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Strategy and the Institutional Envelope

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Abstract. Classical approaches to strategy are built around two dominant pillars to explain firm performance: industry structure and firm strategy and capabilities. Firm performance is typically seen as a result of a "fit," or complementarity, between industry structure and firm strategic choices. We supplement the classical model of strategy with a third pillar, that of the *institutional envelope*. We argue that the institutional envelope, as its name suggests, is a pervasive influence on the strategy-performance relationship. Both firm strategy and industry structure are simultaneously shaped by, and shape, the institutional envelope, which is both a primitive to and product of firm strategy and industry structure. It also moderates the relationship between firm strategy and industry structure.

Institutional considerations are therefore not simply a subfield of strategy research. The institutional envelope is a critical component of any consideration of strategy. Theories of industry structure and strategic choice are insufficient without a fully formed model of the institutional envelope at their very foundation. All strategies, market or non-market, are consciously or unconsciously related to their institutional envelope—being tailored to conform to the institutional envelope or tailoring the institutional envelope to suit them. We see this institutional project that we are advancing as nothing less than the third great wave of strategy research, building off the previous waves emphasizing industry structure and firm choice and resources. It is in the context of this *institutions-based strategy* model that we preview the papers in the special issue.

Keywords: institutional theory • nonmarket strategies • industry analysis • resource-based approaches • competitive strategy • ecosystems • transactions costs • theory of the firm • international business

Classical approaches to strategy are built around two dominant pillars to explain firm performance. First, industry structure has been persuasively argued as a key predictor of firm performance. Based on the "structure conduct performance" paradigm of industrial organization economics and popularized in strategy research by Michael Porter (1980), this first pillar explains performance variations across firms by structural elements of the industry such as the presence of barriers to entry. Second, a number of alternative perspectives emphasize individual firm heterogeneity as a key driver of performance. These firm-centered perspectives include theories of competitive positioning and firm boundaries that follow from the industrial organization tradition and theories of firm performance being driven by firms' access to and development of key resources.

Together, firm performance in the classical approach is typically seen as a result of a "fit," or complementarity, between industry structure and firm strategic choices (see Figure 1). Although this characterization is an oversimplification of the very rich research heritage of the strategy field, we adopt it purely to set up our perspective underlying this special issue and highlight what we perceive to be an under-emphasis of a set of predictors of firm performance that may be far more substantial than they are typically assumed to be.

Against this backdrop, we position this special issue, and the broader stream of work informing it, under the label of the "Institutions-Based View" (see Peng et al. 2009, Ahuja and Yayavaram 2011). Broadly speaking, we supplement the classical model of strategy with a third pillar, that of the institutional envelope. We argue that the institutional envelope, as its name suggests, is a pervasive influence on the strategy-performance relationship. Both firm strategy and industry structure are simultaneously shaped by, and shape, the institutional envelope. Hence, in a sense, the institutional envelope is both a primitive to and product of firm strategy and industry structure. Taken together our arguments suggest that Figure 1, which we call the Classical Strategy Model, can be supplanted by Figure 2, the Institutions-Based Strategy Model. As we argue, this re-characterization hopefully draws attention more aggressively to many aspects of the institutions-strategy agenda. Our institutions-based strategy model is consistent with and draws upon past work that has argued for institutions as constituting the third leg of a tripod

Figure 1. (Color online) The Classical Strategy Model

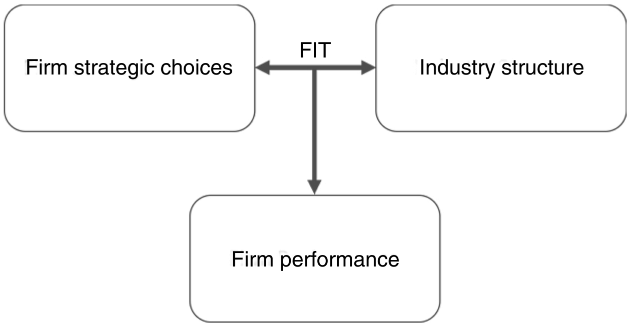
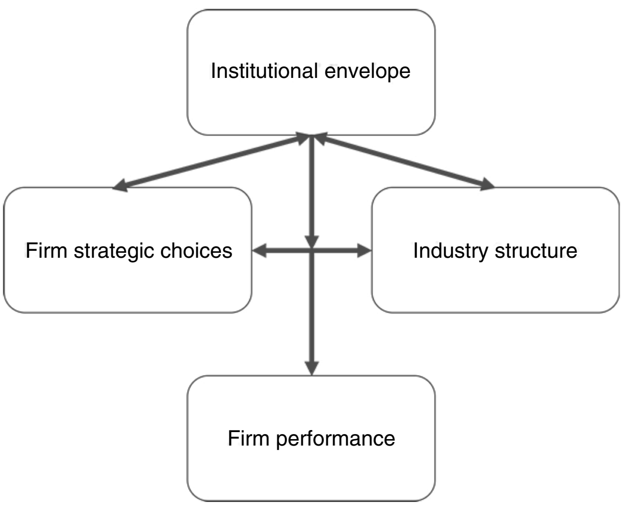


Figure 2. (Color online) The Institutions-Based Strategy Model



for strategy research (e.g., Peng et al. 2009). Our model, however, emphasizes a stronger claim—that institutions, or the institutional envelope more precisely, is more than just the third leg of a tripod, it is in some senses the foundation of the other two legs as well. We elaborate on this claim later.

We define the institutional envelope as the assemblage of formal and informal bodies that govern, facilitate and constrain organizational action and the practices, and the norms and regulations supported by such bodies, to accomplish the achievement of their goals. We conceive of this collection of bodies and their practices as an envelope that surrounds all organizations and influences organizational behavior. In addition to goals specific to individual institutions, a broader objective of institutions and their practices is the development and maintenance of social and economic order. Order, in turn, reduces uncertainty and the costs of transactions facilitating the achievement of organizational objectives. In this sense, the effectiveness of the institutional envelope is integral to organizational performance. The institutional envelope thus, not only shapes organizations and their behavior and strategy, but also their performance.

Several aspects of our definition of the institutional envelope merit attention. First, we note that in this definition, we explicitly include not just physical organizations and institutions, but also the practices, norms and regulations that are spawned and supported by them. As others have noted before (e.g., Ahuja and Yayavaram 2011), an institution can be willed into physical existence; however, its actual practices and norms may not accomplish its formally intended goals. Hence, even filling an "institutional void" (Khanna and Palepu 1997) may not lead to desired outcomes if the actual policies and practices of the institutions are ineffective or policy-practice decoupling occurs (Guillén and Capron 2016).

We see the institutional envelope also as including not just institution-specific practices and norms but general norms of business conduct and interpersonal relationships in a given society. For instance, shared expectations of what constitutes appropriate behavior (e.g., acceptability or unacceptability of bribes, use of official time to conduct personal business) are likely to significantly influence the costs of transacting business. Shared belief in and behavior consistent with the rule of law is clearly an important component of the institutional envelope. However, the institutional envelope also contains many more informal beliefs, traditions and expectations about behaviors that go beyond even inclusive definitions of the rule of law. A tradition among civil servants of taking pride in their work and efficiently delivering services to the citizens may be difficult to encompass within the definition of the rule of law. It can nevertheless be a very real source of competitive advantage for firms operating in such an environment. Similarly, norms about appropriate behavior within families may influence the performance of family-managed firms.

The point is that there remain multiple facilitators or constraints to human and organizational action that extend beyond the rule of law. Such informal institutional realities, be they norms, traditions or shared expectations, retain the ability to influence firm outcomes especially in the context of global competition where competitors may come from different traditions. In our definition of the institutional envelope we include not just institutions, but also the formal and informal facilitators and constraints to action that accompany such institutions and often are dispositive of the effectiveness of such institutions.

A second notable aspect of our definition of the institutional envelope is that we include both formal and informal institutions. Informal institutions such as social networks and industry associations also facilitate order in social and market transactions (Gulati 1995). Indeed, to the extent that development of formal institutions often takes time and is likely contemporaneous with economic development, informal institutions are important key purveyors of order especially in developing nations. This possibility alone suggests that researchers should be cognizant of both formal and informal institutions. Failing to appreciate the role of informal institutions may seriously bias our measurement of the impact of institutions on firm performance. Understanding the effects of the institutional envelope on firms may entail not just understanding the relations between formal and informal institutions and firm behavior and performance but also the relationship *between* formal and informal institutions that can serve as both complements and substitutes to each other. Indeed, formal and informal institutions may conflict with each other (see Eesley et al. 2018).

It is also useful to distinguish the institutional envelope from one of its key components, the institutional infrastructure, defined as the set of resources such as capital, talents, technology, and regulatory framework, that firms need to set up their operations and grow (Gatignon and Capron 2018). Emerging markets are often plagued with severe deficiencies in their institutional infrastructure, constraining development of robust markets and businesses (Khanna and Palepu 2010, Mair et al. 2012). The institutional envelope covers a wider range of institutions including, for example, the network of norms, traditions, and expectations that affect both the quality and effectiveness of the institutions in facilitating or constraining different types of organizational action.

Having identified the institutional envelope as a key construct of interest we now proceed to elaborate upon the various links in this model to establish our case for the importance of institutions and highlight the multiple research opportunities and loci that this institutions-based strategy model encompasses.

The Institutional Envelope and Firm Strategic Choices

The institutional envelope influences firm strategic choices through at least two distinct mechanisms. First, the institutional envelope determines and shapes the strategy space, the set of factors or variables that the firm can strategize about. For instance, in many contexts, bank regulations standardize both deposit and lending rates for all banks, ruling out variations in these rates as a component of competitive strategy. Surge pricing, a key component of the strategy of firms like Uber, exists in the strategy space only as long as civic jurisdictions permit it (Baron 2018). More broadly, through a variety of *regulatory relationships* the institutional envelope shapes or circumscribes the strategy space. This is one of the better studied aspects of the institutions–firm strategy relationship. However, part of our endeavor through this special issue is to highlight that there are many further paths through which the institutional envelope can connect with firm performance.

A second, far less studied, pathway, involving the institutional infrastructure (Gatignon and Capron 2018), is the way that the institutional envelope influences the *resources available* for executing the strategies made possible through the strategy space. Providing a highly differentiated experience may be a great strategy for a hotel in a competitive market. However, whether such differentiation can be created in the guest experience depends upon the availability of sufficient educated and trained staffers who can provide the service. To the extent that local school systems fail to educate and provide skilled labor such a strategy cannot be executed even if it is possible given the strategy space.[1] We note that labor markets are frequently underdeveloped in emerging economies because of the difficulties involved in identifying, training, and then retaining talent. Weaknesses in the institutional envelope can thus play a major role in perpetuating a problem that firms would like to solve, but cannot fully do so individually, thus limiting their ability to effectively execute a strategy even when conceptually the strategy is not restricted by the strategy space.

More generally, moving beyond labor markets, we note that lack of formal institutional structures is a key feature of many developing economies. Neither the organizational architectures nor the rules of the game are conducive to establishing strong institutional infrastructure in emerging markets (Mahmood et al. 2011). As a result, firms operating in these environments find it more difficult to foster robust supply chains (Parmigiani and Rivera-Santos 2015), startups (Dutt et al. 2016), innovation (Mahmood and Mitchell 2004), and new products (McDermott et al. 2009). They thus have to deploy extra efforts and resources (e.g., business group affiliations, political activities, interpersonal ties) to develop a viable institutional infrastructure that can support their operations.

Essentially, the institutional envelope determines the behaviors of a variety of constituents that are relevant for a firm to create value. The effectiveness of the rule of law and the attendant and analogous norms that develop around efficiency, honesty, and transparency, sharply affect firm's revenues and costs. Use of rules, too, are backed by mutual understanding regarding broader principles that may have developed between two specific organizations, be accepted by the business community, or come from strong societal cultural norms. Hence, contract provisions are much more extensive in some countries than others, consumers respond differently to revelations of misdeeds of firms, and employees act differently if they anticipate the firm will protect their jobs during economic downturns.

Overall, significantly greater effort has been focused on understanding the implications of the regulatory pathway relative to the resource pathway. A lot of this work comes out of an economics tradition and focuses on the social welfare consequences of regulation. The strategist's interest differs in multiple ways, for instance, in terms of its implications for relative competitive advantage (Capron and Chatain 2008, Oberholzer-Gee and Yao 2018, Baron 2018) and firm strategy more generally (Capron and Guillén 2009). Consider that as regulation expands in its scope to cover more aspects of firm behavior, it may in some cases restrict the strategy space by leaving fewer opportunities for differentiation (see Ahuja and Yayavaram 2011). Conversely, the broadening of the regulatory space may concomitantly expand the strategy space as well, as firms may need to strategize about managing the regulators. For instance, Hillman (2005) showed that firms in more regulated industries had more politicians on their boards, presumably to better manage their dependence on regulators.

It is critical to recognize that the relationship between the institutional envelope and firm strategy is strongly bidirectional (as the arrow in Figure 2 highlights). Just as regulators may attempt to shape or circumscribe the strategy space, firm strategists try to shape or circumscribe the regulatory space. The study of corporate political activity (see Hillman et al. 2004 for a review) has a long tradition in the strategy and international business literatures. Most of this work focuses on identifying factors that make particular strategies more or less successful. Others focus on the effort firms make to influence government (Capron and Chatain 2008). Somewhat independently, a different group of scholars focus on how "nonmarket" institutions are shaped as an outcome of competitive interaction among firms and other interested parties (Baron 2012). This includes "public politics" where individuals, firms, nongovernmental organizations, and the government engage in the process of determining public policy and "private politics" where, for example, firms and nongovernmental organizations such as activist groups interact directly (Baron 2001).

Firms try both to influence the locus of regulatory activity and limit the effectiveness of the practices, norms, and activities of institutions to regulate behavior (Ahuja and Yayavaram 2011). These attempts to manage, or in extreme cases, "capture" regulators have been significantly catalogued in specific industries as well as more broadly in typologies of strategies (e.g., Oliver 1991, Ahuja and Yayavaram 2011). However, such cataloging is perhaps the first stage of understanding this phenomenon. The long-term trade-offs and implications of such strategic behavior remain to be understood. For instance, firms can often be very effective in terms of reducing apparently "heavy-handed" regulation, yet later come to rue their success at this task (Ahuja and Yayavaram 2011). Some would argue that the United States banking sector faced such an outcome with the financial crisis. More generally, though, our understanding of the long-term performance consequences of attempting to influence regulation remain limited. Conversely, our understanding of the ability of institutions to withstand manipulative pressures is also in its infancy. For instance, Guillén and Capron (2016) provide a fascinating study of the role of state capacity in moderating the influences of external actors in policy-practice decoupling.

One conjecture (purely illustrative, to highlight the kinds of questions we could ask) would be that as regulation is reduced significantly, firm financial performance will improve initially but may be subject to extreme shocks (as in the banking sector). Hence, easing regulation may affect not just the first moment of firm performance but also the second. Exploring only the first moment effect may lead to flawed understanding. Further, such outcomes may vary across industries suggesting that the returns to policy capturing may differ sharply in the short- versus the long-run and by industries with different characteristics. What such characteristics are and how they affect the payoffs to institution-influencing behavior and the term-structure of such effects all await illumination from future research.

The Institutional Envelope and Industry Structure

In addition to its effects on firm strategic choices and its own shaping by firm strategic actions, there is also a bidirectional relationship between the institutional envelope and industry structure. The institutional envelope can directly address industry concentration, the height of barriers to entry, and the relative power balance between the firm and its buyers, suppliers, and complementors. Perhaps most foundationally, the institutional envelope determines the size and very existence of an industry. In extreme cases, certain markets may simply fail to exist because weaknesses in the institutional envelope leave the transaction costs too high for the market to emerge or be worth serving.

A classic illustration of this is provided by the Indian home-mortgage market that, for years, simply did not exist in substantive terms (Khanna 2017). Because eviction through Indian courts could take decades, a defaulting debtor could safely live in the home for years, sometimes even decades, after defaulting. Since the typical mortgage lasts 15–20 years, taking the loan and immediately defaulting on it would be an effective strategy for borrowers to live at low cost. Recognizing this possibility, banks would naturally not offer home loans—which indeed was the situation in India until fairly recently (see Khanna 2017 for details). In turn, the absence of a home loan market would impact the size and activity for not just the home-mortgage market but also the markets for a variety of products that were complementary to home loans such as construction and building materials.

The effects of the institutional envelope on market structure are too numerous to be detailed exhaustively here. Indeed, institutions can influence scale economies (e.g., antitrust enforcement, local content laws), product differentiation (e.g., trademark and patent protection), cost structure (e.g., labor laws), and even the experience curve (political incentives to produce in separate locations). Most obviously, regulatory institutions can create barriers to entry. Additionally, in many contexts, industrial policy often favors small enterprises over large ones in many respects limiting the development of scale economies.

The institutional envelope can impact technology choice and innovation within and between industry sectors (Anton and Yao 1994, 2002). In the United States, government subsidies for the adoption of renewable energy generation technology such as solar panels and wind turbines have helped support investment in these technologies in the face of competing technologies such as natural gas turbines. At the same time, government policies with respect to the ability, ease, and cost of extracting natural gas have positively impacted the relative cost effectiveness of natural gas turbines. Intellectual property protection rules have a huge impact on the ability of firms to prevent entry and the incentives for firms to invest in innovation in the first place.

Equally interesting and important are the ways that industry structure affects the institutional envelope. For example, concentrated industries may be more likely to attract regulatory interest. The effectiveness of nonmarket strategies to influence regulators and institutions may differ sharply between countries where lobbying is open but regulated versus countries in which it is largely undercover. In the latter, concentration may facilitate easier organization of influence efforts and enable the industry to generate a greater surplus that would be available for rent-seeking by regulators. The concentrated industry can hold prices above normal and generate a surplus, which can be shared with regulators far more efficiently than if the regulators tried to organize piecemeal rent extraction through small bribes from a fragmented industry of many small players (Ahuja and Yayavaram 2011).

Similarly, the relative power among vertically connected industries may determine each sector's ability to influence the institutional envelope. For instance, in the United States, a recent decision to impose tariffs on steel and aluminum provided protection to those upstream industries but at a cost to their many downstream industry buyers that would see their cost of production rise. Similarly, consumer protection standards differ sharply across the United States and the European Union in a variety of industries. More deeply understanding the systematic effects of relative power in vertically connected industries on the institutional envelope would be another domain worthy of further research.

Industries may not just attempt to influence existing institutions in their institutional envelope, they may also actively create their own new institutions through mechanisms both formal (Lenox and Nash 2003, King and Lenox 2000, King et al. 2005) and informal (Gulati 1995, Granovetter 1985, Polidoro et al. 2011). Trade associations and other collaborative organizations can serve to not only lobby government policy, but to enact structures that "self-regulate" an industry (King and Lenox 2000). Codes of conduct, industry standards, and product labels are just some of the ways that industry players can construct their institutional envelope creating winners and losers.

Industries may also foster order by informal strengthening of the institutional envelope. Dense social networks within an industry can provide a platform that strengthens governance of market transactions for actors within the network (Uzzi 1996). Social pressure, ostracism, and norms serve as vital control mechanisms that smooth the task of commerce. In a classic example, New England lobstermen enforced norms limiting over-fishing by collectively threatening offended parties (Ostrom 1990). Yet, the exploration of such social structural informal institutions has been relatively limited. Although in the context of alliance networks there is a fair amount of usage of the notion of embeddedness and its economic benefits, relatively little research has actually focused on the pros and cons of social structural institutions and the conditions under which they are born, are most effective, and collapse.

The Institutional Envelope as a Moderator of the Firm Strategy-Industry Structure Relationship

The institutional envelope does more than just influence firm performance through its direct shaping of firm strategy and industry structure. Its influence is far more pervasive as it moderates the *relationship* between firm strategy and industry structure. The same firm strategy can have very different performance outcomes under different institutional regimes. For example, in an institutional context where expropriation is easy and dispute resolution difficult or expensive, vertical integration is more attractive than in a context where institutions provide better safeguards. Similarly, the ability to contract effectively in either vertical or horizontal domains and the need to protect against expropriation (Anton and Yao 1995) may shape both firm boundaries and the very nature of an industry—for instance its size distribution.

The moderating influence of the institutional envelope on the fit between firm strategy and industry structure is most easily observed across variations in institutional context such as those across nations. The international business arena provides a great opportunity for natural experiments and learning through institutional contrasts (Marquis and Raynard 2015). For instance, corporate scope-changing decisions (such as mergers and acquisitions (M&As), restructuring) have been found to be influenced by the country's governance institutions. Countries fall at some point along a continuum defined by two major types: liberal-market economies and coordinated-market economies. In liberal-market economies, shareholder rights are highly protected (La Porta et al. 1999) and labor relations are characterized by open-market relationships, increasing likelihood of M&A activity and asset restructuring. Using an international sample, Atanassov and Kim (2009) found that the ability of shareholders to force value-enhancing measures on poorly performing firms varies with the degree of shareholder protection. Schneper and Guillén (2004) found that hostile takeovers increase in frequency with the extent to which shareholder rights are protected.

While mature economies typically have better developed institutions to support economic and business activity than less mature economies, those "mature" institutions are frequently far from ideal. They arise from political and social processes, balance multiple objectives, are path dependent, and, of course, confront difficult and often changing problems. Even in mature Western economies there are many contexts in which informational asymmetries, uncertainty, and incomplete contracts contribute to ill-structured institutional envelopes and the attendant institutional weakness.

In such demanding situations, one would expect that many institutions would be subject to ongoing pressures for change, a situation that heightens the importance of understanding not just the static but the dynamic relationships among the institutional envelope, firms, and other societal players. To be sure, some institutions are more immutable in the medium term than others (see, e.g., Eesley et al. 2018), but when institutions that bear on a firm's activities are mutable, achieving and sustaining competitive advantage may depend on a firm or industry's success in the nonmarket arena.

Consider, for example, the institutions for protecting patents, trademarks, and trade secrets that create incentives for invention and commercialization as well as support markets for the sale of ideas (Anton and Yao 1994, 2002) and technologies (Arora et al. 2001). One can think of these regulatory institutions as widening the scope of a firm's economically feasible strategy space. For example, intellectual property right protection makes it easier for a firm to exploit its inventions through licensing or sale rather than commercializing its invention itself.

When new technology categories develop, a combination of the legislative, administrative, and legal systems influence whether and to what extent these technologies are protected. In the intellectual property area, countries may have somewhat similar laws, say regarding patents, but have quite different levels of enforcement both in terms of timing and outcomes. The uncertainty, timing, and resolution of disputes lead firms to engage in a range of actions from building patent "thickets" (Shapiro 2001) to strategically delaying a dispute resolution to defensive publishing. These more immediate intellectual property concerns, in turn, have ramifications for one's willingness to locate R&D clusters (Alcacer and Chung 2007), or engage in technology sales, and strategic alliances, and can affect the incentives to exploit inventions within a firm or through a startup (Anton and Yao 1995).

A Call to Arms

We recognize that most strategy scholars, at some instinctive or intellectual level, would grant that institutions have a big role to play in firm performance and many would argue that much of what we say here is not surprising. For years, specialized conferences such as the Strategy and the Business Environment Conference and the Alliance for Research in Corporate Sustainability Conference have highlighted the role of institutions on firm strategy. The major professional gatherings in the strategy field, such as the Strategic Management Society and Academy of Management annual gatherings, have also focused on the topic.

Yet, we assert that research in strategy has, nonetheless, underplayed the importance of institutions. When strategy scholars have focused on institutions, it has often been on nonmarket strategies to influence regulators, activists, media, or other influential actors in their environment (Baron 2018). Given the importance and ability of firms to shape the institutional envelope, an "integrated strategy" (Baron 1995) that recognizes the importance and complementarity of both market and nonmarket strategies is an important frontier for strategy research.

Institutional considerations are not simply a subfield of strategy research. We argue that the institutional envelope is a critical component of any consideration of strategy and needs be fundamental to our theories and models. Theories of industry structure and strategic choice are insufficient without a fully formed model of the institutional envelope at their very foundation. As we have hopefully made clear, not only do these various institutional strands of work inform us about the relationship between firm strategic choices and industry structure, they indeed help us understand both firm choices and industry structure itself.

Next, we briefly preview the papers included in this special issue. These fine contributions shed light on several aspects of the framework we developed earlier; however, as can only be expected given the limitations of a single issue, they only touch upon a few parts of that framework. In a sense, our goal of providing the guiding framework was to promote work not just as a follow-on to the papers published here but also to provide a bigger picture to generate possible questions and areas of investigation on the institutions-based strategy research agenda.

The articles in this special issue highlight some promising paths forward on this research agenda. The papers can largely be split into two groups. The first set of articles exploits cross-geography and cross-time variation in institutional envelopes to explore various ways in which the institutional envelope affects firm choice (Nartey et al. 2018, Waguespack et al. 2018) and industry structure (Eesley et al. 2018, Jourdan 2018). In all of the articles, informal structure plays a major role in outcomes. The second set of articles explores how firms make market and nonmarket choices to shape formal institutions that alter the constraints under which market competition occurs. The work here looks at how those choices interact to impact competitive advantage.

Nartey et al. (2018) explore the mechanisms by which engagement with particular types of stakeholders engenders conflict with other stakeholders to the detriment of the focal firm. These mechanisms suggest ways to manage stakeholder choice and conflict to avoid the liability of foreignness. One might think that shaping occurs via the path through which stakeholder relationships develop. However, the choice of which stakeholders to engage, those who provide political clout versus those who provide knowledge, depend on the strength of institutions such as the rule of law. Relating to our earlier discussion of the institutions-based model, Nartey et al. (2018) highlights the idea that the institutional envelope, specifically, the rule of law, can serve as a moderator of firm strategy.

Eesley et al. (2018) provide an explanation for the level of entrepreneurship based on interaction of formal and informal institutions, especially when they conflict. The authors argue that in conflict settings the informal institutions dominate and propose a theory in which the differences in the combination of formal and informal institutions at a country level explain the vibrancy of entrepreneurial activity. This paper focuses upon a key aspect of the institutional envelope—the coexistence of formal and informal institutions. Particularly notable, this is one of the first strategy papers that we are aware of wherein the conflict between formal and informal institutions is explicitly studied and related to economic outcomes. As we noted earlier, our understanding of whether such institutions are substitutes or complements or share a more complex or contingent relationship with firm outcomes is in its infancy. This paper hopefully is in the vanguard of a rich stream of research investigating these relationships.

Jourdan (2018) highlights that the institutional environment may be populated by a diverse set of stakeholders that hold potentially different institutional logics regarding legitimate modes of operating within an industry. Using the French film industry as the context of the study, the author demonstrates how the degree of institutional specialization of film producers shifts as the environment shifts over time. Furthermore, the study finds that firms that are institutional specialists are more likely to survive than firms that are institutional generalists. This result contrasts with work done on market specialization, which finds the opposite result and highlights the importance of studying and understanding mechanisms through which the institutional envelope affects industry structure.

Waguespack et al. (2018) leverage geography-based institutional variation to explore how “home” country institutions culturally imprint on decision makers affecting their strategic choices—in this case, organizational design—even in different institutional environments. This study cleverly avoids many of the complicating empirical problems associated with imprinting studies by studying choice in a virtual world where all participants operate in the same institutional environment. It is found that firms that are created by founders from home countries with more transparent and predictable institutions are more likely to choose less centralized organizational structures in the virtual world. This paper highlights that the institutional envelope includes not only the formal structures based on one’s locus of operation, but the informal structures such as norms and beliefs that may persist across geographies.

In terms of the institutions-based strategy model, the Baron (2018) and Oberholzer-Gee and Yao (2018) articles are concerned with the interactions among the institutional envelope, firm strategic choices, and industry structure. Both of these articles emphasize the bidirectional nature of the relationships between the elements of the model and how these elements are best understood as a system that produces performance outcomes. The focus is on formal regulatory institutions rather than informal institutions.

Baron (2018) builds a formal model of these interactions in the context of initial competition between ride-sharing services and conventional taxi services. Because the regulatory constraints imposed on ride-sharing services are in flux, intense competition between conventional taxis and rider-sharing services takes place simultaneously in both the market and nonmarket arenas. Baron’s analysis offers a disciplined analysis of “dual-purpose” strategies that simultaneously affect both market and nonmarket outcomes and involve tradeoffs between choices that would be optimal absent regulation and choices intended to mitigate future adverse regulation. The paper illustrates the importance of considering market and nonmarket strategies together as an "integrated strategy" rather than as separate strategies.

Oberholzer-Gee and Yao (2018) also offer an integrated strategy perspective on firm performance. Their conceptual framework begins with the insight that market imperfections that allow value capture in the market are also the primary public interest justification for regulatory intervention. Hence, the value capture portion of any strategy may be vulnerable to, and in some cases may even invite, regulatory intervention, which could partially undermine value capture. Thus, anticipating or even shaping these potential regulatory interventions becomes a critical consideration in the choice of market strategy. Oberholzer-Gee and Yao (2018) also note that market imperfections are opportunities for value creation on the part of the firms that, when effective, would also reduce the likelihood of regulatory intervention.

In conclusion, we hope to send a broad message through this special issue that all strategies, market or nonmarket, are consciously or unconsciously related to their institutional envelope—either tailoring the institutional envelope to suit them or tailoring themselves to suit the institutional envelope. Hence, thinking of institutions as being relevant to only nonmarket strategies or creating a distinction between market and nonmarket strategies may be underselling the criticality and centrality of institutions to strategy. We see this institutional project that we are advancing as nothing less than the third great wave of strategy research, building off the previous waves emphasizing industry structure and firm choice and resources.

This special issue was driven by more than a goal to rectify this purported under-emphasis on a fundamental topic in strategy research. It was driven by the nature and importance of institutions in a world that is simultaneously being buffeted by the winds of both globalization and anti-globalization, and in which many institutions are under threat—institutions of unparalleled importance to not just business but civic society more broadly. All around there are signs of the importance of institutions. The financial crisis and the resulting Great Recession and consequent suffering of the public across many countries was a watershed event in highlighting the dangers of overlooking or weakening institutional constraints. The dangers posed by global warming, and attendant concerns about sustainability more broadly, and the worsening inequality of income distributions are some of the many factors that have sparked interest in the issues highlighted in this special issue. It is our fervent hope that this special issue will catalyze further work in this domain. While much research has been done to highlight the interaction between institutions and firm strategy over the past couple decades, many interesting questions remain to be identified and addressed.

Endnote

[1] The discerning reader might argue that the lack of availability of a good education through schools in the previous illustration is really an infrastructural deficiency and that the construct of an institutional envelope is not necessary to explain this illustration. We would disagree for at least two reasons. First, infrastructural spending can create schools and provide books to students; it cannot ensure that the teachers hired show up to work and do a satisfactory job of actually educating the students. That is where norms, traditions, and expectations, the other ingredient of the institutional envelope, come in. In some countries, companies need to invest in remedial education for their employees that officially have degrees but are functionally illiterate. Similarly, toll roads can be built through infrastructural spending; however, whether tolls are honestly collected is an effect of the institutional envelope. Where rule of law is not deeply embedded in the body civic, building toll roads does not ensure toll collections. Second, at a more fundamental level, the question that arises is where do infrastructural deficiencies come from? In many cases there is a prior undermining of the rule of law that limits the provision of capital for such purposes. Such capital constraints may occur in a variety of ways. People may not pay taxes because of a lack of trust in the government's ability to effectively provide infrastructure and the capital markets may not be willing to fund long-term infrastructure projects because investors may not trust the government to credibly live up to its promises. In either case, the infrastructural deficiency is rooted in an institutional deficiency.

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