

The Institutional Ecology of Economic and Business Development

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ABSTRACT

The weakness or absence of institutions that facilitate the growth of capitalism in the developing world is an oft-noted, almost offhand, observation among leading theorists in standard economic analysis, development economics, business strategy, and organization theory. The paucity of institutional capital looms largest in the poorest economies of the world and reinforces cycles of poverty, violence, and despair. Ardent calls by scholars, government officials, NGO leaders, and thoughtful executives for institutional change inevitably appear alongside the diagnosis of weak institutions; paradoxically, however, little institutional change occurs, or change occurs in ways that hinder the very development such change is designed to foster. This research addresses a fundamental theoretical question with huge practical impact: Why are weak institutions so strong? Why are poor institutions so intransigent to change?

Drawing from economics and institutional theory I focus on the role of cognitive, normative, and regulatory institutions in the processes of economic development. Regulatory institutions are often portrayed as the “rules” of the game actors play by in society and the referees who enforce those rules. Cognitive and normative institutions define, respectively, the nature of the game and what constitutes winning, losing, fair, and unfair moves. Economists, sociologists, and political scientists all view institutions as creating the foundation for stable social life and economic interaction.

I argue that institutional change follows a fundamentally economic logic; that is, social actors and change agents will engage in institutional change and development so long as the benefits of the proposed changes exceed the social costs of such change. The cost benefit comparison determines the willingness of actors to alter institutional frameworks, but also determines the limit of such changes; actors will engage in change up to the point where benefits equal cost.

I examine three forces that raise the costs of institutional change: Threats to elite power structures, the socially embedded nature of institutional foundations, and the structural dynamics of the process of institutional change. Unless properly managed and controlled these elements work to raise the cost of changing weak institutions above the level of projected benefits. I also identify three “benefit reducers”: Legitimacy concerns, functional substitution among social institutions, and causal ambiguity in determining beneficial impacts. Each of these forces reduces the potential benefits of changing weak institutions, thus contributing to their persistence.

The paper concludes with a discussion of the implications of each of these elements for the design and implementation of system-wide institutional change driven by global or national public policy makers, NGO change agents, and business executives and leaders. In short, these leaders need to consider how the time frame of institutional change will run, with more time devoted to developing legitimacy and consensus around proposed changes before they are announced or implemented. Leaders also need to determine ways to shorten the time lags between the imposition of costs and accrual of benefits surrounding institutional change.