underplays capabilities that enable agency for creating disequilibrium and transforming business ecosystems (Teece, 2014). Researchers typically choose one approach over the other (Wright et al., 2005), resulting in fragmented insights and incomplete explanations. Even in cases of paired adoption (e.g., Wu, 2013), they often treat the two approaches independently without an involved interaction in their frameworks.

In the strategy and entrepreneurship literature, IA and DCA remain relatively engulfed, and both of them fall short of offering a fuller understanding of strategic entrepreneurship as a holistic capability-driven phenomenon embedded in its context (Lessard, Teece, & Leih, 2016). These two approaches inadvertently feed the enduring structure vs. agency debate (Heugens & Lander, 2009). Unwarranted negligence of the interplay between institutions and DCs could lead to incomplete and even inconsistent explanations (Barreto, 2010; Heugens & Lander, 2009).

Earlier researchers have been on a pursuit for theories to facilitate the study of strategic entrepreneurship (Alvarez, Audretsch, & Link, 2016), and acknowledged the benefits of bridging different perspectives

in doing so (Welter, Mauer, & Wuebker, 2016). Therefore, our study is an attempt to answer this call. The central yet overlooked void in the literature is the analysis of these two approaches jointly to bridge the divide between them for their fruitful application in strategic entrepreneurship. How DCs as a key entrepreneurial attribute co-evolve with institutions as contexts that entrepreneurs populate and what underlies the interaction between them are still largely unknown (Lawrence, Suddaby, & Leca, 2011). The need for a synthesized application of IA and DCA is highlighted by the complementary perspectives these two theoretical approaches offer to strategic entrepreneurship. Their synthesized application can help advance strategic entrepreneurship from its disparate and rather incoherent state (Burg & Romme, 2014; Kiss et al., 2011) and address the relevant phenomena more realistically and inclusively.

The purpose of this study is to provide a ground for a synthesis of institutional and dynamic capabilities approaches and develop a foundational research agenda on issues related to strategic entrepreneurship that could better be explained by such synthesis. This study lays the ground for a synthesized adoption of the two approaches for management research. In doing so, our paper takes insights from both neo-institutional theory and new institutional economics strands of IA in context of strategic entrepreneurship, as researchers focusing on IA have been influenced by debate between these complementary strands and followed insights from both strands in their theorization and empirical testing (e.g., Peng & Khoury, 2008; Peng et al., 2009).

Our paper contributes to theory by a) developing an understanding of the interplay between institutions and DCs; b) bridging the divide between IA and DCA that follow different theoretical paradigms, have different foci, and are underlined by different sets of assumptions; and c) developing a research agenda for strategic entrepreneurship linked to better understanding of issues like agency, behavior, performance, and structure in context of strategic entrepreneurship. Although the two focal approaches are distinct, they are inextricably intertwined, and they have the potential to inform each other. While IA can explain how DCs are conditioned within and by institutions, DCA can explain

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enabling elements of socioeconomic entities actively engaging with institutions. Viewed together, their explanations of relevant issues are complementary. Thus, insights gained through the synthesized adoption of IA and DCA are expected to lead to rich, and generative theorizing enhancing understanding of strategic entrepreneurship phenomenon.

## 2. Theoretical background

The foci of strategic entrepreneurship are wide-ranging and diverse, drawing on research from multiple disciplines such as economics and sociology, together with research fields in management including organizational behavior and organization theory (Hitt et al., 2011). Simply referring to entrepreneurial activities with a strategic approach, the strategic entrepreneurship phenomenon is naturally theorized and examined at the intersection of strategic management and entrepreneurship and informed by theories adopted in these fields (Alvarez et al., 2016).

There are strong, intricate, and multifaceted connections between entrepreneurship as a research field and IA and DCA as theoretical approaches as inputs, processes, and outcomes of strategic entrepreneurship involve DCs and institutions (Hitt et al., 2011). IA and DCA are found to be two of the important lines of theorizing entrepreneurship research follows (Kiss et al., 2011). Actions are a manifestation of capabilities, and enterprises are a collection of capabilities. Thus, DCs are pivotal in underlying and defining entrepreneurial actions (Tece, 2014). At the same time, entrepreneurial and strategic behaviors are embedded in and shaped by the context in which they occur (Schriber, 2016; Welter & Smallbone, 2011). The instrumental relevance of IA for strategic entrepreneurship resides in IA being one of the strongest theoretical approaches in explaining external (contextual) influences on socioeconomic behavior (Hoskisson et al., 2013; Peng et al., 2009). Accordingly, both approaches explain important influences on firm behavior and outcomes (Peng et al., 2009; Tece, 2007) and comprise important place for strategic entrepreneurship decisions and can be utilized for explaining various issues and questions within this domain.

In this section, we briefly explain the core premises of IA and DCA and the core concepts examined via these approaches i.e., institutions and DCs respectively. Then, we include the relevance of IA and DCA for strategic entrepreneurship research. Both theoretical approaches have generated substantial literature, and these approaches are not always consistent internally with respect to definitions of constructs, behavioral assumptions, and even the units of analysis. We offer a concisely stated base of the two approaches for their synthesis by drawing on the *mainstream body of work in each approach* rather than providing an exhaustive review of these approaches and accounting for the divergences in each approach.

### 2.1. Institutions and limitations of institutional approach

Institutions are taken-for-granted, culturally-embedded “rules of the game”, which constrain, shape, and enable social and economic activity (DiMaggio & Powell, 1983; North, 1990). They are the sum of a consistent and frequent pattern of social behaviors that majority performs. They are, in a way socially constructed “reality” of life, as human existence takes place in a context of order, direction, stability (Berger & Luckmann, 1967). Institutions provide order to social and economic life (Metcalf, 2001), and diffuse their influence through coercive, normative and mimetic mechanisms (DiMaggio & Powell, 1983). Thus, the concept of institutions is used to understand how and why firms and other socio-economic entities attend, and attach meaning, to some elements of their institutional fields (Suddaby, 2010). Institutional theorists suggest that values, norms, and organizational templates often exist outside of firms but influence the way in which firms are structured and managed (Meyer & Rowan, 1977). Institutions

constitute the ground that both underpins and shapes (controls, constrains, and structures) entrepreneurship. They help account for the role of external environment in entrepreneurial behavior (Welter & Smallbone, 2011), leading to a greater understanding of entrepreneurship phenomena in the context in which it occurs.

IA has two major strands, namely “new institutional economics (NIE)” and sociology-oriented “neo-institutional theory”. These strands share similar views of institutions as socially constructed rules and behavioral systems that are accepted by the majority (Berger & Luckmann, 1967; DiMaggio & Powell, 1983; North, 1990). Likewise, central assumptions and the core tenets of these strands of IA are similar or comparable. However, these two strands have produced somewhat divergent definitions of some shared constructs and often focused on different units of analysis over time. In particular, while NIE has tended to focus on macro-level forces that influence economic decision-making and behavior (Acemoglu et al., 2003; Boschma & Capone, 2015; North, 1990), neo-institutional theory has often focused on social and organizational fields as domains of institutions (DiMaggio & Powell, 1983; Hasselbladh & Kallinikos, 2000; Scott, 2001). Still, they offer complementary insights into the subject matter of this study, because macro-level institutions and organizational fields are reflected in each other’s domain. Researchers have referred to using insights from both strands as being expected due to multidisciplinary nature of strategy research (Peng & Khoury, 2008; Peng et al., 2009). In the current paper, we use insights from neo-institutional theory, NIE, and institutional entrepreneurship, when synthesizing IA and DCA to make best and holistic use of their body of knowledge across research domains to advance the understanding of strategic entrepreneurship.

IA and its economics and sociology-rooted strands have evolved further over the last decades (e.g., Seo & Creed, 2002) and increasingly recognized the role of agency and institutional entrepreneurship in shaping institutions (Garud, Hardy, & Maguire, 2007; Greenwood & Suddaby, 2006; Kiss et al., 2011). However, most empirical applications of IA in business fields adhere to the dominant view of IA that emphasizes the conventional understanding (i.e., an understanding and empirical applications that follow widely accepted assumptions and arguments sown by early seminal works of influential institutional theorists) of institutions (Li et al., 2010), which we primarily follow when discussing the core tenets of IA. In turn, particularly conventional theorization in IA has limitations in explaining management issues (Pernkopf-Konhäusner, 2014; Suddaby, 2010). Seo and Creed (2002) illustrate the innate paradoxes of conventional IA. They explain how seeking legitimacy often undermines efficiency and creativity; adaptation to institutional demands frequently hinders adaptability to other changing requirements; and isomorphism conflicts with divergent interests of endogenous and exogenous actors (Seo & Creed, 2002). Conventional streams of IA have understudied the issues of how socioeconomic actors proactively engage with institutional complexity (Pernkopf-Konhäusner, 2014), how situated forms of organizing are linked with wider instrumental beliefs and practices (Hasselbladh & Kallinikos, 2000), how institutional differences across various contexts are explained, and what role diverse stakeholders within and across institutional systems play (Wood, Dibben, & Ogdén, 2014).

IA has inherently adopted a conformist perspective on socioeconomic behavior, and entrepreneurial approaches to relevant phenomena have until recently been muted in the institutional line of theorizing (Willmott, 2014). Conventional IA explains the persistence and homogeneity of phenomena; assumes equilibrium, similarity, and legitimacy imperative for survival; and downplays actorhood, leadership, learning, and capabilities (Kostova, Roth, & Dacin, 2008; Pernkopf-Konhäusner, 2014; Seo & Creed, 2002; Tece, 2014). Based on these limitations, strategic entrepreneurship could be confined into a specified framework under the strong presence and tight influence of institutions due to their regulative pressures and normative requirements in seeking order and reality construction. As, reality construction

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