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## Economic vs. organizational perspective on inter-organizational relations' analysis - are economists on the dead-end track?

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**Economic vs. organizational perspective on inter-organizational relations' analysis – are economists on the dead-end track?**

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## **Economic vs. organizational perspective on inter-organizational relations' analysis – are economists on the dead-end track?\***

**JEL Classification:** D010, D020, D030, D230, D850, L210, L220

**Keywords:** inter-organizational relations theory; transaction costs theory; NEI, resource based view; relational view

**Abstract:** Inter-organizational relations (IORs), complex constructs existing on the verge of companies' boundaries, are a popular area of managerial and academic investigation, due to their ability to create sustainable competitive advantage. The aim of the article is to show applicability, insights and limitations of economic perspective in IORs analysis. By reviewing advances of selected economic and organizational theories exploring IORs, we will try to answer the following questions:

- can economic thought add any novelty to IOR analysis in the era of dynamic global shifts in competitive environment?, are economic lenses still useful and applicable here?,
- do organizational sciences' academics take more practical, down to earth approach or have they just moved forward (or blurred the clarity of) their theories by employing advances from social sciences, like sociology and psychology?,
- are these two perspectives contradictory or supplementary?

The article is divided into four parts. Firstly, we propose an analytical framework to study inter-organizational relations, secondly we analyze theories focused on

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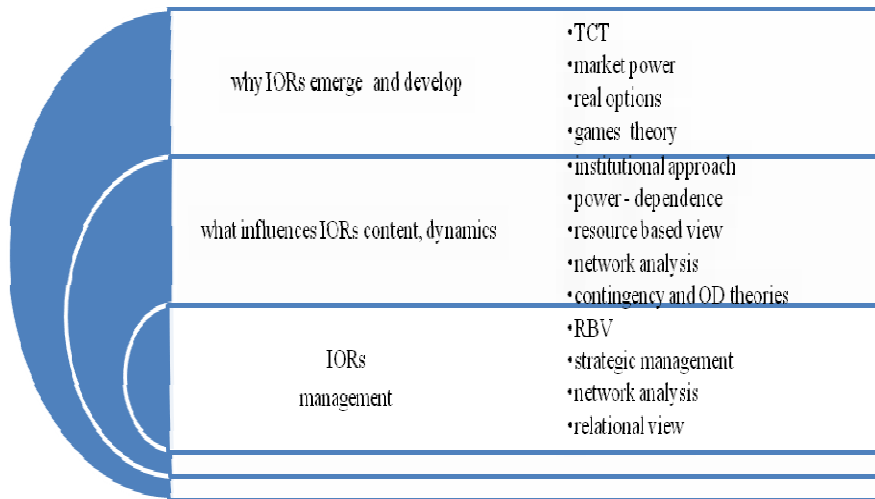
IORs as results of rational choices; thirdly we go to theories exploring reasons why IORs are built in a specific way, and then to concepts looking for conditions, methods and key drivers of IORs successful management. In conclusion we give a brief summary of the main findings together with the limitations and open areas of further investigation of inter-organizational relations.

## **Introduction**

Inter-organizational relations (IOR), being ties of different nature, length and strength, can be investigated from different points of view on: their components, structure, power, strength, dynamics or impact they have on companies. In order to effectively study, and manage these complex constructs we need to look on relations between enterprises from many - economic, sociological, psychological or even anthropological - theoretical perspectives. In this article we focus on economic and organizational view in IORs analysis and show in what aspects certain economic or organizational theories seem viable. We review some economic disciplines dealing with IORs and juxtapose them with organizational view on inter-organizational relations, in order to show their insights and consequences of using particular theoretical concepts as analytical framework.

We take different perspectives and use accordingly various theoretical concepts being a consequence of questions we ask. We can examine the grounds of IOR creation, study their shape or structure over time or take a closer look at impact they have on entities and environment. The answers built here reflect not only theoretical lenses we use but also result from different background (social, economic, cultural) or knowledge and experience we have acquired. The question is – taking which perspective brings the desired outcomes?

Scheme 1. Theoretical framework to study IOR



The theoretical framework we propose in this article (see scheme 1) divides theories dealing with IORs into three main groups: theories that focus on IORs as results of rational choices; theories concentrated on the exploration of reasons, why IORs are built in a specific way and concepts looking for conditions, methods and key drivers of IORs successful management. Using this division criteria we want to show, the main focus of a certain theory in IORs analysis, but we are fully aware that insights of certain theories can overlap between sections (as they can e.g. explain both why and how IORs are shaped together with building some normative propositions how to construct them effectively).

### Methodology of the research

The article presents results of critical theoretical analysis based on thorough literature review. The authors reviewed the body of literature on economic and organizational theories (respectively: new institutional economics, resource based view, power – dependence theory and institutional analysis of organizations, market power theory, real options theory, contingency view of the firm, strategic management, network analysis).

## **Inter- organizational relations as consequences of economic choice**

Economic entities emerge and develop over time with the main primary goal to maximize their value over time. Pursuit to optimize activities in the long run requires choosing the right activities' composition in a particular environmental set. Transaction cost theory (TCT) examines premises and consequences of different governance structures: the firm with its hierarchy system; the market with its price mechanism, and hybrid relations, where the features of both price mechanism and hierarchy system are mixed (Hennart, 1993, pp. 529-548.). Pooling (with its intrafirm relations), contracts (governed by market mechanisms) and cooperation (with inter-organizational relations based on long term loose framework contracts) are chosen after transaction cost and value analysis, grounded in the given external conditions (Hennart, 2010, pp. 339 – 365; Jacobides & Billinger, 2005, pp. 249 - 261; McCarthy & Anagnostou, 2004, pp. 61-71).

TCT perceives IORs as results of economic calculation and rational choice of certain governance models. In a hierarchy, one has to cope with the internal coordination problems and provide the set of managing rules minimizing shirking. In market, when the external transactions prevail, relations between the partners are highly formalised by contract rules and reflect market conditions. When calculations opt for hybrid solutions then relations between the partners are determined by relatively loose set of mutual obligations accompanied by a mixture of managing and coordinating tools. As TCT assumes bounded rationality and opportunism of humans, IORs may be subject of cheating, unethical behaviour and misleading judgement accompanied by information scarcity or its misinterpretation. Resulting from certain governance model choice, IOR will be shaped accordingly. They will differ in their:

- length (market type – the shortest, even if repetitive; pooling the longest; hybrid solutions – lengthy);
- strength: from the weakest (external, governed by market and contracts) to very strong internal hierarchical ties; the strength of hybrid relations is highly dependent on the value created due to these ties, resources engaged, mutual commitment of partners and the length of these relations;
- shape determined by market, hierarchical order or loose framework contracts.

In market relations, transaction costs will stem from finding partners and information about them and a formation and execution of a contract with

stress on securing parties interests. In hybrid (co-operation) relations, transaction costs will raise due to difficulties in acquiring information about co-operation partner, costs related to performance and management of the cooperation subject and cooperative relations (e.g. monitoring, organisation, controlling) and possible difficulties of contract execution (due to its loose framework but complex character). In hierarchy/ pooling transactions the main burden of costs will be associated with internal management.

While TCT gives explanation why particular relations evolve within and between economic entities and what kind of costs and risks they carry, it does not bring clear answers how they should be shaped/ managed in order to use them as a source of long-term competitive advantage. IORs are perceived here as the outcomes of certain economic decisions aiming at long-term value maximization, but not as the causes and sources that can raise this value over time. Another big drawback of TCT body of literature, yet being diminished recently, is too shallow reflection over an institutional impact on economic performance of enterprises (and thus on IOR's shape, strength and influences). Paradoxically, TCT is a part of the new institutional economics, that analyses institutions and their impact on economic behaviour, and when supported by institutional theorists' reflections, it gains a lot in explanatory value.

Similarly to TCT, IORs are perceived as outcomes of external factors in the market power theory. Co-operation is treated here as the alternative form of co-ordination and composition of company's value chain, chosen as the best result of costs and environmental factors' analysis. What differentiates these two perspectives, is the stress on possible gains and costs of co-operation or coalitions. Co-operation allows for risk reduction, economies of scale or pooling and sale of knowledge, competencies that are created and internalized in IORs. The costs of co-operation include coordination and mutual adjustment of the partners, risk of cheating, information, knowledge outflow, or even conversion of competitive power between the partners. The shape, nature and management of IOR in this stream is also (like in TCT) somewhat neglected; they are necessary to build effective co-ordination structures, they can be either offensive or defensive, aiming at mutual learning or piggy-backing, but the way they are built and developed in order to support, enhance or ruin certain co-ordination structures remains a black box here.

Game theory describes economic actors' behaviour patterns in social situations (called games here) involving two or more entities, having different goals but interdependent or interconnected interests. Cooperative relations are treated as an outcome of players' behavioural optimal choices between either competition or cooperation. Companies compare the

consequences of cooperative and competitive behaviour to create successful strategies based on a chosen dominant approach or flexible coupling of cooperation in one sphere with competition in another (Nalebuff & Brandenburger, 1996).

Real options theory (used in strategic management), concentrates on explaining why a company should (or should not) make certain investments in developing assets due to planned growth. Companies should create their future potential accordingly to changes in their market situations and bundle of information they have. Both organizational structure and assets structure of a company should be flexible to meet challenges occurring in turbulent and hardly predictable environment.. Real option is an investment in existing assets, that give firm's managers discretion to decide about their exploitation in order to achieve firms goals and profits. Internal (hierarchical) and external (market and hybrid) growth methods are treated as alternative investments of different risk to profit ratio. Rational choices between options, (e.g. to invest in building new own factory or to co-produce new product with a partner and invest in mutual process integration) decide about preferred ways to grow in certain market conditions. Involvement in inter-organizational relations is seen as a kind of investment giving company a chance to increase its profits and market value. Some authors point out that real options theorizing is somewhat cynical treating partnerships more like cheaper and less risky way to gain firms goals, while e.g. traditional cooperation theory concentrates on positive thinking and states that cooperation is a mutual commitment regarding strategy bringing profits for all involved partners (Faulkner & de Rond, 2005, p. 17).

### **Inter-organisational relations as a result and reflection of environmental conditions**

When we divert our interest from the question why certain types of intra- and inter-organizational relations arise and develop, into examining what influences their content, durability or effectiveness, TCT, real options' or market power theory do not offer a comprehensive answer, (even though we can learn some of their traits like length, type of costs involved, market conditions which give impulse to their rise and development). We can learn a lot more of their shape and nature from power – dependence theory or contingency approach to study organizations, as they take into account the social component of IOR, lying



either in the composition of environment or depending on certain resources of entities entering into a certain relation.

To start with, we will examine institutional approach to studying IORs and define institutions (after D. North) as formal rules, informal compulsions and ways to impose and enforce them (North, 1986, p. 231), but they are also called “hardened preferences” (Riker, 1980, pp. 432-446), “rules, procedures and arrangements” (Shepsle, 1989, pp. 131-147), or “principles which define how one should act and what is forbidden” (Ostrom 1986, pp. 3-25). According to the new institutionalists of the organizational theory, institutions are macroabstracts of rationalized and depersonalised recommendations (Powell & DiMaggio, 1991, p.15) and they originate from certain scripts of behaviour, categorizations or rules, not necessarily rational but becoming ingrained, and then institutionalised when repeated without any reflection.

Despite the differences, all definitions emphasize a significant impact of institutions on economic performance. Institutions (both external and internal, within the organization) create a tunnel which restricts full rationality of economic actors (Simon, 1987; Stępień & Szarzec, 2007), influence their performance together with shaping IORs and any outcomes of economic actions.

Despite the agreement about the impact of institutions on economic performance, there are big differences among institutional theoretical fractions, concerning the question how strong this impact is. For example, according to TCT and the theory of public choice, institutions originate from logical reasoning aiming at optimization, so economic performance influenced by institutions can diversify the strategy the goals are achieved, but will not disrupt its economic logic. Quite different is the approach of economic historians to this interplay between institutions and economic performance. Institutions, being socially embedded and therefore persistently lengthy, deteriorate in time; the quicker and more drastically, the more turbulent environment is. Due to social embeddedness, legacy and change persistence, economic effectiveness of institutions remains questionable, thus they can blur or mislead economic performance and outcomes.

This difference in the (either rational or social, cultural, historic) nature of institutions and its impact on economic performance is also reflected in the way IOR are perceived and analysed.

In the public choice theory inter-organizational relations result either from obedience or legal (or illegal) avoidance of existing constraints, but economic actors are self –determined and can efficiently cope with these restrictions. To juxtapose, the institutional organisational perspective shows

an economic actor as a passive individual entangled and bound by environmental regulations, striving for legitimization in its desire to adapt to external rules (Lotia & Hardy, 2008, p. 370). Adhering to routines, duplicating patterns or favouring institutionalization often leads to structural inertia (Hannan & Freeman, 1984, pp. 149-164; Podolny & Stuart, 1995, pp. 1224-1260), as changes in performance (and in IOR) occur rarely and rather creep than step. Revolutionary, fundamental changes in economic performance (and IOR) are possible, but only as a response to major revolution or institutional breakdown (Stępień, 2001, pp. 53-71).

The perception of IORs depends also on the type of institutions we analyze. New institutional economists concentrate mostly on formal institutions (e.g. regulations concerning the freedom to conduct economic activity, tax systems); their content, stability, executing power and overall ability to lower transaction costs (North, 1992, pp. 477-478). The more stable the institutional framework, the stronger social confidence in the state and in business partners, the more efficient and lasting IOR can be: they embody social trust, bear less informational misinterpretation or shirking and allow co-operation partners for innovative business development.

By comparison, researchers developing the new institutionalism in the organisation theory put emphasis on informal institutions and their impact on IORs structure and dynamics. Only these formal institutions that originate from informal set of rules, reinforce social approval and stability (Grannovetter 1985; Uzzi 1997; Kenis & Knoke, 2002; Rooks et. al. 2000). Building effective and long lasting IOR requires convergence of both formal and informal institutions, that stem from social trust and are strengthened by political stability and transparency. Social capital can then be developed in order to minimize transactions costs and temptations to behave in opportunistic manner (Gulati, 1995; Gulati & Sytch, 2008; Gulati & Singh, 1998).

To sum up, institutional analysis offers better understanding how the outside rules of game shape the content, length and effectiveness of IORs, but can be hammered as environmental determinism. In order to balance the criticism of this perspective, the resource dependence theory can be analysed, as internal perception of environmental pressures and its consequences on IORs.

Resource dependence theory views IORs as organisation's reaction to either internal or environmental pressures, caused by power imbalance (Pfeffer & Salancik, 2003). The power itself is generated from three main analytic sources: resources, regulations and networks (Knoke & Chen, 2009, p. 443). Environmental forces (like state imposition of certain acts, powerful

stakeholders, competitors' networks etc.) may limit organisation's autonomy and profitability and exert their power on organisations internal processes. IORs are responses to power-related problems, built to modify power relationships between organisation and external forces (Huxham & Beech, 2009, pp. 556-557). They are means to gain power and are themselves resources that combine both material and social capital in a certain (most desirably – optimal) way, substantiated in internal and external routines. Forms, mutual interdependencies, dynamics of IORs are analysed in power-dependency theory, but the main focus is put on their ability to neutralize environmental constraints (Casciaro & Piskorski, 2005, pp. 167-199). This ability derives from resources (possessed or controlled by an organization), obtained through investment, self-development or participation in IORs (Pfeffer, 1992; Knoke & Chen, 2009, pp. 446). The value and competitive power of a resource rises with its: ability to reduce costs and differentiate the portfolio of a company; uniqueness (measured by rarity and external demand) and the difficulty to duplicate them by competitors (Godfrey & Hill, 1995, p. 520).. The value of IORs (as co-opetitive forms of organisation), is relative and different for each partner, since it depends on the partner's ability to effectively utilise them (Sulimowska-Formowicz & Stępień, 2014).

To summarise, power – dependency theory perceives economic entities as open systems exchanging resources and building external ties, that shape their competitive power through:

- creating and managing valuable relational competencies that shape outstanding IOR - the source of power comes from the ownership of knowledge and the competence to build and manage such IOR,
- controlling IOR - the source of power comes from the ability to control relations, which were not necessarily created by a given entity,
- having formal authorisation to create the rules of the game within certain environment, and therefore the power to create favourable IOR,
- having informal authorisation to create both the rules of the game and IOR.

From a point of view of contingency theory, IORs may be seen as alternative structures of firm's activities in given context. Structural contingency means that organization has a plan how to organize its internal value chain and its external connections in order to assure the best fit and adaptability to changes necessary for successful operation in a given business environment. Structural contingency is affected by a set of external and internal determinants - contingency factors. Organizations as open systems interact with environment and adapt to its circumstances by choosing the best structure to both fit to outside conditions and satisfy

internal needs . Strategic, structural, technological, managerial and cultural fit (both external and internal) is a key success factor explored in this field and further developed in organizational development theory.

### **IOR as manageable capital and a source of competitive advantage**

Power – resource dependence or contingency theories show IORs as a special kind of resources and ties, which value depends on an environmental fit and a set of relative competencies of the company. The latter diverts our attention into the inside of the organization and provokes the question about the ability and limits of successful management of internal resources.

Business cooperation allows independent organizations to achieve mutual benefits by: resource connection, exchanging and distribution and co-creation of products, services, procedures and organizational processes (Serrat, 2009). Engagement in cooperation is also considered to be a ‘hard times strategy’; the answer for increasing market uncertainty by reliance on trustworthy external partners. (Lorenzoni & Lipparini, 1999). When we take the managerial perspective into studying IORs, using advances of resource based view theory strategic management or relational theories are both promising and useful here, as both fields are developed on the foundation of human ability to actively and successfully manage internal resources in order to achieve the desired goals.

Strategic management theories, perceiving IORs as alternative ways of companies development (compared with usage of internal resources or market transactions) explore motives of IORs creation, problems with choosing cooperation partners, but focus mainly body on creation and development of competitive cooperation structures (Faulkner & de Rond, 2005, pp. 4-16). IORs, perceived as potential source of a competitive advantage, can be then effectively managed by partners through creating common governance modes and conditions for inter-partner learning and by companies themselves in order to gain individual advantages from the partnership.

Efficient long-term inter-organisational relations should positively affect not only the profitability of partners, but also the quality of their competitive power by improvement of their: products, technological chains or increasing partners’ knowledge, competences related to the subject of cooperation and skills in establishing, maintaining, and developing long-term business relations (Hansen & Schaumburg-Mueller, 2006, p. 12). Cooperation effectiveness and efficiency is influenced by factors coming

from the environment - partners' home markets and the arena of partnership, related to transaction attributes (information asymmetry, asset specificity and differences in bargaining power) as well as connected with firms' characteristics (cooperative capabilities and trustworthiness). By managing these factors (some of them remain beyond firm's control) cooperation partners try to reach their business goals, what means they try to maximize the gain from the relationship and minimize its cost. The latter means efforts made in order to balance formal and informal governance methods preventing opportunistic behavior (Hansen, et. al. 2008).

Resource based view concentrates on factors determining the success of cooperation strategies. The assumption is that cooperation can create such competitive advantage for partners, that could not be achieved independently (due to bigger costs or longer time required) (Madhhok 2005, p. 77). IORs are means to get the access to partners' resources, internalize them and build the competitive advantage out of this access. In order to make IORs lasting and effective partners have to build mechanisms that secure their interests, allow to manage relations smoothly and effectively by creating synergy effects. Within the organizations, soft, dynamic, systemic and multi-structured relational competencies (reflected in social capital and organizational knowledge) have to be built in order to create, monitor, develop, sustain, and cease cooperation together with enhancing the possibility to absorb external knowledge, competencies, information etc.

Contrary to RBV, a relational view assumes that the main source of competitive advantage are not the resources acquired through cooperation, but IORs themselves (Dyer & Singh 1998; Gomes-Casseres 1994; Smith, et. al 1995, Lavie 2006). Relations, networks are valuable resources (as potential sources of sustainable competitive advantage), as they embody social capital, relational competencies and condition the absorption of information and knowledge.

Network approach, adopting this view builds on practically all above mentioned theoretical findings, although it is not a cohesive set of theoretical streams (Hakansson & Snehota 1995; Ford & Hakansson 2002;). Depending on the paradigm, studying IORs can be driven by; rational choices reflected in an economic stream of thought (they result from transaction costs or power imbalances); organizational outcomes (and then IORs stem from structures and procedures inside companies but transformed by environmental pressures) or individual traits of actors involved in the co-operation (due to their genes, experience etc.). The focus is put on detailed descriptions of network and relations content and types, partner selection topics and endogenous network-based processes: Why do organizations choose each other to be partners?, whom do they choose for

what purpose?, what are mechanisms structuring relation - social ties type?, what trust building mechanisms are used?, how do corporate practices diffuse in networks?, how do governance structures change?, what is the route of organizational forms adoption among partners? (Lomi et. al. 2009, pp. 322-323). Even though very popular today, with many plots developed here, no consistent theoretical set of rules has emerged clearly yet.

## **Conclusions**

Both economic and organizational perspectives are vital not only to understanding, but also to effective IORs managing in order to convert them into sources of sustainable competitive advantages and fibre for companies' value maximization. In spite of some areas where economic and organizational approaches are contradictory (in the perception of the level of bounded rationality of economic entities, the strength of institutional impact, the source of competitive power IORs possess and carry) they supplement and enrich the relational analysis by stressing different aspects of their creation, dynamics and performance.

Economic thought, although not answering in detail how IOR should be shaped and managed in the era of global environmental turbulence, has built unquestionably useful grounds for determining optimal structure and governance mode of intra – and inter-organizational relations, and highlights their environmental dependence (arising either from institutional impact or power imbalances) and embeddedness in company's structure, knowledge and social capital.

Academics representing organizational sciences do not always take practical, managerial approach (even though they heavily lie on and employ social sciences advances in their IORs research), as some concepts perceive organizations as entangled with environmental constraints, or disempowered by internal structural inertia.

Each of the theories reviewed here shows certain limitations – especially in the light of efficient IOR management and by doing so, defines its boundaries. In order to push these boundaries forward and increase the probability of successful IOR management, it is vital to look on relations between enterprises from many theoretical perspectives, as each theory focuses usually on one or few different aspects while overshadowing remaining areas. IOR are complex artefacts and cannot be sufficiently explained only by one, no matter how well developed theory. By the same token successful IOR management requires tools that are built with careful usage of economic, sociological, psychological and anthropological

theoretic achievements. We also have to remember, that persistence and development of inter-organisational relations blurs the boundaries of organisations involved in such interplay, but it does not necessarily makes the IOR management more difficult. Acquiring experience and building trust together with learning various types of relational boundaries (like economic, political, functional, time, cultural constraints etc.) (Williams, 2006) makes IOR management easier despite the fact that the action takes place on the verge of control.

In the table below, we summarize the above review of selected economic and organizational perspectives on IORs analysis, together with shedding some light on their usefulness and areas, that remain further investigation.

**Table 1.** Theories studying inter-organizational relations – their insights and limitations

	Theories	Focus on	IOR as:	Limitations/ Questions remaining
The reason why IOR are created and are shaped accordingly	1) TCT 2) real options theory 3) market power theory 4) game theory	1,2,3) outside conditions/ rational economic choices 4) actors' behavior optimization in certain game context, due to maximum profit gaining	1) Outcomes of companies goals and both internal and external conditions; 2) set of IORs as a portfolio of real options for assets that may or may not be invested in 3) IORs structure, length and strength reflects the governance structure determined by transaction costs minimization 4) Result of calculation when cooperative behaviour should prevail self-interest	The level of control (and managerial feasibility of IOR is belittled due to the framework contracts and high risk of such relations, IORs treated as investments, not social interactions IORs are created as outcomes of both economic and political (power imbalances) choices, but the grounds of IORs can be of social or psychological nature. The question - how to ensure maximum profit of cooperative relation – still remains open

Impact of environment on IOR shape, length and effectiveness	<p>1) institutional economics (TCT, historic school, public choice)</p> <p>2) new organizational institutionalism</p> <p>3) power dependence</p> <p>4) contingency approach</p>	<p>1, 2, 3) institutions, power relations; IORs as reflections of environmental conditions and companies' experience, structure and internal power .</p> <p>4) being fit to external conditions</p>	<p>1,2) institutions determine probability of successful co-operation, to be effective companies should consider smart adjustment to market rules and partner's routines</p> <p>3) IORs as results of power imbalances and tools to gain the power over external actors</p> <p>4). alliances and coalitions as a means for best situational and structural fit to environment conditions</p>	<p>IOR depend heavily on the proper understanding and adjustment to the given set of rules in a certain environment, IOR embedded in social structure, difficult to control and shape, not necessarily result of rational choices</p> <p>No clear answer how to create and manage IORs in order to make them cohesive, environmentally fit and efficient at the same time.</p>
IORs as source of competitive advantage	<p>1) RBV incl. knowledge based view, relational view and dynamic competences approach</p> <p>2) Strategic management</p> <p>3) Network analysis</p>	<p>1) Resources' composition and value added thanks to cooperation (relational rent - advantage gained thanks to relational embeddedness) and dynamic relational competences</p> <p>2) methods to achieve goals with IORs usage, critical success factors of relations' effectiveness</p> <p>3) structure, composition of ties, insights how to compose them effectively.</p>	<p>1) unique resources (dynamic, relational competencies) as a source of sustainable competitive advantage, access to inimitable, path dependent resources as a main motive to cooperate, being a part of broader network of relations and profit from partners' interdependencies.</p> <p>2,3) IORs as sources to gain external knowledge, power, strengthen position in network of IORs</p> <p>3) Embeddedness in network via IORs as a source of relational advantage - relational rent</p> <p>Explains why actors form ties and also with whom they do that, and how IORs lead to informational and control benefits</p>	<p>1) Relative competencies are "hidden" in social capital in the whole structure of the company, depend on specific, selected sources and determinants of IORs success – so the main problem is to find them and manage accordingly</p> <p>2) No general rule, no systemic set of general guidelines for successful inter-firm relation, lots of propositions but all of them shall be adapted to relation - specific context</p> <p>3) Many plots raised, discussed, highlighted, lack of synthetic approaches and recommendations</p>



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