Chapter 2

RESOLVING THE CONFLICT BETWEEN CONTINGENCY AND INSTITUTIONAL THEORIES OF ORGANIZATIONAL DESIGN

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Abstract: The previous chapter argued that contingency theory and institutional theories lead to prescriptions for organizational design that often conflict. This conflict could pose a dilemma for the organizational designer. However, this chapter demonstrates that the conflict can be resolved. By rendering the outcomes from both the contingency fit and the institutional fit in directly comparable terms, i.e., money, their joint outcome may be found. Thus, the superior fit – contingency fit or institutional fit – can be identified. This gives the overall optimal structure, that is, the meta-fit. Thereby, the organizational designer will usually be able to make a decisive choice.

Key words: Resolving, conflict, contingency, institutional, organizational design, fit, effectiveness, legitimacy, external support.

1. INTRODUCTION

Organizational design is traditionally guided by structural contingency theory (Burton and Obel, 2004; Burton, DeSanctis, and Obel, 2006; Khandwalla, 1977; Donaldson, 2001; Pfeffer, 1982). The previous chapter has argued that institutional theory also has organizational design implications. While fitting the organization to its contingencies (e.g., size, Child, 1975) leads the organization to receive benefits of internal effectiveness, fitting the organization to the requirements of its institutional environment leads the organization to receive the benefits of legitimacy and

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external support (Scott, 1995). Conflict can arise, however, between the organizational design implications of contingency and institutional theories, because institutional theory usually leads to fits with the institutional requirements by structures that are not those that fit the contingencies of the organization (DiMaggio and Powell, 1983). This may seem to prevent rational organizational design. However, the chapter shows that when the different outcomes of contingency and institutional fits can both be valued by a common metric, it is possible to find the optimal design for an organization. While each of the contingency and institutional theories posit different outcomes – internal effectiveness and external support, respectively – from their structural fit, they can sometimes be made comparable by the common metric of money. Then, the relative monetary strengths of contingency fit and institutional fit can be used to find which fit is superior, and so identify which structural design is the most rational for an organization.

Where contingency and institutional fits conflict, the extent to which traditional, contingency theoretical organizational design prescriptions need to be revised depends upon the extent to which the institutional requirement for structure differs from the contingency requirement. This gives the amount of difference between the structure that fits the contingency and the structure that fits the institutional requirement. And the need to revise contingency theory prescriptions depends also on the relative strengths of the contingency and institutional fits on monetary outcomes. This gives which of the differing fits, contingency or institutional, is preferable. The chapter seeks to show that the joint outcome of the two theories can be ascertained by rendering both outcomes in money and calculating their joint monetary effects. The organizational design decision becomes choosing between the fit (contingency or institutional) that produces the best joint outcome. This best overall fit is the meta-fit for the organization.

An implication is that, in certain situations, the optimal design, i.e., meta-fit, is to choose the institutional fit, despite misfitting the contingency. In certain other situations, the meta-fit (i.e., optimal design) is to choose the contingency fit, despite that misfitting the institutional requirements. Which fit type should predominate in organizational design depends upon the relative strength of the outcomes of each fit type. Contingency theory is the more determining of rational organizational designs if the monetary effect of contingency fit is larger than the monetary effect of institutional fit. Conversely, institutional theory is the more determining of rational organizational designs if the monetary effect of institutional fit is larger than the monetary effect of contingency fit. The chapter gives an illustration of a procedure, for valorising the outcomes of each of institutional fit and contingency fit in the common metric of money. This analysis is then used

to find the best overall fit, that is, meta-fit. Thus, while organizational design needs to include institutional considerations that often conflict with contingency considerations, nevertheless, it is possible to identify an organization design that takes account of both considerations.

2. RESOLVING THE CONFLICT FOR ORGANIZATIONAL DESIGN

The fit between structure and contingency maximizes the internal effectiveness of the organization, that is, the ability to achieve the gaols of the organization, e.g., profitability of a business corporation (Child 1975; Donaldson, 1987; Hamilton and Shergill, 1992; Van de Ven and Drazin, 1985). Thus, contingency fit leads to profitability, which, in turn, leads to higher dividends. In contrast, institutional fit maximizes conformity to the model of the organization that is approved by the institutional environment, leading the organization to be seen as legitimate (Parsons, 1961) and to receive external support, such as grants and loans (Meyer and Rowan, 1977; Meyer and Scott, 1983). For instance, a business corporation that has a legitimate structure (Fligstein, 1985) is more likely to win the confidence of investors, so that there is demand for its shares that are, consequently, more highly priced. Thus institutional fit leads to higher share price. Hence, contingency fit and institutional fit lead to the different outcomes of dividend and share price, respectively. Given that both dividend and share price are measured in the same metric, money, they may be rendered directly comparable, so the outcomes of contingency and institutional fits can be directly compared in their value to the organization.

In economics and finance, shareholder value is the objective of the corporation and so this evaluation gives the outcome that is in the best interest of the corporation. From the viewpoint of the shareholder, their shares give them two benefits: the appreciation in share price and the dividends. Both share price and dividends are expressed in money, e.g., dollars, and for a shareholder, a dollar increase in share price is as valuable as a dollar increase in dividends, so that price and dividends are directly comparable benefits.

Let us consider, as the structural aspect for analysis, the structure of the board of directors of a business corporation. The proportion of directors who are non-executive directors, and who are therefore in a position to be independent of, and to provide control over, the management, is subject to differing theories of organizational design. Having a high proportion of non-executive directors conforms to community expectations about vigilant monitors who can act on behalf of shareholders (Kesner and Dalton, 1986),

so that this is the institutional theory fit. In contrast, contingency theory holds that the optimal proportion of non-executive directors is that which fits the contingency variable of need for control of the management (Rogers, 2005). Hence the institutional fit is a high proportion of non-executive directors, whereas the contingency fit varies as to the proportion of non-executive directors. The prescription derived from the institutional theory is that a high proportion of non-executive directors will maximize share price. The prescription derived from contingency theory is that the proportion of non-executive directors that fits the contingency will maximize dividend. Given that both price and dividend are measured in money, and so are directly comparable, we can see whether the monetary value for the organization is greater from institutional or contingency fit.

Suppose that the institutional fit, the majority non-executive board structure, produces a share price gain of $X. For corporations for which a majority non-executive board structure misfits their contingency, the misfit leads to a reduction in dividends of $Y. If the share price gain of $X is greater than the dividend reduction of $Y, then the shareholder will benefit from the corporation having a majority non-executive board. In this case, external support is more valuable than internal effectiveness. Here, institutional fit is more valuable than contingency fit. However, if the share price gain of $X is *less* than the dividend reduction of $Y, then the shareholder would benefit from the corporation moving into fit with the contingency, by adopting a majority executive board. In this case, internal effectiveness is more valuable than external institutional support. Here, contingency fit is more valuable than institutional fit.

In this way, it is possible to calculate the level of structure that yields the most monetary outcome and so identify the optimal structure, the meta-fit. The joint outcome of a structure is the sum of the effects of its degree of contingency fit on internal effectiveness, and of its degree of institutional fit on external support. Whether the meta-fit is the contingency or the institutional fit depends upon the relative monetary effect of the two fits. Where the monetary effect of the contingency fit is greater than that of the institutional fit, then the meta-fit is the contingency fit. Conversely, where the monetary value of the institutional fit is greater than that of the contingency fit, then meta-fit is the institutional fit. Hence, we can find which organizational design is best overall for the organization.

3. ANALYSIS OF CONTINGENCY AND INSTITUTIONAL FITS AND THEIR JOINT OUTCOMES

Let us give a hypothetical example. There are several purposes of this example. Visually representing the differing contingency and institutional fits helps to bring out the contrast between them. This enables an appreciation of the possible divergence of their structural fits. By showing that substantial structural divergences could hold under a range of scenarios, it bolsters the argument that conflict between the contingency and institutional fits is potentially widespread. The example demonstrates that, by valorising both outcomes in money, their joint outcome may be calculated. This, in turn, gives the overall optimum, or meta-fit. Furthermore, it is seen that the meta-fit is usually clear-cut for each organization, in its contingency circumstance, so that rational organizational design would usually have a single prescription.

Let us use as our hypothetical example the structural effects of boards of directors. The structural variable is the proportion of directors who are non-executives (rather than executives) and varies from 20 per cent to 100 per cent, in increments of 20 per cent (see Figure 1). The contingency variable is need for control of the managers by non-executive directors (who are independent of management and hence able to control them). The contingency variable varies from 1 to 5, in increments of 1. The internal effectiveness outcome is produced by the degree of fit of the structural variable to the contingency variable. Fit is attained where the board structure fits the need for control. The greater is the need for control over management by the board, the higher is the required proportion of non-executive directors.

Structure is on the vertical axis, while the contingency is on the horizontal axis (Figure 1). The contingency fit is a line that runs from the origin (structural and contingency variables both zero) diagonally across to the top right hand corner (structural and contingency variables both maximum) (Keller, 1994). The line is at 45 degrees to the horizontal, so that the fit line is defined such that an increase of the contingency variable needs to be fitted by an equally proportionate increase in the structural level. Specifically, for an organization in fit, each increase of one unit in the level of the contingency variable needs an increase of 20 per cent in the non-executive directors to maintain fit. Being anywhere on the fit line produces the highest level of dividend for an organization. Each step away from the fit line is an increase in the degree of misfit and so causes a decline of dividend in dollars.

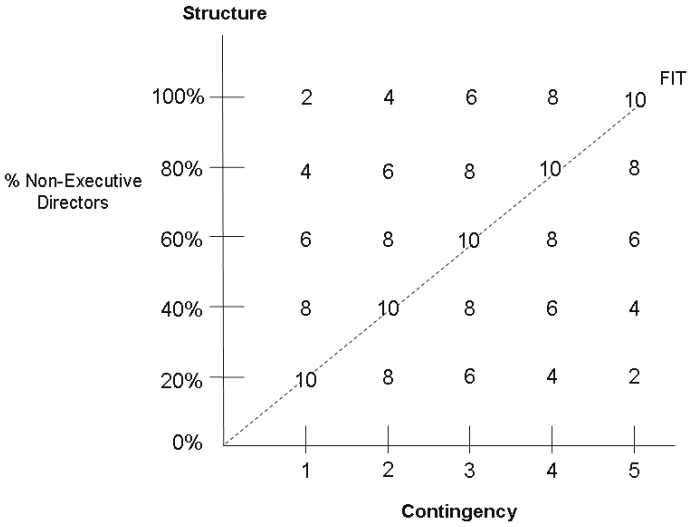


Figure 1. Contingency theory: fit, misfit and internal effectiveness (dividend) – strong effect

The external support outcome is produced by the level of the structural variable, such that each increase of 20 per cent in the proportion of non-executive directors, that is, increase of one degree of institutional fit, produces an increase in the share price of the company in dollars (Figure 2). Therefore, the institutional fit is the maximum structural level. The institutional fits form a line that runs horizontally, because institutional fit is invariant across increasing levels of the contingency variable.

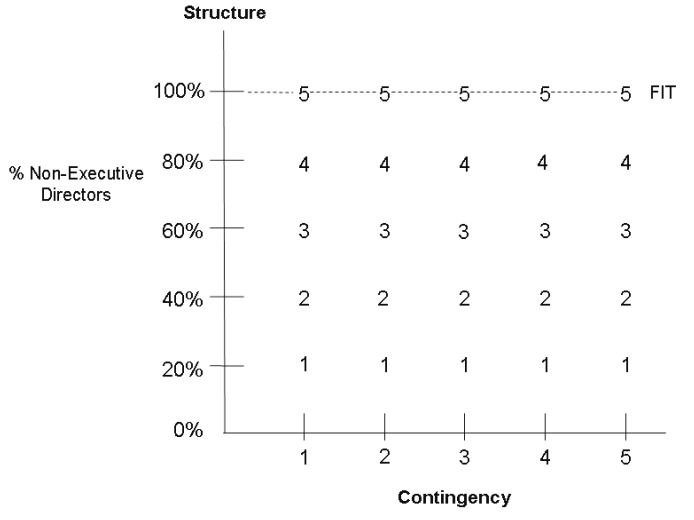


Figure 2. Institutional theory: structure and external support (price) – weak effect

The contingency and institutional theories of fit produce conflicting prescriptions for organizational design. As stated, the contingency fits are on the diagonal (from bottom-left to top-right), whereas the institutional fits are all at the maximum structural level of 100 per cent non-executives. Therefore, the institutional fits tend to diverge from the contingency fits, especially at lower levels of the contingency variable. The lower is the contingency level, the greater is the divergence between the institutional and contingency fits. At the lowest contingency level (1), the institutional fit (100 per cent non-executives) completely conflicts with the contingency fit (20 per cent non-executives). The only exception to this pattern of conflict, is at the highest level of the contingency variable (5), where the contingency fit and institutional fit are the same (maximum) structural level (100 per cent non-executives), so that, in this case, the theories are not in conflict. Overall, for almost all levels of the contingency variable, the contingency and institutional fits diverge, showing that the conflict is widespread. Thus, there is much conflict between the contingency and institutional theories.

These conflicts in structural fits might seem to pose insuperable dilemmas for organizational design, but a resolution may be found by monetarizing each outcome. Then it is possible to identify the optimal design for an organization, that is, to pick either the contingency fit or the institutional fit as giving the superior outcome for the organization. Where the monetary effect of the contingency fit is greater than monetary effect of the institutional fit, then the contingency fit is the optima, that is, the meta-fit for the organization. Where the monetary effect of the institutional fit is greater than monetary effect of the contingency fit, then the institutional fit is the optima, that is, the meta-fit for the organization.

3.1 Monetary Effect of Contingency Fit on Internal Effectiveness Stronger Than Institutional Fit on External Support

Where the monetary effect of contingency fit on dividends is stronger than the monetary effect of institutional fit on price, the optimal organizational design (meta-fit) is to fit the contingency, despite usually being in institutional misfit. For instance, suppose that contingency fit is twice as strong as institutional fit, so that each increase of a degree of contingency fit increases dividend by $2 (Figure 1), whereas each increase of a degree in institutional fit only produces a $1 increase in price (Figure 2). The joint outcome of these two effects is given by the addition of the outcomes – which is shown for each level of the structural and contingency variables in (Figure 3).

For an organization at the lowest level of the contingency variable (1), the highest joint outcome is \$11 (= \$10 dividend plus \$1 price). The point is at contingency level of 1 and structural level of 20 per cent non-executives. It is on the contingency fit line. This is the best overall monetary outcome. Yet it sacrifices \$4, by being in complete institutional misfit – rather than being in institutional fit, which would have given \$5 in price.

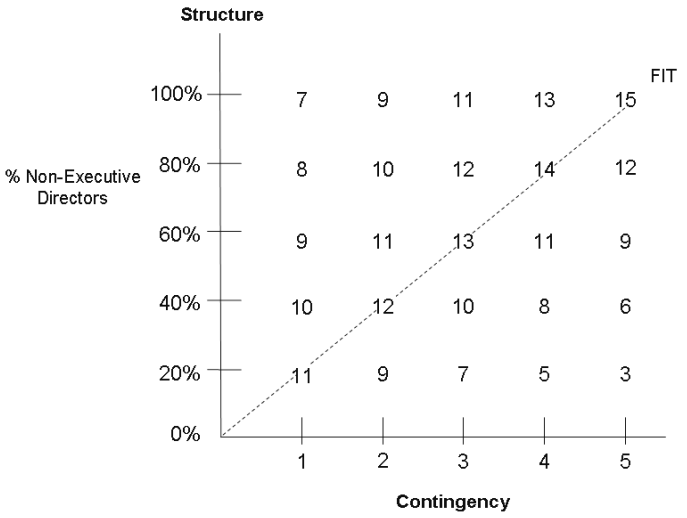


Figure 3. Joint outcomes in money (dollars) where effect of internal effectiveness (dividends) is stronger than effect of external support (price)

Similarly contingency levels 2, 3 and 4, all have as their optimal positions being on the contingency fit line, despite being in degrees of institutional misfit. Contingency level 2 has its best joint outcome of \$12 (= \$10 of dividend plus \$2 of price), at 40 per cent non-executives. This point is on the contingency fit line, but misfits the institutional fit (i.e., 100 per cent non-executives) by 60 per cent of non-executives. The point therefore sacrifices \$3 of price. Similarly, contingency level 3 has its best joint outcome of \$13 (= \$10 of dividend plus \$3 of price), at 60 per cent non-executives. This point is on the contingency fit line, but misfits the institutional fit by 40 per cent of non-executives, and therefore sacrifices \$2 of price. Again, contingency level 4 has its best joint outcome of \$14 (= \$10 of dividend plus \$4 of price), at 80 per cent non-executives. This point is on the contingency fit line, but misfits the institutional fit by 20 per cent of non-executives, and therefore sacrifices \$1 of price. As the contingency level increases, there is a decrease in the amount of difference in the structural

variable (the percentage of non-executives) between the contingency fit and the institutional fit, and so a decrease in the sacrifice of price.

Finally, contingency level 5 has its best joint outcome of \$15 (= \$10 of dividend plus \$5 of price), at 100 per cent non-executives. This point is on the contingency fit line, and is also the institutional fit (i.e., 100 per cent of non-executives), and therefore attains the maximum price of \$5. At contingency level 5, there is no conflict between the contingency fit and the institutional fit, and it is possible to be in both fits simultaneously. This exception apart, there is always a conflict. However, as seen, the conflict can be resolved – by picking the contingency fit rather than the institutional fit. For every level of the contingency variable, there is an optimal fit, that is, a meta-fit, which is the contingency fit.

This analysis illustrates that, despite the usually conflicting prescriptions of contingency and institutional theories, there is always one fit that is the optimum. For each level of the contingency variable, there is an unambiguous, best solution, i.e., the meta-fit. In this scenario, the meta-fits are always the contingency fits and are almost always not the institutional fits. The reason is that, in this scenario, contingency fit is monetarily stronger than institutional fit.

3.2 Monetary Effect of Institutional Fit on External Support Stronger Than Contingency Fit on Internal Effectiveness

Consider the opposite scenario: where the monetary effect of institutional fit (Figure 4), is stronger than the monetary effect of contingency fit (Figure 5). Again, there is widespread conflict between the contingency and institutional theories. The institutional fits are all at the maximum structural level, while the structural fit to the contingency varies by the contingency. The monetary effect of the institutional fit on price is stronger than the monetary effect of the contingency fit on dividends. Therefore, the optimal organizational design, i.e., meta-fit, is to fit the institutional requirement, despite usually being in contingency misfit. In this scenario, the effect of institutional fit on price is monetarily twice as strong as contingency fit on dividend. Each increase in the degree of institutional fit produces a \$2 increase in price (Figure 4), whereas each increase of a degree of contingency fit increases dividend by only \$1 (Figure 5). The joint outcome of these two effects is given by the addition of the outcomes, as shown in Figure 6.

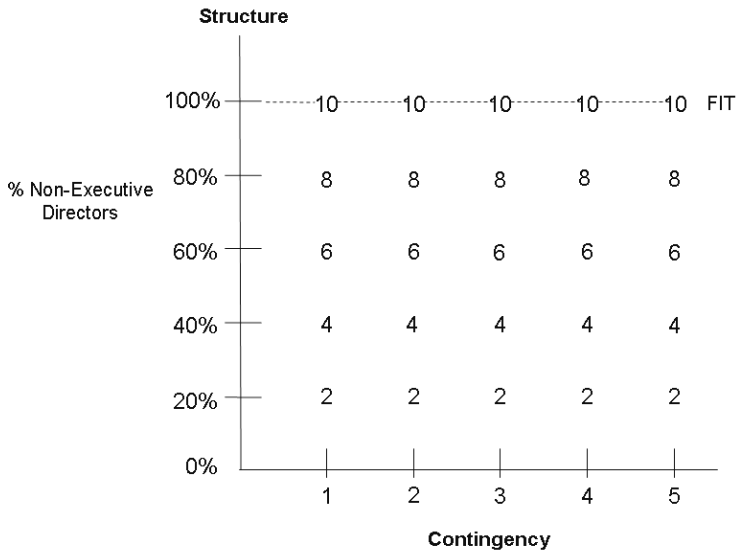


Figure 4. Institutional theory: structure and external support (price) – strong effect

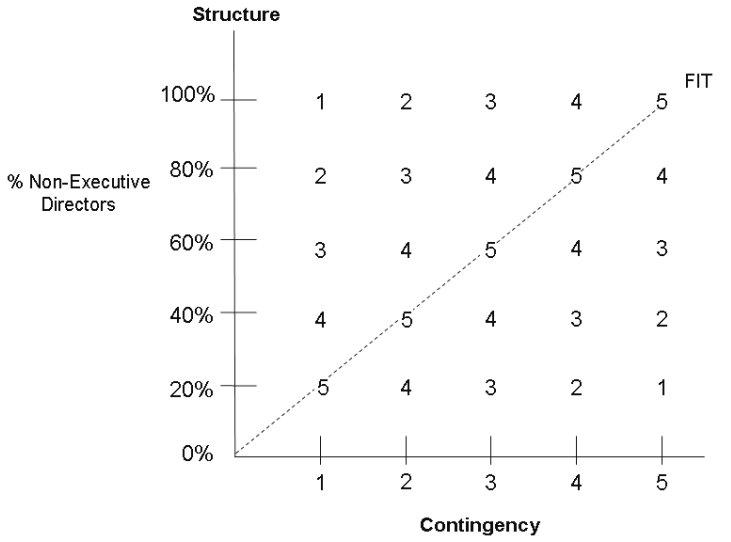


Figure 5. Contingency theory: fit, misfit and internal effectiveness (dividend) – weak effect

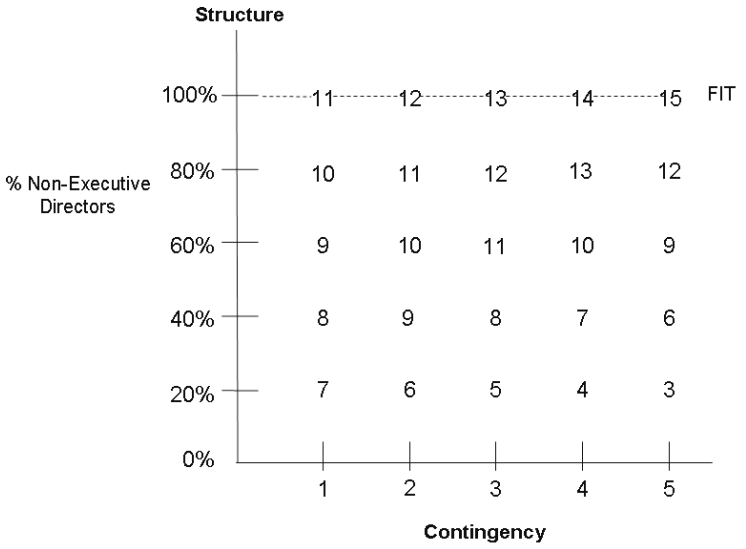


Figure 6. Joint outcomes in money (dollars) where effect of external support (price) is stronger than effect of internal effectiveness (dividends)

For an organization at the lowest level of the contingency variable (1), the highest joint outcome is \$11 (= \$10 price plus \$1 dividend). This comes from being in institutional fit, at the highest structural level (100 per cent non-executives), giving a \$10 price. This entails being in maximum contingency *mis*fit, producing a dividend of only \$1, thereby sacrificing an additional \$4 of dividend that would have occurred had the organization been in contingency fit.

Similarly for contingency levels 2, 3 and 4, the highest joint outcomes, of \$12, \$13 and \$14, respectively, are all produced by being in institutional theory fit, by being at the highest structural level. This always gives a \$10 price, but entails them all also being in contingency misfit, so that each point attains a dividend of only \$2, \$3 or \$4, respectively, thereby sacrificing an additional amount of dividend. The sacrifice is less for each successively higher level of the contingency: being \$3 for contingency level 2, \$2 for contingency level 3, and \$1 for contingency level 4.

For contingency level 5, the meta-fit is again the maximum structural level, yielding the maximum possible joint outcome, of \$15, because it is both the institutional fit (\$10 price) and the contingency fit (\$5 dividend).

Overall, the meta-fits are always the institutional fits – which are almost always not the contingency fits. The reason is that the institutional fit is monetarily stronger than contingency fit. Despite conflict between

institutional and contingency fits, an optimal fit, the meta-fit, can be ascertained for each contingency level.

Note that, for this, like the previous scenario, the conflict between contingency and institutional fits is greater at lower levels of the contingency variable than at higher levels. This is because the structural levels of the fits are more divergent at lower levels. In these scenarios the institutional fit is the highest level of the structural variable. If the institutional fit was at the lowest level of the structural variable, then conflicts would also arise, but they would be greater for the higher levels of the contingency variable.

The overall pattern is that the relative monetary effects of internal effectiveness and external support determine whether a rational organization fits the contingencies or the institutional requirements, respectively. Where internal effectiveness is stronger monetarily than external support, then it is optimal for the organization to move into fit with the contingency, usually at the sacrifice of some degree of external support. Where external support is stronger monetarily than internal effectiveness, then it is optimal for the organization to fit the institutional requirements, although usually sacrificing some internal effectiveness. The key point for organizational design is that there is an optimal fit. This holds wherever one of the two monetary outcomes is stronger than the other.

3.3 Same Strength Effects of Institutional Fit and Contingency Fit

Above, we have established the general position, which is that where internal effectiveness and external support differ in their monetary effects, then it is possible to find an optimal fit by choosing between the contingency and institutional fits to pick the fit that has the stronger effect. However, for completeness, we need to consider also the situation where both have the same monetary effect. This is something of a special case, which is unlikely in practice, and it has odd results. Because the contingency fit and institutional fit effects are equal, they can offset each other, leading to a range of optima that allow choice of structure. The optimal organizational design, i.e., meta-fit, is to fit *either* the contingency *or* the institutional requirement. Thus, there is harmony between the contingency and institutional theories and both give rational organizational designs. Moreover, where the contingency meta-fit and institutional meta-fit diverge in their structural levels, the intervening structural levels are also meta-fits. Hence many meta-fits exist, allowing much choice.

In this scenario, an organization in contingency fit produces a dividend of \$5 and each decrease of one degree of fit decreases the dividend by \$1 (Figure 5). Equally, the institutional effect is that the institutional fit

produces a price of $5 and each decrease in institutional fit of one degree produces a $1 decrease in price (Figure 2).

For the lowest contingency level (1), *any* level of the structural variable produces the maximum joint outcome ($6), as shown in (Figure 7). The reason is that as the structural level increases, the decline in dividend from $5 to $1, from increases in contingency misfit (Figure 5), is completely compensated by the increases in price from $1 to $5, from increasing institutional fit (Figure 2).

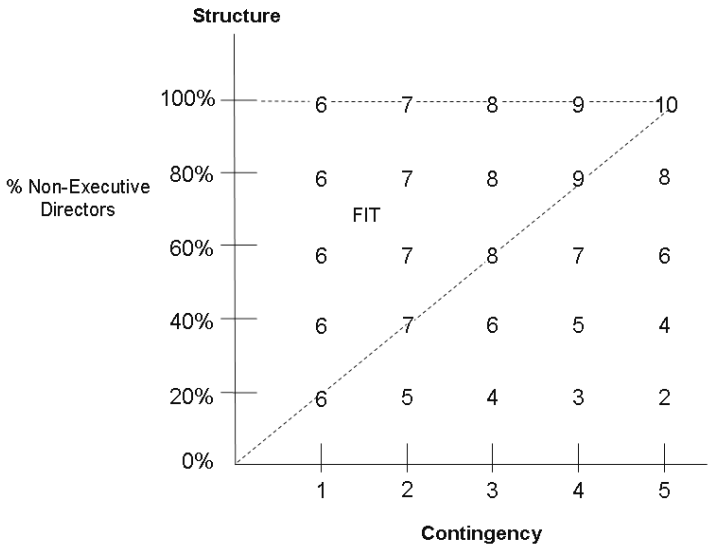


Figure 7. Joint outcomes in money (dollars) where effect of internal effectiveness (dividends) is the same as the effect of external support (price)

Thus, the contingency fit, at 20 per cent non-executive directors, and the institutional fit, at 100 per cent non-executive directors, are both meta-fits. Thus, there is no conflict between the theories. Moreover, the intermediary structural positions (at 40, 60 and 80 per cent non-executive directors) are also meta-fits. Thus, optimal organizational design is not restricted to either the contingency or institutional fits. Hence, here there is equifinality or indifference about level of structure, and the organizational designer could choose any structural level.

Similarly (in Figure 7), for contingency level 2, the contingency fit (40 per cent non-executives) yields the maximum joint outcome, of $7, as does the institutional fit (100 per cent non-executives), and the intermediary structural levels (60 and 80 per cents non-executives). Similarly again, for contingency level 3, the contingency fit yields the maximum joint outcome,

as does the institutional fit, and the intermediary structural level. For contingency level 4, again, the contingency fit and the institutional fit both yield the maximum joint outcome (and there is no intermediary structural level).

Over all the contingency levels, sixty per cent of the points in the contingency-structure space are meta-fits (within their contingency level). Both contingency and institutional fits are always included among the meta-fits. Thus, conflict between the contingency and institutional fits is avoided. For the highest contingency level (5), the optimal position is to have the highest structural level (100 per cent non-executives), which is a contingency fit and also an institutional fit, so that conflict is again avoided. Thus, in this scenario (Figure 7), conflict between contingency and institutional fits is always avoided. However, equality of monetary effects is not likely to be typical.

3.4 Institutional Fit of Intermediate Structural Level

So far, we have treated the institutional effect as being such that the institutional fit, the approved structural model, is the highest level of the structural variable. The relationship between structure and outcome is positive and linear. This is the sort of view implied by institutional theory for Weberian bureaucracy, where the approved model is highly rationalized, in the Western cultural account (Meyer and Scott, 1983). However, other aspects of structure could have different structural levels as their institutional fits. Conceivably, for some aspect of organizational structure, the approved structural model could be at some intermediate level of the structural variable. Thus, we need to consider this possibility.

Again, there would be many conflicts between the contingency and the institutional fits. However, the conflicts are greatest at the extremes of the contingency variable, where the prescribed structures are the most divergent. And, as before, there would a point of harmony between the two theories, but at an intermediate level of the contingency variable.

To explore in detail, consider the following scenario. The institutional fit is at the middle level of the structural variable (60 per cent non-executives) (Figure 8). Thus, the institutional fits are a horizontal line of points at this middle structural level. Once again, the contingency fit is the diagonal line (Figure 5). The horizontal and diagonal lines intersect at the middle level (3) of the contingency variable. Thus, for contingency level 3, the institutional fit is also the contingency fit, so conflict between institutional and contingency fits is avoided.

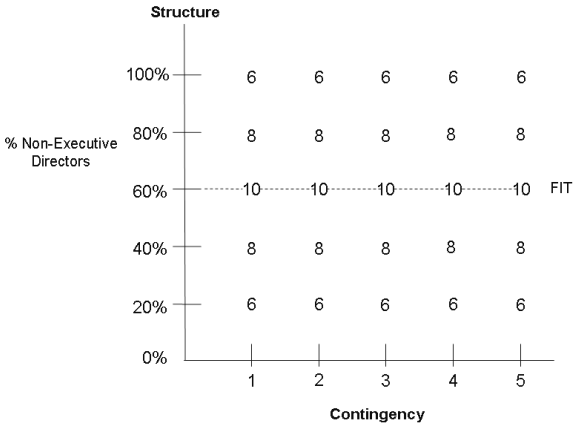


Figure 8. Institutional theory: structure and external support (price) maximum at mid-level of structure

For all other contingency levels (1, 2, 4 and 5) in Figure 8, however, the contingency fit diverges from the institutional fit, so that the fits conflict. The divergence is more so at the extremes of the contingency variable (levels 1 and 5). At contingency level 1, the contingency fit is a structure of 20 per cent non-executives, while the institutional fit (60 per cent non-executives) is a structure of 40 per cent *more* non-executives. Whereas at contingency level 2, there is also divergence, but less so: the contingency fit is a structure of 40 per cent non-executives, while the institutional fit is a structure of only 20 per cent more non-executives than the contingency fit. Similarly, at contingency level 5, the contingency fit is a structure of 100 per cent non-executives, while the institutional fit is a structure of 40 per cent *less* non-executives. Whereas at contingency level 4, there is also divergence, but less so: the contingency fit is a structure of 80 per cent non-executives, while the institutional fit is a structure of 20 per cent less non-executives.

Thus, at almost all contingency levels, the institutional and contingency fits are in conflict, but the conflicts are either side of the middle contingency level. Because the institutional fit is at an intermediate structural level, the conflict between the contingency and institutional fits is greatest at the extremes of the contingency variable. As before, the amount of conflict is a function of the contingency variable, but here it is curvi-linear, not linear. Again, we can resolve the conflict by looking at the joint outcomes to find the optimal fit.

In this scenario, the effect of contingency fit is $5, which decreases by $1 for every degree of misfit (Figure 5), while the effect of institutional fit is $10, which decreases by $2 for every degree of misfit (Figure 8). The joint

outcomes are shown in Figure 9. For each level of the contingency variable, an optimum can be found that yields the maximum joint monetary outcome. Calculating the monetary outcomes allows resolving the conflicts between the contingency and institutional fits for contingency levels 1, 2, 4 and 5. At contingency level 1, the optimal structure produces a joint outcome of \$13 (= \$10 price plus \$3 dividend), at the middle structural level (60 per cent non-executives). At contingency level 2, the optimal structure produces a joint outcome of \$14 (= \$10 price plus \$4 dividend), again at the middle structural level. Similarly, contingency levels 4 and 5 also have their optima at the middle structural level. Thus there is always a meta-fit, with a clear superiority in monetary outcome between the contingency and institutional fits, so that a rational design exists. In this example, the meta-fit is always the institutional fit, usually not the contingency fit, because the monetary effect of institutional fits has been defined as being greater than that of contingency fit.

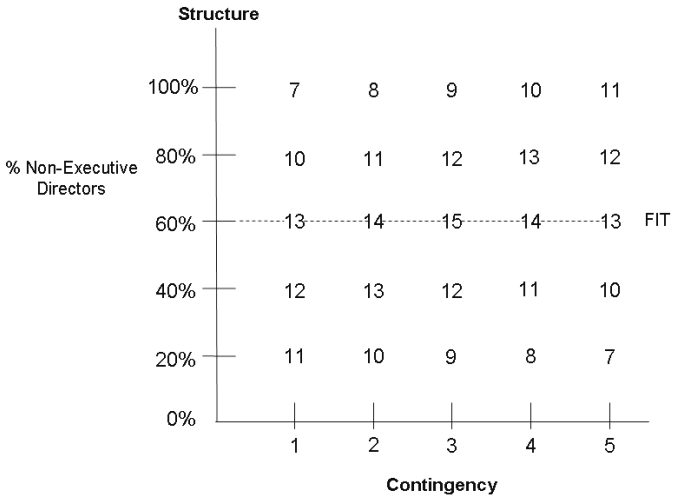


Figure 9. Joint outcomes in money (dollars) where effect of external support (price) is stronger than effect of internal effectiveness (dividends) and maximum external support is at mid-level of structure

In summary, whatever level of the structural variable that constitutes the institutional fit, it will usually be some degree of misfit to the contingency, so that institutional and contingency theory prescriptions conflict. Thus, most organizations will not be able to attain simultaneously the full benefits of external support and internal effectiveness. Nevertheless, if both outcomes can be directly compared in their worth to the organization, the

optimal fit, or meta-fit, can be calculated. Then, a rational organizational designer can choose between attaining institutional fit or contingency fit. Whether the institutional fit or contingency fit is optimal will depend upon their relative strengths, such as monetary benefits. Only in rare cases, where the two outcomes are of equal benefit, will both institutional and contingency fits be equally viable options and so leave the best organizational design ambiguous. Thus, there is the potential that organizational design might be enriched and made more comprehensive, by recognizing the benefits of institutional fits, and, through the use of common metrics, evaluating them along with the benefits of contingency fit, leading to better organizational designs.

Thus far, we have treated the level of a contingency variable as a given, which the organization cannot choose and to which it has to adjust its structure. This accords with traditional treatments of contingencies in the structural contingency literature, and is seen most clearly where the environment is the contingency (e.g., Burns and Stalker, 1961), because most organizations cannot control their environments. Evidence exists that strategy (Chandler, 1962), even though an intra-organizational contingency, is the fixed point to which managers adjust organizational structure (Donaldson, 1987; Hamilton and Shergill, 1992). Moreover, for the organizational size contingency, freedom of choice about it would mean that a small organization could choose to become very large, e.g., to go from a dozen employees, to a hundred thousand employees – which is clearly unrealistic. Environment, strategy and size are some of the most important contingencies of organizational structure, and so if there is limited choice over their levels, this is a significant limitation in choice of contingencies of organizational structure. Regarding board structure, the contingency of need for control over the managers is set by the abilities of the managers and whether their motivations support, or conflict with, the interests of the company. To the degree that managerial ability and motivation are givens, then the board cannot choose the level of the contingency variable. Thus, for some contingencies, organizations will not be able to choose their contingency levels, and so many organizations will have the contingency levels that mean that contingency and institutional fits conflict.

Internal effectiveness is wider than just dividend, and external support is wider than just price. Furthermore, there are other possible evaluative criteria besides shareholder value, and some organizations are not for-profit business firms, so that organizational performance criteria may have to reflect other considerations and other stakeholders. If these criteria can provide metrics for directly comparing the value to the organization of internal effectiveness and external support, then the outcomes from contingency and institutional fits can be compared and the meta-fit selected.

In that way, the method for resolving conflict between contingency and institutional fits that has been suggested herein may be generalized.

4. INFORMING THE THEORY OF ORGANIZATION DESIGN

To date, structural contingency theory is the main theory of organizational design regarding organizational structural aspects. Recently, it has been argued that institutional theory also provides some insight about organizational design. Both theories hold that fitting structures produce outcomes that are beneficial for the organization. However, they differ in the types of outcomes that they theorize. Contingency theory holds that structures that fit the contingencies maximize the internal effectiveness of the organization. Institutional theory holds that structures that fit the institutional environment maximize the legitimacy and external support of the organization. These differences make the theories difficult to directly compare.

A way to make the two theories commensurable, however, is to render their differing effects directly comparable, by finding a common metric to measure them. Both internal effectiveness and external support have monetary effects. Therefore the monetary effect of internal effectiveness and external support can be directly compared, so that their superiority relative to each other can be found. This allows identification of the superiority of either the contingency fit or the institutional fit to be established.

5. INFORMING THE PRACTICE OF ORGANIZATION DESIGN

The conflicting organization design prescriptions from contingency and institutional theory make it difficult to decide whether to choose the contingency fit or the institutional fit. Because the fits from the two theories usually diverge, and so are in conflict, this makes the problem of selecting an optimal design potentially serious. However, by using the common metric of money, the value to an organization of being in contingency fit as contrasted with institutional fit may be directly compared. This allows an organizational designer to pick which fit is best for the organization. Thus there is a clear-cut decision for the organizational designer. This holds in the circumstances where the contingency and institutional fits diverge, which, as

seen, is the typical situation. In the unusual circumstances where the contingency and institutional fits are the same, then no choice is required of the organizational designer, who has only to embrace that fit.

6. CONCLUSIONS

Contingency theory and institutional theories prescribe different fits and predict different effects. Nevertheless, an overall optimal organizational design may be found by comparing quantitatively the benefits from internal effectiveness with those from external support. This gives the structure that is the best overall fit, or meta-fit, for that organization. These points were illustrated hypothetically for companies whose internal effectiveness outcome from contingency fit is dividend and whose external support outcome from institutional fit is share price. An analysis showed that the contingency and institutional fits almost always diverge, so that contingency and institutional theories frequently lead to conflicting prescriptions about organizational design. When, however, the effects of these fits is expressed in a common metric, money, then the optimal overall fit, or meta-fit could be found, facilitating rational organizational design.

In the analysis, if the structural contingency effect on dividend is monetarily stronger than the institutional effect on price, then the meta-fit is the contingency fit. This holds despite there being a degree of institutional misfit and thus sacrifice of some external support (share price). However, if the institutional effect on price is monetarily stronger than the structural contingency effect on dividend, then the meta-fit is the institutional fit. This holds despite there being a degree of contingency misfit and thus sacrifice of some internal effectiveness (dividend). Thus, for each level of the contingency variable, there is always a clear-cut, overall optimal fit, that is, a meta-fit. It is either the contingency or the institutional fit. (In a minority of cases, the contingency fit and the institutional fit are identical.) In the majority of cases, where the contingency and institutional fits conflict, there is a best organizational design that can be recommended to the company. This result holds regardless of whether the institutional fit is at a structural level that is high, middle or low. The exception is where the contingency and institutional fits have the same monetary effects, so that both are optimal designs, which can create a range of equally beneficial structures, rather than a clear-cut preferred structure; however, this is an unusual circumstance that is unlikely to apply to most real organizations.

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