

## **2. THEORETICAL FOUNDATIONS**

Theoretical foundations are crucial in the study of any academic discipline because they provide a structured framework for understanding complex phenomena, guiding both research and practical applications. Theories help organize and connect various concepts within a field, enabling systematic analysis and interpretation of relationships between variables. They also serve as a basis for generating and testing hypotheses, which advances knowledge by allowing scholars to refine or challenge existing ideas. Theories facilitate interdisciplinary connections, enriching the understanding of issues that span multiple fields. Additionally, they establish academic rigor, ensuring that the discipline is grounded in systematic inquiry rather than anecdotal evidence. Furthermore, theoretical foundations foster intellectual debate, providing a platform for critique and discussion that is essential for the continuous development and refinement of the discipline. Without strong theoretical foundations, the systematic development and application of knowledge in any academic field would be significantly impaired. In the following sub-sections, we will review some of the main theories which are used in the study of academic areas related to the fields of IB, IM or CM.

### **2.1. Contingency theory (Balázs Vaszkun and Sára Koczkás)**

#### **2.1.1. Introduction**

Contingency theory has been a cornerstone of organizational studies since its inception in the 1960s (Koczkás, 2024; Vaszkun, 2012). It has offered valuable insights into how organizations adapt to varying environments, emphasizing that there is no one-size-fits-all approach to management. The theory fundamentally argues that the effectiveness of an organization depends on the fit between its internal subsystems (e.g., strategy, structure, behaviour) and the external environment. While its popularity waned in later decades, contingency theory remains a valuable tool for understanding how organizations can optimize their performance in changing environments, and provides a theoretical framework especially useful for comparative management studies. This chapter elaborates on key insights on contingency theory, providing a detailed exploration of its development, key concepts, modern applications, and criticisms.

### **2.1.2. Origins, development and key concepts of contingency theory**

Contingency theory was first developed in the 1960s, with influential work from researchers like Burns and Stalker (1961), or Lawrence and Lorsch (1967) setting the stage for its widespread adoption. These early theorists studied organisations, especially their structural characteristics and their relationship with the external environment. With these early results, they challenged traditional management approaches, such as Taylor's scientific management and Weber's bureaucracy, which sought to identify "the best way" to manage organizations regardless of contextual circumstances (Vaszkun, 2012). Instead, contingency theorists argued that the best management practices depend on the organization's environment and specific situational factors.

As the theory gained traction in the 1970s, it became the dominant paradigm for studying organizations (Burton & Obel, 2018; Volberda et al., 2012). During this period, the theory evolved to include a broader range of contingencies along the external environment, such as intra-organizational context, structure, strategy, organisational behaviour and performance, all interacting with each other (Donaldson, 1987, 2001; Vaszkun, 2012). By the late 20<sup>th</sup> century, contingency theory began to lose some of its prominence as other approaches, such as resource-based theory and institutional theory, gained popularity. However, its core principles remain relevant today, particularly in understanding how organizations can align their internal processes with external demands, and how a particular management system can be compared with another one (e.g. from a different time period or geographical area).

The central premise of contingency theory is that organizational effectiveness is achieved through a proper fit between organizational subsystems (e.g., strategy, structure, behaviour) and the contextual factors. This section will explore the main subsystems addressed by contingency theory and how they contribute to organizational performance.

One of the primary concerns of early contingency theory is the relationship between organizational structure and performance. Theorists like Lawrence and Lorsch argued that there is no universally optimal structure for all organizations; instead, the structure must fit the specific environment in which the organization operates (Lawrence & Lorsch, 1967). Lawrence and Lorsch (1967) focused on how different organizational subsystems interact with the environment. They argued that organizations facing highly uncertain

environments should adopt more flexible structures, such as decentralized decision-making and less formalized processes. Conversely, organizations operating in stable environments could benefit from more centralized structures with formalized rules and procedures. This early work laid the foundation for later research on structural contingency theory. Burton and Obel (2018) built on this foundation by examining the impact of environmental turbulence on organizational structure. They suggested that organizations facing high levels of uncertainty, such as those in rapidly changing industries, should adopt decentralized structures to enable quick decision-making and flexibility. For example, a technology company operating in a fast-paced industry like software development would benefit from a more fluid structure, allowing teams to pivot quickly in response to market changes.

Drazin and Van de Ven (1985) also explored the relationship between structure and performance, emphasizing the importance of specialization, standardization, and hierarchy. Their research showed that organizations with highly specialized and standardized processes tend to perform well in stable environments, where efficiency and predictability are key. On the other hand, organizations with flatter hierarchies and more flexible processes tend to excel in dynamic environments, where the ability to adapt is critical.

Another critical aspect of contingency theory is the role of strategy in aligning organizational subsystems with the external environment. The theory suggests that organizations must adapt their strategies to fit both their internal resources and the external environment. Donaldson (1987, 2001) highlighted the importance of strategic fit, arguing that a well-aligned strategy enables organizations to leverage their strengths while mitigating external threats.

In highly competitive and uncertain environments, organizations must adopt more flexible strategies to remain competitive. Lee and Miller (1996) explored the impact of environmental uncertainty on strategy, finding that organizations facing high levels of uncertainty should adopt flexible, adaptive strategies. For instance, companies operating in volatile markets should prioritize innovation and differentiation, while those in stable markets can focus on efficiency and cost control. Strategic decisions are also influenced by other contingency variables, such as organizational size, structure, and technology. For example, large organizations with more resources may pursue diversification strategies, while smaller firms with fewer resources may focus on a narrow niche or cost leadership. Additionally, organizations with more advanced

technology may adopt strategies focused on innovation and differentiation, while those with less advanced technology may emphasize efficiency and cost reduction.

Burton and colleagues have dealt with the contingency approach in multiple works. They address environmental factors: changes of competition and technology (Burton et al., 2004), environmental uncertainty (Burton & Obel, 2018), complexity and unpredictability (Burton et al., 2021). Organizational size, ownership and technology (Burton et al., 1999), and workforce size and capabilities (Burton et al., 2021) are also addressed. All of the four referenced studies deal with the structural (e.g., configuration, span of control, formalization, centralization, communication, coordination); behavioural (e.g., organizational climate, leadership style) and performance aspects. Goals and strategic focus are also a main concern of the studies. (Burton et al., 1999, 2004, 2021).

Behavioural and cultural factors in general became important elements of contingency theory. Luthans and Stewart (1977) introduced the idea that both management practices and employee behaviour must align with the organization's strategy and structure. In recent years, the importance of organizational culture in shaping employee behaviour and aligning it with organizational goals has become more widely recognized. Volberda *et al* (2012) also take a more comprehensive approach to organizations: they address environmental turbulence, the applied technology and the structure of the organization, as well as organizational culture and firm performance (as dependent variable). They argued that organizations with strong, adaptive cultures are better able to navigate uncertain environments by fostering innovation, flexibility, and collaboration.

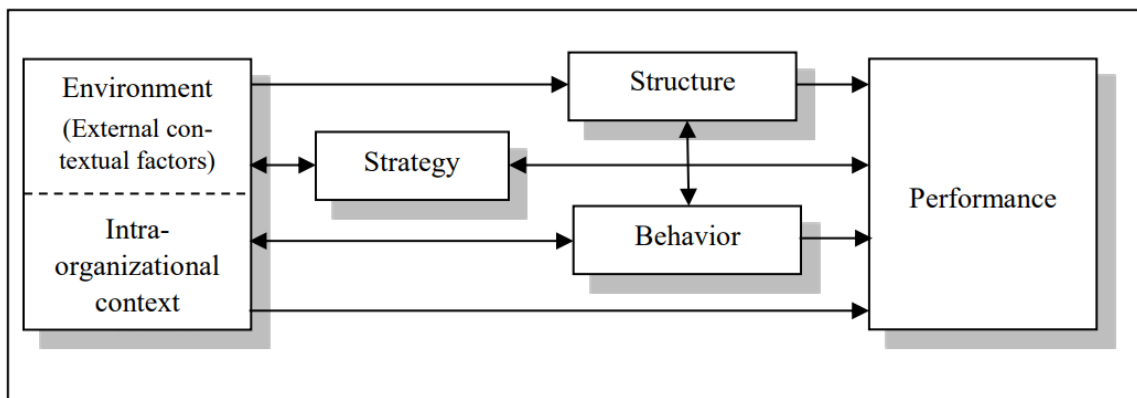
These researchers pointed out that organizational behaviour is the result of interactions between the human elements of the organization and its formal structure. Leadership style, communication patterns, and organizational culture significantly influence employee motivation, morale, and, ultimately, organizational performance. Leadership styles must be adapted to fit the organization's context. For instance, in dynamic environments where innovation is critical, transformational leadership styles that encourage creativity and risk-taking may be more effective. In contrast, in stable environments where efficiency is the primary goal, transactional leadership styles that focus on clear goals and rewards may be more appropriate.

Most recently, Burton and colleagues completed the contingency approach with other environmental factors: changes of competition and technology (Burton et al., 2004), environmental uncertainty (Burton & Obel, 2018), and complexity and unpredictability (Burton et al., 2021). Organizational size, ownership and technology (Burton et al., 1999),

and workforce size and capabilities (Burton et al., 2021) have also been addressed. All of the four referenced studies deal with the structural (e.g., configuration, span of control, formalization, centralization, communication, coordination); behavioural (e.g., organizational climate, leadership style) and performance aspects. Goals and strategic focus are also a main concern of the studies (Burton et al., 1999, 2004, 2021). New external pressures such as sustainability and digitalisation have been added to contingency elements (Csedő 2023; Magyari et al., 2022). It became evident that organizations with advanced sustainable technology and greater resources tend to have more flexibility in adapting to environmental changes. Larger organizations typically have more resources, which allow them to implement more complex strategies and structures. However, large organizations may also face more significant challenges in coordinating their activities and maintaining flexibility, especially in dynamic environments. Smaller organizations, on the other hand, may be more agile but lack the resources to implement large-scale changes.

In 1988, Dobák summarized the findings of contingency researchers in the following way, representing groups of dependent and independent variables with their relationships.

**Figure 1: A representative model for contingency theory**



Source: Dobák (1988)

Based on Figure 2, we can sum up the main ideas of the “matured” contingency theory as follows.

- (1) Organizational efficiency and therefore the output depend heavily on the structure.

- (2) There is no structure valid for every kind of environment and organization. This basic assumption was subjected to scrutiny in the earliest studies.
- (3) Contingencies can be manipulated by elite groups (“dominant coalitions”).
- (4) Strategy interacts with both contingencies and performance, it is sensitive to them, and affects both. Basically, all elements are connected.
- (5) With appropriate information on the organizational context and environment, managers are facilitated in choosing the adequate form (structure) and strategy for any company, developing adequate behavioural characteristics, and therefore optimizing performance.

### **2.1.3. Modern Applications of Contingency Theory**

Contingency theory remains relevant today, particularly in understanding how organizations can navigate complex and rapidly changing environments. One of the key strengths of contingency theory is its flexibility: it provides a framework for organizations to assess their internal and external environments and make appropriate adjustments to their strategy, structure, and behaviour.

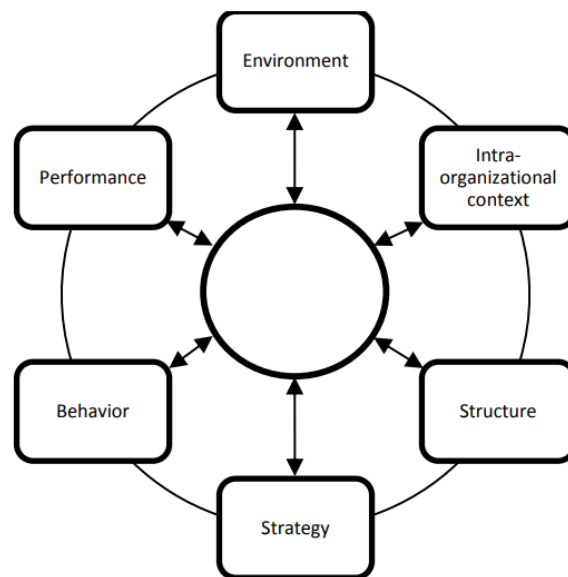
For example, in today's globalized and technologically advanced world, organizations must constantly adapt to changing market conditions, technological advancements, and shifting consumer preferences. The principles of contingency theory can help organizations navigate these challenges by providing a framework for assessing environmental uncertainties and adjusting their structures and strategies accordingly.

However, criticisms of contingency theory suggest that it may oversimplify the complexities of modern organizations without convincing explanations on its assumptions (Morgan, 2011; Schoonhoven, 1981; Shenkar & Ellis, 2022). In today's globalized economy, organizations often operate in multiple environments simultaneously, making it difficult to identify a single set of contingencies that applies to the entire organization. Moreover, as organizations become more complex, the simple cause-and-effect relationships outlined in traditional contingency theory may no longer hold.

Early theory assumed for example that organizations are passive actors that must adapt to their environment. However, as Morgan (2006) pointed out, many large organizations have the power to shape their environment through lobbying, public relations, and

strategic partnerships. This ability to influence the environment challenges the fundamental premise of contingency theory, which assumes that organizations are at the mercy of external contingencies. And external environment can be changed not only by lobbying, PR, marketing, R&D, but also by the business success and failure of any actor, along with new ventures, media news etc. And recent developments affect not only the causalities with external environment. Multinationals have several options to deploy headquarters or build other types of location. Intrapreneurship, growing revenue sources, internationalization may push companies to diversify their scope of activities. Competition and innovation force companies to keep their human resources regularly trained. Behavioural elements can be enhanced by various methods of organization development (OD), coaching, etc. All these elements affect performance and performance affects all. Thus, for the twenty-first century, it could be simpler and also more realistic to represent elements as in Figure 2 where all elements are interconnected: any element in the model might possibly affect the others.

Figure 2: The interconnectivity of contingency elements: a modern approach



Source: Vaszkun (2012)

The (external) environment as a category covers all external factors to companies, e.g. market (economic) characteristics, technical, legal, cultural background, or relations with and positioning to other organizations essential for daily operations (partners, suppliers, etc.).

By intra-organizational context, we mean the size, the origin, the main activity, the operational technology, the location, and the material or human resources of a given company.

Strategy contains elements (variables) describing how the organization wants to make money in the middle or long run (cost advantages, ways of differentiation from competitors, etc.).

Structure covers all structural characteristics of companies (division of work, authority, coordination mechanisms) making a certain configuration and organisational form in each company (functional or unitary “U-form”, multidivisional or “M-form”, matrix, virtual, agile...).

Behaviour stands for interpersonal relations within the company, issues related to morale, values, motivation, or team efficiency. As formulated by Luthans (1973): “organizational behaviour is the result of the interaction between the human being and the formal organization.” (p.69)

Performance includes the means of control and the measurement of output, even the definition of performance itself as the expected outcome in distinct cases may be drastically different.

#### **2.1.4. Conclusion**

Contingency theory has made significant contributions to our understanding of how organizations adapt and move towards organisational fit, suggesting that they must always adapt to their environment and look for coherence between context, strategy, structure, behaviour, and performance in order to achieve success. By emphasizing the importance of aligning organizational subsystems with both the external and internal environment, the theory provides valuable insights into how organizations can optimize their performance. However, as organizations become more complex and operate in increasingly dynamic environments, contingency theory must continue to evolve to account for these new realities. Recent developments suggest that organizations may be able to achieve success by defying environmental pressures and pursuing innovative or unconventional strategies. This chapter offered an updated model of contingency theory covering these shortcomings. Thus, while contingency theory may have its limitations, it remains a powerful tool for analysing organizational behaviour and guiding decision-making in today’s complex and rapidly changing world.



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